NFA NATIONAL FUTURES ASSOCIATION
200 W. MADISON ST•CHICAGO, IL•60606•(312) 781-1300

COMMODITY FUTURES TRADING COMMISSION
RECEIVED
OFFICE OF THE SECRETARIAT

MAR 2 2 44 PM '84

February 29, 1984

Ms. Jane K. Stuckey
Office of the Secretariat
Commodity Futures Trading Commission
2033 K Street, N.W.
Washington, D.C. 20581

Re: National Futures Association;
Proposed Amendments to Bylaw 1301 and
Addition of Bylaw 705 and Compliance Rule 2-24.

Dear Ms. Stuckey:

Pursuant to Section 17(j) of the Commodity Exchange Act, as amended, ("Act") National Futures Association ("NFA") hereby submits to the Commodity Futures Trading Commission ("Commission") proposed amendments to Bylaw 1301 and new Compliance Rule 2-24 and hereby requests review and approval of these amendments. These amendments were approved by the Board of Directors ("Board") at a meeting on February 16, 1984.

In the text below, where appropriate, additions are underscored and deletions are bracketed:

I. The Amendments

A. Bylaw 1301

BYLAWS OF NATIONAL FUTURES ASSOCIATION

* * *

CHAPTER 13

DUES AND ASSESSMENTS

Bylaw 1301. Schedule of Dues and Assessments.

(a) Contract Markets.

Each contract market Member shall pay to NFA an assessment calculated on the basis of [$.02] $.01 for each round-turn transaction in a commodity futures contract (purchase and sale or sale and purchase) executed on the contract market, except that in any NFA fiscal year, the total of such assessments paid by a contract market Member with two (2) Directors on the Board shall not be more than $150,000 and the total of such assessments paid by a contract market Member with one (1) Director on the Board shall not be more than $100,000 [$300,000 nor less than $25,000].

(b) FCM Members.

(i) Each FCM Member shall pay to NFA an assessment equal to:

(A) $0.28 [$0.30] for each commodity futures contract (other than an option contract traded on a contract market and a dealer option contract) on a round-turn basis, and

(B) $0.16 [$0.20] for each option contract traded on a contract market on a per trade basis,

carried by it for a customer other than (1) a person having privileges of membership on a contract market where such contract is entered or (2) a person whose contracts are carried in a proprietary account, as defined in Commission Rule §1.3(y), by a person having privileges of membership on such contract market or (3) an omnibus account carried for another FCM Member for which assessments are payable to NFA by the other FCM; and

(C) $0.16 [$0.20] for each dealer option contract on a per trade basis carried by it for a customer other than a person whose contracts are carried in a proprietary account, as defined in Commission Rule §1.3(y), by such FCM Member:

Provided, however, such assessments shall be suspended by the Board during any fiscal year when in the judgment of the Board the budget goals of NFA for the fiscal year, as prescribed by the Board under Section 6 of Article VII, have been met. The FCM Member shall invoice these assessments to its customer and shall remit the amount due to NFA; and

[(ii) Each FCM Member shall pay to NFA an amount equal to 10% of the sum invoiced to customers under (b)(i)(A) above; and] [(iii)] (ii) Each FCM Member shall pay to NFA annual dues of $1,000 if such FCM Member does not carry dealer option contracts for customers, or $1,500 if such FCM Member does carry dealer option contracts for customers.

B. Compliance Rule 2-24

Rule 2-24. QUALIFICATION TESTING OF ASSOCIATED PERSONS OF FCMs.

Subject to the provisions of paragraphs (d) and (e) of Bylaw 301, no person (except any person who was registered as an associated person of an FCM or IB or who had applied for such registration as of March 1, 1984 and whose registration as an associated person of an FCM or IB has not lapsed since that date) may be associated with an FCM Member of NFA (See Bylaw 301(b)) unless such person has taken and passed the National Commodity Futures Examination.

Pursuant to Section 17(j) of the Act, NFA also hereby submits to the Commission the following proposed new Bylaw 705 which NFA intends to make effective ten days after receipt of this submission by the Commission. This amendment was unanimously approved by the Board at its meeting on February 16, 1984.

C. Bylaw 705

Bylaw 705. Finance Committee.

There shall be a Finance Committee not having or exercising the authority of the Board, to advise the Executive Committee on matters of NFA financial policy including the establishment of major plans and priorities regarding the commitment and expenditure of NFA funds and the establishment of dues, assessments, fees and other charges upon Members and others. The Finance Committee shall consist of six (6) members as follows:

(a) NFA's President,

(b) NFA's Vice Chairman (who shall act as chairman of the Finance Committee), and

(c) Four (4) other Directors as follows who shall not also be members of the Executive Committee and who shall be proposed by the Executive Committee and appointed by the Board at the first Board meeting in each fiscal year:

(i) One (1) Director representing contract markets,

(ii) One (1) Director representing FCMs,

(iii) One (1) Director representing CPOs or CTAs, and

(iv) One (1) Director who is a public representative.

II. Explanation of Amendments

A. Bylaw 1301

1. Contract Market Assessments.

NFA Bylaw 1301(a) currently requires that contract market Members of NFA pay an assessment of $.02 per round-turn executed on the contract market with an annual minimum and maximum of $25,000 and $300,000, respectively. Upon review of this contract market assessment, the Board has determined that in view of the large recent increases in futures volume it would be possible to meet a greater proportion of NFA's funding requirements out of the FCM Assessment Fee set forth in Bylaw 1301(b). Further, in view, in part, of the increase in trading volume, NFA believes that the current structure of the contract market assessments may not adequately distribute NFA funding burdens among exchanges of different "size." The Board has noted that the result of more exchanges' approaching the annual maximum assessment is that exchanges of materially different "size" pay the same amount to NFA. A related problem is presented by the several exchanges which, on a per contract basis, would pay substantially less than $25,000 were it not for the established minimum.

In addition, the current contract market assessment structure was predicated, in part, on the assumption that NFA would provide substantial direct services to the various exchanges. NFA does not doubt that such services will be provided in the future at the request of the various exchanges, but NFA does not currently provide such direct services. Therefore, NFA believes that at this time it would be more equitable to reduce the basic contract market assessment and further require that each contract market be charged a reasonable amount for direct services from NFA as and when the contract markets request such services.

Finally, NFA believes it appropriate to reduce contract market assessments in view of the amendments reducing dues and charges upon other Members including the reduction in dues applicable to commodity pool operators, commodity trading advisors, commercial banks and commercial firms submitted by letter dated December 14, 1984 and the reduction in the FCM Assessment Fee by amendment to Bylaw 1301(b) submitted in this letter.

Accordingly, NFA has proposed to amend Bylaw 1301(a) to provide that (1) the contract assessment be reduced to $.01 per round turn, (2) the minimum payment be eliminated and (3) the maximum payment be lowered to $150,000 for those contract markets having two seats on the Board and $100,000 for those having one Board representative. The Board further adopted a resolution that NFA shall perform direct services for contract market Members subject to such charge, in addition to the ordinary contract market assessment, as the Board shall establish. In the interest of fairness among exchanges which joined NFA at different times, the Board also resolved that this amendment should be effective with respect to each existing contract market Member as of the beginning of its second year of NFA membership. In order that contract market Members may make appropriate plans with respect to the contract market assessment, NFA is giving such Members immediate notice of the effect which the proposed amendment will have on the account of each with NFA.

NFA believes that the reduction of contract market assessments will not substantially impair NFA's ability to meet its overall revenue needs considering other sources of revenue such as the FCM Assessment Fee (discussed below). The elimination of the $25,000 minimum will ensure that the NFA contract market assessment will not serve as an economic barrier to NFA membership for smaller exchanges. Further, NFA believes the lowering of the maximum payment and the distinction between those contract markets having two seats on the Board and those having one seat is more equitable approach to attaining NFA's revenue at this time.

For the foregoing reasons NFA believes that the proposed amendment to Bylaw 1301(a) is consistent with the requirements of Section 17(b)(6) of the Act and Commission Regulation 170.4 that dues be equitably allocated among Members and that dues not constitute a barrier to entry.

2. Bylaw 1301(b).

When the Commission approved NFA's original Assessment Fee levels by letters dated September 30, 1982 and January 11, 1983 the Commission suggested that the Assessment Fee levels should be periodically reevaluated in terms of the volume of assessable trading and experience with the operational costs which NFA incurs in fulfilling its self-regulatory responsibilities under the Act. NFA agrees that systematic reevaluation of the Assessment Fee is necessary to ensure that it continues to represent a fair allocation of charges to defray NFA administrative expenses. Along with the establishment of the Finance Committee, discussed below, the proposed amendment to Bylaw 1301(b) represent a step in that continuing process.

