



6351-01-P

COMMODITY FUTURES TRADING COMMISSION

17 CFR Part 1

RIN 3038-AE73

Financial Surveillance Examination Program Requirements for Self-Regulatory Organizations

AGENCY: Commodity Futures Trading Commission.

ACTION: Final rule.

SUMMARY: The Commodity Futures Trading Commission (“Commission” or “CFTC”) is amending its regulations governing the minimum standards for a self-regulatory organization’s (“SRO”) financial surveillance examination program of futures commission merchants (“FCMs”). The amendments revise the scope of a third-party expert’s evaluation of the SRO’s financial surveillance program to cover only the examination standards used by SRO staff in conducting FCM examinations. The amendments also extend the minimum timeframes from three years to five years between when an SRO must engage a third-party expert to evaluate its FCM examination standards for consistency with applicable auditing standards. The amendments should reduce the costs associated with the operation of a financial surveillance program, while also providing effective third-party evaluation of the FCM examination standards.

DATES: This rule is effective [INSERT DATE 30 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER].

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SUPPLEMENTARY INFORMATION:

I. Background

A. Statutory and Regulatory Background of SRO Oversight of FCMs

FCMs perform critical functions to facilitate the efficient operation of Commission-regulated exchange-traded derivatives markets.¹ In addition to trading for their own accounts and carrying the accounts of their affiliates, FCMs are market intermediaries, standing between customers trading futures and swaps transactions on one side and designated contract markets (“DCMs”), swap execution facilities, and derivatives clearing organizations (“DCOs”) on the other side. As market intermediaries, FCMs carry customer accounts and hold customer funds to margin futures and cleared swap transactions. Additionally, FCMs fulfill daily settlement obligations on behalf of customers by posting sufficient funds to DCOs to support their customers’ futures and swap positions, including paying mark-to-market losses associated with such positions. FCMs also are essential to the efficient operation of Commission-regulated markets in that they guarantee each customer’s financial performance for futures and swap positions

¹ An FCM is generally defined in CFTC Regulation 1.3 as (1) an entity that is engaged in soliciting or accepting orders for the purchase or sale of any commodity for future delivery or a swap and, in connection with the solicitation and acceptance of such orders, accepts money, securities or property (or extends credit in lieu thereof) to margin, guarantee or secure futures or swaps transactions, or (2) an entity registered as an FCM.

Commission regulations referred to herein are found at 17 CFR chapter I, and are accessible on the Commission’s web site, <http://www.cftc.gov>.

to DCOs by agreeing to use their own financial resources to cover any shortfall resulting from a customer default.²

The Commodity Exchange Act (“Act”)³ recognizes the functions performed by FCMs and authorizes the Commission to adopt regulations to help ensure that they maintain the necessary financial resources to properly perform such functions.⁴ Consistent with this statutory objective, the Commission has adopted regulations requiring FCMs to maintain a minimum level of regulatory capital,⁵ to segregate customer funds from their own funds in specially designated customer accounts,⁶ and to maintain appropriate risk management programs to monitor and manage the risks associated with their activities as FCMs.⁷ The Commission also has imposed periodic financial reporting requirements on FCMs, which allows Commission staff to monitor their financial condition and compliance with regulatory obligations. The financial reporting requirements include daily statements demonstrating compliance with the segregation of customer funds requirements,⁸ monthly unaudited and annual audited financial statements,⁹ and regulatory notices upon the occurrence of specified events including failing to meet minimum capital requirements, failing to comply with segregation requirements, and failing to maintain current books and records.¹⁰

² Regulation 39.16(c)(2)(vi).

³ 7 U.S.C. 1 *et seq.*

⁴ Section 4f(b) of the Act authorizes the Commission to adopt regulations imposing minimum capital and financial reporting requirements on FCMs to help ensure that they maintain adequate financial resources to meet their obligations.

⁵ Regulation 1.17.

⁶ Regulations 1.20, 22.2, and 30.7 impose segregation requirements for customer accounts containing futures positions, swap positions, and foreign futures positions, respectively.

⁷ Regulation 1.11.

⁸ Regulations 1.32, 22.2 and 30.7 require FCMs to prepare and submit to the Commission daily segregation computations and schedules for customer futures, cleared swaps and foreign futures accounts, respectively.

⁹ Regulation 1.10.

¹⁰ Regulation 1.12.

The Act also establishes a regulatory oversight structure that imposes an obligation on DCMs and registered futures associations (“RFAs”),¹¹ as SROs,¹² to perform frontline regulatory oversight of market intermediaries, including FCMs.¹³ To further the objective of effective self-regulation of market participants and market professionals, the Act and Commission regulations require RFAs and DCMs to adopt financial and related reporting requirements for member FCMs, and to periodically examine FCMs for compliance with such requirements. In this regard, section 17(p) of the Act requires an RFA to establish and submit for Commission approval rules imposing minimum capital, segregation and other financial requirements applicable to its members for which such requirements are imposed by the Commission.¹⁴ Section 17(p) further provides that the RFA must implement a program to audit and enforce compliance by its members with the RFA’s minimum financial requirements.¹⁵

With respect to DCMs, section 5(d)(11)(B) of the Act and Regulation 38.600 require, in relevant part, each DCM to implement rules to ensure the financial integrity of any member FCM and the protection of customer funds.¹⁶ DCMs also are required to monitor an FCM member’s compliance with the DCM’s minimum financial requirements

¹¹ The National Futures Association (“NFA”) is the only registered RFA. NFA’s financial requirements for FCMs are available at its web site, <http://www.nfa.futures.org>.

¹² An SRO is defined in Regulation 1.52 to include a contract market (as defined in Regulation 1.3) or an RFA under section 17 of the Act. The term “SRO” as defined in Regulation 1.52(a)(2), however, does not include a swap execution facility (as defined in Regulation 1.3).

¹³ Section 3(b) of the Act provides in relevant part that it is the purpose of the Act to serve the public interest through a system of effective self-regulation of market participants and market professionals under the oversight of the Commission.

¹⁴ Section 17(p)(2) of the Act.

¹⁵ *Id.*

¹⁶ *See also*, Regulation 38.602 which provides that a DCM must provide for the financial integrity of its transactions by establishing and maintaining appropriate minimum financial standards for its members and non-intermediated market participants, and Regulation 38.603 which requires a DCM to have rules concerning the protection of customer funds.

by reviewing financial information filed with the DCM and by conducting periodic examinations of the FCM.¹⁷

In recognition of SROs as frontline regulators and the importance of FCM oversight, the Commission adopted Regulation 1.52 which establishes minimum standards that all SRO programs must satisfy in conducting FCM financial oversight. Regulation 1.52 requires each SRO (including NFA) to adopt rules prescribing minimum financial and related reporting requirements for member FCMs that are the same as, or more stringent than, the requirements imposed by the Commission.¹⁸ Regulation 1.52 also requires each SRO to maintain a financial surveillance oversight program that includes detailed examinations of member FCMs' books and records to assess their compliance with SRO and Commission minimum financial and related reporting and recordkeeping requirements.¹⁹

Regulation 1.52 also permits two or more SROs to file a plan with the Commission to delegate primary, but not exclusive, responsibility to monitor and to examine the financial condition of an FCM that is a member of two or more SROs to a designated self-regulatory organization ("DSRO").²⁰ The participating SROs form a Joint Audit Committee ("JAC") and submit a Joint Audit Program to the Commission, which may approve such plan after providing an opportunity for public notice and comment.²¹

¹⁷ See Regulations 38.600 through 38.605.

¹⁸ Regulation 1.52(b)(1).

¹⁹ Regulation 1.52(c)(1)(iv).

²⁰ Regulation 1.52(d)(1).

²¹ Regulation 1.52(j).

The delegation of an FCM that is a member of two or more SROs to a DSRO under a Joint Audit Program allows for a more efficient use of SRO resources, while also reducing burdens that otherwise would be imposed on an FCM from duplicative supervision, including periodic on-site examinations from multiple SROs. All SROs currently are members of a single JAC and operate pursuant to one Joint Audit Program approved by the Commission.²²

B. Current Requirements of Commission Regulation 1.52

Regulation 1.52 requires each SRO or JAC to establish and operate a supervisory program that includes written policies and procedures concerning the examination of its member registrants (including FCMs). The purpose of the supervisory program is to assess whether each member registrant is in compliance with applicable SRO and Commission regulations governing net capital and related financial requirements, the obligations to segregate customer funds, risk management requirements, financial reporting requirements, recordkeeping requirements, and sales practices and other compliance requirements.²³ The supervisory program is required to address an SRO's or JAC's staffing levels and independence, ongoing surveillance of member registrants, procedures for identifying and monitoring high-risk firms, on-site examinations of registrants, and documentation of surveillance activities.²⁴

The supervisory program as it relates to FCMs also is required to, at a minimum, incorporate FCM examination standards addressing: (1) The ethics of an examiner; (2)

²² The current JAC Joint Audit Program assigns each FCM to either the CME Group ("CME") or NFA as the FCM's DSRO. Accordingly, only the CME and NFA currently engage in routine, periodic on-site examinations of FCMs pursuant to the JAC agreement.

