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ARTICLE

The Joint Audit Committee in the Post-Archegos Risk Management Regulatory Landscape

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Highlighting the risk management regulatory environment following the 2021 default of Archegos Capital Management, the article discusses the Joint Audit Committee's (JAC) regulatory function in connection with futures commission merchants (FCM). In examining the JAC's recent practice in conducting annual financial and operations audits of the industry's largest FCMs, the author outlines initiatives from the Fed and the SEC and suggests ways in which the JAC can align its risk management guidance with those initiatives.

Specifically, the article offers an overview of SR 21-19, issued by the Fed's Division of Supervision and Regulation in December 2021, and a March 2022 statement issued by the SEC's Division of Trading and Markets. The article looks to the history of the JAC's audit practice in relation to the issues raised by the Fed's and the SEC's regulatory releases, including discussion of the JAC's oversight of recent guidance from the Commodity Futures Trading Commission (CFTC) on CFTC Regulation 1.56.

According to the author, that raises a critical question: "when is an FCM account agreement in violation of CFTC Regulation 1.56?" While some aspects of the answer are clear, there is less clarity on whether the JAC and CFTC guidance bars an FCM from agreeing to cure periods or grace periods, entirely.

"The JAC has a broad remit under CFTC Regulation 1.52 to examine FCMs for compliance with CFTC and [self-regulatory organization] 'risk management requirements, including policies and procedures relating to the customer funds.' But an indispensable precondition to the effective execution of that mission is clarity about what those requirements are," the author argues. Noting that the Fed's SR 21-19 and the SEC's statement can offer a useful clarifying framework, the article concludes with a suggestion that the CFTC and the JAC should align their current guidance on Regulation 1.56 with the Fed's and SEC's regulatory guidance:

"Specifically, the CFTC and JAC should clarify that FCM customer account agreements (whether or not entered into with customers that maintain separately managed and separately margined accounts), when construed in their entirety under applicable contract law, should not include terms that would prevent the FCM from 'improving its margin position or closing out positions quickly' upon a default or in the event of an 'increasing risk profile,' or that provide the customer with risk-insensitive margin terms or extended close-out periods. Subject to those general standards (and the [designated self-regulatory organization's] power to examine for compliance with those standards), an FCM should otherwise be free to contract with its customers within the constraints of its risk management program and its risk management policies and procedures."

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