In view of NFA's current financial situation and after having generally considered projected budgets and Assessment Fee levels for the coming years, the Executive Committee recommended to the Board that the FCM Assessment Fee prescribed in Bylaw 1301(b) be reduced to $.26 from $.33 on futures round-turns and to $.16 from $.20 on exchange traded and dealer option trades. This recommendation was made in conjunction with the recommendaton, which was accepted by the Board, that NFA's Fiscal Year 1984 budget be revised as described in the memorandum attached hereto as Exhibit A. The memorandum from the Executive Committee to the Board attached hereto as Exhibit B, along with the enclosed reports from Arthur Andersen & Co., describe in general the proposed approach to regular analysis of the Assessment Fee and the basis for the Executive Committee's specific recommendation.

The Executive Committee further recommended that the Board eliminate the FCM 10% surcharge under former Bylaw 1301(b)(ii). The Committee believed that this amount is generally passed on to customers along with the portion of the Assessment Fee which is required to be invoiced. Thus, the Committee viewed the surcharge as unnecessarily complicating the calculation of the FCM Assessment Fee.*

The Board accepted the recommendations of the Executive Committee with the modification that the Assessment Fee on futures round-turns be reduced from $.33 to $.28 rather than the $.26 proposed by the Executive Committee. The Board's rationale in adopting a slightly higher Assessment Fee than proposed by the Executive Committee is that the higher figure will enable NFA to adopt more conservative fiscal posture. This approach would allow a larger cash reserve fund which will help ensure that NFA will be able to meet anticipated budgeting needs should futures trading or public participation in the futures markets fall significantly below NFA's estimates. The Board also believes that adoption of the $.28 figure for the fourth quarter of Fiscal 1984 (pending Finance Committee consideration of the

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*/ The Board and the Commission have previously accepted the concept of simplifying the Assessment Fee in this manner. In establishing the Assessment Fee for exchange traded and dealer options the Board adopted a flat fee of $.20 and eliminated any surcharge.

appropriate level for Fiscal 1985) will make an increase in the Assessment Fee as of July 1, 1984 less likely. NFA believes the amendments to the FCM Assessment Fee under proposed Bylaw 1301(b) comport with Section 17(b)(6) of the Commodity Exchange Act and Commission Regulation 170.4. In that regard it should be noted that the proposed reduction will also benefit those CPO and CTA Members whose compensation arrangements are linked to assets under management or net performance.

The Board resolved to make the proposed amendment to NFA Bylaw 1301(b) effective as of the later of April 1, 1984 or the date of approval by the Commission. NFA has given immediate notice to its FCM Members of the proposed Bylaw amendment in the attached letter. April 1, 1984 is preferred as the effective date of the amendment to Bylaw 1301(b) because it permits the change in the Assessment Fee (which is paid quarterly to NFA by FCM Members) to be accomplished at the beginning of an NFA fiscal quarter. In order to be able to achieve that convenient effective date and to be able to give our FCM Members the advance notice necessary to change their invoicing procedures, NFA respectfully requests that the Commission conduct its review of the proposed amendment to Bylaw 1301(b) as promptly as possible. NFA would encourage consideration of that proposed amendment separately from the other proposed amendments submitted in this letter if that would result in a more expeditious review. Although NFA is aware that the Commission and its Staff have many important matters competing for attention, NFA hopes that this submission contains sufficient information to permit immediate review.

B. Compliance Rule 2-24.

Proposed Compliance Rule 2-24 would prohibit an FCM Member from permitting an employee to act as an associated person ("AP") if that employee has not taken and passed the National Commodity Futures Examination ("NCFE"). The proposed rule exempts from this testing requirement any person who was registered, or had applied for registration, as an AP of an introducing broker ("IB") or FCM as of March 1, 1984 and whose registration has not lapsed. By letter dated September 1, 1983 NFA submitted for Commission approval proposed amendments to Section II(a) of Schedule A of the Bylaws to require new AP's of IB's to have taken and passed the NCFE. Proposed Compliance Rule 2-24 operates as a compliance requirement upon FCMs as opposed to the IB testing rule which is a precondition of registration for the AP applicant. When NFA is authorized to perform registration functions with respect to APs of FCMs a registration related testing rule will be adopted. As NFA has stated with respect to the IB testing rule, proposed Compliance Rule 2-24 is intended to be an early step toward a complete complement of NFA proficiency standards which will ensure that every NFA Member demonstrates proficiency through training, testing or experience.

Currently most APs are already required to pass the NCFE due to rules of various contract markets. Proposed Compliance Rule 2-24 will, therefore, extend the testing requirement to non-exchange Member FCMs. However, certain contract markets require only specialized tests of APs of their FCM members. NFA expects that with respect to APs which solicit or accept orders for execution only on a contract market which requires such a limited test NFA may, at the request of the relevant contract market, take a position that NFA will not enforce Compliance Rule 2-24 for a limited period against FCMs whose APs have taken and passed the limited contract market test.

C. Bylaw 705.

The proposed amendment to chapter 7 of the Bylaws would establish a six member Finance Committee to review NFA staff's budget proposals and recommend approval of plans and priorities regarding NFA's financial policy to the Executive Committee. Although the Executive Committee is responsible for advising the Board on these matters and the Board makes all final decisions, NFA believes that establishment of a Finance Committee as a subcommittee of the Board to focus particularly on NFA financial policy and provide guidance to the Executive Committee would be beneficial. In addition to NFA's President and Vice Chairman who will serve on the Finance Committee automatically, the Board has appointed Thomas R. Donovan, Barry J. Lind, William A. Dunn and J. Dewey Daane as Finance Committee members.

NFA respectfully requests that the amendments to Bylaw 1301 and Compliance Rule 2-24 be declared effective upon approval by the Commission and that Bylaw 705 become effective ten days after receipt by the Commission.

Very truly yours,
National Futures Association

By: [signature]
Joseph H. Harrison, Jr.
General Counsel and Secretary

cc: Chairman Susan M. Phillips
Commissioner Kalo A. Hineman
Commissioner Fowler C. West
Commissioner William E. Seale
Andrea M. Corcoran, Esq.
Theodore W. Urban, Esq.
Linda Kurjan, Esq.

NFA NATIONAL FUTURES ASSOCIATION
200 W. MADISON ST•CHICAGO, IL•60606•(312) 781-1300

I-84-2

February 27, 1984

Dear FCM Member:

At its meeting on February 16, 1984 the Board of Directors of NFA took two important actions concerning the FCM Assessment Fee which your firm invoices to customers and pays to NFA. The changes to the Assessment Fee, which are described below, are intended to be made effective as of April 1, 1984. However, the changes must first be approved by the CFTC. If approval is not given before April 1, 1984, the effective date will be delayed until such approval is given.

First, in view of NFA's current financial condition the Board determined to reduce the Assessment Fee to $.28 per futures round-turn and $.16 per option trade. This represents a decrease in the futures Assessment Fee of over 15% from its current level of $.33 per round-turn and a decrease in the option Assessment Fee of 20% from its current level of $.20 per trade.

Second, the Board determined to eliminate the 10% surcharge which FCM's are currently required to add to the amount of the futures Assessment Fee collected from customers. Currently the $.33 futures Assessment Fee is composed of $.30 which must be invoiced to customers and an additional 10% ($.03) which is payable by the FCM. Once the Board's action takes effect, both the futures and options Assessment Fee will be a single amount ($.28 and $.16 respectively), all of which must be invoiced to customers.

As stated above, the reduction in the Assessment Fees and the elimination of the 10% surcharge will not take effect until April 1, 1984 and may not take effect until after April 1, 1984 if CFTC approval is delayed. We are making every effort to secure approval prior to April 1, 1984 and, therefore, we urge you to prepare to make the necessary changes as of that date. However, we will send you another notice prior to April 1, 1984 informing you of the actual effective date of these changes in the Assessment Fees. All Assessment Fees invoiced on or after the effective date should be at the new amount.

Sincerely,

Joseph H. Harrison, Jr.
General Counsel

JHH:cm

NATIONAL FUTURES ASSOCIATION
200 W. MADISON ST•CHICAGO, IL•60606•(312) 781-1300

February 8, 1984

Memo To: Board of Directors

From: Jean W. Tippins

Re: Revised Forecast - Fiscal 1984 Budget

Attached is an updated fiscal 1984 budget which incorporates our first six months of actual expenditures and our revised forecast for the last six months of the fiscal year. This revised forecast has been reviewed by Arthur Andersen & Co. at the request of the Executive Committe. Arthur Andersen's report, which finds this revision reasonable, is provided to the Board under separate cover.