²³ Regulation 1.52(c)(1) for an SRO and Regulation 1.52(d)(2)(ii)(A)-(B) for a JAC.

²⁴ Regulation 1.52(c)(1) for an SRO and Regulation 1.52(d)(2)(ii)(A)-(B) for a JAC.

The independence of an examiner; (3) The supervision, review, and quality control of an examiner’s work product; (4) The evidence and documentation to be reviewed and retained in connection with an examination; (5) The examination planning process; (6) Materiality assessment; (7) Quality control procedures to ensure that the examinations maintain the level of quality expected; (8) Communications between an examiner and the regulatory oversight committee, or the functional equivalent of the regulatory oversight committee, of the SRO of which the FCM is a member; (9) Communications between an examiner and an FCM’s audit committee of the board of directors or similar governing body; (10) Analytical review procedures; (11) Record retention; and (12) Required items for inclusion in the examination report, such as repeat violations, material items, and high risk issues.²⁵ All aspects of an SRO’s supervisory program, including the FCM examination standards, must conform to auditing standards issued by the Public Company Accounting Oversight Board (“PCAOB”) as such standards would apply in the conduct of a non-financial statement audit.²⁶

Regulation 1.52 also requires an SRO or JAC to engage an “examinations expert” to evaluate its supervisory program prior to its initial use, and to evaluate the SRO’s or JAC’s application of the supervisory program at least once every three years after its initial use.²⁷ For each evaluation, the SRO or JAC is required to obtain a written report

²⁵ Regulation 1.52(c)(2)(iii) for an SRO and Regulation 1.52(d)(2)(ii)(G) for a JAC.

²⁶ Regulation 1.52(c)(2)(ii) for an SRO and Regulation 1.52(d)(2)(ii)(F) for a JAC. The PCAOB is a nonprofit corporation established by Congress to oversee the audits of public companies in order to protect investors and the public interest by promoting informative, accurate, and independent audit reports. The PCAOB also oversees the audits of brokers and dealers registered with the Securities and Exchange Commission (“SEC”). The PCAOB, however, is not vested with the authority to oversee the audits of FCMs.

²⁷ Regulation 1.52(c)(2)(iv) for an SRO and Regulation 1.52(d)(2)(ii)(I) for a JAC. An “examinations expert” is defined in Regulation 1.52(a) as a nationally recognized accounting and auditing firm with

from the examinations expert on its findings and recommendations. The written report is required to be issued under the consulting services standards of the American Institute of Certified Public Accountants (“AICPA”). The written report must include: (1) A statement that the examinations expert has evaluated the supervisory program (including its design to detect material weaknesses in an FCM’s system of internal controls), including any comments and recommendations regarding such evaluation; (2) A statement that the examinations expert has evaluated the application of the supervisory program by the SRO, including any comments and recommendations in connection with such evaluation; and (3) A discussion containing recommendations of any new or best practices as prescribed by industry sources, including the AICPA and PCAOB.²⁸

An SRO or JAC is required to provide the written report, including responses to any findings, comments, or recommendations made by the examinations expert, to the Commission within 30 days of receipt of the report. The SRO or JAC must commence applying the revised supervisory program, incorporating the examinations expert’s findings, comments, and recommendations, once the Commission has advised the SRO or JAC, by written notice, that the Commission has no questions or comments on the written report.

C. Commission Initiative to Simplify and Modernize Regulations

Commission staff initiated an agency-wide internal review of CFTC regulations and practices in March 2017 to identify areas that could be simplified, to make them less

substantial expertise in the audits of futures commission merchants, risk assessment and internal control reviews, and is an accounting and auditing firm that is acceptable to the Commission.

²⁸ Regulation 1.52(c)(2)(iv)(A) for an SRO and Regulation 1.52(d)(2)(ii)(I)(1)-(4) for a JAC.

burdensome and costly for market participants.²⁹ The Commission subsequently published in the *Federal Register* on May 9, 2017, a Request for Information soliciting suggestions from the public regarding how the Commission’s existing rules, regulations, or practices could be applied in a simpler, less burdensome, and costly manner (*i.e.*, “Project KISS”).³⁰

The CME submitted suggestions on a variety of rules, regulations, and practices, including Regulation 1.52, in response to the Commission’s Request for Information.³¹ The CME expressed its view that the requirement in Regulation 1.52 for an SRO or JAC to engage an examinations expert at least once every three years does not provide any meaningful regulatory benefit.³² The CME noted that under the current regulatory framework, Commission staff provides effective oversight of SRO and JAC FCM examination programs through the conduct of its rule enforcement reviews.³³ The CME further noted that it revises its FCM examination programs to incorporate any regulatory changes adopted by the Commission or SROs, and provides the actual FCM examination programs, with the revisions, to Commission staff for review at least once each year.³⁴ Accordingly, the CME suggested that the Commission eliminate the requirement for an

²⁹ See Remarks of Acting Chairman J. Christopher Giancarlo before the 42nd Annual International Futures Industry Conference in Boca Raton, FL, dated March 15, 2017. The remarks are available at the Commission’s web site: <https://www.cftc.gov/PressRoom/SpeechesTestimony/opagiancarlo-20>.

³⁰ Project KISS, 82 FR 21494 (May 9, 2017); amended on May 24, 2017, 82 FR 23765 (May 24, 2017). The *Federal Register* Request for Information and the suggestion letters filed by the public are available at the Commission’s web site: <https://comments.cftc.gov/KISS/KissInitiative.aspx>.

³¹ Letter from Kathleen Cronin, Senior Managing Director, General Counsel and Corporate Secretary, CME Group, dated September 29, 2017 (“CME Project KISS Letter”), pp. 13-14. The CME Project KISS Letter is available at the Commission’s web site: <https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=61395>.

³² *Id.*

³³ *Id.*

³⁴ *Id.*

SRO or JAC to engage an examinations expert once every three years to evaluate the SRO's or JAC's supervisory program.³⁵

II. Proposed Amendments and Comments

A. The Proposal

On July 3, 2018, the Commission published for public comment a Notice of Proposed Rulemaking (“Proposal”)³⁶ to amend Regulation 1.52 to revise the scope and frequency of an examinations expert's evaluation of an SRO's or JAC's supervisory program, and to address certain non-substantive revisions to provide greater clarity and organization to the Regulation. The Proposal was initiated in response to both comments received from the Project Kiss initiative and knowledge gained through Commission staff's firsthand experience with the JAC's implementation of its initial FCM supervisory program pursuant to Regulation 1.52.³⁷

In addition to requesting comment on proposed amendments to Regulation 1.52, the Commission also solicited comments on the impact of the Proposal on small entities, the Commission's cost-benefit considerations, and any anticompetitive effects of the Proposal. The comment period closed on September 4, 2018.

³⁵ *Id.*

³⁶ Financial Surveillance Examination Program Requirements for Self-Regulatory Organizations, 83 FR 31078 (July 3, 2018).

³⁷ Commission staff gained first-hand experience with the supervisory programs as staff participated in several meetings with the JAC (via the CME and NFA as the JAC's representatives) and its examinations expert to address issues and questions arising during the drafting of the initial FCM examination standards and examination programs. This interaction culminated with Commission staff approving the initial FCM examination standards and programs pursuant to delegated authority from the Commission in 2015. The examination standards and programs are now fully implemented and are used in each JAC examination of an FCM.

The Commission received comment letters from the JAC, NFA and CME concerning the Proposal.³⁸ The JAC, NFA and CME were supportive of the Commission's proposed amendments to revise the scope of the examinations expert's evaluation of the SRO or JAC supervisory program and to revise the minimum timeframes between when an SRO or JAC must engage an examinations expert to evaluate the SRO's or JAC's FCM examination standards for consistency with auditing standards issued by the PCAOB. The comments are discussed below.

1. Scope of the Examinations Expert's Evaluation of a Supervisory Program

Regulation 1.52 requires an SRO or JAC to engage an examinations expert to evaluate its supervisory program prior to its initial use and at least once every three years thereafter.³⁹ The examinations expert's evaluation is required to address the SRO's or JAC's application of its supervisory program, including the sufficiency of the supervisory program's risk-based approach and internal controls testing (including its design to detect material weaknesses in an FCM's internal control environment). The examinations expert is further required to evaluate whether the SRO's or JAC's FCM examination standards are consistent with auditing standards issued by the PCAOB as such standards would be applicable to a non-financial statement audit.

