



U.S. COMMODITY FUTURES TRADING COMMISSION

Three Lafayette Centre
1155 21st Street, NW, Washington, DC 20581
Telephone: (202) 418-5977
Facsimile: (202) 418-5407
gbarnett@cftc.gov

Division of Swap Dealer and
Intermediary Oversight

Gary Barnett
Director

CFTC Letter No. 14-158
No-action
November 25, 2014
Division of Swap Dealer and Intermediary Oversight

Re: Commodity Exchange Act § 4s(k)(2) and Commission Regulation 3.3

Dear :

This letter is in response to your correspondence, dated September 19, 2014, and multiple telephone conferences (the “**Correspondence**”) with the Division of Swap Dealer and Intermediary Oversight (“**DSIO**” or “**Division**”). In the Correspondence, [Firm X, a provisionally registered swap dealer,] requested that the Division issue a no-action letter stating that it will not recommend that the U.S. Commodity Futures Trading Commission (“**Commission**”) commence an enforcement action against [Firm X] for (i) establishing a reporting line for the chief compliance officer (“**CCO**”) to its governing body established pursuant to Commission regulation 23.600, (ii) providing that the CCO’s various consultations required under regulation 3.3 are being engaged in with the governing body instead of the board of directors or senior officer, and (iii) having the CCO meet at least annually, and upon his or her election, with the governing body, rather than with the board or senior officer as required under regulation 3.3(a), so long as the CCO is able to meet with the board or senior officer at his or her election, subject to the conditions described below.

I. Background

Section 4s(k) of the CEA and Commission regulation 3.3(a) require a registered swap dealer (“**SD**”) or major swap participant (“**MSP**”) to designate an individual to serve as CCO. The statute provides that the CCO must “report directly to the board or to the senior officer of the [SD/MSP]”¹ CEA Section 4s(k) also assigns the CCO with several duties and expressly provides that for one of those duties – resolving conflicts of interests – the CCO shall consult with the board of directors, a body performing a function similar to the board, or the senior

¹ CEA Section 4s(k)(2)(A).

officer of the organization.² Commission regulation 3.3(d) assigns these same duties to the CCO and requires that a number of these duties be accomplished in consultation with the board of directors or the senior officer.³

Commission regulation 23.600 charges the SD/MSP's governing body, which may be a body other than the SD/MSP's board of directors, with the oversight of the SD/MSP's risk management program.⁴ As part of that oversight, Commission regulations assign the governing body with certain duties, including without limitation: approving the risk management program,⁵ setting risk tolerance limits,⁶ receiving periodic risk exposure reports,⁷ reviewing the results of the annual review of the risk management program,⁸ and reviewing the quarterly written report on the SD/MSP's compliance with position limits.⁹ Further, because the risk management program is required to be established pursuant to regulation 23.600, the CCO necessarily plays a significant role in the registrant's compliance with that section. In addition,

² CEA Section 4s(k)(2)(A)-(G). With the exception of the duty to resolve conflicts of interest, the other duties specifically enumerated under CEA Section 4s(k)(2) are assigned solely to the CCO and include:

- Reviewing the compliance of the SD/MSP with respect to each SD/MSP requirement described in this section [CEA Section 4s];
- Resolving any conflicts of interest that may arise “in consultation with the board of directors, a body performing a function similar to the board, or the senior officer of the organization;”
- Being responsible for administering each policy and procedure that is required to be established pursuant to this section [CEA Section 4s];
- Ensuring compliance with the CEA (including regulations) relating to swaps, including each rule prescribed by the Commission under this section [CEA Section 4s];
- Establishing procedures for the remediation of non-compliance issues identified by the CCO; and
- Establishing and following appropriate procedures for the handling, management response, remediation, retesting, and closing of non-compliance issues.

³ Commission regulations 3.3(d)(2), (4), and (5) require the CCO to consult with the board of directors or senior officer in the performance of certain duties. In addition, Commission regulation 3.3(a) requires the CCO to develop, in consultation with the board of directors or the senior officer, appropriate policies and procedures to fulfill the duties set forth in the CEA and Commission regulations relating to the SD/MSP's swaps activities.