The revised fiscal 1984 budget of $10.3 million produces a net reduction of $1.5 million from the original budget approved by the Board last May. The actual expenditures through the first half of fiscal 1984 combined with the revised forecast for the second half reveal several instances where previous totals as budgeted at the May 1983 Board meeting will not be achieved or will be exceeded. A brief explanation of the most significant variances follows. A detailed explanation will be presented at the February 16 meeting.

A. Overages - Higher than anticipated construction costs, particularly in our New York facility ($179M)

- Expanded and improved MRRS and FACTS computer systems and purchased additional equipment ($127M)

- The expansion and buy out of our telephone lease ($156M)

B. Savings - Fewer compliance staff because of slow hiring rates means less travel ($901M) and less salaries and related benefits ($172M)

- Reduced need for outside fees and services ($98M)

- Reduced Board and Committee expenses due to fewer meetings ($204M)

EXHIBIT A

- Reduced Arbitration expenses as hearings are just beginning ($141M)

- Lower printing requirements in legal and registration ($114M)

- No need to borrow money ($240M)

The Executive Committee has reviewed the revised budget and recommends its adoption and approval by the Board. The following draft resolution is offered for adoption by the Board.

RESOLVED, that the revised budget forecast for fiscal year 1984 is hereby approved and adopted as the plan regarding the commitment and expenditure of NFA funds.

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Revised Forecast F al 1984 Expenses

By Expe .ture

	Actual Expense July-Dec. 83	Estimated Expense Jan.-June 84	Revised Forecast Fiscal 84 Expenses	Original Fiscal 84 Budget	Forecast [Over] Under Orig. Budget
Salaries & Related Expenses	1,957,912	2,876,966	4,834,878	5,006,630	171,752
Travel & Meetings	298,370	681,004	979,374	1,880,841	901,467
Computer Services	276,738	875,487	1,152,225	1,025,630	[126,595]
Outside Fees and Services	88,519	212,951	301,470	399,928	98,458
Telephone Lease & Expense	59,697	341,856	401,553	245,816	[155,737]
Utilities	11,403	30,597	42,000	52,000	10,000
Space Rental	342,582	71,218	413,800	450,000	36,200
Furniture & Fixtures	540,495	174,475	714,970	694,180	[20,790]
Equipment	104,299	26,157	130,456	161,688	31,232
Construction Costs	518,127	127,873	646,000	467,000	[179,000]
Board & Committee Fees	73,847	116,153	190,000	394,100	204,100
Arbitration Expense	1,452	13,800	15,252	156,000	140,748
Registration Test/Forms Development	1,705	23,295	25,000	50,000	25,000
Postage Printing & Publications	27,570	270,542	298,112	411,725	113,613
Interest Expense	27,531	7,469	35,000	275,000	240,000
Office Supplies, Insurance & Other Operating Expenses	107,934	58,867	166,801	180,462	13,661
	$4,438,181	$5,908,710	$10,346,891	$11,851,000	$1,504,109

NFA

February 8, 1984

Memo to: Board of Directors

From: Executive Committee

Re: Proposed Formula for Adjustment of Assessment Fee and Specific Revenue Recommendations

I. Introduction

NFA's Bylaws recognize that NFA's income, which is largely dependent on the volume of futures trading conducted by the public, may not precisely match the amount necessary to meet NFA's budget goals as established by the Board. Bylaw 1301(b) provides an objective method to adjust income by allowing for suspension of the FCM Assessment Fee whenever, in the judgment of the Board, during any fiscal year the budget goals for that year have been met.

Although suspension of the FCM Assessment Fee for the last portion of fiscal 1984 is discussed below, the Executive Committee believes that method is imperfect in two important respects. First, it addresses only the situation where revenue exceeds NFA's budget goals and does not provide any objective approach to adjusting for a revenue shortfall. Second, it would place upon FCMs the difficult practical burden of suspending collection from customers of the Assessment Fee for the remainder of a fiscal year and then re-establishing its collection at the beginning of the next fiscal year. (See Arthur Andersen & Co.'s Report on Review of Budgeting Process and Methods for Determining FCM Assessment Fees for further discussion of the suspension of Assessment Fees.)

The method of adjusting income set forth in Bylaw 1301(b) is not mandatory but is only operative at the Board's election. The Executive Committee believes that it would be beneficial to consider an alternative method for adjusting income which objectively accounts for income shortfalls as well as excesses and which avoids placing unnecessary burdens on FCM members.

II. Alternative Method of Revenue Adjustment

Under the following alternative method of revenue adjustment the FCM Assessment Fee would remain the only income source which is annually subject to change. All other income sources, such as dues and contract market assessments, would be fixed unless fair allocation of dues and assessments required some adjustment. (See specific recommendations for these areas).

EXHIBIT B

A. Establishment of Budget

At the May meeting of the Board of Directors the Board will adopt NFA's overall operating and capital budget for the following fiscal year. At any subsequent meeting during the fiscal year the Board would be free to re-examine that budget and make any revisions which become necessary due to unforeseen circumstances or changes in NFA programs.

B. Determination of Revenue Target

1. Establishment of Total Funding Requirement

As a part of the annual budgeting process at the next May meeting the Board will determine NFA's total funding requirement for the following fiscal year ("Total Funding Requirement"). The Total Funding Requirement would consist of at least the amount of funds necessary to meet the operational and capital expenses called for in the approved budget.

NFA's outside auditors have recommended and NFA's Officers and the Executive Committee concur that NFA should maintain a reasonable cash reserve as of fiscal year-end of at least one quarter's income (currently estimated at $3.5 million). If the Board agrees with that concept, it could be accomplished by including the amount of such a reserve along with budgeted operational and capital expenses in determining NFA's Total Funding Requirement. For example, if the Board approved an operating and capital budget of $14.5 million and authorized a reserve of $3.5 million, then the Total Funding Requirement for the following year would be $18.0 million. The reserve would be available to secure NFA from temporary declines in futures trading volume and to provide resources to meet emergencies. Of course, any use of the reserve for previously unbudgeted expenditures would require Board approval.

2. Calculation of Revenue Target

Once the Total Funding Requirement for the following fiscal year is determined, the Board can proceed to determine the amount of that Requirement which must be met by actual revenue during the year (the "Revenue Target"). Staff will present the Board with its estimate of the cash balance or cash deficit as of the end of the current fiscal year.* The

* A cash balance will include cash on hand less accrued expenses as of the end of the fiscal year. That cash may come in part from income received in excess of expectations and any portion of the reserve authorized for the current fiscal year remaining at year-end. Assuming that the authorized reserve will generally be substantially intact at the end of most years, there will likely be a substantial cash balance at the end of each fiscal year.

Board will be able to calculate the Revenue Target by subtracting the amount of any cash balance from, or adding the amount of any cash deficit to, the Total Funding Requirement. For example, if the Total Funding Requirement for the following fiscal year (including a reserve of $3.5 million) is $18.0 million and the projected cash balance as of June 30 is $6.0 million, then the Revenue Target for the succeeding fiscal year would be $12.0 million. Alternatively, if there were a cash deficit as of June 30 of $.5 million then the Revenue Target would be $18.5 million.

C. Determination of FCM Assessment Fee

Once the Revenue Target is known the portion of that amount to be realized through FCM Assessment Fees ("Assessment Fee Target") may be calculated by subtracting the total of expected revenue from all other sources. The amount of the FCM Assessment Fee per round-turn for the coming fiscal year may then be determined by dividing the Assessment Fee Target by the Board's estimate of total assessable futures volume for the fiscal year (for purpose of this estimate an option trade could be considered as two-thirds of a futures round-turn and, for purposes of calculating the Assessment Fee, the per trade option assessment may be set at approximately two-thirds of the round-turn futures Assessment Fee). Under the first of the two examples above in which the Total Funding Requirement is $12.0 million, Assessment Fees must total $10.25 million if NFA expects income from other sources of $1.75 million. Thus, in order to achieve the Assessment Fee Target if volume is projected at 150 million contracts (assuming 28% of total volume is assessable public business) then the Assessment Fee for the coming year would be calculated as follows:

$$\frac{10{,}250{,}000}{150{,}000{,}000 \times .28} = \frac{10.25}{42} = \$.24$$

(See Attachment A for other examples.)

D. Summary

Essentially in May of each year the Board would be required to make judgments in two areas: (i) the budget for the following year and (ii) the level of assessable volume in the following year. Having made these judgments the Board would then set the FCM Assessment Fee for the next year according to the following objective formula:

Budget		______		
plus reserve	______			
Total Funding Requirement		______		
less cash balance as of 6/30	______			
plus cash deficit as of 6/30	______			
Revenue Target		______		
less income from other sources	______			
Assessment Fee Target (AFT)		______		
AFT divided by estimated assessable volume		______	÷ ______	= ______
FCM Assessment Fee				______

III. Specific Revenue Alternatives

The Executive Committee believes that consideration of specific plans with respect to the setting of the Assessment Fee and establishment of the Fiscal 1985 budget should be left, in the first instance, to the Finance Committee. However, in order for the Board to determine whether any action with respect to the Assessment Fee may be appropriate now, it is necessary to look at several alternatives in advance of the Finance Committee. The Executive Committee believes that this can be done without substantially restricting the choices available to the Finance Committee.

