

May 29, 2012

**Via Federal Express**

Mr. David A. Stawick  
Office of the Secretariat  
Commodity Futures Trading Commission  
Three Lafayette Centre  
1155 21st Street, N.W.  
Washington, DC 20581

Re: National Futures Association: Protection of Customer Funds – Proposed Amendment to NFA Financial Requirements Section 4 and Adoption of NFA Financial Requirements Section 16 and its Related Interpretive Notice Regarding FCM Financial Practices and Excess Segregated Funds/Secured Amount Disbursements\*

Dear Mr. Stawick:

Pursuant to Section 17(j) of the Commodity Exchange Act, as amended, National Futures Association (“NFA”) hereby submits to the Commodity Futures Trading Commission (“CFTC” or “Commission”) the proposed amendment to NFA Financial Requirements Section 4 and the proposed adoption of NFA Financial Requirements Section 16 and its related Interpretive Notice entitled *NFA Financial Requirements Section 16: FCM Financial Practices and Excess Segregated Funds/Secured Amount Disbursements.* NFA’s Board of Directors (“Board”) approved the proposal on May 17, 2012, and NFA respectfully requests Commission review and approval of the proposal.

---

**PROPOSED AMENDMENTS**

**(additions are underscoring and deletions are ~~stricken through~~)**

---

**FINANCIAL REQUIREMENTS**

**SECTION 4. FINANCIAL REQUIREMENTS AND TREATMENT OF CUSTOMER PROPERTY.**

- (a) Any Member FCM, RFED, or IB who violates any of CFTC Regulations 1.10, 1.12, 1.16, 1.17 1.20 through 1.30, 5.6, ~~or~~ 30.7 (as applicable) shall be deemed to have violated an NFA Requirement.

\* \* \*

**SECTION 16. FCM FINANCIAL PRACTICES AND EXCESS SEGREGATED FUNDS/SECURED AMOUNT DISBURSEMENTS.**

- (a) Each Member FCM must maintain written policies and procedures regarding the maintenance of the FCM's residual interest in its customer segregated funds account(s) as identified in CFTC Regulation 1.20 and in its foreign futures and foreign options customer secured amount funds account(s) as identified in CFTC Regulation 30.7. The written policies and procedures must target amounts (either by percentage or dollars) that the FCM seeks to maintain as its residual interest in both customer segregated funds and foreign futures and foreign options customer secured amount funds and be designed to reasonably ensure the FCM maintains these target amounts. The FCM's Board of Directors or similar governing body, Chief Executive Officer (CEO) or Chief Financial Officer (CFO) must approve in writing the FCM's targeted residual amount, any change(s) thereto, and any material change(s) in the FCM's written policies and procedures regarding the maintenance of the FCM's residual interest in either the customer segregated funds account(s) or the foreign futures and foreign options customer secured amount funds account(s).
- (b) No Member FCM via a single or multiple transaction(s) may withdraw, transfer or otherwise disburse funds (disbursement) from any customer segregated funds account(s) as identified under CFTC Regulation 1.20 that exceed twenty-five percent (25%) of the FCM's residual interest in customer segregated funds based upon the most current daily segregated funds calculation performed pursuant to CFTC Regulation 1.32 unless:
- (i) The FCM's CEO, CFO or other designated individual(s) who holds a position with knowledge of the FCM's financial requirements and financial position and is listed as a principal on the firm's Form 7-R (for purposes of this Section only, a "Financial Principal") pre-approves in writing the segregated funds disbursement whereby the FCM exceeds or will exceed the twenty-five percent (25%) threshold referred to in (b) above; and
- (ii) The FCM files written notice signed by the FCM's CEO, CFO or Financial Principal in the form and manner prescribed by NFA immediately after the FCM's CEO, CFO or Financial Principal pre-approves in writing the disbursement whereby the FCM exceeds or will exceed the twenty-five percent (25%) threshold referred to in (b) above, which includes the following:

