

# CFTC Examination Initiative

## CFTC thematic review roundtable

Q&A WITH THE REGULATORS HOSTED BY AIMA AND SCHULTE ROTH & ZABEL

Please note that subsequent to the roundtable summarized below, the CFTC’s Division of Swap Dealer and Intermediary Oversight announced that the Thematic Review initiative would commence in 2021, instead of 2020.

**O**n Oct. 30, 2019, Joshua B. Sterling, Director of the U.S. Commodity Futures Trading Commission’s (CFTC) Division of Swap Dealer and Intermediary Oversight (DSIO), and Regina Thoele, Senior Vice President, Compliance, of the National Futures Association spoke at a seminar hosted by the Alternative Investment Management Association (AIMA) and Schulte Roth & Zabel LLP (SRZ) on the CFTC’s new “Thematic Review” initiative. The text below reflects excerpts from that seminar and the full text of Director Sterling’s remarks can be found at <https://www.cftc.gov/PressRoom/SpeechesTestimony/opasterling4>.

**Brian T. Daly (BTD):** Director Sterling, can you share with us some of the changes at DSIO?

**Joshua B. Sterling (JS):** For the first time in the CFTC’s nearly 45 year history, we have a clear vision statement: to be the global standard for sound derivatives regulation. As the Chairman has indicated, to promote and achieve sound regulation, we need to use the right tools, at the right time, for the right reason.

To understand when and how best to use those tools, we need to have a comprehensive understanding of the markets that we oversee, as well as the activity of our registrants in those markets. Whenever we have the potential for blind spots in our oversight, there is a risk that we will fail to provide for sound regulation.

Here is the issue, simply stated: DSIO has not itself conducted direct reviews of CPOs and swap dealers, yet we are the registrant oversight division of the federal regulator for the derivatives markets. Through targeted thematic

Initials	Name	Organisation
<b>BTD</b>	Brian T. Daly, Partner, Investment Management Regulatory & Compliance Group	Schulte Roth & Zabel LLP
<b>SR</b>	Suzan Rose, Senior Adviser, Government and Regulatory Affairs	Alternative Investment Management Association
<b>JS</b>	Joshua B. Sterling, Director, Division of Swap Dealer and Intermediary Oversight	Commodity Futures Trading Commission
<b>RT</b>	Regina Thoele, Senior Vice President, Compliance	National Futures Association

reviews, we hope to both mitigate the potential for blind spots in our oversight and enhance our engagement with registrants. The reviews will support our efforts to take a principles-based approach to registrant oversight when possible. To articulate clear principles, after all, we first need to have a better handle on how CFTC rules affect our registrants.

**BTD:** Could you tell us about these “thematic reviews” and what asset managers can expect?

**JS:** What is a thematic review? It is simply a targeted look into specific areas of interest to my Division. Each area of interest relates to potential rules and rule amendments that the Division is interested in evaluating. Thematic reviews can be distinguished from other types of examinations in the following respects:

First, they are targeted. Our teams will focus on just a few issues that the Division may consider recommending to the Commission for potential action in the coming months. They are not “all areas” reviews of firms, nor are they “event driven” sweeps at this point.

Second, they are informational. We are looking to gather information from individual firms, assess that information on an individual basis, and compare our assessments across firms to identify potential better ways of doing things. While this process will involve assessing what we find, we will not be issuing deficiency letters.

We would expect to publish an examination manual that would give firms an understanding of our process before doing so.

Third, they are educational. We intend to take what we’ve learned from our assessment and share our findings on potential areas of improvement in a general report of review. That report will explain our scope, describe the general nature of the types of firms selected, and compare and contrast the different ways firms tackle the issues involved. If we spot potential better ways of doing things, we’ll flag them for registrants.

Finally, they are confidential, much like other types of reviews and examinations to which your firms have been subject.

**Suzan Rose (SR):** Regina, what do thematic reviews mean for the NFA’s examination program?

**Regina Thoele (RT):** The thematic reviews will not impact NFA’s examination program. We will continue to select CPOs for examination that appear to pose the highest risk of noncompliance with regulatory requirements. In selecting firms to examine, we first perform a quantitative review using our risk models that are based on predictive analytics and which are designed to identify the firms that pose the highest risk of noncompliance with regulatory requirements. We then overlay those results

with a qualitative review to ensure that final examination decisions are made by a human. When we examine a firm, we also examine the areas at that firm that appear to be areas where there is the highest risk of noncompliance. We also focus on ensuring that the firms have adequate controls in place. We will, of course, try to coordinate with DSIO to avoid firms being reviewed by NFA and DSIO at one time.

**BTD:** Will the CFTC be duplicating or replacing NFA examinations?

**JS:** No. The thematic reviews will have more focused and tailored scopes than the broader compliance examinations that NFA undertakes, which are important in their own right and vital to the successful oversight of all registrants. The thematic reviews are looking at key issues across firms for the purpose of providing general guidance and informing potential future rulemakings.

**SR:** We have members who are uncomfortable with the irregularity of the NFA examinations. Is there a desire to move to a more regular cycle?

**RT:** NFA does not plan on moving to an examination program that uses a cycle to choose firms for examination. We have been using our risk model approach for some time, which we believe is a better approach than a regular cycle because it allows us to focus on those firms that appear to pose the highest risk of noncompliance with regulatory requirements. This risk modeling approach also means that

some firms will be examined more frequently than others. For example, if as a result of an examination, we identify a lack of controls at a firm or we take a disciplinary action against a firm, the risk models will likely identify the firm as a higher risk firm, and that firm will again be identified for an examination. There have been instances where we examine a firm two years in a row.

**SR:** Are you really just going out to look for matters to refer to the Division of Enforcement?

**JS:** No, we are not. Nor will the Division of Enforcement participate in the review teams. That said, DSIO communicates regularly with Enforcement, as do other policy-making Divisions, as part of the Commission's ongoing work.

In addition, under our Guidance Program, we are developing processes for registrant oversight that will enable us to retain the ability — within clearly established parameters — to determine that particular indications of noncompliance do not warrant referral to Enforcement based on the available facts and circumstances. We expect to discuss those decisions with Enforcement periodically, so that we can confirm that our assessments are consistent with the separate roles of DSIO, as an overseer of registrants, and Enforcement, as the enforcer of the Commission's requirements.

Having said all this, my Division retains complete flexibility in setting course and

changing tack as the circumstances of any specific review or multiple reviews dictate.

**BTD:** For an NFA exam, tools such as self-exam checklists help our clients prepare. What is changing on your side and what else are you doing to help registrants get ready?

**RT:** Self-exam checklists, like you said, are a good thing. When we conduct our examinations, it is key to have the right documents and the right people readily available. These examinations will go much quicker if these are in place. We also try to be reasonable. If the CCO is going to be out for the exam when we call, we will try to work around your schedule. Of course, we will also see who is covering for the CCO when the CCO is out, but we will work with the firm.

**SR:** What makes a registrant prime to be selected for thematic review?

**JS:** We will attempt to select firms for the review process that are likely to have a significant impact on the derivatives markets. Certainly, the size of the firm and the relative amount of its derivatives trading will be important considerations for us at this stage. This approach makes intuitive sense to us, as we consider the fact that the CFTC is principally a market regulator. We should consider the potential market impact of registrant-focused rules in assessing how firms operate and whether those rules should be revised in any way. **THFJ**

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