³⁸ The JAC comment letter was submitted by Debra K. Kokal, Executive Director, Financial and Regulatory Surveillance, CME Group, and Chairman of the Joint Audit Committee ("JAC Comment Letter"). The NFA comment letter was submitted by Carol A. Wooding, Vice President and General Counsel, National Futures Association ("NFA Comment Letter"). The CME comment letter was submitted by Sunil Cutinho, President, CME Clearing ("CME Comment Letter"). The comment file also includes submissions from United States Sharable and from Eric Alan Dela Pena, both of which did not include any discussion of the Proposal. All five submissions are available in the comment file on the Commission's web site: <http://comments.cftc.gov/PublicComments/CommentList.aspx?id=2891>.

³⁹ Paragraphs (c)(2)(vi) and (c)(2)(iv) of Regulation 1.52, respectively, contain the requirement for an SRO to engage an examinations expert prior to the initial implementation of its supervisory program and at least once every three years thereafter. Paragraphs (d)(2)(ii)(H) and (I) of Regulation 1.52, respectively, contain the requirement for a JAC to engage an examinations expert prior to the initial implementation of its supervisory program and at least once every three years thereafter.

Regulation 1.52 also requires an SRO or JAC to obtain from the examinations expert for each evaluation a written report on findings and recommendations issued under AICPA consulting services standards. The report is required to include a statement that the examinations expert has evaluated the supervisory program, including the sufficiency of its risk-based approach and internal controls testing. The report also is required to include a statement that the examinations expert has evaluated the SRO's or JAC's application of the supervisory program.

The Commission proposed to amend Regulations 1.52(c)(2)(iv) and (d)(2)(ii)(I) to remove from the scope of the examinations expert's evaluation the SRO's or JAC's application of its respective supervisory program during periodic reviews and the analysis of the sufficiency of the supervisory program's risk-based approach, internal controls testing, and design to detect material weaknesses in internal controls during both the initial assessment of the SRO's or JAC's supervisory program and during subsequent periodic evaluations. Therefore, the Proposal limits the scope of the examinations expert's evaluation during both initial and subsequent periodic evaluations to an assessment of whether the SRO's and JAC's FCM examination standards are consistent with PCAOB audit standards as such standards would be applicable to a non-financial statement audit.

The CME, NFA and JAC each expressed strong support to revise the scope of the examinations expert's evaluation and written report during both the initial review and subsequent periodic reviews, to encompass only whether the FCM examination standards are consistent with applicable PCAOB auditing standards as such standards would be

applied in a non-financial statement audit.⁴⁰ The CME and JAC each stated that with respect to the periodic evaluations, requiring the examinations expert to focus on any new or amended PCAOB auditing standards issued since the examinations expert's prior evaluation may enhance an SRO's or JAC's supervisory program.⁴¹ NFA also stated that an examinations expert has expertise with respect to reviewing PCAOB auditing standards and can provide meaningful input to an SRO or JAC supervisory program regarding the consistency of the FCM examination standards with the PCAOB audit standards.⁴²

Each of the commenters also stated, however, that an evaluation of the application of an SRO's or JAC's supervisory program was best performed by Commission staff. The JAC stated its belief that Commission staff has subject matter expertise and is best suited to evaluate, comment upon, and make recommendations regarding enhancements to the JAC's supervisory program and to assess its application against the Commission's own regulatory requirements.⁴³ NFA also stated that it agreed with the Commission's statement in the Proposal that Commission staff has the expertise in the application of CFTC regulations to operations of FCMs, and that Commission staff is appropriately situated to assess whether an SRO or JAC is accurately and properly applying Commission requirements to FCMs in the execution of the examination programs.⁴⁴ NFA further stated that it believes that the rule enforcement reviews currently performed by Commission staff of the NFA's financial surveillance program are similar in nature to

⁴⁰ CME Comment Letter, p. 1; NFA Comment Letter, p. 2; JAC Comment Letter, p. 1.

⁴¹ CME Comment Letter, p. 1; JAC Comment Letter, p. 1.

⁴² NFA Comment Letter, p. 2.

⁴³ JAC Comment Letter, p. 1.

⁴⁴ NFA Comment Letter, p. 2.

the examinations expert's review required by Regulation 1.52 and provide effective and meaningful oversight of the NFA's application of its FCM supervisory program.⁴⁵ The CME stated that it agreed with the reasoning set forth in the Proposal revising the scope of the examinations expert's evaluation, and noted that the proposed amendment strikes the proper balance between reliance on the Commission's expertise in its oversight of an SRO's examination program and the expertise of an examinations expert in evaluating the consistency of the FCM examination standards with PCAOB audit standards.⁴⁶

2. *Frequency of the Examinations Expert's Evaluation of an SRO's or JAC's Supervisory Program*

Regulation 1.52 currently requires an SRO or JAC to engage an examinations expert to evaluate its respective supervisory program prior to the initial implementation of the program, and at least once every three years thereafter.⁴⁷ The Commission proposed to amend the timeframes for an SRO or JAC to engage an examinations expert to conduct periodic evaluations subsequent to the initial implementation.⁴⁸ Specifically, the Commission proposed to amend Regulation 1.52 to require an SRO or JAC to review any new or amended auditing standards as such standards are issued by the PCAOB, and to revise its FCM examination standards promptly to reflect any changes that are applicable in the context of the SRO's or JAC's examination of FCMs.⁴⁹ The Proposal also requires the SRO or JAC to engage an examinations expert to evaluate any material revisions that the SRO or JAC makes to the examination standards to conform such

⁴⁵ *Id.*

⁴⁶ CME Comment Letter, p. 1.

⁴⁷ Regulations 1.52(c)(2)(iv) and (d)(2)(ii)(I) for an SRO and JAC, respectively.

⁴⁸ The Commission did not propose to amend the requirement that an SRO or JAC engage an examinations expert to evaluate its FCM examination standards at the initial implementation of its supervisory program.

⁴⁹ Proposed Regulation 1.52(c)(2)(iii)(B) for SROs and Regulation 1.52(d)(2)(ii)(G)(2) for JACs.

standards with the new or amended PCAOB auditing standards. In addition, the Proposal requires the SRO or JAC to engage an examinations expert to evaluate the FCM examination standards in light of new or amended PCAOB auditing standards if such engagement is directed by the CFTC Director of the Division of Swap Dealer and Intermediary Oversight (“DSIO”).⁵⁰ The Commission further proposed to limit the maximum amount of time between an examinations expert’s evaluation of an SRO’s or JAC’s FCM examination standards to no more than five years.⁵¹

At the conclusion of each review, the Proposal requires an SRO or JAC to obtain from the examinations expert a written report on findings and recommendations issued under the AICPA consulting services standards.⁵² The SRO or JAC must provide a copy of the report to the DSIO Director, along with any written responses to any of the findings and recommendations in the report, within 30 days of the SRO’s or JAC’s receipt of the report. The SRO or JAC must commence applying the revised FCM examination standards upon receipt of a written notice from DSIO staff that it has no questions or comments on the revised FCM examination standards or the written report.

The CME, NFA, and JAC supported the proposed amendments to extend the maximum timeframe for an SRO or JAC to engage an examinations expert from three to five years.⁵³ The JAC and CME, however, requested that the Commission consider a maximum ten-year timeframe between examinations expert’s reviews given the infrequency with which the PCAOB issues new or revised auditing standards, particularly

⁵⁰ Proposed Regulation 1.52(c)(2)(iii)(B) for SROs and Regulation 1.52(d)(2)(ii)(G)(2) for JACs.

⁵¹ Proposed Regulation 1.52(c)(2)(iii)(A) for SROs and Proposed Regulation 1.52(d)(2)(ii)(G)(1) for JACs.

⁵² Proposed Regulation 1.52(c)(2)(iii)(C) for SROs and Proposed Regulation 1.52(d)(2)(ii)(G)(3) for JACs.

⁵³ CME Comment Letter, pp. 1-2; NFA Comment Letter, p. 3; JAC Comment Letter, p. 1.

auditing standards that apply in the context of a non-financial statement audit.⁵⁴ In support of their respective requests, the JAC and CME represented that the SEC has only approved two amendments to PCAOB auditing standards since the Commission adopted the FCM examination standards requirement in 2015, and neither of the two amendments have an impact on FCM examination standards for non-financial statement audits.⁵⁵

The JAC, CME and NFA further expressed views that a longer maximum timeframe between required evaluations by an examinations expert was warranted given that the Proposal requires an SRO or JAC to review any new or amended audit standards issued by the PCAOB, to promptly make any necessary revisions to the FCM examinations standards resulting from such new or amended auditing standards, and to engage an examinations expert to evaluate material revisions made to the FCM examination standards.⁵⁶ The JAC, CME and NFA further stated that a regulatory provision providing for a maximum five-year timeframe between reviews by an examinations expert is not necessary as the Proposal authorizes the DSIO Director to require an SRO or JAC to engage an examinations expert at any time.⁵⁷ The JAC, CME and NFA also requested that if the Commission were to adopt a final rule that includes a requirement for an SRO or JAC to engage an examinations expert no less frequently than once every five years that the Commission also consider amending the Regulation to

⁵⁴ JAC Comment Letter, p. 1; CME Comment Letter, p. 2.