⁴ Pursuant to Commission regulation 23.600(a)(4), the governing body of a SD or MSP could be (i) the board of directors, (ii) a body performing a function similar to a board of directors, (iii) any committee of a board or body, or (iv) the CEO of the SD/MSP, or any such board, body, committee, or officer of a division of a registrant, provided that the registrant's swaps activities for which registration with the Commission is required are wholly contained in a separately identifiable division.

⁵ Commission regulation 23.600(b)(3).

⁶ Commission regulation 23.600(c)(1).

⁷ Commission regulation 23.600(c)(2).

⁸ Commission regulation 23.600(e)(2).

⁹ Commission regulation 23.601(g). As a consequence of the assignment of oversight over these functions, the governing body should have every incentive to be fully informed, to analyze, and to understand the information provided, and to respond and act on such information.

the CCO's enumerated duties under regulation 3.3 likely require the CCO to interact with the governing body and risk management unit.¹⁰

II. Relief Requested

[Firm X] asserts that given the size and structure of its business, having the CCO report to, and meet and consult with, its governing body, instead of the board of directors or senior officer, is appropriate because it better facilitates the role of the CCO and supports the risk governance and management functions of the swap dealer. Under the requested relief, the CCO would still retain the ability, in his or her discretion, to require a meeting with the board or senior officer. Lastly, the requested relief also provides that the board of directors or senior officer would still be responsible for appointing, approving the compensation of, and making any removal decisions regarding the CCO. In particular, in the Correspondence, [Firm X] made the following representations regarding its operation and structure:

- [Firm X's] board of directors is composed of 14 directors, all of whom are outside, independent directors with the exception of Mr. [Y], [Firm X's] Chairman and Chief Executive Officer ("CEO").
- [Firm X] is a New York State-chartered bank, regulated in the U.S. by the New York State Department of Financial Services and U.S. Federal Reserve with a substantial asset management, custody and administration business.
- [Firm X's] swap dealing activities are a small and contained part of its overall business.
- All of the firm's swap dealing activities requiring [Firm X] to register with the Commission as an SD are conducted through [Firm X's] [A] Group.
- Pursuant to Commission regulation 23.600(a)(4)(4),¹¹ [Firm X's] board of directors has established a swap dealer governing body composed of the senior managers of [Firm X's] swap dealing and foreign exchange businesses, and the heads of various risk management and compliance groups.¹² Mr. [Z], President of the [A] Group, is currently the chair of the governing body.¹³ The governing body, like a board of directors, observes corporate formalities by keeping minutes, recording votes, and holding regularly scheduled meetings with formal agendas.

Given these facts, [Firm X] asserts that the reporting line to the governing body would ensure that the body responsible for the risk governance decisions with respect to the swap

¹⁰ For example, in order to remediate a serious non-compliance issue related to the risk management program, the CCO would likely need to interact and consult with the governing body.

¹¹ See *supra* text accompanying note 4.

¹² [Firm X's] head of market risk management, head of credit risk management, and head of corporate treasury all currently sit on the governing body, as does [Firm X's] Chief Risk Officer, to whom the head of global compliance reports.

¹³ Mr. [Z] also oversees other regulated, non-swap business lines.