NFA Officers in conjunction with Arthur Andersen & Co. have identified three alternative plans for handling the FCM Assessment Fee:

1) Suspend Assessment Fee for remainder of Fiscal Year ("FY") 1984 (as of, for example, 4/1/84).

2) Continue Assessment Fee at current level until end of FY 1984 and then apply formula to reduce Fee for FY 1985 and beyond.

3) Implement estimated reduction in Fee (per formula) for FY 1985 now (as of 4/1/84) and continue at that level through FY 1985.

These alternatives will be discussed in detail at the meeting. The following is an analysis to be used in preparation for that discussion.

<u>Alternative I.</u>
<u>Suspend Assessment Fee for Remainder of FY 1984.</u>

Bylaw 1301(b) states that the FCM Assessment Fee "shall be suspended by the Board during any fiscal year when in the judgment of the Board the budget goals of NFA for the fiscal year as prescribed by the Board have been met."

NFA's budget goals for FY 1984 were set by the Board at its meeting on May 23, 1983. At that meeting the Board approved a budget of $11.8 million with the understanding, if revenues exceeded that amount "that additional monies could be applied toward eliminating indebtedness and building a fund to avoid borrowings between major revenue collection dates." NFA staff, in coordination with our outside accounting firm, determined that the accumulation of a reserve of $3.5 million, approximately one quarter's income, was reasonably within the budget goal established by the Board. On the basis of the overall budget goal, and including the excess of receipts over expenditures carried forward from FY 1983, the FCM Assessment Fee could be suspended as of April 1, 1984.

However, we have also reviewed our budget in recent weeks analyzing our actual expenditures for the first six months of FY 1984 and reforecasting our anticipated expenditures for the remaining six months of FY 1984. This examination has led us to the conclusion that our revised budget expenditures for FY 1984 will total only $10.3 million. Based on this revised budget and a reserve of $3.5 million the suspension of the FCM Assessment Fee could occur as early as February 15, 1984.

In addition to the difficulties associated with suspending the Assessment which were described in the introduction to this memorandum, if the Assessment Fee is suspended for the last quarter of FY 1984, the required Fee in FY 1985 will be higher than the Fee which could be charged if it were not suspended in FY 1984. To analyze the impact of suspending the Fee we have assumed that for practical reasons the suspension should take place as of April 1, 1984 even though it theoretically could take place sooner. The revenue impact on NFA of suspending the Fee for the last quarter of FY 1984 would not be felt until FY 1985 because Fees for the suspension period would not be due until July 30, 1984. Suspension of Fees for the last quarter of FY 1984 means NFA would only collect Fee revenue at the end of three rather than four quarters during FY 1985. The following table uses the formula discussed above to set out the Assessment Fee necessary to meet budget goals in FY 1985 over <u>three quarters of collection</u> at various budget levels.

Table I

Budget	Fee
$13.5 MM	$.29
14.0	.31
14.5	.33
15.0	.34
15.5	.36

Assumptions: 150 million contracts at 28% public participation
$6 million invested funds as of 6/30/84
$3.5 million cash reserve funded in FY 1985
$1.75 million income from sources other than Assessment Fee.

Alternative II.
Continue Assessment Fee at Current Level Until End of FY 1984 and Then Apply Formula to Reduce Fee for FY 1985 and Beyond.

This alternative is essentially in accordance with the routine annual "formula" approach outlined above. The following table shows the Fee for FY 1985 at various budget levels assuming 150 million contracts traded, 28% public participation, $1.75 million in FY 1985 income from other sources, a $6.0 million cash balance carried forward into FY 1985 and a cash reserve of $3.5 million.

Table II A

Budget	FCM Fee	% Reduction From Current Level
$13.5 MM	$.22	33.3%
14.0	.23	30.3
14.5	.24	27.3
15.0	.26	21.2
15.5	.27	18.2

The $6.0 million cash balance carried forward into FY 1985 will not, of course, be repeated every year. In subsequent years if the cash reserve to be funded in the next year equals the cash reserve from the prior year the two items should "wash" and Assessment Fees and Income from other sources must equal the budgeted expenditures. Therefore, assuming that the $3.5 million cash reserve for FY 1985 is kept constant thereafter and assuming that all increases in budget are to be covered by income from other sources, the following table projects the Assessment Fee into 1986 and beyond.

Table II B

	1985	1986	1987	1988	1989
Budget	$14.50	$15.50	$16.50	$17.50	$18.50
Other Income	(1.75)	(2.75)	(3.75)	(4.75)	(5.75)
Cash Carry Forward From Prior Year	(2.50)	0	0	0	0
Assessment Fee Target	$10.25	$12.75	$12.75	$12.75	$12.75
FCM Fee	$ .24	$ .30	$ .30	$ .30	$ .30

By establishing a higher cash reserve for FY 1985 and a lower reserve for FY 1986 the Board could reduce somewhat the drastic changes in the Fee through the period FY 1984-1985-1986. Roughly every cent added to the Assessment Fee in FY 1985 increases the cash reserve at the end of FY 1985 by $.5 million. For example, in fiscal 1985 at a budget of $14.5 million a $.26 Assessment Fee yields a cash reserve of slightly less than $4.5 million instead of the $3.5 million assumed in Table II A. This "extra" reserve could be carried into FY 1986 to reduce the Assessment Fee for that year.

Alternative III.
Implement Estimated Reduction in Fee (per formula) for FY 1985 Now (as of 4/1/84) and Continue at that Level through FY 1985.

This alternative is essentially identical to Alternative II except that the estimated reduction of the Fee per the formula as applied to the 1985 budget at the May Board meeting would be implemented as of April 1, 1984. This approach would not alter the way the formula is applied for FY 1985 but would reduce the first quarter collections in FY 1985 (July 30, 1984) and, therefore, would reduce the cash carry forward into FY 1986. This would tend to increase the pressure for the Fee to rise in FY 1986. As explained above, that pressure could be alleviated somewhat by increasing the cash reserve for FY 1985. The following table sets out some Fee alternatives for a sample budget for FY 1985 of $14.5 million.

Table III

FY 84 Fee (Last Qtr)	FY 85 Fee	FY 85 Targeted Reserve	FY 86 Fee	FY 86 Targeted Reserve
$.24	$.24	$3.4 MM	$.30	$2.7 MM
.25	.25	3.8	.29	2.7
.26	.26	4.2	.28	2.7
.27	.27	4.6	.27	2.7

Summary

The following table sets out the various alternatives described above along with a general description of what could happen to the Assessment Fee under each alternative. Of course, as demonstrated above, the precise level of the Fees shown will vary with different assumptions with respect to size of budget and cash reserves.

Table IV

Alternative		Fee 1984 (Last Qtr.)	1985	1986
I.	Suspend Assessment Fee 4/1/84	0	$.33	$.30
II.	Continue Assessment Fee for FY 1984 and Revise for FY 1985 Per Formula			
	A. Constant cash reserve	$.33	.24	.30
	B. Using cash reserve to reduce FY 1986 increase	.33	.26	.28
III.	Implement Reduction as of 4/1/84	.26	.26	.28

Attachment A

Alternatives

Assumptions

- 150,000,000 contracts traded
- 28% public participation
- $1,750,000 other income (interest income, dues, contract market fees, registration fees, testing, miscellaneous)
- $6,000,000 invested funds as of 6/30/84
- no FCM surcharge
- Reduction of contract market fee (as of 4/1/84)
- Current FCM assessment fee remains as is until 6/30/84

With Cash Reserve of $3,500,000

Budget	FCM Fee	% Reduction from Current Level
$13.5	22¢	33.3%
14.0	23	30.3
14.5	24	27.3
15.0	26	21.2
15.5	27	18.2

With Cash Reserve of $4,000,000

Budget	FCM Fee	% Reduction from Current Level
$13.5	24¢	27.3%
14.0	25	24.3
14.5	26	21.2
15.0	27	18.2
15.5	28	15.1

With Cash Reserve of $4,500,000

Budget	FCM Fee	% Reduction from Current Level
$13.5	25¢	24.3%
14.0	26	21.2
14.5	27	18.2
15.0	28	15.1
15.5	29	12.1

Higher Cash Cushion could help to reduce dramatic changes in FCM assessment fee in periods of reduced volume or low public participation and would also allow for unusual expenditures.

ARTHUR ANDERSEN &CO.