⁵⁵ JAC Comment Letter, p. 1; CME Comment Letter, p. 2. NFA also stated that the SEC has approved only two amendments to PCAOB audit standards since 2015 and both of the amendments do not apply to FCM examination standards. NFA Comment Letter, p. 3. Section 107(b) of the Sarbanes Oxley Act of 2002 generally requires the SEC to approve PCAOB rules prior to their implementation.

⁵⁶ JAC Comment Letter, p. 2; CME Comment Letter, p. 2.; NFA Comment Letter, p. 3. NFA further stated that it envisions that the only situation in which it would have to engage an examinations expert once every five years is if there are no changes to the PCAOB standards during the previous five years that impact the FCM examination standards. The NFA believes that such a requirement is unduly burdensome and costly. NFA Comment Letter, pp. 3-4.

⁵⁷ JAC Comment Letter, p. 2; CME Comment Letter, p. 2; NFA Comment Letter, pp. 3-4.

authorize the Director of DSIO to grant a waiver or otherwise provide relief from the requirement under appropriate circumstances, including situations where there are no new or revised auditing standards issued by the PCAOB during the five-year period since the prior examinations expert's review.⁵⁸

Commenters also requested that the Commission confirm or clarify several aspects of the Proposal or existing Regulation 1.52. The JAC and CME requested that the Commission confirm that the proposed maximum five-year timeframe between an examinations expert's evaluation of the FCM examination standards is reset whenever an SRO or JAC engages an examinations expert.⁵⁹ The JAC and CME also noted that the regulation requires that all aspects of the supervisory program must conform to auditing standards issued by the PCAOB as such standards would be applicable to a non-financial audit. The JAC and CME requested confirmation that when auditing standards of the PCAOB are referenced in Regulation 1.52, it is the standards that would be applicable to a non-financial statement audit.⁶⁰

3. *Technical Amendments to Regulation 1.52*

The Proposal includes several technical amendments to Regulation 1.52 to eliminate redundancies and to simplify the intent of the Regulation. Specifically, the Commission proposed to consolidate the examination standards required to be included in an SRO supervisory program that are currently listed in paragraphs (c)(2)(ii) and (iii) into a single revised paragraph (c)(2)(ii) of Regulation 1.52. The Commission further

⁵⁸ JAC Comment Letter, p. 2; CME Comment Letter, p. 2; NFA Comment Letter, pp. 3-4. The JAC and CME also requested that the Commission continue to monitor the adoption of auditing standards by the PCAOB and consider eliminating the requirement for an examinations expert to perform evaluations in a future rulemaking.

⁵⁹ JAC Comment Letter, p. 2; CME Comment Letter, p. 3.

⁶⁰ JAC Comment Letter, p. 2; CME Comment Letter, p. 3.

proposed to amend paragraphs (d)(2)(ii)(F) and (d)(2)(ii)(G) of Regulation 1.52, which sets forth the examination standards required of a JAC supervisory program, to be consistent with, and to incorporate by cross-reference, the SRO examination standards contained in revised paragraph (c)(2)(ii) of Regulation 1.52. The Commission did not receive any comments on the proposed amendments to paragraphs (c)(2)(ii), (d)(2)(ii)(F)-(G) of Regulation 1.52.

III. Final Rules

The Commission has considered the comments received and is adopting the amendments to Regulation 1.52 as proposed, with minor changes discussed below.

A. Scope of the Examinations Expert's Evaluation of a Supervisory Program

Amended Regulation 1.52 revises the scope of the examinations expert's initial and ongoing evaluations of an SRO's or JAC's supervisory program to encompass only an evaluation of whether the supervisory program's FCM examination standards are consistent with auditing standards issued by the PCAOB as such auditing standards would be applied to a non-financial statement audit. Accordingly, amended Regulation 1.52 will not require an SRO or JAC to engage an examinations expert to evaluate the sufficiency of the supervisory program's risk-based approach or internal controls testing, including the program's design to detect material weaknesses in an FCM's internal control environment. Amended Regulation 1.52 also will not require an SRO or JAC to engage an examinations expert to evaluate the SRO's or JAC's application of the supervisory program.

Amended Regulation 1.52 continues to require an SRO or JAC to obtain from the examinations expert a written report on findings and recommendations issued under

AICPA consulting services standards as part of both the initial and periodic, ongoing evaluations of the SRO's or JAC's supervisory program. Consistent with the amendments to the scope of the examinations expert's evaluation, the written report is required to address the consistency of the supervisory program's FCM examination standards with auditing standards issued by the PCAOB, as such standards would be applied in a non-financial statement audit. The written report is no longer required to include statements regarding the examinations expert's evaluation of the sufficiency of the supervisory program's risk-based approach and internal control testing. The written report also is no longer required to include an analysis of the supervisory program's design to detect material weaknesses in an FCM's internal control environment. The written report also is required to be provided to the Director of DSIO.⁶¹

As noted in the Proposal, the Commission initially adopted the requirement for an examinations expert to evaluate an SRO's or JAC's application of its supervisory program, including ongoing assessments of the sufficiency of the SRO's or JAC's internal controls testing, to address concerns that a third-party assessment was necessary due to limited Commission resources and expertise to perform a comparable periodic evaluation. Commission staff subsequently worked closely with both the CME and NFA in the development of their initial supervisory programs and has determined that it has sufficient resources and expertise to effectively oversee the application of SRO and JAC supervisory programs. In this regard, Commission staff ultimately approved the JAC's initial supervisory program in 2015, including the supervisory program's FCM examination standards and detailed examination programs. Commission staff also has

⁶¹ As stated in the Proposal, DSIO will provide the written report to the Commission on an informational basis.

performed routine scheduled oversight reviews of both the CME's and NFA's application of their respective supervisory programs since their initial approvals in 2015, including their internal controls testing at member FCMs. Commission staff also routinely reviews the JAC examination programs to assess their sufficiency in examining FCMs' compliance with Commission and SRO financial, reporting, and general operational requirements, as well as their sufficiency in assessing the effectiveness of the internal controls at an FCM. Therefore, although the size of the relevant staff has remained relatively constant since 2015, the Commission believes that it has the appropriate expertise to provide the level of supervision necessary to assess an SRO's or JAC's application of its respective supervisory program.

B. Frequency of the Examinations Expert's Evaluation of an SRO's or JAC's Supervisory Program

The Commission is amending Regulation 1.52 to adopt a risk-based approach to determine the required frequency of an examinations expert's evaluation of an SRO's or JAC's supervisory program. Amended Regulation 1.52 requires an SRO or JAC to review new or amended auditing standards as such standards are issued by the PCAOB, and to revise its FCM examination standards promptly to reflect any changes that are applicable in the context of the SRO's or JAC's examination of FCMs. The final amendments also require the SRO or JAC to engage an examinations expert to evaluate any material revisions that the SRO or JAC makes to the examination standards to conform such standards with the new or amended PCAOB auditing standards. In addition, the final amendments require the SRO or JAC to engage an examinations expert to evaluate the FCM examination standards in light of new or amended PCAOB auditing

standards whenever such engagement is directed by the Director of DSIO. The Commission also is amending Regulation 1.52 to revise from three to five years the maximum period of time that an SRO or JAC may operate its supervisory program without engaging an examinations expert to evaluate its FCM examination standards for consistency with PCAOB auditing standards as such standards would apply to a non-financial statement audit.

As noted in the Proposal, the Commission believes that the examinations expert's evaluation provides an important oversight mechanism whereby an independent third-party that has expertise in the application of PCAOB auditing standards can assess an SRO's or JAC's FCM examination standards for consistency with such PCAOB auditing standards. The Commission further believes that the FCM examination standards should be reviewed and revised promptly whenever the PCAOB issues new or amended auditing standards, and an SRO or JAC should engage an examinations expert to review any material revisions made to the FCM examination standards instead of waiting for the next scheduled review under a three-year cycle. The provision providing the Director of DSIO with the authority to direct an SRO or JAC to engage an examinations expert to evaluate its FCM examination standards for consistency with PCAOB audit standards is intended to ensure that an independent third-party assessment is performed whenever material revisions are made to the FCM examination standards. Accordingly, the third-party assessment may be initiated either by the SRO/JAC or by the DSIO Director, if necessary. Lastly, the amended regulation provides that an SRO or JAC must engage an examinations expert to evaluate its FCM examination standards if it has not engaged an examinations expert to perform such an evaluation within the last five years.

