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CFTC 2019 Examination Priorities

CFTC Divisions of Market Oversight, Swap Dealer & Intermediary Oversight and Clearing & Risk Announce Examination Priorities for CFTC-Regulated Entities for the First Time

SUMMARY

On February 12, 2019, the Commodity Futures Trading Commission (the “CFTC”) released the 2019 “Examination Priorities” developed by the Compliance Branches of the agency’s Division of Market Oversight (“DMO”), Division of Swap Dealer & Intermediary Oversight (“DSIO”) and Division of Clearing & Risk (“DCR”). This marks the CFTC’s first-ever publication of examination priorities. DMO will focus on designated contract markets (“DCMs”) and their self-regulatory programs, and DMO will also begin to formulate an examination program for swap execution facilities (“SEFs”). DSIO identified six examination priorities for futures commission merchants (“FCMs”), swap dealers (“SDs”) and other intermediaries registered with the CFTC, all related to its core focus of protecting customer funds. DCR, which oversees derivative clearing organizations (“DCOs”), indicated that it will work to identify areas of weakness or noncompliance in activities that are critical to a safe and efficient clearing process.

DMO EXAMINATION PRIORITIES IN 2019

Examination Priorities for DCMs

DMO is primarily responsible for overseeing activities of DCMs and SEFs, and currently there are 14 DCMs and 23 SEFs registered with the CFTC. DMO’s Compliance Branch has historically conducted examinations of DCMs to monitor their compliance with the Commodity Exchange Act (the “Act”) and CFTC regulations through rule enforcement reviews (“RERs”). Examinations conducted through RERs will continue in 2019 and will focus on specific elements of a DCM’s self-regulatory program, including emerging areas of self-regulation where regulatory requirements and best practices are under

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development. DMO will take a comparative approach in 2019 examinations to help it more easily identify model regulatory practices across DCMs.

Based on findings and feedback received in connection with a high-level review of 11 DCMs that was conducted in 2018, the Compliance Branch of DMO identified the following practices of DCMs as its examination priorities in 2019:

- Cryptocurrency surveillance;
- Surveillance for disruptive trading (including DCMs' rules, surveillance practices, investigations, and disciplinary cases);
- Trade surveillance practices (selected elements);
- Block trade surveillance;
- Market surveillance (selected elements);
- Real-time market monitoring;
- Market maker and trading incentive programs; and
- Relationships with and services received from regulatory service providers.

DMO expects that most DCMs will undergo at least one examination in 2019 and the typical target period will be six months. In addition to examinations, DMO will schedule regular calls with DCMs (expecting to do so quarterly with large and medium volume DCMs and biannually with lower volume DCMs), during which the regulator and the DCM will discuss investigations and disciplinary cases, new products and rules, volume trends and up-to-date changes at the DCM's organizational level.

Regulatory Consultations with SEFs in 2019

SEFs are not included in DMO's 2019 examination plan because of the pending changes to the CFTC's SEF regulations. However, DMO will initiate regulatory consultations with SEFs, similar in nature and purpose to the high-level review of DCMs conducted in 2018, and will begin designing an examination program for SEFs while it finalizes the SEF rules. The series of regulatory consultations will help establish a baseline of information regarding each SEF's regulatory and business operations; SEFs are expected to learn more about the examination program in general and about how DMO interacts with registered entities to evaluate their compliance with the Act and CFTC regulations.

DMO anticipates that it will continue to publish Examination Priorities annually to increase awareness and attention by regulated entities and market participants on areas that the Compliance Branch of DMO identifies as important to effective self-regulation in the U.S. derivatives markets.

DSIO EXAMINATION PRIORITIES IN 2019

DSIO oversees derivative markets intermediaries: FCMs, SDs, major swap participants ("MSPs"), commodity pool operators, commodity trading advisors, introducing brokers and retail foreign exchange dealers.

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A core mission of DSIO is the protection of customer funds, and traditionally its examination resources have focused on approximately 65 FCMs. Approximately 100 SDs are also under the oversight of DSIO, though the examination responsibilities performed are relatively limited as the National Futures Association has thus far functioned as the primary examiner of SDs.

In 2019, DSIO examinations will continue to monitor CFTC registrants' activities, which functions include but are not limited to, reviewing notices, risk management programs, financial statement filings, risk exposure reports, risk assessment reports and chief compliance officer annual reports. In particular, the Compliance Branch of DSIO identified the following areas as its examination priorities in 2019:

- Withdrawal of residual interest from customer accounts;
- Accepted forms of non-cash margin;
- Compliance with segregation requirements;
- FCM use of customer depositories;
- FCM customer account documentation; and
- SD/MSP relationships with third-party vendors.

DCR EXAMINATION PRIORITIES IN 2019

DCR conducts examinations of DCOs, including those that have been designated as systemically important by the Financial Stability Oversight Council. Examinations of systemically important DCOs are performed in consultation with the Board of Governors of the Federal Reserve.

The priority of DCR examinations is to identify areas of weakness or noncompliance in a DCO's activities that are critical to safe and efficient clearing, while the scope and methodology of each examination is risk-based and is customized, taking into consideration the unique characteristics of each DCO and the products it clears. DCR's 2019 examinations will seek to assess the maturity, capabilities and overall resilience of a DCO through examining its financial resources, risk management, system safeguards and cyber-security policies, practices and procedures.

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