



U.S. COMMODITY FUTURES TRADING COMMISSION

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Gary Barnett
Director

Division of Swap Dealer and Intermediary Oversight

CFTC Letter No. 14-40
Interpretation
March 28, 2014
Division of Swap Dealer and Intermediary Oversight

Mary Kay Scucci
Managing Director
Securities Industry and Financial Markets Association
120 Broadway, 35th Floor
New York, NY 10271-0080

Re: **Interpretation of Commission Regulation 1.16 Auditor Independence
Standards for Audits of Futures Commission Merchants**

Dear Ms. Scucci:

This letter responds to your letter dated February 27, 2014, requesting the Division of Swap Dealer and Intermediary Oversight (the “**Division**”) of the Commodity Futures Trading Commission (the “**Commission**”) to confirm that it will not recommend that the Commission initiate an enforcement action against a futures commission merchant (“**FCM**”), a dual-registered FCM/broker-dealer (“**FCM/BD**”), or the designated auditor of an FCM or dual-registered FCM/BD that complies with the auditor independence requirements in Securities and Exchange Commission (“**SEC**”) Rule 17a-5¹ in conducting the audit of the FCM or FCM/BD under Commission Regulation 1.16.² Although you requested no-action relief, staff has determined that an interpretation of Regulation 1.16 is more appropriate based on the discussion below.

Background

On November 14, 2013, the Commission published in the Federal Register final regulations requiring enhanced customer protections for FCMs holding customer funds, including risk management programs, internal monitoring and controls, capital and liquidity

¹ See 17 CFR 240.17a-5.

² 17 CFR 1.16.

standards, customer disclosures, and auditing and examination programs (the “**Customer Protection Rule**”).³

In the Customer Protection Rule, the Commission revised Regulation 1.16(c)(2) to require, among other things, an accountant’s audit report of an FCM to state whether the audit was made in accordance with the auditing standards adopted by the Public Company Accounting Oversight Board (“**PCAOB**”). The Commission explained that it recognized the adoption of final regulations by the SEC to Rule 17a-5 mandating public accountants use PCAOB standards in the examination of the financial statements of broker-dealers (“**BDs**”).⁴ The Commission noted that its amendments to Regulation 1.16(c)(2), requiring public accountants to use PCAOB standards in conducting an examination of the financial statements of an FCM, would be consistent with the SEC’s revisions to Rule 17a-5.⁵ To further achieve consistency with the SEC, which set June 1, 2014 as the compliance date for the revisions to Rule 17a-5, the Commission also set a compliance date for public accountants to use PCAOB auditing standards for all FCM examinations with a year-end date of June 1, 2014, or later.⁶ The Commission specifically noted that the alignment of the compliance dates of Regulation 1.16(c)(2) and the revisions to Rule 17a-5 would allow dual-registered FCMs/BDs to be subject to uniform SEC and Commission audit requirements.⁷

In your letter, you noted that there are aspects of SEC Rule 17a-5 concerning auditor independence that are not specifically identified in the Commission’s amendments to Regulation 1.16. In particular, you pointed out that the SEC Rule 17a-5 references the independence requirements contained in SEC Rule 2-01 of Regulation S-X.⁸ You stated that the SEC also clarified the difference between issuers and non-issuers and that the auditors of non-issuer BDs are not subject to the partner rotation requirements or the compensation requirement of the SEC’s independence rules because the SEC determined that such requirements are only applicable to issuers. Additionally, you noted that under the SEC regime, auditors of non-issuer BDs are not subject to the audit committee pre-approval requirements or the cooling-off period requirements for employment under Rule 2-01 because those requirements also only reference issuers.

You further asserted that since Regulation 1.16(c)(2) does not specifically incorporate or reference the SEC auditor independence standards, there is a potential for the inconsistent application and an apparent conflict in the auditor independence requirements for standalone FCMs and dual-registered FCMs/BDs. Therefore, you have requested that the Division confirm

³ See Enhancing Protections Afforded Customers and Customer Funds Held by Futures Commission Merchants and Derivatives Clearing Organizations, Final Rule, 78 FR 68506 (Nov. 14, 2013).

⁴ *Id.* at 68528.

⁵ *Id.*

⁶ *Id.*

⁷ *Id.*

⁸ 17 CFR 210.2-01

that FCMs, dual-registered FCMs/BDs, and their auditors would be deemed to be in compliance with Regulation 1.16(c)(2) if they comply with the auditor independence requirements as adopted in SEC Rule 17a-5.

Discussion

In the Division's view, while the amendments to Regulation 1.16(c) are silent as to applicable auditor independence standards, Regulation 1.16(b)(2) already had, and still retains, the Commission's principle auditor independence rule.⁹ The Division also believes that the Commission generally sought congruity with SEC Rule 17a-5 in revising Regulation 1.16(c), including creating uniform auditor independence requirements for both FCMs and BDs that are consistent with the SEC's revisions to Rule 17a-5. Moreover, nothing in the SEC's revisions to Rule 17a-5 conflict with Commission's own independence rule in Regulation 1.16(b)(2). Accordingly, it is the Division's view that an FCM, a dual-registered FCM/BD, or the designated auditor of an FCM or a dual-registered FCM/BD that complies with the auditor independence requirements in SEC Rule 17a-5 also will be in compliance with Regulation 1.16.

The Division also notes that the PCAOB has recently amended its rules to provide that auditors of non-issuer BDs are not subject to certain ethic and auditor independence provisions relating to tax services and the pre-approval of certain non-audit services contained in PCAOB Rules 3523, 3524, and 3525.¹⁰ As noted above, the Division believes that it was the Commission's intention in adopting amendments to Regulation 1.16 to align the audit, independence and other standards that an auditor must follow in conducting an examination of an FCM with the standards that an auditor is required to follow in conducting an examination of a BD. Accordingly, it is also the Division's view that an auditor of an FCM or BD/FCM is not required to comply with PCAOB Rules 3523, 3524, and 3525 in conducting an audit of a non-issuer FCM or FCM/BD in order to maintain compliance with Regulation 1.16.

⁹ In addition, similar to the construct of the SEC's Rule 210.2-01, Regulation 1.16(b)(2) generally lays out an independence standard and enumerates a list of non-exclusive circumstances for which that independence standard cannot be complied with. This includes examples of direct financial interest, the performance of certain bookkeeping services and other services.

¹⁰ See Public Company Accounting Oversight Board; Notice of Filing of Proposed Rules on Amendments To Conform the Board's Rules and Forms to the Dodd-Frank Act and Make Certain Updates and Clarifications, 79 FR 6272 (Feb. 3, 2014); see also PCAOB Release No. 2013-010, Amendments to Conform the Board's Rules and Forms to the Dodd-Frank Act and Make Certain Updates and Clarifications (adopted Dec. 4, 2013).

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This letter represents the position of this Division only and does not necessarily represent the views of the Commission or of any other office or division of the Commission. Should you have any questions, please do not hesitate to contact Josh Beale, Attorney Advisor at 202-418-5446, or Francis Kuo, Attorney Advisor, 202-418-5695.

Sincerely,

Gary Barnett