NATIONAL FUTURES ASSOCIATION

FORECASTED STATEMENTS OF CASH BASIS EXPENSES BY TYPE OF EXPENSE AND BY DEPARTMENT
FOR THE YEAR ENDING JUNE 30, 1984
TOGETHER WITH AUDITORS' REPORT

ARTHUR ANDERSEN & CO.

CHICAGO, ILLINOIS

To the Executive Committee of the
Board of Directors of
National Futures Association:

The accompanying forecasted statements of cash basis expenses by type of expense and by department and the related assumptions and reasons for increase (decrease) contained in Schedules A through P of National Futures Association for the year ending June 30, 1984, are management's estimate of the most probable cash basis expenses for the forecast period. Accordingly, the forecast of cash basis expenses reflects management's judgment based on present circumstances of the most likely set of conditions and its most likely course of action.

We have made a review of the statements and related schedules referred to above in accordance with the applicable guidelines for a review of a financial forecast as established by the American Institute of Certified Public Accountants (AICPA). Our review included procedures to evaluate both the assumptions used by management and the preparation and presentation of the forecast of cash basis expenses. We have no responsibility to update this report for events and circumstances occurring after the date of this report.

The guidelines for presentation of financial forecasts as established by the AICPA contemplate the inclusion of statements and information in addition to a forecasted statement of expenses. Forecasted statements of revenues and changes in financial position would also be required in a financial forecast and, therefore, the accompanying statements do not conform to the guideline.

Based on our review, we believe that the accompanying forecasted statements of cash basis expenses by type of expense and by department and the related Schedules A through P have been prepared on the basis of the assumptions as described, and we believe that the underlying assumptions provide a reasonable basis for management's forecast. However, some assumptions inevitably will not materialize and unanticipated events and circumstances may occur; therefore, the actual results achieved during the forecast period will vary from the forecast and the variations may be material.

This report is solely for the information of the Executive Committee and the Board of Directors of National Futures Association in their review of the 1984 budget and it is not to be used for any other purposes.

Arthur Andersen & Co.

Chicago, Illinois,
February 3, 1984.

NATIONAL FUTURES ASSOCIATION

FORECASTED STATEMENT OF CASH BASIS EXPENSES BY TYPE OF EXPENSE

YEAR ENDING JUNE 30, 1984

	Index of Schedules	Budget Original	Budget Revised	Increase (Decrease)
OPERATING EXPENSES:				
Salaries and related expenses	A	$ 5,006,630	$ 4,834,878	$ (171,752)
Travel and meetings	B	1,880,841	979,374	(901,467)
Computer services	C	953,530	1,074,850	121,320
Outside fees and services	D	399,928	301,470	(98,458)
Telephone expenses	E	141,850	165,587	23,737
Utilities	-	52,000	42,000	(10,000)
Space rental	F	450,000	413,800	(36,200)
Furniture and fixtures	-	3,270	6,970	3,700
Equipment	G	152,612	114,980	(37,632)
Construction costs	H	75,000	106,000	31,000
Board and committee fees	I	394,100	190,000	(204,100)
Arbitration expense	J	156,000	15,252	(140,748)
Registration testing and forms development	-	50,000	25,000	(25,000)
Postage, printing and publications	K	411,725	298,112	(113,613)
Interest expense	L	275,000	35,000	(240,000)
Office supplies, insurance and other operating expenses	M	180,462	166,801	(13,661)
Total operating expenses		$10,582,948	$ 8,770,074	$(1,812,874)
CAPITAL EXPENDITURES:				
Furniture and fixtures	N	$ 690,910	$ 708,000	$ 17,090
Construction costs	O	392,000	540,000	148,000
Telephone lease	P	103,966	235,966	132,000
Computer equipment	-	72,100	77,375	5,275
Equipment	-	9,076	15,476	6,400
Total capital expenditures		$ 1,268,052	$ 1,576,817	$ 308,765
Total		$11,851,000	$10,346,891	$(1,504,109)

See accompanying Summary of Significant Accounting Policies.

NATIONAL FUTURES ASSOCIATION

FORECASTED STATEMENT OF CASH BASIS EXPENSES BY DEPARTMENT

YEAR ENDING JUNE 30, 1984

	Budget Original	Budget Revised	Increase (Decrease)
OPERATING EXPENSES:			
Administration	$ 646,401	$ 630,340	$ (16,061)
Board and Committees	394,100	190,000	(204,100)
Compliance-			
Chicago	3,914,572	3,229,623	(684,949)
New York	761,621	536,064	(225,557)
General Counsel	861,604	543,146	(318,458)
Information Systems	582,817	413,387	(169,430)
Occupancy	1,014,717	490,817	(523,900)
Office Services	155,858	130,133	(25,725)
Personnel	199,878	182,586	(17,292)
Public Affairs	224,467	365,953	141,486
Registration	1,217,258	1,508,720	291,462
Treasurer's Office	609,655	549,305	(60,350)
Total operating expenses	$10,582,948	$ 8,770,074	$(1,812,874)
CAPITAL EXPENDITURES:			
Occupancy	$ 1,195,952	$ 1,499,442	$ 303,490
Information Systems	72,100	77,375	5,275
Total capital expenditures	$ 1,268,052	$ 1,576,817	$ 308,765
Total	$11,851,000	$10,346,891	$(1,504,109)

See accompanying Summary of Significant Accounting Policies.

NATIONAL FUTURES ASSOCIATION

1984 BUDGET

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The forecasted statements of cash basis expense by type of expense and by department have been prepared on a cash basis rather than the accrual basis of accounting, which was used to prepare the financial statements as of June 30, 1983. As such, the 1984 forecasted statements do not include, among other things, the incremental change in accounts payable and accrued expenses during 1984 or depreciation expense which management believes will approximate $300,000 for the year ended June 30, 1984.

NATIONAL FUTURES ASSOCIATION

1984 BUDGET

SALARIES AND RELATED EXPENSES

A. SUMMARY:

Original budget	$5,006,630
Decrease	(171,752)
Revised budget	$4,834,878

B. REASONS FOR INCREASE (DECREASE) IN ORIGINAL BUDGET:

Hiring at less than projected levels, primarily Compliance Department	$ (370,373)
Hiring at greater than projected levels, primarily Registration Department	227,238
Reductions in employee benefits	(78,849)
Additional recruiting costs	50,232
	$ (171,752)

C. ASSUMPTIONS UNDERLYING ORIGINAL BUDGET:

1. Number of employees would increase from approximately 110 at June 30, 1983, to 177 at June 30, 1984

2. Salary increases are based on stated percentages from NFA's Salary Guidelines for performance levels

3. Components of original budget-

Wages	$4,070,551
Employee benefits	725,797
Recruiting	85,770
Tuition reimbursement	52,640
Other	71,872
	$5,006,630

NATIONAL FUTURES ASSOCIATION

1984 BUDGET

TRAVEL AND MEETINGS

A. SUMMARY:

Original budget	$1,880,841
Decrease	(901,467)
Revised budget	$ 979,374

B. REASONS FOR DECREASE IN ORIGINAL BUDGET:

1. Completion of out-of-town assignments under budget
2. Use of discounted airfares when available
3. Lower than projected staff level for Compliance Department resulting in fewer audits and reviews than budgeted

C. ASSUMPTIONS UNDERLYING ORIGINAL BUDGET:

1. See Schedule A for assumption concerning increase in the number of employees
2. Performance of approximately 450-500 audits and reviews by the Compliance Department
3. Coach airfare

NATIONAL FUTURES ASSOCIATION

1984 BUDGET

COMPUTER SERVICES

A. SUMMARY:	
Original budget	$ 953,530
Increase	121,320
Revised budget	$1,074,850
B. REASONS FOR INCREASE (DECREASE) IN ORIGINAL BUDGET:	
Decision not to purchase a compliance system	$ (100,000)
Design and programming of new compliance system	400,000
Reduction of estimate for enhancements to current systems	(150,000)
Reduction in computer equipment lease and maintenance fees	(42,820)
Other, net	14,140
	$ 121,320
C. ASSUMPTIONS UNDERLYING ORIGINAL BUDGET:	
Computer processing services	$ 459,020
Systems development fees--registration	250,000
Computer consulting services	240,000
Other	4,510
	$ 953,530

NATIONAL FUTURES ASSOCIATION

1984 BUDGET

OUTSIDE FEES AND SERVICES

A. SUMMARY:	
Original budget	$399,928
Decrease	(98,458)
Revised budget	$301,470
B. REASONS FOR INCREASE (DECREASE) IN ORIGINAL BUDGET:	
Use of an outside writer and public relations firm	$ 76,000
Outside legal fees	(57,598)
Use of FBI for fingerprint verifications	25,353
Wire services fees and bank service charges	(7,213)
Other consulting fees and outside services	(135,000)
	$(98,458)
C. ASSUMPTIONS UNDERLYING ORIGINAL BUDGET:	
Outside audit fees	$ 25,000
Outside legal fees	106,000
Wire services fees and bank service charges	34,918
Other consulting fees and outside services	234,010
	$399,928

