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CFTC Adopts Internal Business Conduct Standards

On April 3, 2012, the Commodity Futures Trading Commission (the "**CFTC**") published final rules (the "**Final Rules**") implementing the "internal business conduct" provisions of Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("**Dodd-Frank**").[1] The Final Rules primarily address a detailed set of recordkeeping, risk management, conflicts of interest, and compliance requirements for swap dealers ("**SDs**") and major swap participants ("**MSPs**", and, together with SDs, "**Swap entities**"). The Final Rules also implement new conflicts of interest and compliance requirements for existing futures commission merchants ("**FCMs**") and introducing brokers ("**IBs**").

The Final Rules impose very detailed requirements. The CFTC did not accept suggestions to defer to existing regulatory regimes already applicable to banks and broker-dealers (*e.g.*, for risk management and compliance programs), but instead interpreted Dodd-Frank to require new and specific standards. In addition, while the CFTC adopted certain limitations to the scope of these standards for registrants engaged in non-swaps activities, those limitations appear primarily intended to accommodate commercial firms that become subject to SD or MSP registration. The effective date of the Final Rules is June 4, 2012, although the CFTC has subjected specific requirements of the Final Rules to various delayed compliance dates as discussed in further detail below. Compliance with some of the Final Rules will begin to be required on July 2, 2012. As a result, very significant organizational decisions will need to be made, and extensive policies developed, in the near term.

[1] 77 Fed. Reg. 20128 (Apr. 3, 2012). The Final Rules are based on five earlier CFTC proposals: 75 Fed. Reg. 76666 (Dec. 9, 2010) (Reporting, Recordkeeping, and Daily Trading Records Requirements for Swap Dealers and Major Swap Participants); 75 Fed. Reg. 71397 (Nov. 23, 2010) (Regulations Establishing and Governing the Duties of Swap Dealers and Major Swap Participants); 75 Fed. Reg. 70152 (Nov. 17, 2010) (Implementation of Conflicts of Interest Policies and Procedures by Futures Commission Merchants and Introducing Brokers); 75 Fed. Reg. 71391 (Nov. 23, 2010) (Implementation of Conflicts of Interest Policies and Procedures by Swap Dealers and Major Swap Participants); and 75 Fed. Reg. 70881 (Nov. 19, 2010) (Designation of a Chief Compliance Officer; Required Compliance Policies; and Annual Report of a Futures Commission Merchant, Swap Dealer, or Major Swap Participant).

I. RECORDKEEPING

The Final Rules impose very comprehensive and technologically intensive recordkeeping obligations on Swap Entities with regard to their swaps activities. In some cases, these recordkeeping obligations extend to oral communications. Categories of records subject to specific requirements include transaction and position records, business records, records of data reported to swap data repositories ("**SDRs**"), and real-time reporting data. The CFTC rejected proposals that Swap Entities be permitted to meet certain recordkeeping obligations by relying on data maintained by SDRs, requiring instead that records be maintained individually by Swap Entities.

A. **Transaction Records**. Swap Entities are required to keep records of each swap transaction, including all documents on which swap information is originally recorded. This obligation applies to all documents "customarily generated in accordance with market practice that demonstrate the existence and nature of an order or transaction."

1. Transaction records include records of "unfilled or cancelled orders."

   The Final Rules do not provide guidance as to the definition of the term "order" in the swap context, but an "order" in other contexts is commonly understood to be limited to offers or instructions that, if accepted or followed by the recipient, would result in an execution (i.e., an executable order).

2. Transaction records must be kept in a manner that allows them to be searched by transaction and counterparty.

   In the preamble to the Final Rules, the CFTC explains that this rule does not require raw data to be tagged with transaction and counterparty identifiers so long as a Swap Entity can readily access and identify records pertaining to transaction or counterparty by running a search on the raw data. The discussion of this rule during the CFTC's February 23 open meeting suggests that the CFTC expects Swap Entities to be capable of conducting searches through their raw data using key terms, but does not expect the raw data to contain metadata tags enabling more precise searches.

B. **Daily Trading Records**. Swap Entities are required to maintain daily trading records of their swaps and all related records, including related cash and forward transactions. The information must be sufficient to conduct a comprehensive and accurate trade reconstruction for each swap and must be identifiable and searchable by transaction and counterparty. The obligation includes trade information related to pre-execution, execution and post-execution data.

1. *Pre-execution Data*. Swap Entities must record both oral and written communications, however communicated, that "lead to the execution of the swap." These records must also include, among other things, reliable timing data for the initiation of the trade and a timestamp (or similar record) in Coordinated Universal Time ("**UTC**") to the nearest minute for each quotation made or received.

   a. *The preamble to the Final Rules clarifies that if any pre-execution information (which includes information concerning quotes, solicitations, bids, offers, instructions, trading and prices) is communicated by telephone, the Swap Entity must record such communications. In other words, even if telephone communications would not ordinarily be recorded by the Swap Entity, and the Swap Entity maintains other records to satisfy the Final Rules' audit trail requirement, it would appear that the CFTC will additionally require the Swap Entity to make and maintain a wide range of telephone recordings (unless the Swap Entity's personnel do not communicate pre-execution information by telephone at all). However, the scope of pre-execution oral communications subject to recording is not entirely clear (e.g., when is a communication related to "instructions" or "trading"?). In addition, the application of the recording requirement to extended negotiations relating to bespoke or structured transactions is likely to pose some practical difficulties.*

   b. *In contrast with the CFTC's original proposal, the Final Rules subject oral records to a shorter retention period (one year) than other records (life of swap plus five years). As a result, timestamps for quotes will need*

to be retained by Swap Entities in a format other than the recording of oral communications in order to permit trade reconstruction once the recordings are cycled over after one year.

2. *Execution Data*. Swap Entities must make and keep trade execution records, including all terms of the swap, the trade ticket, the unique swap identifier, the time of execution to the nearest minute in UTC, the counterparty name including its unique counterparty identifier, date and title of any agreement to which the swap is subject, the swap's unique product identifier, the price, fees or commissions and "any other information relevant to the swap."

   a. *The Final Rules do not specify whether the retention of standard trade documentation, including trade confirmations, is sufficient to fulfill the requirement to maintain "all terms of the swap," or if additional recordkeeping will be required.*

   b. *Execution is defined by the Final Rules as "an agreement by the parties . . . to the terms of a swap that legally binds the parties to such swap terms under applicable law." This is different from the applicable definition in the CFTC's real-time public reporting rules, which refer to "execution" as occurring simultaneously or immediately following "affirmation" (which is when parties agree to all the "primary economic terms" of the swap). Furthermore, the CFTC's regulatory reporting rules similarly suggest that execution occurs only after all of a swap's "primary economic terms" have been agreed. The CFTC does not explain why it chose to use these different definitions in such similar contexts.*

   c. *The catch-all requirement to maintain "any other information relevant" to the swap could be read to require Swap Entities to maintain any other record relating to their swaps activities, similar to the requirement under Securities and Exchange Commission ("**SEC**") rules that a broker-dealer retain records "relating to its business as such."*

3. *Post-execution Data*. Swap Entities must make and keep itemized records of: (a) all relevant post-trade processing and events; (b) swap confirmations with a timestamp (or similar record) in UTC to the nearest minute; (c) detailed records of swap portfolio compression exercises; and (d) swaps cleared centrally categorized by transaction and counterparty.

