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Phone: +1 646 783 7100 | Fax: +1 646 783 7161 | customerservice@law360.com

# CFTC, Watchdog Disagree Over Futures Association Oversight

By **Carmen Germaine**

*Law360, New York (June 12, 2017, 7:51 PM EDT)* -- The U.S. Commodity Futures Trading Commission took issue with several aspects of a recent internal watchdog review of the agency's oversight of the National Futures Association, particularly disagreeing with a suggestion the CFTC hand some of its review responsibilities to an independent public accountant.

The report, issued May 31 by the CFTC's Office of the Inspector General, summarized the results of a four-year performance audit of the agency's oversight of the NFA. Among other recommendations, the inspector general suggested the CFTC require the NFA to submit the eight program areas it has responsibility over to engagements by an independent public accountant to cut costs.

But the CFTC's Division of Swap Dealer and Intermediary Oversight disagreed.

"DSIO believes that direct and active oversight of NFA is necessary to perform the responsibility of proper oversight and outsourcing resulting in merely reviewing a report by a third party would not satisfy those obligations," the division said in a response included in the audit report.

The NFA is responsible for performing all registration functions for futures commission merchants, swap dealers, commodity trading advisers, and other futures market participants. Those responsibilities include evaluating registrants' fitness and conducting compliance examinations, as well as collecting regulatory filings.

The DSIO oversees the NFA, including by conducting reviews of the self-regulatory organization's performance in eight program areas such as registration and examination of futures commission merchants and swap dealers, the arbitration program, and the financial surveillance program.

The OIG said its performance audit evaluated the DSIO's oversight of those eight program areas between 2012 and 2016. While saying the division's oversight of the NFA's examinations of futures commissions merchants appeared adequate, the report also outlined several shortcomings in the DSIO's oversight and issued five recommendations.

The DSIO generally concurred with the recommendations but disagreed on several points, most notably the OIG's recommendation that the division conduct a study of costs and require the NFA to submit its program areas to outside audits if the DSIO finds doing so would be cost-effective.

The OIG said that given that the DSIO "does not rigorously follow government audit" or other recognized auditing standards in creating written reviews of the futures association, the division was sensitive to "appearance issues" that could arise from payments the NFA makes to the CFTC expressly for the agency's oversight.

"In addition to benefitting NFA's finances, engaging IPAs to conduct audits of eight program areas on a regular basis could also permit DSIO to devote staff resources to other mission-critical regulatory efforts, such as targeted reviews," the OIG report said.

But DSIO Director Eileen T. Flaherty responded that outsourcing the CFTC's oversight of the NFA to a third party would be inconsistent with Section 3 of the Commodities Exchange Act, which provides that the act serves the public interest through a system of effective market self-regulation "under the oversight of the Commission."

She added that the DSIO has "significant doubts" about whether an independent accountant could adequately assess the NFA's oversight programs, especially for substantially less than the fees currently assessed by the agency itself.

"DSIO is not confident that any independent public accounting firm or other entity has the experience to perform a detailed assessment of the effectiveness of NFA's oversight of such a broad range of complex regulatory areas," Flaherty said.

In a response to Flaherty's comments, the OIG said it believed the DSIO would "benefit professionally" from a pilot project with the NFA evaluating the impact of outsourcing reviews.

"The outcome should show whether certain examinations are better left to the private sector as desired by the President in his executive order for reorganizing the executive branch," the report said.

The response references a March executive order directing federal agencies to prepare plans to reorganize themselves to improve their efficiency, effectiveness and accountability. As an independent agency, the CFTC is not bound by presidential executive orders, but acting CFTC Chair J. Christopher Giancarlo has indicated the agency will adopt the "spirit" of at least one order aimed at reducing regulation.

Covington & Burling LLP attorney Anne M. Termine, a former CFTC chief trial attorney, said that based on a reading of the report, it appeared the DSIO was saying that it has a core mission and a core duty and that accordingly "shirking its duties off to a third party simply doesn't make sense."

"Further, this stance by DSIO is not in contravention to the executive order, as sending these core duties to a third party is neither effective nor efficient," Termine said. "Acting Chairman Giancarlo has already indicated a number of ways that the agency can fulfill that executive order, such as through his Project KISS initiative."

Project KISS — for keep it simple, stupid — is an initiative started by Giancarlo to review the current regulatory framework to identify areas that can be streamlined.

The OIG report also recommended that the DSIO adopt written standards for its reviews of the futures association, and provide all final written reports and audits to the NFA.

The DSIO, however, disputed that it does not currently follow written standards in its examinations, highlighting that it is not required to follow government or other audit standards in preparing its reports but does generally incorporate similar procedures into its reporting. The division said it does not object to providing additional details on the methodology and standards of its examinations in future reports.

In response, the OIG admonished the division that its stance that it generally incorporates the procedures included in Generally Accepted Government Auditing Standards and other auditing standards “ignores the fact” that those standards do not allow for partial adoption.

The report also noted that the DSIO had closed out recommendations in four written reviews it conducted since August 2015 despite concerns the NFA expressed over two of the reviews. The OIG said that the NFA had conveyed difficulty in identifying instances supporting the DSIO’s recommendations in those reviews, adding that there may have been confusion on both sides about the intent of the recommendations, and said it would be examining the DSIO’s recommendation closeout procedures in a subsequent review.

The CFTC and its inspector general’s office, led by Inspector General A. Roy Lavik, have butted heads in the past.

The agency disputed some of the findings of an audit released in December, conducted by Brown & Co. CPA and Management Consultants PLLC on behalf of the inspector general, that recommended the DSIO begin independently verifying whether its futures and swap dealers are effectively prepared for cyberattacks. The CFTC said that its assessments were more comprehensive than a simple “request for information” and that creating an independent testing program is not feasible due to current budget constraints.

A March 2016 OIG report looking into the agency’s collection of civil penalties from enforcement actions included a letter from the CFTC outlining “significant concerns” with the report and questioning the inspector general’s finding that its financial reporting of uncollected penalties may be unreliable.

--Editing by Edrienne Su.

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