NATIONAL FUTURES ASSOCIATION

1984 BUDGET

TELEPHONE EXPENSES

A. SUMMARY:

Original budget	$141,850
Increase	23,737

Revised budget	$165,587
	========

B. REASON FOR INCREASE IN ORIGINAL BUDGET-- telephone usage greater than original estimate

telephone usage greater than original estimate	$23,737
	=======

C. ASSUMPTIONS UNDERLYING ORIGINAL BUDGET:

Chicago telephone expense	$127,330
New York telephone expense	14,520

	$141,850
	========

NATIONAL FUTURES ASSOCIATION

1984 BUDGET

SPACE RENTAL

A. SUMMARY:	
Original budget	$450,000
Decrease	(36,200)

Revised budget	$413,800
	========
B. REASONS FOR DECREASE IN ORIGINAL BUDGET:	
Move into New York office delayed until mid-February, 1984	$(30,000)
Other, net	(6,200)

	$(36,200)
	========
C. ASSUMPTIONS UNDERLYING ORIGINAL BUDGET:	
Chicago rent	$250,000
New York rent	200,000

	$450,000
	========

NATIONAL FUTURES ASSOCIATION

1984 BUDGET

EQUIPMENT

A. SUMMARY:

Original budget	$152,612
Decrease	(37,632)
Revised budget	$114,980

B. REASONS FOR DECREASE IN ORIGINAL BUDGET-- equipment scheduled to be leased in fiscal 1984 was purchased instead. $(37,632)

C. ASSUMPTIONS UNDERLYING ORIGINAL BUDGET:

Copier expense	$ 67,904
Lease payments--word processing equipment	38,820
Word processing supplies	32,540
Other	13,348
	$152,612

NATIONAL FUTURES ASSOCIATION

1984 BUDGET

CONSTRUCTION COSTS

A. SUMMARY:	
Original budget	$ 75,000
Increase	31,000
Revised budget	$106,000
B. REASON FOR INCREASE IN ORIGINAL BUDGET--increase in space design fees	$ 31,000
C. ASSUMPTION UNDERLYING ORIGINAL BUDGET--space design fees	$ 75,000

NATIONAL FUTURES ASSOCIATION

1984 BUDGET

BOARD AND COMMITTEE FEES

A. SUMMARY:	
Original budget	$ 394,100
Decrease	(204,100)
Revised budget	$ 190,000
B. REASONS FOR DECREASE IN ORIGINAL BUDGET--number of meetings, attendees at each meeting and related expenses will be less than planned	$(204,100)
C. ASSUMPTIONS UNDERLYING ORIGINAL BUDGET:	
Board of Directors (4 meetings--100% attendance by 40 directors)	$ 161,000
Executive Committee (12 meetings--100% attendance by 9 members)	56,250
Business Conduct Committee (3 committees with 9 members on each committee--21 meetings with 100% attendance)	79,600
Membership Committee (10 meetings--100% attendance by 9 members)	47,500
Advisory Committee (3 meetings--100% attendance by 11 members)	25,500
Appeals Committee (3 meetings--100% attendance by 9 members)	18,000
Nominating Committee (1 meeting--100% attendance by 15 members)	6,250
	$ 394,100

NATIONAL FUTURES ASSOCIATION

1984 BUDGET

ARBITRATION EXPENSE

A. SUMMARY:

Original budget	$156,000
Decrease	(140,748)
Revised budget	$ 15,252

B. REASONS FOR DECREASE IN ORIGINAL BUDGET:

1. Less than anticipated number of cases (approximately 50 cases either in process or settled through January 31, 1984)

2. More than half of the cases have been settled without a hearing

3. A majority of the cases have been instituted in Chicago

C. ASSUMPTIONS UNDERLYING ORIGINAL BUDGET:

1. 180 arbitration cases

2. Substantial portion of the cases would involve a hearing

3. Cases would be instituted throughout the country

4. Components of the original budget:

Meetings	$120,000
Fees and expenses	36,000
	$156,000

NATIONAL FUTURES ASSOCIATION

1984 BUDGET

POSTAGE, PRINTING AND PUBLICATIONS

A. SUMMARY:

Original budget	$ 411,725
Decrease	(113,613)
Revised budget	$ 298,112

B. REASON FOR INCREASE (DECREASE) IN ORIGINAL BUDGET:

Additional publications and additional costs for budgeted publications	$ 89,365
Payments required by contract for the NFA Manual were spread over three fiscal years (total amount originally budgeted in fiscal 1984):	(93,962)

1983	$ 45,000
1984	60,000
1985	15,000
	$120,000

Reduction in printing costs due to use of U. S. Government supplied forms	(93,462)
Decrease in number of mass mailings	(15,554)
	$(113,613)

C. ASSUMPTIONS UNDERLYING ORIGINAL BUDGET:

NFA publications	$ 195,200
Outside printing and duplicating, primarily forms	120,190
Postage	96,335
	$ 411,725

NATIONAL FUTURES ASSOCIATION

1984 BUDGET

OFFICE SUPPLIES, INSURANCE AND OTHER OPERATING EXPENSES

A. SUMMARY:	
Original budget	$180,462
Decrease	(13,661)
Revised budget	$166,801
B. REASONS FOR INCREASE (DECREASE) IN ORIGINAL BUDGET:	
Decrease in office supplies, primarily Registration Department	$(20,159)
Other, net	6,498
	$(13,661)
C. ASSUMPTIONS UNDERLYING ORIGINAL BUDGET:	
Dues and subscriptions	$ 38,229
Office supplies	116,563
Insurance	25,670
	$180,462

NATIONAL FUTURES ASSOCIATION

1984 BUDGET

INTEREST EXPENSE

A. SUMMARY:	
Original budget	$ 275,000
Decrease	(240,000)

Revised budget	$ 35,000
	=========
B. REASON FOR DECREASE IN ORIGINAL BUDGET-- borrowing costs will be minimal in fiscal 1984	$(240,000)
	=========
C. ASSUMPTION UNDERLYING ORIGINAL BUDGET-- borrowings would occur during fiscal 1984	

NATIONAL FUTURES ASSOCIATION

1984 BUDGET

FURNITURE AND FIXTURES

A. SUMMARY:	
Original budget	$690,910
Increase	17,090

Revised budget	$708,000
	========
B. REASONS FOR INCREASE (DECREASE) IN ORIGINAL BUDGET:	
New York	$ 90,000
Chicago	(72,910)

	$ 17,090
	========
C. ASSUMPTIONS UNDERLYING ORIGINAL BUDGET:	
New York	$ 80,000
Chicago	610,910

	$690,910
	========

NATIONAL FUTURES ASSOCIATION

1984 BUDGET

TELEPHONE LEASE

A. SUMMARY:	
Original budget	$103,966
Increase	132,000
Revised budget	$235,966
B. REASONS FOR INCREASE IN ORIGINAL BUDGET:	
Expansion of telephone capacity (Chicago)	$ 75,000
Purchase of new telephone equipment for 15th floor (Chicago)	35,000
Telephone equipment for New York office	22,000
	$132,000
C. ASSUMPTION UNDERLYING ORIGINAL BUDGET-- payments for leased telephone equipment	$103,966

NATIONAL FUTURES ASSOCIATION

1984 BUDGET

CONSTRUCTION COSTS

A. SUMMARY:	
Original budget	$392,000
Increase	148,000
Revised budget	$540,000
B. REASONS FOR INCREASE IN ORIGINAL BUDGET:	
Additional New York construction costs	$ 75,000
Additional Chicago construction costs	40,000
Installation of audiovisual equipment and security access system (Chicago)	33,000
	$148,000
C. ASSUMPTIONS UNDERLYING ORIGINAL BUDGET:	
Preparation of and move to 15th floor (Chicago)	$242,000
Improvements to New York office space	150,000
	$392,000

ARTHUR ANDERSEN & CO.

NATIONAL FUTURES ASSOCIATION

REPORT ON REVIEW OF BUDGETING PROCESS AND METHODS FOR DETERMINING FCM ASSESSMENT FEES

ARTHUR ANDERSEN & CO.

33 WEST MONROE STREET
CHICAGO, ILLINOIS 60603
(312) 580-0033

February 3, 1984

To the Executive Committee of the
Board of Directors of
National Futures Association:

As you requested, we performed a review of the forecasted expenses for the National Futures Association for fiscal 1984. Our report dated February 3, 1984, has been issued separately. In connection with this review, we studied the general approach and related policies used by NFA management in formulating the fiscal 1984 budget. We have also reviewed alternative methods for determining assessment fees charged to FCMs.