4. *Ledgers*. Each Swap Entity is required to keep ledgers (or other records) including, among other things, daily calculations of swap value, counterparty exposure, initial and variation margin requirements, and transfers and daily valuation of collateral.

5. *Related Cash and Forward Transactions.* In addition to the recordkeeping obligations for swaps described above, a Swap Entity must make and keep daily trading records of all related cash or forward transactions it executes, including all documents on which the transaction is originally recorded. These transactions are subject to the same standards regarding searchability by transaction and counterparty.

    a. Definition. The Final Rules define "related cash and forward transactions" as any "purchase or sale for immediate or deferred physical shipment or delivery of an asset related to a swap where the swap and the related cash or forward transaction are used to hedge, mitigate the risk of, or offset one another."

        i. *The CFTC took the view that a cash or forward transaction can be related to more than one swap as a portfolio hedge and is not required to be linked to a particular swap. However, it did not articulate any particular rationale for why records of such indirectly "related" cash or forwards should be maintained.*

        ii. *It is unclear to what extent the Final Rules intended to capture cash purchase or sales of securities (How "related" must those purchases or sales be?), but it does not*

appear that the rules cover security-based swaps, securities options or futures.

b. Types of Records. Under the Final Rules, a Swap Entity must record both oral and written communications, however communicated, that "lead to the conclusion" of the transaction. The records must also include, among other things:

i. Reliable timing data for the initiation of the related transaction;

ii. A timestamp (or similar record) in UTC to the nearest minute for: (A) each quotation made or received; and (B) for the date and time of execution;

iii. All terms of the related transaction;

iv. The price at execution; and

v. The daily calculation value of the related transaction and "any other relevant financial information."

C. **Position Records**. In addition to the recordkeeping obligations described above, under the Final Rules a Swap Entity must maintain position records of each position it holds identified by product and counterparty, including whether the position is "long" or "short" and whether it is cleared. These position records must be linked to relevant transaction records to permit identification of transactions establishing relevant positions.

The CFTC has not provided any additional guidance on how transaction and position records are to be linked, nor the scope of "transaction records" subject to the linking requirement (for instance, although telephone recordings would appear technically to constitute "transaction records," linking them to position records would not seem necessary in order to identify which transaction established which position).

D. **Transactions Executed or Cleared by Another Regulated Entity**. A Swap Entity must maintain records of transactions executed on a swap execution facility ("**SEF**") or designated

contract market ("**DCM**") or cleared by a derivatives clearing organization ("**DCO**").

The preamble to the CFTC's proposal indicated that this obligation can likely be satisfied by data generated directly by the SEF, DCM or DCO through procedures it establishes (e.g., confirmation or valuation of transactions, or margining the position).

E. **Business Records**. A Swap Entity must maintain full, complete and systematic business records, including records relating to corporate governance, financial records, complaints and marketing and sales material.

1. *The Final Rules do not specify whether financial records can be in the format required by prudential regulators, the SEC or foreign regulators. However, Swap Entities will also be subject to Compliance Rule 2-10 of the National Futures Association, which currently requires that any financial reports required to be filed with the CFTC be prepared in English and in accordance with U.S. Generally Accepted Accounting Principles.*

2. *The CFTC has indicated that these obligations do not apply to the parent company of a registrant unless the parent is itself a Swap Entity.*

3. *The CFTC has also clarified that these business records do not have to be kept in a single comprehensive file, although they must be "full, complete and systematic" and "available for inspection or disclosure."*

F. **Data Reported to an SDR or Reported Real-Time**. Swap Entities must maintain records of data reported under Parts 43 (Real-Time Public Reporting) and 45 (Swap Data Recordkeeping and Reporting Requirements) of the CFTC Regulations, along with a record of the time when such reports were made.

G. **Record Retention and Inspection**. All records must be kept by a Swap Entity at its principal place of business (or other office it designates).

1. *Records Kept Outside the United States*. If its principal place of business is outside the United States, the Swap

Entity must, upon request, make records available to the CFTC in the United States within 72 hours.

If the CFTC does not limit its regulation to the U.S. operations of a Swap Entity (and any foreign operations trading with U.S. persons), this rule may pose serious logistical issues for Swap Entities that conduct business in distant locations. In addition, the CFTC has not yet clarified how it plans to coordinate its examination authority with oversight by Swap Entities' existing home country and local supervisors.

2. *Record Retention*. Records must be open to inspection by any representative of the CFTC, the SEC (for security-based swap agreements), the U.S. Department of Justice, or any applicable prudential regulator and be kept according to the following guidelines:

   a. Records of oral communication for one year;

   b. Records of any swap or related cash or forward transaction (other than oral communications) for the life of transaction plus 5 years, with such records readily accessible until 2 years after the life of the transaction;

   c. Records of swap data reported under Part 45 of the CFTC Regulations for the life of the transaction plus 5 years, with such records readily accessible until 2 years after the life of the transaction; and

   d. All other records for 5 years, readily accessible for the first 2 years.

   e. *It is unclear whether written pre-execution communications (e.g., e-mails and instant messages) are considered to be "records of any swap or related cash and forward transaction." If they are, then they would as a practical matter need to be linked to particular swap transactions for the purpose of establishing their retention period, or maintained indefinitely.*

H. **Compliance Date**. The effective date of the recordkeeping rules is June 4, 2012. However, the Final Rules provide specific

compliance dates that differ amongst different categories of Swap Entities:

1. *Prudentially Regulated or Registered with the SEC*. Swap Entities that are regulated by a U.S. prudential regulator or registered with the SEC must comply with these rules by the later of July 2, 2012, or the date on which Swap Entities are required to apply for registration (which will be the effective date of the pending joint CFTC-SEC definitional rules).

2. *Not Prudentially Regulated or Registered with the SEC*. Swap Entities that are not regulated by a U.S. prudential regulator or registered with the SEC must comply with these rules by the later of September 30, 2012, or the date on which Swap Entities are required to apply for registration.

3. *Alternative Compliance Schedule for Daily Trading Records*. The Final Rules include a provision that allows Swap Entities to apply to the Director of Division of Swap Dealer and Intermediary Oversight or his or her designee for permission to use an extended compliance schedule if the daily trading records requirements are found to be technologically or economically impracticable. The Director must act on any such application within 30 days from its receipt, or it will be deemed approved.