dealing activities of the swap dealer and for the oversight of the risk management program would have the benefit of the CCO's input. For example, in the event of a serious risk management non-compliance issue, the governing body, which oversees the risk management program, and the CCO, who is charged with administering policies and procedures for the handling, responding, remediation and closing of all non-compliance issues,¹⁴ would both benefit from each other's involvement given their respective roles and responsibilities. In contrast, requiring the CCO to consult with the board of directors or senior officer under those circumstances would not yield the same benefits, because although the board and senior officer have overall responsibility for overseeing the firm's operations, they do not have the same level of direct involvement with the swap dealing business as the governing body, which was established by the board for the purposes of directly overseeing the SD's risk management program. Similarly, with respect to regulation 3.3's meeting and consultation requirements, [Firm X] states that the CCO would be able to better contribute valuable insights to, and receive meaningful views from, the governing body, rather than the board of directors or senior officer, who do not have the governing body's expertise or direct oversight of the firm's swap dealing business. Accordingly, [Firm X] requests no-action relief to establish a CCO reporting line to the governing body that also retains the CCO's ability, at his or her discretion, to meet with the board of directors or senior officer, and to provide that the CCO can satisfy the obligation to meet and consult with the board or senior officer under Commission regulations 3.3(a) and 3.3(d) through meeting and consulting with the governing body, rather than the board of directors or senior officer.¹⁵ Importantly, under this reporting line structure, [Firm X] states that, to ensure sufficient CCO independence, the board of directors or senior officer would still be responsible for appointing, approving the compensation of, and making any removal decisions regarding the CCO. In addition, the board of directors or senior officer would continue to receive the CCO annual report and the CCO would continue to be able to meet with the board of directors or senior officer at his or her election.

III. Division No-Action Position

Based on the facts and circumstances as represented by [Firm X], and so long as the conditions stated below are satisfied, DSIO will not recommend that the Commission commence an enforcement action against [Firm X] for (i) establishing a CCO reporting line to the governing body, (ii) providing that the CCO's various consultations required under regulation 3.3(a) and (d) are being engaged in with the governing body instead of the board of directors or senior officer, and (iii) having the CCO meet at least annually, and upon his or her election, with the governing body, rather than with the board or senior officer as required under regulation 3.3(a).

The foregoing relief is subject to the following conditions:

¹⁴ See Commission regulation 3.3(d)(1), (4), (5).

¹⁵ DSIO notes that having the CCO consult with [Firm X's] governing body is consistent with the statutory requirement under CEA Section 4s(k)(2)(C) to resolve any conflicts of interest in consultation with the "board of directors, a body performing a function similar to the board, or the senior officer of the organization" because the governing body under regulation 23.600(a)(4)(4) is a body "performing a function similar to the board."

1. [Firm X's] board of directors, or senior officer, must remain responsible for appointing, and approving the compensation of, the CCO as contemplated by CEA Section 4s(k)(2)(A) and Commission regulation 3.3. Only the board or senior officer may have the authority to remove the CCO. The CCO must provide the annual report required under Commission regulation 3.3(e) to the board or senior officer, and the governing body, concurrently at such time as the report is required to be delivered to the board or senior officer under Commission regulation 3.3(e).
2. The governing body must meet with the CCO at least annually and at the election of the CCO, at such times and under the same conditions as would prevail under Commission regulation 3.3(a)(1) with respect to the board or senior officer.
3. Although under the terms of this letter the CCO is not required to meet with the board of directors or senior officer annually, if the CCO elects to meet with the board or senior officer either annually or otherwise at the election of the CCO, then the meeting must occur as otherwise would have been provided for under Commission regulation 3.3(a)(1).
4. The CCO must provide to the board of directors or senior officer a summary of his or her consultations with the governing body. The summary or summaries should be included in the next annual report to be provided to the board or senior officer, or may be provided more frequently if deemed appropriate by the CCO.
5. The governing body must observe all required corporate formalities, including having regularly scheduled formal meetings with formal agendas, where minutes are taken and attendance and voting recorded.

This letter is based upon the representations made to the Division. Any different, changed, or omitted material facts or circumstances might render this letter and the no-action positions taken herein void. Further, this letter and the positions taken herein represent the views of this Division only and do not necessarily represent the views of the Commission or any other office or division of the Commission.

If you have any questions concerning this correspondence, please contact the undersigned at (202) 418-5977, Erik Remmler, Deputy Director, DSIO, at (202) 418-7630, or Margo Dey, Attorney-Advisor, DSIO, at (202) 418-5276.

Very truly yours,

Gary Barnett, Director
Division of Swap Dealer and
Intermediary Oversight