In the following report, we have summarized our review of the budgeting process and include our suggested approach for determining capital requirements and establishing a "financial policy." We have also summarized the pros and cons of the alternative methods for determining assessment fees charged to FCMs and specifically addressed the "formula method" proposed by management.

In the attached Exhibit, we have summarized certain financial data of the NASD and various commodities and securities exchanges. This may be useful in providing perspective as to NFA's capital requirements.

We would be pleased to discuss any aspect of this report with you at your convenience.

Very truly yours,

ARTHUR ANDERSEN & CO.

Arthur Andersen & Co.

by Mitchell R. Fulscher

THE BUDGETING PROCESS

The budgeting process represents a fundamental aspect of the management of any organization. In the case of the NFA, this process is essential in making informed decisions regarding broad policies, ranging from the amounts of fees and dues charged to members to decisions pertaining to the breadth and timing of program implementation. The NFA is still in its "start-up phase." Therefore, the budgeting process is a unique challenge to management since there is no historical information on program costs to help forecast future expenditures. In addition, there are significant nonrecurring start-up costs and significant capital budget requirements for leaseholds and equipment which must be funded. These funding requirements must be balanced with the needs and pressures of outside constituencies including the membership, government and the public.

Major considerations in preparing a budget are the capital requirements, normal operating expenses and the sources of revenue.

Capital Requirements

Capital can be defined as a combination of equity (or net worth) plus borrowed funds. For purposes of this discussion, we will generally refer to equity as being the source of capital.

As with most other organizations, the NFA requires capital to operate. Although NFA is not a manufacturing entity with requirements to invest in plant or inventories, there are similarities in that NFA needs capital for the funding of (1) the "cash flow gap," (2) fixed assets and (3) a capital reserve. During the first period of operation, the NFA budgetary process has focused on the cash requirements for each year. At this time, it is necessary to determine and consider the longer term capital requirements for NFA.

Cash Flow Gap-

The major portion of NFA's revenues are derived from assessment fees. These fees are not received on a current basis, but rather are due 30 days after the end of the fiscal quarter. This means that although fees are accruing daily, there will be up to three or four months of uncollected revenue. On the other hand, the NFA must pay its salaries twice a month and most of its other expenditures at least once a month. Inherent in NFA's revenue structure, therefore, is a "cash flow gap." This results in a mandate that NFA maintain capital for an amount at least equal to this "cash flow gap."

Fixed Assets

During the first year of operation, NFA invested $1.6 million in fixed assets consisting of leasehold improvements, furniture and equipment. An additional $1.5 million of expenditures is anticipated for fiscal 1984. It is likely that until the initial growth of the Association has stabilized, there will be additional requirements over the next few years. This represents significant capital requirements.

Capital "Reserve"

The NFA also must maintain some amount of additional capital to provide for variances between actual and budgeted revenues and expenses. With respect to revenues, NFA is extremely vulnerable to changes in the volume of futures activity in the industry. In fact, volume changes affect NFA to a greater extent than a FCM is affected by similar volume changes. In the case of a FCM, reduced commission income is offset by reduced commissions paid to AE's and others. That is not the case for NFA since assessment fees go straight to the "bottom line." Although only some of NFA's costs and expenses truly are "fixed," in reality most expenses cannot be reduced during a short-term period. Indeed, on a longer term basis, they are only variable to the extent that NFA's programs are changed. Of course, assessments per trade and fees could be increased if the volume of futures industry activity declines. But, it must be recognized that there will be increased industry pressure to reduce fees during such times.

Summary

The NFA should consider the total capital requirements for the next few years and develop a plan as to when and how these capital requirements will be met. This calculation has implications to current-year budgeting and ultimately to the amount of assessment fees charged.

Statement of Financial Policy

The budgeting process involves many considerations as to how an organization is to be run. However, there are certain fundamental precepts which form a basis for budgeting action, both long term and short term.

o Should the annual operating budget be balanced?

o Should budgets show a surplus?

o How will the capital budget be financed? Pay as you go?

o What are the policies regarding bank borrowings?

o How much additional capital reserves are desirable?

Presumably, these questions have been considered by the Executive Committee in determining budget policy. They are implicit in actions taken to date. We believe the Board of Directors should formally adopt a Statement of Financial Policy which addresses these questions.

To some extent, these policies will represent a statement of "objectives" since at times they may not be achievable. For example, it may be necessary to operate at a deficit in a particular year even though the policy will require a balanced budget.

The adoption of a financial policy in this area will help management have the appropriate direction in guiding NFA. In addition, it may be useful to include a summary of this policy in the published annual report as an explanation of NFA's direction and the relationship of its annual surplus to overall capital needs.

ASSESSMENT FEES

The major portion of NFA's revenue is derived from FCM assessment fees. This fee is based directly on the volume of customer generated transactions in the futures industry. NFA's revenue for each period, therefore, will vary based upon the futures industry volume of business and the percentage of customer transactions. As a part of the overall budgeting process, there are two approaches available to deal with the variability of this major revenue source:

1. Temporary suspension or adjustment of assessment fee on an interim basis.

2. Adjust for variances in the following year.

The NFA Bylaws (1301(b)) refer to the possibility of the temporary suspension of assessment fees when revenues reach desired levels.1 This approach would be applicable in the case where variances in either revenues or expenditures are producing "excess revenue."

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[1]Bylaws 1301(b) provides that "such assessments shall be suspended by the Board during any fiscal year when in the judgment of the Board the budget goals of NFA for the fiscal year, as prescribed by the Board under Section 6 of Article VII, have been met."

Article VII, Section 6 of the Articles of Incorporation provides that "The Board shall establish for observance by the Executive Committee (see Article VIII) and NFA staff major plans and priorities, including those regarding the commitment and expenditure of NFA funds."

As an alternative to this method, management has suggested the second approach whereby current-year variances would be factored into the budget in the following year.

Pros and Cons

There are advantages and disadvantages to each of the above methods of dealing with budget variances in a year when "excess revenue" is developing. Following is a summary of the pros and cons of each approach:

I. Cease Fees in Midyear

A. Advantages-

- Easy to control NFA operation--This method provides precision in determining the year's results. Fees are cut off when the absolute amount of required revenues are in hand.

- Reduces the possibility of requiring an increase in fees--A conservative budgeting approach can be used for revenues without concern about creating excess reserves.

- Negative budget variances have less public visibility--The assessment fee could be continued throughout the year even though originally budgeted to cease earlier in the year. There would be little public reaction to the failure to cease fees in midyear (as contracted with being required to increase fees if the budget is not met).

- <u>Futures Industry has experienced this approach</u>--The CME has used this method for its clearance fees for many years.

B. <u>Disadvantages</u>-

- <u>Interim changes are disruptive</u>--Commissions and arrangements with customers may be impacted by these changes which could be disruptive. FCM's information system may be impacted.

- <u>Difficulty in understanding "on/off" fee changes.</u>

- <u>Creates impression that fee is too large</u>--The public may feel that if the NFA is able to cut off their fees, then the fee must be too high.

- <u>Image of "poor budgeting"</u>--The public may think that the NFA is not adequately preparing its budget if fees are turned on and off.

- <u>Weakened budget restraints</u>--Some might perceive that there would be less pressure on the NFA to meet their budget.

II. Adjust Fees in Following Year

In addition to the pros and cons listed above, considerations dealing specifically with the second method for adjusting fees in the following year are as follows:

A. Advantages-

- Smooths out changes in fee--Prospective adjustments to assessment fees can be accomplished more smoothly. This may be helpful in facilitating arrangements with customers and improve overall public image.

- Focus on long-range planning--It becomes imperative that long-range planning and forecasting be implemented to make this method work well.

B. Disadvantages-

- Difficulty in raising fees--Any shortfall in one year must be made up in the following year. If changes are only made prospectively at the beginning of the next year, known shortfalls are not dealt with immediately but begin to accumulate.

- Requires greater capitalization--Since the NFA must be able to absorb shortfalls for periods of time, there must must be a greater capital base or surplus.

"Formula Method" for Adjusting Fees

Management has prepared a formula for determining prospective FCM assessment fees. This formula is designed to accomplish the goals of alternative Number 2. above. This formula is described in a draft of a memorandum to the Board of Directors dated February 2, 1984.

Implication of Bylaws-

As noted earlier, the Bylaws suggest "temporary suspension" rather than prospective adjustment of assessment fees. However, the present Bylaws are fairly general in this regard. It would seem that Alternative 2. could meet an interpretation of the Bylaws. If the Board considers the subsequent year's budget plans in evaluating current year's "budget goals", it would appear that this approach would be permissible. The Board of Directors could conclude that anticipated variances in the current year are useable (or would be made up) as a part of the following year's budget.