II. RISK MANAGEMENT AND OTHER DUTIES OF SWAP ENTITIES

A. **Risk Management Program**. The Final Rules require each Swap Entity to establish and maintain a system of risk management policies and procedures designed to monitor and manage the risk associated with its swaps activities (the "**Risk Management Program**"). "Swaps activities" are defined to include any activities of the Swap Entity related to swaps and any product used to hedge such swaps.

1. *Organizational Requirements*. Each Swap Entity must establish a risk management unit ("**RMU**") that reports directly to senior management, is independent from the business trading unit ("**BTU**") and has sufficient authority and resources to carry out the Risk Management Program.

a. The CFTC has clarified that Swap Entities are not required to establish a separate formal risk management division, but rather need only be able to identify all personnel who administer the Risk Management Program.

b. The BTU includes any department, division, group, or personnel of the Swap Entity or any of its affiliates, whether or not identified as such, that performs, or personnel exercising direct supervisory authority over the performance of, any pricing (excluding price verification for risk management purposes), trading, sales, marketing, advertising, solicitation, structuring, or brokerage activities of the Swap Entity. The CFTC modified this definition under the Final Rules to include only those personnel that perform or "exercis[e] direct supervisory authority" over performance of—as opposed to those merely "involved in"—BTU activities.

   As a result of this change, the independence requirement should not prohibit a Swap Entity from instituting joint supervision of a BTU and RMU one level (or higher) above the level of management that directly supervises the BTU. At the same time, Swap Entities will need to be sensitive to whether senior personnel directly perform BTU activities, such as marketing or solicitation.

c. The CFTC also expanded the definition of "senior management" to include any officer specifically granted the authority and responsibility of senior management by the Swap Entity's governing body, rather than limiting the definition to the CEO or supervisors reporting directly to the CEO.

   This change provides Swap Entities with significantly greater flexibility with respect to their internal governance structures, both for commercial firms engaged in swap dealing as well as potentially global, multiservice financial institutions registered as SDs.

2. *Risk Policies*. Each Swap Entity must maintain written policies and procedures that describe its Risk Management Program.

   a. Approval by Governing Body. The Risk Management Program must be approved, in writing, by the Swap Entity's governing body. The CFTC has modified the definition of "governing body" under the Final Rules to allow a Swap Entity to designate as its governing body a board committee, or the governing body of or senior management of a division, provided that the swaps activities of the Swap Entity are wholly contained in a separately identifiable division.

   b. Risk Tolerance Limits. The Risk Management Program should, in written policies and procedures, take into account "market, credit, liquidity, foreign currency, legal, operational, settlement, and any other applicable risks," together with "a description of the risk tolerance limits. . .and the underlying methodology." The risk tolerance limits must be reviewed and approved quarterly by senior management and annually by the governing body. It must also include policies and procedures for detecting breaches of these limits and alerting supervisors within the RMU and senior management, as appropriate.

      i. *Exceptions to the risk tolerance limits are approvable by risk or by trading supervisors pursuant to written policies and procedures. The CFTC's initial proposal would have limited such approval authority to risk supervisors.*

      ii. *Neither the Final Rules nor their preamble provide guidance as to whether or how risk tolerance limits are to take into account qualitative risks, such as legal or operational risk.*

   c. Risk Posed by Affiliates; Consolidated Risk Management. The Risk Management Program must take into account risks posed by affiliates and be

integrated into risk management at the consolidated entity level.

i. *The CFTC has clarified that a Swap Entity must consider all the risks posed by an affiliate, not only those risks that are related to swaps activity.*

ii. *The CFTC did not explain how the Risk Management Program is to be integrated into overall risk management at the consolidated entity level in circumstances when a Swap Entity's consolidated holding company group is subject to existing prudential standards different from or inconsistent with the Final Rules. The CFTC also did not explain whether, or in what instances, existing reports or policies that address risks at the consolidated level (e.g., credit risk reports) can be used to comply with the Final Rules.*

d. Periodic Risk Exposure Reports. The RMU of a Swap Entity is required to provide quarterly written reports to senior management, its governing body, and the CFTC setting forth the risk exposures of the Swap Entity, as well as certain information regarding recommendations for, changes to and implementation of the Risk Management Program.

e. New Product Policy. The Risk Management Program must include a new product policy designed to assess the risks of any new products prior to engaging in transactions in such products. The Final Rules set forth a number of specific elements that should be included in the new product policy.

i. The Final Rules permit "limited preliminary approval" of a new product at a risk level that would not be "material" to the Swap Entity, and solely for the purpose of facilitating development of appropriate

operational and risk management processes for such product.

The CFTC did not provide guidance on how materiality is to be assessed in this context, and it is not clear to what extent the CFTC staff will defer to existing best practices in this area.

ii. *The CFTC has refused to defer to existing guidance from banking regulators, the SEC and self-regulatory organizations ("**SROs**") regarding new product policy rules. As a result, registrants must consider whether existing policies need to be modified to comply with the new CFTC requirements.*

f. Specific Risk Policies. The Risk Management Program must include separate policies for daily measurement of market, credit, liquidity and foreign currency risks as well as those necessary to monitor and manage legal, operational and settlement risks. The CFTC has indicated that Swap Entities have significant discretion in specifying the methods for monitoring and managing these risks.

i. Market risk inputs used in the daily market risk calculation under the Final Rules do not have to be calculated daily if such inputs have a reasonable degree of accuracy over a period longer than one day.

ii. Ledger reconciliation must only occur periodically, rather than daily as originally proposed.

iii. With respect to liquidity risk, the CFTC has clarified that Swap Entities must only "assess" and not actually "test" procedures for liquidating non-cash collateral.

iv. With respect to operational risk, the CFTC clarified that only the data within operating

and information systems must be reconciled, rather than the systems themselves.

v. Legal risk policies and procedures must take into account "[d]eterminations that transactions and netting arrangements entered into have a sound legal basis."

The CFTC rejected comments proposing to provide Swap Entities with greater flexibility in managing legal risk, and did not provide further guidance as to what steps would be sufficient for a Swap Entity to ascertain whether transactions and arrangements have a "sound legal basis" (e.g., Is use of approved documentation sufficient? When are legal opinions required?).

g. Use of Central Counterparties. The Risk Management Program must include policies related to the central clearing of swaps, including mandating the use of central counterparties ("**CCPs**") where required by CFTC rules, establishing conditions for the voluntary use of CCPs, and requiring diligent investigation into the adequacy of a CCP's financial resources and risk management procedures.

3. *Business Trading Unit Policies*. Each Swap Entity must establish certain policies and procedures that apply to its BTU and relevant traders.

a. Approval by Governing Body. All trading policies must be approved by the governing body of the Swap Entity.