The Commission considered the comments received in adopting the final amendments. The Commission does not believe that it is appropriate at this time to extend the maximum timeframe between examinations expert's evaluations to once every 10 years as suggested by the JAC and CME. Nor does the Commission believe that the provision granting the Director of DSIO the authority to direct an SRO or JAC to engage an examinations expert supports the elimination of a maximum five-year timeframe from the regulation as suggested by the JAC, CME and NFA.

The requirement that an SRO or JAC engage an examinations expert is a new requirement that was adopted in 2013. While the NFA and CME have engaged an examinations expert to assist them with the development of their initial supervisory programs, including assisting them with developing FCM examinations standards that are consistent with applicable PCAOB auditing standards, neither the NFA nor CME has gone through the process of engaging an examinations expert to perform an evaluation subsequent to the initial approval. As noted above, both the Commission and commenters recognize the benefits that an examinations expert may provide by evaluating the FCM examination standards. The Commission believes that a maximum five-year period of time between evaluations provides a more appropriate balance between the costs of engaging the examinations expert and the benefit provided by the independent evaluation of the FCM examination standards than a 10-year timeframe.

The Commission also acknowledges the infrequent nature by which the PCAOB issues new or amended auditing standards, and the Commission recognizes that the PCAOB has not issued new or amended auditing standards that are applicable to an SRO or JAC examination of an FCM since the NFA and CME supervisory programs were

initially adopted. The Commission believes, however, that existing regulations provide an appropriate mechanism for an SRO or JAC to seek regulatory relief from the requirement to engage an examinations expert in situations where the PCAOB has been relatively inactive in issuing new or amended auditing standards during the previous five-year period. In such situations, an SRO or JAC may seek regulatory relief, including requesting a no-action position from Commission staff pursuant to Regulation 140.99.⁶²

As noted above, the Commission is adopting the amendments to Regulations 1.52(c)(2)(iii) and 1.52(d)(2)(G) setting forth a requirement that an SRO and JAC, respectively, engage an examinations expert at least once every five years as proposed. The Commission also is setting the starting date of the five-year period to coincide with the effective date of the final amendments to Regulation 1.52. In addition, the Commission confirms that the five-year timeframe is restarted whenever an SRO or JAC engages an examinations expert to evaluate its FCM examination standards.⁶³ The restart date for the running of the five-year period shall be the date on which DSIO staff provides written notice to an SRO pursuant to Regulation 1.52(c)(2)(iii)(C) or a JAC pursuant to Regulation 1.52(d)(2)(ii)(G)(3) that DSIO staff has no further comments or questions on the revised examination standards.

C. Technical Amendments to Regulation 1.52

The proposed technical amendments consolidate in Regulation 1.52(c)(2)(ii) the FCM examination standards required to be included in an SRO supervisory program that

⁶² The availability of regulatory relief under Regulation 140.99 also negates the need for Regulation 1.52 to include a provision providing the Director of DSIO the authority to issue waivers from requirement for an SRO or JAC to engage an examinations expert.

⁶³ The scope of the examinations expert's review shall ensure that each FCM examination standards is assessed for consistency with new or revised PCAOB auditing standards issued since the most recent review.

are currently listed in paragraphs (c)(2)(ii) and (iii) of Regulation 1.52. The technical amendments also revise paragraphs (d)(2)(ii)(F) and (d)(2)(ii)(G) of Regulation 1.52, which sets forth the FCM examination standards required of a JAC supervisory program, to be consistent with, and to incorporate by cross-reference, the SRO examination standards contained in amended paragraph (c)(2)(ii) of Regulation 1.52.

The Commission did not receive any comments regarding the proposed technical amendments. The Commission is adopting the technical amendments as proposed.

D. Additional Comments

The Commission also received several comments that addressed issues in addition to the scope and frequency of the examinations expert's evaluation of FCM examination standards. The CME and JAC noted in their respective comment letters that current Regulation 1.52(d)(2)(iii)(B)(6) provides that JAC members must consider issuing "risk alerts" to both FCMs and DSRO examiners on an as needed basis as issues arise.⁶⁴ The CME and JAC stated that the requirement to consider issuing risk alerts to DSRO staff examiners is not necessary and requested that the requirement be eliminated.⁶⁵

The CME and JAC also commented that Regulation 1.52(d)(2)(ii)(E) requires a JAC supervisory program to, among other requirements, "address all areas of risk to which an FCM can reasonably be foreseen to be subject to."⁶⁶ The CME and JAC stated that this provision is vague and overly broad, and further noted that such requirements are addressed in Regulation 1.11, which imposes an enterprise risk management requirement

⁶⁴ CME Comment Letter, p. 2; JAC Comment Letter, p. 3.

⁶⁵ CME Comment Letter, p. 3; JAC Comment Letter, p. 2.

⁶⁶ CME Comment Letter, p. 3; JAC Comment Letter, pp. 2-3.

on FCMs. The CME and JAC requested that Regulation 1.52 be amended to remove the requirement.

In addition, the CME noted that Regulation 1.52(k) requires an SRO to provide the Commission with notice when an FCM, a registered retail foreign exchange dealer, or a registered introducing broker ceases to be a member in good standing of the SRO.⁶⁷ The CME stated that CME members include both clearing members, which are subject to the supervisory procedures specified in Regulation 1.52, and “corporate members”, which may include FCMs, retail foreign exchange dealers, and introducing brokers that are not clearing members and are subject to NFA as their DSRO. The CME requested that Regulation 1.52(k) be amended to clarify that NFA is responsible for providing the notice on the status of such corporate members not being in good standing of the SRO.

Each of the comments above are beyond the scope of the Commission’s Proposal and the Commission has determined not to amend Regulation 1.52 to address these issues at this time. The Commission, however, understands that with respect to Regulation 1.52(k), that DSRO responsibilities are allocated amongst SROs pursuant to the Joint Audit Plan, and Regulation 1.52 does not prohibit NFA from being the DSRO of FCMs, retail foreign exchange dealers, or introducing brokers that are corporate members of an SRO that may be a designated contract market. Accordingly, the CME is not obligated to file a notice with the Commission under Regulation 1.52(k) if an FCM, retail foreign exchange dealer, or introducing broker solely terminated its corporate membership in the CME. The Commission would expect, however, that if an SRO is aware of a regulatory issue with a corporate member that may indicate that the corporate member is not

⁶⁷ CME Comment Letter, p. 3.

complying with Commission or SRO regulations, that the SRO would communicate such concerns to the appropriate DSRO for further review consistent with the terms and intent of the Joint Audit Plan and Regulation 1.52.

IV. Related Matters

A. Regulatory Flexibility Act

The Regulatory Flexibility Act (“RFA”)⁶⁸ requires Federal agencies, in promulgating regulations, to consider the impact of those regulations on small entities. The Commission has previously established certain definitions of “small entities” to be used by the Commission in evaluating the impact of its rules on small entities in accordance with the RFA.⁶⁹ The proposed regulations would affect designated contract markets.

The Commission has previously determined that designated contract markets are not small entities for purposes of the RFA, and, thus, the requirements of the RFA do not apply to designated contract markets.⁷⁰ Accordingly, the Chairman, on behalf of the Commission, certifies pursuant to 5 U.S.C. 605(b) that the proposed regulations would not have a significant economic impact on a substantial number of small entities.

B. Paperwork Reduction Act

As the Commission stated in the Proposal, this rulemaking does not impose any new recordkeeping or information collection requirements, or other collections of information that require approval of the Office of Management and Budget under the Paperwork Reduction Act (“PRA”). All recordkeeping or information collection

⁶⁸ 5 U.S.C. 601 *et seq.*

⁶⁹ 47 FR 18618 (Apr. 30, 1982).

⁷⁰ *Id.* at 18619.

requirements relevant to the subject of this rulemaking, or discussed herein, already exist under current law. The title for this collection of information is Core Principles & Other Requirements for DCMs, OMB control number 3038-0052. The Commission invited public comment on the accuracy of its estimate that no additional recordkeeping or information collection requirements or changes to existing collection requirements would result from the Proposed Amendment. The Commission did not receive any comments that addressed whether additional recordkeeping or information collection requirements or changes to existing collection requirements would result from the adoption of the Proposal. Nevertheless, the Commission notes that the final rule will reduce the current burden estimate of OMB control number 3038-0052. Accordingly, the Commission will, by separate action, publish in the Federal Register a notice and request for comment on the amended PRA burden associated with the final rule, and submit to OMB an information collection request to amend the information collection, in accordance with 44 U.S.C. 3506(c)(2)(A) and 5 CFR 1320.8(d).