Comments on Formula-

We have reviewed the formula as described and have determined that it would accomplish its stated purpose.

It should be recognized, however, that inherent in this formula are certain important aspects which we have highlighted below:

1. There will be no revenue adjustments for known or anticipated revenue or expenditure variances until the following year (i.e., assessment fees will only be adjusted for customer transactions beginning July 1).

2. Capital expenditures in any year will be funded out of that same year's current revenues.

3. The amount of available cash balance at each fiscal year-end will drive the formula.

4. A cash reserve will be maintained (proposed at $3.5 million).

This formula focuses on cash balances at the fiscal year-end. Accrual basis items are not considered. Determination of cash flow projections are, of course, essential for managing any organization and this formula fits in well with the determination of cash flow requirements. On the other hand, additional reconciliations to accrual basis data will be necessary to relate to developments of financial resources and capital requirements.

Further, it must be recognized that any formula, although an effective tool, does have limitations. It is likely that from time-to-time there will be other important considerations in the final determination of assessment fees. It will be important, for example, to consider prospective budget requirements beyond the forthcoming year. In the case of a major capital improvement, it may not be reasonable to expect to fund the expenditure out of one year's revenues. It would be better to begin to anticipate those needs and provide funds in earlier years or otherwise spread the requirement over several funding periods. Anticipated changes in the NFA's programs in future years or perhaps anticipated volume changes and its effect on assessment fees may represent important considerations which cannot be contained in any single formula.

Recommendations

1. Assessment fees will periodically require revision through one method or another. We suggest that the Bylaws be amended to eliminate the stated amount of the fee. Authority for setting fees should be vested directly with the Board of Directors.

2. The "Formula" should be considered a tool rather than a mechanical provision of the Bylaws.

3. As the budgeting practice becomes further refined, all information should be prepared on an accrual basis which will be consistent with the year-end financial statements.

4. Primary attention should be placed on overall capital requirements rather than cash balance.

FINANCIAL DATA FOR SECURITIES/COMMODITIES EXCHANGES

	Capital	Revenue	Fixed Assets	Total Assets
		(in millions)		
National Association of Securities Dealers, Inc.	$ 38	$ 55	$ 27	$ 53
Chicago Board of Trade	35	45	116	134
Board of Trade Clearing Corporation	15	9	3	16
Chicago Mercantile Exchange	48	43	5	447
Chicago Board Options Exchange, Incorporated	31	46	14	68
New York Stock Exchange, Inc.	121	169	65	191
American Stock Exchange, Inc. and Subsidiaries	35	57	15	53
Midwest Stock Exchange	11	29	3	96
	===	===	===	===

Source: Published annual reports dated December 31, 1982, except for American Stock Exchange (December 31, 1981), Chicago Board Options Exchange (June 30, 1983) and National Association of Securities Dealers, Inc. (September 30, 1982).

COMMODITY FUTURES TRADING COMMISSION
2033 K STREET, N.W., WASHINGTON, D.C. 20581

DIVISION OF
TRADING AND MARKETS

March 8, 1984

Mr. Joseph H. Harrison, Jr.
General Counsel and Secretary
National Futures Association
200 West Madison Street
Chicago, Illinois 60606

Dear Mr. Harrison:

On March 2 the Commission received your February 29 letter submitting, among other proposals, NFA's new Bylaw 705 establishing a Finance Committee which will advise the Executive Committee on matters of NFA financial policy. This particular proposal was submitted under the provision in section 17(j) of the Act that permits a rule change proposed by a registered futures association to take effect ten days after Commission receipt unless the Commission notifies the association in writing that the Commission determined to review the proposal for approval. This is to advise you that the Division has not recommended that the Commission review the proposal for approval and that accordingly the proposed rule may be made effective.

Yours truly,

Linda Kurjan
Special Counsel
Registered Futures Associations

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GENERAL COUNSEL'S OFFICE

UNITED STATES OF AMERICA
COMMODITY FUTURES TRADING COMMISSION
2033 K Street, N.W.
Washington, D.C. 20581

March 22, 1984

Mr. Joseph J. Harrison, Jr.
General Counsel
National Futures Association
200 West Madison Street
Chicago, Illinois 60606

Re: Proposed Amendments to Bylaw 1301(a) and (b)

Dear Mr. Harrison:

By letter dated February 29, 1984, you submitted, among other NFA rule changes not addressed at this time, the captioned bylaw amendments under section 17(j) of the Commodity Exchange Act. The proposed amendments reduce the transaction assessments paid to NFA by contract market members and futures commission merchant members. The Commission approved these fee revisions on March 21, 1984 and determined that they may be implemented as proposed on April 1, 1984.

While the Commission is pleased that NFA undertook an extensive reevaluation of the assessment fee structure which led to the proposals the Commission has just addressed, the Commission again reminds NFA that it expects NFA to reexamine its revenue and budgetary program on an ongoing basis to assure that it fairly and equitably allocates charges to defray expenses.

Very truly yours,

Jane K. Stuckey

Jane K. Stuckey
Secretary of the Commission

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GENERAL COUNSEL'S OFFICE

UNITED STATES OF AMERICA
COMMODITY FUTURES TRADING COMMISSION
2033 K Street, N.W.
Washington, D.C. 20581

MAY 7 1984

May 4, 1984

Mr. Joseph H. Harrison, Jr.
General Counsel and Secretary
National Futures Association
200 West Madison Street
Chicago, Illinois 60606

Re: Section II(a) of Schedule A (Bylaw 305) and Compliance Rule 2-24

Dear Mr. Harrison:

By your letter of September 1, 1983, NFA submitted, among other things, Section II(a) of Schedule A for Commission approval pursuant to section 17(j) of the Commodity Exchange Act. This proposal establishes a testing requirement for certain applicants for registration as associated persons of introducing brokers ("AP/"IB"). The requirement will operate as a condition of registration for APs/IBs. NFA supplemented the original submission by letter dated January 3, 1984. Subsequently, NFA submitted Compliance Rule 2-24 for Commission approval (your letter dated February 29, 1984). This second proposal establishes a testing requirement for certain associated persons of NFA-member futures commission merchants ("AP/FCM"). Unlike the AP/IB proposal, AP/FCM testing will operate as a compliance requirement affecting the employing FCM. This is to inform you that the Commission approved the proposed rule on May 4, 1984. Both Section II(a) and Compliance Rule 2-24 may be made effective immediately.

In approving the testing requirements, the Commission relies upon section 17 of the Act and NFA's commitment to establish appropriate standards of training and experience to serve as an effective alternative measure of the proficiency of those APs/IB and APs/FCM who are not required by these rules to take and pass the National Commodity Futures Examination. Although NFA has until September 30, 1985, to implement such alternative proficiency criteria, the Commission urges NFA to develop those standards as soon as possible. Similarly, the Commission urges NFA not to delay proposing appropriate testing and other proficiency requirements for IB applicants who are individuals, since the Commission has also granted NFA registration responsibilities over the introducing broker category of registrants, as well as all other individuals within NFA's regulatory jurisdiction who are involved in the solicitation of transactions subject to the provisions of the Act and their supervisors.

In this regard, the Commission requests NFA to provide within 60 days a detailed description of NFA's plans to develop and implement the remaining elements of the comprehensive program mandated by sections 17(p)(1) and (q) of the Act. This information should cover (but not be limited to) the particular types of standards being developed, the minimum qualifications preliminarily being considered to demonstrate sufficient proficiency and skill under each standard, and a timetable for implementing these standards for each category of NFA members and associates and for each category of registrant for which NFA acquires responsibilities.

The Commission expects NFA to justify any substitution of other standards in place of testing requirements by demonstrating how these standards will assure equivalent expertise by an individual. In this regard, any use of work experience in establishing such other standards should include an analysis explaining how such experience would demonstrate at least a comparable level of expertise. Moreover, the Commission expects NFA, in developing these plans, to reevaluate the two testing rules approved herein and provide an assessment as to what adjustments may be needed to assure that all APs of IBs and APs of FCMs will demonstrate a satisfactory level of expertise.

Although the Commission's approval will be necessary to institute the additional standards which must be adopted in fulfillment of section 17(p)(1), the information that NFA is being asked to provide now is being requested to apprise the Commission of NFA's plans and to assist it in monitoring NFA's progress and will, of course, not be viewed as a submission under section 17(j) of the Act. If you have any questions concerning this Commission request, please contact Linda Kurjan, Special Counsel in the Division of Trading and Markets, at (202) 254-8955.

Very truly yours,

Jane K. Stuckey

Jane K. Stuckey
Secretary of the Commission