It is unclear whether a Swap Entity's trading policies are considered to be part of its Risk Management Program and thereby subject to the audit and testing requirements applicable to that program. This ambiguity arises because the trading policies are not described as an element of the Risk Management Program, and they are subject to this separate approval requirement that would not be necessary if they were part of the Risk Management Program.

b. Counterparty Credit Limit. All counterparties must have an established credit limit in order for traders to execute transactions.

The Final Rules do not define "credit limit," and the preamble suggests that this should provide Swap Entities with sufficient discretion to implement policies addressing limited counterparty credit risk transactions. As a result, it is unclear whether a Swap Entity must specify a quantitative limit for exposure to each counterparty, or whether it could permit execution of transactions with a counterparty without established quantitative limits where there is no credit exposure (e.g., prepaid forwards) or where credit exposure is fully hedged.

c. Quantitative or Qualitative Limits for Traders. Traders and personnel able to commit the capital of the Swap Entity must be subject to quantitative or qualitative limits.

d. Intraday Monitoring of Traders. Traders must be subject to intraday monitoring to "prevent the trader from exceeding any limit to which the trader is subject, or from otherwise incurring any unauthorized risk."

i. *Notwithstanding the reference to "any limit," the CFTC indicated in the preamble that the setting of limits requiring intraday monitoring is left to the discretion of each Swap Entity. The scope of such discretion is, however, unclear.*

ii. *The Final Rules are also unclear with respect to how consistently or with what tolerance for breach a Swap Entity's procedures must "prevent" any breach of applicable limits. With respect to position limits as described below the requirement is for procedures "reasonably designed" to prevent violations, and the Final Rules also require procedures for addressing exceptions to risk tolerance limits.*

iii. *The Final Rules do not indicate whether intraday monitoring must be continuous, or whether periodic intraday checks would be sufficient.*

iv. *The Final Rules do not identify which personnel must be responsible for monitoring traders. For instance, must independent risk managers be responsible, or is monitoring by trading supervisors sufficient?*

v. *The Final Rules require prevention of "unauthorized" risk, rather than "undue" risk as initially proposed. The CFTC indicates this change is intended to ensure that Swap Entities have instituted safeguards to protect against losses due to rogue trading.*

e. Transaction Entry by Traders. Traders must follow established policies and procedures for executing and confirming all transactions.

The CFTC clarified that the Final Rules are not intended to restrict initial recording of trades into a trade capture system by a trader, which the CFTC's proposal had suggested would be impermissible.

f. Detection of Unauthorized Trading. A Swap Entity must have a means to detect unauthorized trading activities or any violations of policies and procedures.

g. Documentation of Trade Discrepancies. All trade discrepancies must be documented and brought to the immediate attention of the BTU management. The Final Rules include a limited exception from the escalation policies for clerical trade discrepancies.

h. Audit of Brokers Statements and Payments. Broker statements and payments to brokers must be subject to periodic audit by persons independent of the BTU.

Under the CFTC's proposal, broker statements, charges, commissions and payments would have been subject to regular review by the RMU. The Final Rules impose a less rigorous review standard of periodic audit of broker statements and payments by independent personnel (such as operations personnel).

i. Trading Programs. Trading programs must be subject to policies and procedures governing their use, supervision, maintenance, testing and inspection.

The Final Rules removed the proposed limitation of this requirement to "algorithmic" trading programs, thereby expanding its scope ambiguously. In addition, the CFTC noted that it anticipates separately addressing the related issues of testing and supervision of electronic trading systems and mitigation of the risks posed by high frequency trading.

4. *Review and Testing.* Swap Entities must review and test their Risk Management Program including an analysis of adherence to, and effectiveness of, associated policies and procedures, and any recommendations for modifications. The results of these tests must be documented, and reported to and reviewed by the chief compliance officer ("**CCO**"), senior management and the governing body of the Swap Entity.

a. Frequency of Testing. Review and testing must occur at least annually or upon any material change in the business of the Swap Entity that is reasonably likely to alter its risk profile. The CFTC had previously proposed to require such review and testing on a quarterly basis.

It is unclear what changes to a Swap Entity's business will be considered sufficiently "material" to warrant review and testing of the Risk Management Program.

b. Independence of Audit Staff. The testing must be performed by qualified internal audit staff that is independent of the BTU or a qualified third party audit service reporting to staff independent of the BTU. The CFTC has indicated that the design of these testing

procedures will be left to the reasonable judgment of each Swap Entity.

5. *Compliance Date.* The effective date of the risk management rules is June 4, 2012. However, the Final Rules provide specific compliance dates with respect to different categories of Swap Entities:

   a. Prudentially Regulated or Registered with the SEC. Swap Entities that are regulated by a U.S. prudential regulator or registered with the SEC must comply with these rules by the later of July 2, 2012, or the date on which Swap Entities are required to apply for registration.

   b. Not Prudentially Regulated or Registered with the SEC. Swap Entities that are not regulated by a U.S. prudential regulator or registered with the SEC must comply with these rules by the later of September 30, 2012, or the date on which Swap Entities are required to apply for registration.

B. **Position Limits Procedures**. Each Swap Entity must establish and enforce written policies and procedures reasonably designed to monitor for and prevent: (1) violations of applicable position limits (imposed by the CFTC, a DCM, or a SEF); and (2) improper reliance on any exemptions or exclusions from such position limits (the "**Position Limits Procedures**"). The CFTC clarified in the Final Rules that the Position Limits Procedures only have to be "reasonably" designed to prevent violations and improper reliance, and not to prevent all breaches.

1. *Futures Equivalents.* For purposes of the Position Limits Procedures, swap positions must be converted to equivalent futures positions pursuant to CFTC Regulations.

2. *Required Training and Notification*. Each Swap Entity must provide annual training on applicable position limits and must promptly notify personnel upon any change to such limits.

3. *Monitoring and Early Warning System*. Each Swap Entity must diligently monitor its trading activities and supervise

its personnel and agents to ensure compliance with the Position Limits Procedures.

It must also have an early warning system to detect and alert senior management when position limits are in danger of being breached, with elevation of violations to its governing body and the CFTC (unless on-exchange and reported by the relevant DCM or SEF). The CFTC rejected suggestions to include a materiality threshold for elevations of violations to a governing body and instead mandates reporting of all breaches of limits.

4. *Quarterly Testing and Annual Audit*. Each Swap Entity must subject its Position Limits Procedures to quarterly testing and written documentation of compliance and an annual audit.

   The CFTC has clarified that the testing requirement entails the testing of accurate data capture by the position reporting systems, which presumably covers the collection and aggregation of data from controlled accounts and subsidiaries.

5. *Compliance Date*. The effective date of the position limit procedures rules is June 4, 2012. However, Swap Entities must comply with these rules by the later of the effective date or the date on which they are required to apply for registration.