The collections contained in this rulemaking are mandatory collections. In formulating burden estimates for the collections in this rulemaking, to avoid double accounting of information collections that already have been assigned control numbers by OMB, or are covered as burden hours in collections of information pending before OMB, the PRA analysis provided in the rulemaking, along with the information collection request (“ICR”) with burden estimates that were incorporated into the rulemaking by reference and submitted to OMB, accounted only burden estimates for collections of information that have not previously been submitted to OMB. As such, the final rules do

not impose any new burden or any new information collection requirements in addition to those that already exist.

C. Cost Benefit Considerations

1. Introduction

Section 15(a) of the Act requires the CFTC to consider the costs and benefits of its actions before promulgating a regulation under the Act or issuing certain orders.⁷¹

Section 15(a) of the Act further specifies that the costs and benefits shall be evaluated in light of five broad areas of market and public concern: (1) protection of market participants and the public; (2) efficiency, competitiveness, and financial integrity of futures markets; (3) price discovery; (4) sound risk management practices; and (5) other public interest considerations. The CFTC considers the costs and benefits resulting from its discretionary determinations with respect to the section 15(a) factors below.

Where reasonably feasible, the CFTC endeavors to estimate quantifiable costs and benefits. Where quantification is not feasible, the CFTC identifies and describes costs and benefits qualitatively.

The commentators to the CFTC's Proposal gave no negative comments on the costs and benefits associated with the rule amendments. Indeed, commentators were supportive of the CFTC's Proposal, in part due to reduced costs and reduced complexity that the rule changes would introduce.

2. Economic Baseline

The CFTC's economic baseline for the rule amendment analysis is the requirements of Regulation 1.52 that currently exist prior to taking into account the final

⁷¹ 7 U.S.C. 19(a).

amendments. Specifically, current Regulation 1.52 requires an SRO or a JAC to engage an examinations expert to evaluate its supervisory program prior to its initial use, and to evaluate the SRO's application of the supervisory program at least once every three years after its initial use.

The Commission's rulemaking will not alter the requirement for an SRO or JAC to engage an examinations expert to evaluate its supervisory program prior to the initial use of the supervisory program. The Commission, however, is eliminating the requirement that the examinations expert must review the SRO's or JAC's ongoing application of its supervisory program during periodic reviews and the analysis of the supervisory program's design to detect material weaknesses in internal controls during both periodic reviews and the initial review prior to the program's initial use as such requirement is not necessary due to Commission staff performing comparable reviews on a routine, periodic basis as discussed below. The Commission also is revising the frequency of when an SRO or a JAC must engage an examinations expert, as discussed below.

The Commission's elimination of the requirement that an examinations expert evaluate an SRO's or a JAC's application of its supervisory program and the program's design to detect material weaknesses in internal controls will reduce costs related to conducting such review. However, the rulemaking will not substantially reduce the benefits obtained from an evaluation of the SRO's and JAC's supervisory program, including internal controls, as such reviews are performed by Commission staff on a routine basis. Commission staff evaluates the SRO's or JAC's execution of its supervisory program, including performing detailed reviews of SRO and JAC

examination work papers, to assess the adequacy of the scope of the work performed by SRO and JAC staff members and to determine whether the conclusions reached by SRO and JAC staff members are supported by the work performed. Commission staff also reviews at least annually all SRO and JAC examination programs for conducting examinations of FCMs to assess the completeness of such programs and to determine that such programs properly reflect any regulatory updates, including rule amendments, adopted since the Commission staff's previous review of the examination programs. Reviews of execution and completeness of supervisory programs for FCMs occur no less frequently than annually. Furthermore, Commission staff has a particular expertise in assessing and reviewing whether registrants are in compliance with Commission regulatory requirements that makes a third-party review redundant.

The final amendments will continue to require that an examinations expert review the FCM examination standards contained in the supervisory program for consistency with PCAOB auditing standards as such standards apply to a non-financial statement audit. The Commission recognizes that examinations experts have a particular expertise in the application of PCAOB auditing standards and can effectively evaluate whether SRO and JAC FCM examination standards are consistent with such auditing standards. The Commission, however, is revising the timeframe for such reviews. Currently, Regulation 1.52 requires an SRO or JAC to engage an examinations expert at least once every three years to perform such a review. The Commission is amending Regulation 1.52 to require an SRO or JAC to engage an examinations expert whenever the PCAOB issues new or revised auditing standards that are material to the SRO's or JAC's examination of member FCMs.

The examinations expert's review, however, is limited to only the new or revised PCAOB auditing standards that have been issued since the most recent prior review that are applicable to the SRO's or JAC's examination of FCMs. Accordingly, the examinations expert will not have to review all of the SRO's or JAC's FCM examination standards for consistency with PCAOB audit standards. The amendments further require an SRO or JAC to engage an examinations expert at least once every five years even if the SRO or JAC determines that the PCAOB did not issue new or revised auditing standards during the previous five-year period that are material to its examinations of member FCMs. Based on past experience, the Commission anticipates that the adoption of new or revised auditing standards that are material to examination standards applicable to FCMs will be infrequent and, therefore, the triggering of an examinations expert review will also likely be an infrequent event.⁷² Finally, the amendments provide that an SRO or JAC must engage an examinations expert if directed to by the Director of the Division of Swap Dealer and Intermediary Oversight.⁷³

The amendments to Regulation 1.52 are intended to streamline the process under which examinations experts conduct their reviews and the time period between those reviews. The Commission believes that these amendments will make conducting the reviews more efficient and less costly, while also continuing to provide the benefit the Commission and public obtain from an independent assessment that SROs and JACs use appropriate FCM examinations standard in the conduct of the oversight of their member

⁷² Since 2016 PCAOB has adopted and the SEC has approved approximately two new standards, neither of which had a significant impact on the examination standards applicable to FCMs. See PCAOB web site available at: https://pcaobus.org/Standards/Pages/Current_Activities_Related_to_Standards.aspx.

⁷³ For example, in circumstances where an SRO or JAC has not engaged an examinations expert yet DSIO staff believes a material change to PCAOB auditing standards warrants such engagement.

FCMs, which perform critical functions in both the operation of the futures markets and in the protection of customer funds.

The Commission does not anticipate that there will be any significant increase in costs associated with the amendments. By narrowing the intended scope of examination reviews from an evaluation of the supervisory program to an assessment of the examinations standards for conformity with auditing standards established by the PCAOB as they apply to FCM examinations, the Commission is purposely limiting the scope of the examinations expert's review. The Commission anticipates that this limitation, coupled with extending the time period between examinations experts' reviews, will reduce costs associated with engaging and hiring an examinations expert.⁷⁴ Nonetheless, the Commission believes that these amendments are appropriately calibrated to ensure the integrity of the SRO and JAC supervisory programs and continued oversight over the minimum financial requirements at FCMs. As noted, Commission staff reviews no less frequently than annually all SRO and JAC examination programs and reviews on a routine and periodic basis the SRO' and JAC's application of their supervisory programs. The Commission anticipates that its staff will continue to perform such reviews as part of its routine oversight of SROs and JACs. These Commission staff reviews will continue to provide the benefits that have been associated with the examinations experts' reviews.

3. *CEA Section 15(a) Factors*

⁷⁴ In 2013, the Commission found that it was not feasible to quantify any costs associated with utilizing an examinations expert, largely because several nationally recognized accounting firms expressed their reluctance to provide such information. *See*, Enhancing Protections Afforded Customers and Customer Funds Held by Futures Commission Merchants and Derivatives Clearing Organizations, 78 FR, 68506, 68605 (Nov. 14, 2013). While it is also not feasible to quantify such costs for the use of an examinations expert under the final amendments, such costs are likely much less than the costs under the existing rule.

a. Protection of Market Participants and the Public

The Commission believes that these amendments maintain the current level of protections of market participants and the public provided by the current regulation. The amendments continue to protect market participants and the public by ensuring that there is sufficient oversight over the minimum financial requirements at FCMs. As noted, the Commission believes that Commission staff is well-equipped to provide reviews that will no longer be provided by outside examinations experts and Commission staff intends to continue to conduct such reviews.

b. Efficiency, Competitiveness, and Financial Integrity of Markets

The Commission believes that Regulation 1.52 as amended will continue to help ensure that FCMs can meet their financial and operational obligations to both customers and DCOs, which, along with the Commission's ongoing reviews, will continue to foster the efficiency and financial integrity of markets. The Commission has not identified any effect of Regulation 1.52 on the competitiveness of derivatives markets.

c. Price Discovery

The Commission has not identified any material effect of the amendments on the price discovery process in futures and swap markets.

d. Sound Risk Management Practices

The Commission believes that Regulation 1.52 as amended, along with the Commission's ongoing reviews, will continue to help ensure that FCMs can meet their financial and operational obligations to both customers and DCOs, which should continue to foster sound risk management practices.

e. Other Public Interest Considerations

The Commission has not identified any additional public interest considerations associated with the amendments.

f. Consideration of Alternatives

The Commission considered several alternative approaches that were specified in the comments. In this regard, the Commission considered the CME's suggestion to fully eliminate the requirement that a third-party examinations expert perform periodic evaluations and assessments of an SRO's program to oversee its member FCMs' compliance with financial and related reporting requirements.⁷⁵ The Commission has elected to maintain the requirement for a third-party examinations expert. The Commission, however, has further decided to eliminate the requirement that the examinations expert periodically review the SRO's or JAC's ongoing application of its supervisory program as Commission staff routinely perform such reviews. The Commission further elected to maintain the examinations expert's required reviews of an FCM's examinations standards at a modified interval. As noted previously, FCMs perform significant market functions, including holding customer funds and guaranteeing customers' financial performance to DCOs. The effective operation of these functions is necessary for the efficient operation of the futures markets. The Commission believes that the SRO or JAC examination program is a critical component of the overall process for determining an FCM's compliance with regulatory requirements and the FCM's ability to fulfill its financial obligations. The Commission further believes that examinations experts have a particular expertise in PCAOB auditing standards and can effectively and efficiently evaluate whether SRO or JAC FCM examination standards are

⁷⁵ CME Comment Letter, p. 2.

consistent with such PCAOB auditing standards, which will help ensure that the SRO and JAC examinations satisfy industry standards for effective FCM audits.