C. **Diligent Supervision**. Each Swap Entity must establish a system to diligently supervise all activities performed by its personnel that is reasonably designed to achieve compliance with the Commodity Exchange Act (the "**CEA**") and CFTC Regulations. The supervisory system must also designate at least one qualified person to supervise the business of the Swap Entity.

1. The CFTC stated that the duty to "diligently supervise" is not intended to "impose a fiduciary duty on [Swap Entities] beyond that which would otherwise exist."

2. The Final Rule requires that supervisors "meet such standards of training, experience, competence, and such other qualification standards as the [CFTC] finds necessary or appropriate."

The CFTC rejected a comment requesting that Swap Entities be given discretion to determine supervisor qualifications and it remains unclear what qualifications are required of supervisors.

3. *Compliance Date*. The effective date of the supervisory rules is June 4, 2012. However, Swap Entities must comply with these rules by the later of the effective date or the date on which Swap Entities are required to apply for registration.

D. **Business Continuity and Disaster Recovery**. The Final Rules require each Swap Entity to adopt a business continuity and disaster recovery plan that includes procedures for the maintenance of backup facilities, systems, infrastructure, personnel and other resources to ensure timely recovery of data and documentation sufficient to resume operations generally within the next business day and comply with applicable law and regulation.

1. *Testing and Audit*. The Final Rules require annual testing of a Swap Entity's business continuity and disaster recovery plan by independent internal personnel or a qualified third party service. Such plans are also required to be audited every three years by a qualified third party service.

2. *Requirements of Other Regulators*. The Final Rules require Swap Entities to comply with these requirements in addition to any similar requirements imposed by a prudential regulator, SRO or other regulatory organization. The CFTC has refused to defer to existing, and potentially overlapping, business continuity and disaster recovery requirements imposed on Swap Entities by other regulators.

It is unclear to what extent Swap Entities located outside the United States will be required to comply with these requirements or the extent to which the CFTC will defer to comparable foreign regulation.

3. *Compliance Date*. The effective date of the business continuity and disaster recovery rules is June 4, 2012. However, the Final Rules provided specific compliance dates with respect to different rules and different categories of Swap Entities.

a. Prudentially Regulated or Registered with the SEC. Swap Entities that are regulated by a U.S. prudential regulator or registered with the SEC must comply with these rules by the later of September 30, 2012, or the date on which Swap Entities are required to apply for registration.

b. Not Prudentially Regulated or Registered with the SEC. Swap Entities that are not regulated by a U.S. prudential regulator or not registered with the SEC must comply with these rules by the later of December 29, 2012, or the date on which Swap Entities are required to apply for registration.

E. **Information Availability**. Each Swap Entity must make available for disclosure and inspection by the CFTC and the prudential regulators of the Swap Entity, if applicable, all information required by, or related to, the CEA or CFTC Regulations.

1. The CFTC has clarified that this rule requires only that Swap Entities have information systems capable of producing the required information promptly and does not mandate any particular storage medium or methodology.

2. *Compliance Date.* The effective date of the information availability rules is June 4, 2012. However, Swap Entities must comply with these rules by the later of the effective date or the date on which Swap Entities are required to apply for registration.

F. **Antitrust**. Swap Entities are prohibited from adopting any process or taking any action that results in any unreasonable restraint of trade or imposes any anticompetitive burden on trading or clearing, unless necessary or appropriate to achieve the purposes of the CEA. They must also adopt policies and procedures to prevent such actions.

1. *The prohibition against action "that results in any unreasonable restraint of trade" is a familiar standard from existing antitrust laws. Consistent with long-standing principles of antitrust law, this prohibition presumably reaches only collusive behavior or unilateral behavior that would create or strengthen a monopoly position. However, the separate prohibition against action that "imposes any*

anticompetitive burden on trading or clearing, unless necessary or appropriate to achieve the purposes of the CEA," is a new standard taken from Dodd-Frank for which no particular antitrust jurisprudence exists. The CFTC provided no additional guidance regarding the meaning of these provisions.

2. *Compliance Date*. The effective date of the antitrust rules is June 4, 2012. However, Swap Entities will not be required to comply with these rules until the later of the effective date or the date on which Swap Entities are required to apply for registration.

III. CONFLICTS OF INTEREST

A. **Research Conflicts**. The Final Rules include prohibitions and protections intended to prevent non-research personnel from influencing the content of research reports or directing research personnel. These prohibitions and protections are based largely on NASD Rule 2711, which is applicable to research analysts and reports in the equity securities context. The research conflicts rules have been issues as two separate rules, applicable as they pertain to FCMs and IBs on the one hand and Swap Entities on the other, but the rules have substantially the same content.

1. Definitions and Scope. The research departments and research analysts that are the subject of the Final Rules are those responsible for "a research report relating to any derivative."

a. *Derivative*. The term "derivative" is defined broadly to include futures, security futures, swaps, certain retail transactions, commodity options and leverage transactions.

i. *Because the definition of derivative includes futures and other non-swap instruments, certain non-swaps activities of an FCM will be subject to the conflicts of interest provisions of the Final Rules.*

ii. *Moreover, the CFTC has declined to exclude research discussing securities subject to NASD Rule 2711 (or any forthcoming SRO*

rules applicable to fixed income research) from the Final Rules where such research may be related to derivatives. To the extent securities underlie the derivatives discussed in the report or are otherwise intertwined with discussion of derivatives, such discussion of securities is subject to the Final Rules. For dually-registered broker-dealer/FCMs in particular, it may not be clear in every instance the purpose for which a report is prepared or used, and certainly for multi-asset reports registrants must ensure compliance with multiple regimes.

b. *Research Analyst and Research Department*. The Final Rules define "research analyst" and "research department" to include employees, departments or divisions responsible for preparing research reports related to derivatives, including not only departments or divisions of the Swap Entity itself but departments or divisions of affiliates.

The CFTC rejected suggestions to exclude global affiliates from the scope of "research department," but noted that only conduct with respect to research departments doing research on behalf of registrants would be subject to the Final Rules. While this interpretation may limit the geographic scope of the research conflicts rules for FCMs and IBs—since they are typically organized as separate U.S. subsidiaries—the extent to which it does so for SDs will depend on whether the CFTC limits the scope of SD status to an entity's swap dealing operations in the U.S. or with U.S. persons. The greater the inclusion of global affiliates, the greater the logistical hurdles and expenses that will be presented for multinational firms.

c. *Research Report*. The Final Rules define "research report" broadly to include "any written communication (including electronic) that includes an analysis of the price or market for any derivative and that provides information reasonably sufficient upon which to base a

decision to enter into a derivatives transaction." A research report for a derivative is necessarily a more abstract notion that a report on the securities of an issuer, and the breadth of the definition could include a wide variety of communications. However, the definition excludes certain communications, including, among others:

i. Communications distributed to fewer than 15 persons;

As explained below, the CFTC clarified that, in the context of public appearances, a "person" refers to either natural persons or entities. The CFTC did not, however, make the same clarification for this exclusion.

ii. Commentaries on economic, political, or market conditions;

The CFTC added this exclusion from research reports in the Final Rules for general economic commentary, however it is unclear in some instances the difference between general economic commentary and reports on derivatives underliers (e.g., a report on the U.S. economy generally could be considered a report on an underlier to U.S. interest rate, inflation or currency swaps).

iii. Internal communications not provided to customers; and

iv. Communication prepared by a BTU employee and conveyed and clearly marked as a solicitation.

The breadth of the definition of "research report" could lead BTU employees to label most communications regarding derivatives as "solicitations" as a matter of course. Note, however, that labeling communications as "solicitations" may have

consequences under other rules (e.g., the "pay-to-play" rules under the external business conduct rules, 17 C.F.R. § 23.451).

d. *Public Appearances*. Certain disclosures and other requirements apply to "public appearances," which include a call, seminar, forum, or other public speaking activity before 15 or more persons (individuals or entities) in which a research analyst makes a recommendation or opinion concerning a derivatives transaction.

   The CFTC modified the Final Rules to clarify that the term "persons" in this context refers to either natural persons or entities (i.e., where a single entity sends multiple natural persons as representatives to a public speaking activity subject to the rule, such natural persons would be counted as a single "person").

e. *Non-Research Personnel*. The Final Rules define "non-research personnel" to include any employee of the BTU or clearing unit, or any other employee of the registrant, other than an employee performing a legal or compliance function, who is not directly responsible for or involved in the preparation of research reports.

   The CFTC modified this definition in the Final Rules to specifically exclude employees performing a legal or compliance function, but did not exclude other control functions.

f. *Business Trading and Clearing Units*. The Final Rules define BTU and clearing unit to include any department, division, group, or personnel of a registrant—or personnel exercising direct supervisory authority over the performance of—any BTU or clearing activity, respectively, of a registrant or its affiliates. As noted above in the context of the Risk Management Program, BTU activities are defined very broadly to include any pricing (excluding price verification for risk management purposes), trading, sales, marketing, advertising, solicitation, structuring or brokerage activities.

i. *The Final Rules expanded the scope of these definitions to include the affiliates of registrants, expanding the scope of the research restrictions potentially globally.*

ii. *As noted above, the CFTC also modified these definitions under the Final Rules to include within their scope only those personnel that perform or "exercis[e] direct supervisory authority" over performance of—as opposed to those merely "involved in"—BTU or clearing unit activities. As a result of this change, the independence requirement should not prohibit a Swap Entity from instituting joint supervision of such units one level (or higher) above the level of management that directly supervises the unit.*

g. *Exclusion for Small IBs*. Any IB that has generated five million dollars or less in aggregate gross revenues over the preceding three years from its activities as an IB is subject to exclusion from the specific provisions of the Final Rules related to influence and control over research analysts and reports. Small IBs must instead only establish safeguards reasonably designed to maintain appropriate informational partitions between research and trading or clearing functions.

2. Barriers Between Research and Non-research Personnel.

a. *Content of Research Reports*. Non-research personnel are prohibited from directing the views and opinions expressed in a research report or from directing a research analyst's decision to publish a research report.

The current prohibition is significantly narrower than the CFTC's originally proposed formulation, which had prohibited non-research personnel from "influenc[ing] the content" of research reports. But note as below that non-research personnel still may not "review" a research report except for limited purposes.

b. *Supervision and Compensation of Research Analysts*. Members of a BTU or clearing unit are prohibited from supervising or controlling any research analyst or having any influence or control over the evaluation or compensation of a research analyst.

c. *Review and Approval of Research Reports*. Non-research personnel may not review or approve a research report prior to its publication.

i. These prohibitions do not apply to the board of directors or any committee thereof.

ii. The Final Rules allow review by non-research personnel where necessary to verify the factual accuracy of information, identify potential conflicts of interest, or provide non-substantive editing.

iii. Any communications between non-research personnel and research personnel concerning the content of a research report must be properly chaperoned by legal or compliance personnel.

3. Restrictions on Research Analyst Communications. Any communication by a research analyst to a current or prospective customer must not omit any material fact or qualification that would cause the communication to be misleading to a reasonable person.

a. The Final Rules omit internal communications from the restriction.

b. *The CFTC did not impose a materiality standard for misleading content. The application of a "materiality" standard in a context outside the investment decision of any particular individual with respect to any particular derivative transaction is an uncertain one.*

4. Restrictions on Research Analyst Compensation. Registrants may not consider a research analyst's contributions to its trading or clearing business as a factor in reviewing or approving such analyst's compensation. No

employee of the BTU or clearing unit may influence the review or approval of a research analyst's compensation.

The Final Rules provide an exception for the communication of client or customer feedback, ratings, and other indicators of research analyst performance to research department management.

5. Prohibition on Promise of Favorable Research. No registrant may directly or indirectly offer favorable research, or threaten to change research, to an existing or prospective counterparty or customer in exchange for business or compensation.

6. Disclosure Requirements.

   a. *Financial Interests*. Registrants and research analysts must disclose in research reports and public appearances, respectively, whether the research analyst maintains a financial interest in any derivative of a type, class, or category that the research analyst follows, and the general nature of the financial interest.

      The Final Rules eliminated language included in the CFTC's proposal that would have required disclosure of interests maintained by a research analyst "from time to time."

   b. *Conflicts of Interest.* Swap Entities and research analysts must disclose in research reports and public appearances, respectively, any other actual, material conflicts of interest of the research analyst or registrant of which the research analyst has knowledge at the time of disclosure.

   c. *Independent Third-Party Research Reports*. Research reports distributed by a registrant that were produced by an unaffiliated person or entity without input from the registrant distributing such report must be accompanied by current applicable disclosures as they pertain to such registrant.

      i. Such disclosures are not required where such third-party research reports are made

available to customers on request or through a website maintained by the registrant.

ii. *Given that the registrant, by definition, has no role in the content or creation of an independent third party research report, it is unclear why such disclosures must be made, and the CFTC offers no guidance other than to note that such reports may be viewed as carrying the endorsement of a distributing registrant which may raise conflicts-of-interest issues. Presumably, however, in adopting this requirement the CFTC was influenced by analogous disclosure requirements applicable under NASD Rule 2711.*

7. No Retaliation Against Research Analysts. No registrant or employee involved in its trading or clearing activities may retaliate (or threaten to retaliate) against any research analyst employed by the registrant or its affiliate as a result of an unfavorable research report or public appearance written or made in good faith.

B. **Clearing Conflicts**. The Final Rules also include prohibitions and protections, including barriers between trading and clearing, which are intended to preserve open access to clearing by protecting market participants from discrimination in the provision of clearing services.