The Commission also considered the CME's and JAC's suggestion that an SRO or JAC should be required to engage an examinations expert at least once every ten years as opposed to the Commission's proposal of once every five years.⁷⁶ The Commission further considered the NFA's request that the Commission consider whether a set time period between reviews is even necessary given that the Director of DSIO is authorized to direct an SRO or JAC to engage an examinations expert at any time.⁷⁷

As noted immediately above, the Commission believes that there are significant benefits to customers, market participants, clearing organizations, and the futures industry in general from SRO or JAC supervisory programs that assess FCMs' compliance with SRO and CFTC regulatory requirements. Such SRO and JAC reviews help ensure that FCMs have the operational and financial capacity to meet their obligations as market intermediaries, which is necessary for efficient markets. The Commission further believes that such reviews should be performed at least once every five years (and also when there are material and relevant changes in PCAOB auditing standards) as required by the amendments. While, as noted, Commission staff is well-equipped to review the ongoing application of SRO and JAC supervisory programs and intends to continue to do so at least annually, the Commission believes that examinations experts are best equipped to perform evaluations of examination standards for conformity with auditing standards established by the PCAOB as they apply to non-financial statement audits.

⁷⁶ CME Comment Letter, p. 2; JAC Comment Letter, p. 1.

⁷⁷ NFA Comment Letter, p. 3.

The Commission believes that a ten-year time period between examinations experts' reviews is not appropriate at the current time given that an SRO or JAC has not gone through an examinations expert's review since the adoption of the initial requirements in 2013. While the Commission recognizes that the final rule authorizes the director of DSIO to instruct an SRO or JAC to engage an examinations expert any time the PCAOB issues new or amended auditing standards, the Commission believes that it should gain further experience with the operation of the rule and develop a more thorough understanding of both the costs and benefits associated with the examinations experts review before considering amending the rule to expand the maximum period of time between such reviews from five to ten years. The Commission further notes that in the event that there are no changes in PCAOB auditing standards that would materially impact FCM examination standards, SROs and JACs may use existing processes for seeking regulatory relief under Regulation 140.99 if they believe such relief is warranted based upon the facts and circumstances.

The Commission also considered maintaining the current rule, but the Commission anticipates that the amendments will significantly reduce costs to SROs and JACs without materially impacting benefits.

D. Anti-Trust Considerations

Section 15(b) of the CEA requires the Commission to take into consideration the public interest to be protected by the antitrust laws and endeavor to take the least anticompetitive means of achieving the purposes of the CEA, in issuing any order or adopting any Commission rule or regulation.⁷⁸

⁷⁸ 7 U.S.C. 19(b).

The Commission believes that the public interest to be protected by the antitrust laws is generally to protect competition. The Commission has considered the amendments to Regulation 1.52 and comments received to determine whether it is anticompetitive and has identified no anticompetitive effects.

Because the Commission has determined that the amendments to Regulation 1.52 are not anticompetitive and have no anticompetitive effects, the Commission has not identified any less anticompetitive means of achieving the purposes of the CEA.

List of Subjects in 17 CFR Part 1

Brokers, Commodity futures, Consumer protection, Reporting and recordkeeping requirements.

For the reasons stated in the preamble, the Commodity Futures Trading Commission amends 17 CFR part 1 as follows:

PART 1—GENERAL REGULATIONS UNDER THE COMMODITY EXCHANGE ACT

1. The authority citation for part 1 continues to read as follows:

Authority: 7 U.S.C. 1a, 2, 5, 6, 6a, 6b, 6c, 6d, 6e, 6f, 6g, 6h, 6i, 6k, 6l, 6m, 6n, 6o, 6p, 6r, 6s, 7, 7a-1, 7a-2, 7b, 7b-3, 8, 9, 10a, 12, 12a, 12c, 13a, 13a-1, 16, 16a, 19, 21, 23, and 24 (2012).

2. Amend § 1.52 as follows:
 - a. Revise paragraphs (c)(2)(ii) through (v);
 - b. Remove paragraphs (c)(2)(vi) and (vii);
 - c. Revise paragraphs (d)(2)(ii)(F) through (I);
 - d. Remove paragraphs (d)(2)(ii)(J) and (K); and
 - e. Revise paragraph (d)(2)(iii).

The revisions read as follows:

§ 1.52 Self-regulatory organization adoption and surveillance of minimum financial requirements.

* * * * *

(c) * * *

(2) * * *

(ii) The supervisory program must, at a minimum, have examination standards addressing the following:

(A) The ethics of an examiner;

(B) The independence of an examiner;

(C) The supervision, review, and quality control of an examiner's work product;

(D) The evidence and documentation to be reviewed and retained in connection with an examination;

(E) The sampling size and techniques used in an examination;

(F) The examination risk assessment process;

(G) The examination planning process;

(H) Materiality assessment;

(I) Quality control procedures to ensure that the examinations maintain the level of quality expected;

(J) Communications between an examiner and the regulatory oversight committee, or the functional equivalent of the regulatory oversight committee, of the self-regulatory organization of which the futures commission merchant is a member;

(K) Communications between an examiner and a futures commission merchant's audit committee of the board of directors or other similar governing body;

(L) Analytical review procedures;

(M) Record retention; and

(N) Required items for inclusion in the examination report, such as repeat violations, material items, and high risk issues. The examination report is intended solely for the information and use of the self-regulatory organizations and the Commission, and is not intended to be and should not be used by any other person or entity.

(iii)(A) Prior to the initial implementation of the supervisory program, a self-regulatory organization must engage an examinations expert to evaluate the examination standards for consistency with auditing standards issued by the Public Company Accounting Oversight Board as such auditing standards are applicable in the context of the self-regulatory organization's examination of its futures commission merchant members. At least once every five years after the initial implementation of the supervisory program, a self-regulatory organization must engage an examinations expert to evaluate the examination standards for consistency with any new or amended auditing standards issued by the Public Company Accounting Oversight Board since the previous review performed by the examinations expert. At the conclusion of each evaluation, a self-regulatory organization must obtain a written report from the examinations expert in accordance with paragraph (c)(2)(iii)(C) of this section.

(B) Notwithstanding paragraph (c)(2)(iii)(A) of this section, a self-regulatory organization must review any new or amended auditing standards issued by the Public Company Accounting Oversight Board, and must revise its examination standards

promptly to reflect any changes in such auditing standards that are applicable in the context of the self-regulatory organization's examination of its futures commission merchant members. A self-regulatory organization must engage an examinations expert to evaluate any material revisions that the self-regulatory organization makes to the examination standards to conform such standards with the Public Company Accounting Oversight Board's auditing standards, or if directed to engage an examinations expert by the Director of the Division of Swap Dealer and Intermediary Oversight. At the conclusion of each review, a self-regulatory organization must obtain a written report from the examinations expert in accordance with paragraph (c)(2)(iii)(C) of this section.

(C) At the conclusion of the examinations expert's engagement pursuant to paragraph (c)(2)(iii)(A) or (B) of this section, the self-regulatory organization must obtain from the examinations expert a written report on findings and recommendations issued under the consulting services standards of the American Institute of Certified Public Accountants. The self-regulatory organization must provide the Director of the Division of Swap Dealer and Intermediary Oversight with a copy of the examinations expert's written report, and the self-regulatory organization's written responses to any of the examinations expert's findings and recommendations, within thirty days of the receipt thereof. Upon resolution of any questions or comments raised by the Division of Swap Dealer and Intermediary Oversight, and upon written notice from the Division of Swap Dealer and Intermediary Oversight that it has no further comments or questions on the examinations standards as amended (by reason of the examinations expert's proposals, consideration of the Division of Swap Dealer and Intermediary Oversight's questions or comments, or otherwise), the self-regulatory organization shall commence applying such

examinations standards for examining its registered futures commission merchant members for all examinations conducted with an “as of” date later than the date of the Division of Swap Dealer and Intermediary’s written notification.