1. Prohibited Influence. Under the Final Rules, a Swap Entity must not interfere or attempt to interfere with the decision of the relevant clearing personnel of an affiliated FCM regarding certain decisions to provide clearing services and activities to a particular customer. The FCM must also not permit its affiliated Swap Entity to interfere with clearing decisions.

a. The relevant decisions include, but are not limited to, whether to:

i. Offer clearing services and activities to a particular customer;

ii. Accept a particular customer for the purposes of clearing derivatives;

iii. Submit a customer's transaction to a particular DCO;

iv. Set or adjust risk tolerance levels for a particular customer;

v. Accept certain forms of collateral from a particular customer; or

vi. Set a particular customer's fees for clearing services based upon criteria that are not generally available and applicable to other customers.

b. Swap Entities and FCMs must ensure that all decisions regarding the acceptance of customers for clearing are made in accordance with publicly disclosed, objective, written criteria.

The CFTC did not, however, provide guidance on the level of specificity for these criteria, which is important because clearing onboarding decisions involve complicated credit evaluations, including reputational and other qualitative considerations.

c. Common supervision of a BTU and a clearing department by those with direct supervisory authority is prohibited.

2. Scope of Informational Barriers. The Final Rules require each Swap Entity and affiliated FCM to maintain an appropriate informational partition between its BTU and clearing unit personnel, respectively, to reasonably ensure compliance with the CEA. At a minimum, such informational partitions shall require that:

a. No employee of a Swap Entity's BTU shall supervise, control, or influence any employee of a clearing unit of its affiliated FCM. Such BTU employees also shall not influence or control the compensation of clearing unit employees.

As a result of the modifications to the definitions of BTU and clearing unit discussed in Section III(a)(1)(f) above, this independence requirement should not prohibit a Swap Entity from instituting joint supervision of a BTU and clearing unit one level (or higher) above the level of management that directly supervises the BTU or clearing unit. In addition, the change in the BTU definition from employees "involved in" BTU activities to employees who "perform" those activities should exclude most control group personnel from the scope of these restrictions.

b. No employee of a BTU may review or approve clearing decisions, in any way condition or tie the provision of trading services upon or to the provision of clearing services, or improperly incentivize or encourage the use of an affiliated FCM.

    i. *The Final Rules added exceptions to the information barriers during an event of default for participation by affiliated BTU employees in default management undertaken by a DCO and the transfer, liquidation, or hedge of any proprietary or customer positions. "Event of default" is not defined for this purpose and might not include a variety of adverse events that increase counterparty risk or exposures.*

    ii. *The CFTC stated in the preamble to the Final Rules that it does not intend to prohibit the offering of discounted clearing services in connection with trading activity. However, conditioning or "tying" trading services to clearing services is not permitted. It is unclear what other types of economic incentives may be considered improper.*

    iii. *Note that while it is prohibited for the same sales people to act jointly for the clearing unit and BTU, referrals would not seem to violate the Final Rules. However, note also*

that the definition of BTU includes "marketing" activities, although the term is not defined. The scope of what constitutes marketing is unclear – for instance, is the marketing of anything other than trading services covered?

c. *While not directly addressed in the Final Rules, communications between BTU and clearing personnel will likely need chaperoning by legal or compliance personnel in many cases to assure that only permissible communications occur.*

d. *The CFTC declined to exclude self-clearing from the provisions of the Final Rules, although the required barriers and disclosures of the Final Rules are not relevant to self-clearing transactions.*

e. *Note also that the territorial scope of the clearing rules is not directly addressed in the Final Rules, although it is possible that the CFTC intends to apply an approach similar in scope to the research rules, which apply to global affiliates providing services on behalf of a registrant.*

3. Conflicts Disclosure. Each registrant must adopt and implement written policies and procedures that mandate the disclosure of any material incentives and any material conflicts of interest in connection with clearing decisions to its counterparties or customers. Swap Entities must also disclose such material incentives and material conflicts of interests regarding whether a counterparty should execute a derivative on a SEF or DCM. Such disclosure must be in advance, and could be provided annually.

C. **Compliance Dates**. Compliance with the research conflicts of interest provisions of the Final Rules for FCMs and IBs will be required by June 4, 2012, but compliance with the clearing conflicts of interest provisions is not required until the later of (i) June 4, 2012 or (ii) the date on which Swap Entities are required to apply for registration. Swap Entities will be required to comply with both sets of provisions upon the later of (i) June 4, 2012, or

(ii) the date on which Swap Entities are required to apply for registration.

IV. CHIEF COMPLIANCE OFFICER DESIGNATION AND DUTIES

A. **Designation of CCO**. Swap Entities and FCMs (but not IBs) are required to designate a CCO with the responsibility and authority to develop appropriate policies and procedures to comply with the CEA and relevant regulations relating to a Swap Entity's swaps activities and an FCM's business as such.

1. *Relationship with Board or Senior Officer*. The CCO must report to its respective board or senior officer, which must approve CCO compensation, meet annually with the CCO, and retain sole removal authority over the CCO.

   "Senior officer" is not defined under the Final Rules, but the CFTC notes that, if a division of a larger company is a registered SD, then the CCO of such registrant could report to the "senior officer" of that division.

2. *Individual Designation and Dual Hatting*. Each Swap Entity and FCM must designate an individual CCO (*i.e.*, CCO responsibilities cannot be shared among multiple CCOs), although CCOs can "wear multiple hats," sharing additional executive responsibilities and/or acting as an existing officer within the entity.

   a. *If a CCO has business or other executive responsibilities, the CCO must still comply with the reporting line requirements noted above.*

   b. *Note also that a single CCO may be appointed to serve as CCO for multiple entities, but such CCO must report to each entity's board or senior officer and <u>not</u> the board or senior officer of a consolidated parent.*

   c. *A member of the legal department or general counsel's office may serve as the CCO where the individual's CCO and non-CCO responsibilities are clearly segregated. In this regard, all reports required under the relevant Final Rules should not be subject to attorney-client privilege, the work-product doctrine or other similar protections.*

3. *Scope of CCO Designation*. As noted above, the scope of the CCO designation is limited to FCM or swaps activities as appropriate, with "swaps activities" defined broadly to include activities related to swaps and any product used to hedge such swaps, including futures, options, other swaps or security-based swaps, debt or equity securities, foreign currency, physical commodities and other derivatives.

   As a result of this change, the CCO should not be responsible for establishing or administering policies relating to laws applicable to other aspects of the registrant's business (e.g., securities, employment or tax laws). Nevertheless, policies maintained by other functional areas, such as finance or operations, will still be relevant to the extent necessary to comply with the CEA and applicable CFTC Regulations (e.g., capital, reporting, etc.).

4. *CCO as Principal*. The Final Rules amend the definition of "principal" to include CCOs, thereby subjecting CCOs to statutory disqualification standards and the requirement to file a Form 8-R with the CFTC.

   The CFTC clarified in the preamble to the Final Rules that the designation of CCOs as principal is not because CCOs necessarily have the power to exercise a controlling influence, as was suggested by the CFTC's original proposal.

B. **CCO Duties**. Specific CCO duties include, but are not limited to:

1. Administering the relevant entity's policies and procedures "reasonably designed" to ensure compliance with the CEA and CFTC Regulations;

   a. *Note that the CFTC's proposal would have required the CCO to "ensure compliance" with relevant compliance policies and all applicable laws and regulations. The CFTC also removed the proposed requirement that a CCO be granted "full" responsibility and authority to "enforce" such policies and procedures. These changes, as well as the modification to the definition of "principal" noted above, should help to limit a CCO's potential exposure to liability as a supervisor.*

b. *Nevertheless, although these changes clarify those responsibilities not required of a CCO, they do not provide clarity on the types of responsibilities a CCO must fulfill to "administer" policies and procedures, or the extent to which the CCO can delegate administration to others.*

c. *Relatedly, the CFTC indicates that a CCO must have, at a minimum, supervisory authority over those who act at the direction of the CCO. It is unclear whether the CFTC intends for such individuals to include only members of the compliance department—consistent with the SEC's business conduct proposal—or whether individuals in other functional departments responsible for taking actions to comply with CFTC rules will be considered to be acting "at the direction of the CCO."*

2. Resolving any conflicts of interest that may arise, in consultation with the board or senior officer;

a. The CFTC confirms, as suggested by commenters, that the term "resolve" encompasses both elimination of the conflict of interest as well as mitigation thereof, and that the CCO's role in "resolving" them may involve actions other than making a final decision.

b. *Neither the Final Rules, nor the preamble, provides guidance as to the scope of covered conflicts of interest.*

3. Taking reasonable steps to ensure compliance with the CEA and CFTC Regulations relating to swaps activities or to the FCM's business as an FCM; and

4. Establishing procedures, in consultation with the board or senior officer, for:

a. The remediation of noncompliance issues identified by the CCO; or

b. The handling, management response, remediation, retesting and closing of noncompliance issues.

C. **Annual Report**. CCOs must also prepare and sign the annual report required under the Final Rules.

1. *Contents*. The annual report shall, at a minimum:

   a. Contain a description of the relevant entity's written policies and procedures;

      The Final Rules eliminated a proposed requirement to provide a description of the relevant entity's compliance itself, instead limiting the description to written policies and procedures.

   b. For each applicable requirement under the CEA and CFTC Regulations:

      i. Identify policies and procedures reasonably designed to ensure compliance;

      ii. Provide an assessment as to the effectiveness of such policies; and

      iii. Discuss areas for improvement, and recommend changes to the compliance program and resources devoted to compliance;

   c. List any material changes to compliance policies and procedures;

   d. Describe the financial, managerial, operational, and staffing resources set aside for compliance, including any material deficiencies; and

   e. Describe any material noncompliance issues identified, and the corresponding action taken.

      The Final Rules limit the reporting requirements to "material" noncompliance issues, but do not provide guidance as to how materiality is to be evaluated.

   f. The Final Rules do not include a requirement from the CFTC's proposal that CCOs provide a certification of compliance with the Volcker Rule and the push-out provisions of Dodd-Frank in the annual report.

2. *Certification*. The annual report must be signed by the CCO and include a certification by the CCO or the relevant entity's CEO that, to the best of his or her knowledge and reasonable belief, and under penalty of law, the information contained in the annual report is accurate and complete.

   a. The Final Rules allow such certification by either the CEO or CCO, rather than the CCO alone.

   b. *While the CFTC noted in the preamble that administrative, civil, and/or criminal liability could be imposed on the relevant entity or a certifying officer, it stated that concerns of overbroad liability should be addressed by the limitation that the certification be provided "to the best of [the certifying officer's] knowledge and reasonable belief." However, the CFTC declined to add a materiality qualifier to the accuracy and completeness of the annual report, thereby potentially increasing exposure to liability for non-material errors or omissions.*

   c. *The CFTC has also confirmed that the qualifying language "to the best of his or her knowledge and reasonable belief" permits the certifying officer to rely on other experts for statements made in the annual report. The CFTC may permit the practice of subcertifications by relevant experts (e.g., risk officer, technology officer), similar to subcertifications under Sarbanes-Oxley.*

3. *Delivery*. The annual report must be provided electronically to the CFTC within 90 days of the end of the fiscal year. However, the CCO must provide the annual report to the board or senior officer of the relevant entity prior to such submission. Such entity may request confidential treatment of its annual report.

   a. *The CFTC declined to treat all such reports as subject to confidentiality as a matter of right under the Final Rules.*

   b. *The CFTC has not provided specific guidance on when the first annual CCO report must be prepared and delivered under the Final Rules, which may differ*

among registrants based on the staggered, delayed compliance dates discussed in Section IV(D) below.

4. *Recordkeeping.* Each Swap Entity or FCM must maintain copies of:

   a. Policies and procedures designed to comply with the CEA and CFTC Regulations;

   b. Written reports provided to the board or senior officer in connection with the review of the annual report; and

   c. Any records relevant to the preparation of the annual report.

      i. *The preamble to the Final Rules suggests that CCOs should make and maintain records of all discussions with traders and management.*

      ii. *The records required to be kept will likely include privileged documents, which could lead to complications given the CFTC's expectations, as noted above, that the reports prepared by a CCO in his or her capacity as such will not be privileged.*

D. **Compliance**. The Final Rules provide specific compliance dates with respect to different rules and different categories of FCMs and Swap Entities.

   a. *Swap Entities Prudentially Regulated or Registered with the SEC*. Swap Entities that are regulated by a U.S. prudential regulator or registered with the SEC must comply with these rules by the later of September 30, 2012, or the date on which Swap Entities are required to apply for registration.

   b. *Swap Entities Not Prudentially Regulated or Registered with the SEC*. Swap Entities that are not regulated by a U.S. prudential regulator or registered with the SEC must comply with these rules by the later of March 29, 2013, or the date on which Swap Entities are required to apply for registration.

c. *FCMs Prudentially Regulated or Registered with the SEC*. FCMs that are (i) currently registered with the CFTC and (ii) currently regulated by a U.S. prudential regulator or registered with the SEC must comply with these rules by September 30, 2012.

d. *FCMs Not Prudentially Regulated or Registered with the SEC*. FCMs that are not (i) currently registered with the CFTC and (ii) currently regulated by a U.S. prudential regulator or registered with the SEC must comply with these rules by March 29, 2013.

e. *Unregistered FCMs*. FCMs that are not registered with the CFTC as of the effective date of the Final Rules must comply upon registration with the CFTC.

* * *

Please call any of your regular contacts at the firm or any of the partners and counsel listed under Derivatives in the Practices section of our website (www.cgsh.com) if you have any questions.

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