(iv) The supervisory program must require the self-regulatory organization to report to its risk and/or audit committee of the board of directors, or a functional equivalent committee, with timely reports of the activities and findings of the supervisory program to assist the risk and/or audit committee of the board of directors, or a functional equivalent committee, to fulfill its responsibility of overseeing the examination function.

(v) The examinations expert’s written report, the self-regulatory organization’s response, if any, as well as any information concerning the supervisory program is confidential.

(d) * * *

(2) * * *

(ii) * * *

(F) The Joint Audit Program must include examination standards addressing the items listed in paragraph (c)(2)(ii) of this section.

(G)(I) Prior to the initial implementation of the Joint Audit Program, the Joint Audit Committee must engage an examinations expert to evaluate the examination standards for consistency with auditing standards issued by the Public Company Accounting Oversight Board as such auditing standards are applicable in the context of the Joint Audit Committee’s examination of its futures commission merchant members. At least once every five years after the initial implementation of the Joint Audit Program, the Joint Audit Committee must engage an examinations expert to evaluate the examination

standards for consistency with any new or amended auditing standards issued by the Public Company Accounting Oversight Board since the previous review performed by the examinations expert. At the conclusion of each review, the Joint Audit Committee must obtain a written report from the examinations expert in accordance with paragraph (d)(2)(ii)(G)(3) of this section.

(2) Notwithstanding paragraph (d)(2)(ii)(G)(1) of this section, the Joint Audit Committee must review any new or amended auditing standards issued by the Public Company Accounting Oversight Board, and must revise its examination standards promptly to reflect any changes in such auditing standards that are applicable in the context of the Joint Audit Committee's examination of its futures commission merchant members. The Joint Audit Committee must engage an examinations expert to evaluate any material revisions that the Joint Audit Committee makes to the examination standards to conform such standards with the Public Company Accounting Oversight Board's auditing standards, or if directed to engage an examinations expert by the Director of the Division of Swap Dealer and Intermediary Oversight. The Joint Audit Committee must obtain a written report from the examinations expert in accordance with paragraph (d)(2)(ii)(G)(3) of this section.

(3) At the conclusion of the examinations expert's engagement pursuant to paragraph (d)(2)(ii)(G)(1) or (2) of this section, the Joint Audit Committee must obtain from the examinations expert a written report on findings and recommendations issued under the consulting services standards of the American Institute of Certified Public Accountants. The Joint Audit Committee must provide the Director of the Division of Swap Dealer and Intermediary Oversight with a copy of the examinations expert's

written report, and the Joint Audit Committee's written responses to any of the examinations expert's findings and recommendations, within thirty days of the receipt thereof. Upon resolution of any questions or comments raised by the Division of Swap Dealer and Intermediary Oversight, and upon written notice from the Division of Swap Dealer and Intermediary Oversight that it has no further comments or questions on the examinations standards as amended (by reason of the examinations expert's proposals, consideration of the Division of Swap Dealer and Intermediary Oversight's questions or comments, or otherwise), the Joint Audit Committee shall commence applying such examinations standards for examining its registered futures commission merchant members for all examinations conducted with an "as of" date later than the date of the Division of Swap Dealer and Intermediary's written notification.

(H) The Joint Audit Program must require the Joint Audit Committee members to report to their respective risk and/or audit committee of their respective board of directors, or a functional equivalent committee, with timely reports of the activities and findings of the Joint Audit Program to assist the risk and/or audit committee of the board of directors, or a functional equivalent committee, to fulfill its responsibility of overseeing the examination function.

(I) The examinations expert's written report, the Joint Audit Committee's response, if any, as well as any information concerning the supervisory program is confidential.

(iii) *Meetings of the Joint Audit Committee.* (A) The Joint Audit Committee members must meet at least once each year. During such meetings, the Joint Audit Committee members shall consider revisions to the Joint Audit Program as a result of regulatory changes, revisions to the examination standards resulting from new or

amended auditing standards issued by the Public Company Accounting Oversight Board, or the results of an examinations expert's review.

(B) In addition to the items considered in paragraph (d)(2)(iii)(A) of this section, the Joint Audit Committee members must consider the following items during the meetings:

(1) Coordinating and sharing information between the Joint Audit Committee members, including issues and industry concerns in connection with examinations of futures commission merchants;

(2) Identifying industry regulatory reporting issues and financial and operational internal control issues and modifying the Joint Audit Program accordingly;

(3) Issuing risk alerts for futures commission merchants and/or designated self-regulatory organization examiners on an as-needed basis;

(4) Responding to industry issues; and

(5) Providing industry feedback to Commission proposals.

(C) Minutes must be taken of all meetings and distributed to all members on a timely basis.

(D) The Director of the Division of Swap Dealer and Intermediary Oversight must receive timely prior notice of each meeting, have the right to attend and participate in each meeting and receive written copies of the minutes required pursuant to paragraph (d)(2)(iii)(C) of this section, respectively.

* * * * *

Issued in Washington, DC, on March 29, 2019, by the Commission.

Robert Sidman,

Deputy Secretary of the Commission.

Note: The following appendices will not appear in the Code of Federal Regulations.

Appendices to Financial Surveillance Examination Program Requirements for Self-Regulatory Organizations

Appendix 1—Commission Voting Summary

On this matter, Chairman Giancarlo and Commissioners Quintenz, Behnam, Stump, and Berkovitz voted in the affirmative. No Commissioner voted in the negative.

Appendix 2—Statement of Chairman J. Christopher Giancarlo

This Project KISS final rule regarding financial surveillance examination program requirements for self-regulatory organizations (SROs) will revise and appropriately limit the scope of a third-party expert's evaluation of a SRO's financial surveillance program, and extend the minimum timeframes from three to five years from when a SRO must engage a third-party expert to evaluate its FCM standards for consistency with certain auditing standards. All of the comments received were in support of this proposal. I also support it because it will reduce the burdens and costs for SRO examinations, without reducing their effectiveness. It also more appropriately balances and recognizes the role and capabilities of the Commission's oversight expertise.

Appendix 3—Statement of Commissioner Dan. M. Berkovitz

I support the targeted amendments to Commission Regulation 1.52 made in today's final rules regarding third-party expert examinations of self-regulatory organization ("SRO") financial surveillance programs. The amendments adopted in these final rules are an outgrowth of the Commission's experience with Regulation 1.52 since

2013, and they maintain the Commission’s strong commitment to customer protection while modifying certain requirements found to provide no incremental regulatory benefit. The Commission’s customer protection rules are fundamental to safeguarding customer assets, promoting the safety and soundness of U.S. derivatives markets, and maintaining public confidence in our markets. I strongly support these customer protection rules.

Regulation 1.52 is part of the Commission’s comprehensive framework for the protection of customers and customer funds. The rules require that SROs, including contract markets and registered futures associations, monitor member FCMs’ compliance with financial and related reporting rules.¹ In 2013, the Commission significantly enhanced its customer protection rules to provide customers with greater confidence that their funds are secure and that SROs have effective programs for the oversight of member FCMs.

The narrow amendments we are adopting address an SRO’s engagement of a third-party expert to evaluate its financial surveillance program. With experience, the Commission has determined that third-party experts are appropriate to assess an SRO’s implementation of examination standards issued by the Public Company Accounting Oversight Board (“PCAOB”). Commission staff is better positioned and has the expertise to evaluate an SRO’s oversight program as measured against the Commission’s rules. Commission staff routinely conducts such evaluations and provides feedback to SROs.

¹ Regulation 1.52 also permits two or more SROs to file a plan with the Commission for delegating to another SRO certain responsibilities related to monitoring and examining FCMs’ compliance with financial and related reporting requirements. SROs participating in such a plan form a Joint Audit Committee (“JAC”), and prepare a Joint Audit Plan in accordance with the requirements of Regulation 1.52. The amendments to Regulation 1.52 adopted in today’s final rules also address the JAC’s engagement of third-party experts, as applicable.

The final rules also make additional amendments to Regulation 1.52 regarding, for example, the frequency with which SROs must engage a third-party expert. Changes to relevant PCAOB standards are infrequent, and the final rules require an SRO to engage a third-party expert at least once every five years. As a further safeguard, Commission staff retains the authority to direct an SRO to engage a third-party expert when relevant changes in PCAOB standards occur.

I thank the CFTC staff for their work on these final rules and for their responsiveness to questions and comments.

[FR Doc. 2019-06443 Filed: 4/2/2019 8:45 am; Publication Date: 4/3/2019]