- (1) Notification that the FCM has made or intends to make a disbursement(s) from segregated funds that exceeds or will exceed twenty-five percent (25%) of the FCM's residual interest in customer segregated funds based upon the most current daily segregated funds calculation performed pursuant to CFTC Regulation 1.32;
  - (2) A description of the reason(s) for, the amount and recipients of the single or multiple transaction(s) that results or will result in the disbursement(s) that exceeds the twenty-five percent (25%) threshold;
  - (3) Confirmation that the FCM's CEO, CFO or Financial Principal (and the identity of that person if different from the person who signed the notice) pre-approved in writing the disbursement whereby the FCM exceeds or will exceed the twenty-five percent (25%) threshold; and
  - (4) The current estimate of the FCM's remaining total residual interest in the customer segregated funds account(s) after the disbursement, and a representation that to the best of the person's (i.e., notice signatory's) knowledge and reasonable belief the FCM remains in compliance with the segregation requirements after the disbursement.
- (iii) In calculating whether an FCM has exceeded or will exceed the twenty-five percent (25%) threshold, an FCM shall exclude any segregated funds disbursement(s) that is made to or for the benefit of commodity and option customers.
- (iv) After making a disbursement that requires the approval and notice filing described in subsections (b)(i) and (b)(ii) above, and until such time that the FCM completes its next daily segregated funds calculation required by CFTC Regulation 1.32, no Member FCM may make any subsequent disbursement(s) in any amount from any customer segregated funds accounts (except to or for the benefit of commodity and option customers) without for each disbursement obtaining the approval required in subsection (b)(i) and filing a written notice signed by the CEO, CFO or Financial Principal that discloses the amount and recipient(s) of the disbursement and the reason(s) for the disbursement, confirming that the CEO, CFO or Financial Principal (and the identity of that person if different from the person who signed the notice) pre-approved the disbursement in writing, indicating the current estimate of the FCM's remaining total residual interest in the customer segregated funds account(s) after the disbursement, and containing a representation that to the best of the person's

(i.e., notice signatory's) knowledge and reasonable belief the FCM remains in compliance with the segregation requirements after the disbursement.

- (c) No Member FCM via a single or multiple transaction(s) may withdraw, transfer or otherwise disburse funds (disbursement) from foreign futures and foreign options customer secured amount funds account(s) as identified under CFTC Regulation 30.7 that exceed twenty-five percent (25%) of the FCM's residual interest in foreign futures and foreign option customer secured amount funds based upon the most current daily secured amount funds calculation performed pursuant to CFTC Regulation 30.7 unless:
- (i) The FCM's CEO, CFO or Financial Principal pre-approves in writing the secured amount funds disbursement whereby the FCM exceeds or will exceed the twenty-five percent (25%) threshold referred to in (c) above; and
  - (ii) The FCM files written notice signed by the FCM's CEO, CFO or Financial Principal in the form and manner prescribed by NFA immediately after the FCM's CEO, CFO or Financial Principal pre-approves in writing the disbursement whereby the FCM exceeds or will exceed the twenty-five percent (25%) threshold referred to in (c) above, which includes the following:
    - (1) Notification that the FCM has made or intends to make a disbursement(s) from secured amount funds that exceeds or will exceed twenty-five percent (25%) of the FCM's residual interest in secured amount funds based upon the most current daily secured amount funds calculation performed pursuant to CFTC Regulation 30.7;
    - (2) A description of the reason(s) for, amounts and recipients of the single or multiple transaction(s) that results or will result in the disbursement(s) that exceeds the twenty-five percent (25%) threshold;
    - (3) Confirmation that the FCM's CEO, CFO or Financial Principal (and the identity of that person if different from the person who signed the notice) pre-approved in writing the disbursement whereby the FCM exceeds or will exceed the twenty-five percent (25%) threshold; and
    - (4) The current estimate of the FCM's remaining total residual interest in the secured amount funds account(s) after the disbursement, and a representation that to the best of the person's (i.e., notice signatory's) knowledge and reasonable belief the FCM remains in compliance with the secured amount requirements after the disbursement.

- (iii) In calculating whether an FCM has exceeded or will exceed the twenty-five percent (25%) threshold, an FCM shall exclude any secured amount funds disbursement(s) that is made to or for the benefit of foreign futures and foreign options customers.
- (iv) After making a disbursement that requires the approval and notice described in subsections (c)(i) and (c)(ii) above, and until such time that the FCM completes its next daily secured amount funds calculation required by CFTC Regulation 30.7, no Member FCM may make any subsequent disbursement(s) in any amount from any customer secured amount funds accounts (except to or for the benefit of foreign futures and foreign option customers) without for each disbursement obtaining the approval required in subsection (c)(i) and filing a written notice signed by the CEO, CFO or Financial Principal that discloses the amount and recipient(s) of the disbursement and the reason(s) for the disbursement, confirming that the CEO, CFO or Financial Principal (and the identity of that person if different from the person who signed the notice) pre-approved the disbursement in writing, indicating the current estimate of the FCM's remaining total residual interest in the customer secured amount funds account(s) after the disbursement, and containing a representation that to the best of the person's (i.e., notice signatory's) knowledge and reasonable belief the FCM remains in compliance with the secured amount requirements after the disbursement.
- (d) Each Member FCM must report the following financial and operational information to NFA in the form and manner prescribed by NFA and in accordance with the respective time periods specified:
  - (i) On a monthly basis, within 17 business days after the end of each month, the following information as of the close of business on the last business day of the month:
    - (1) Adjusted net capital, minimum net capital, and excess net capital (listed in U.S. dollar figures);
    - (2) Whether any depository used to hold customer segregated funds or foreign futures and foreign options customer secured amount funds during the month is an affiliate of the FCM; and

- (3) The firm's measure of leverage (i.e., total balance sheet assets, less any instruments guaranteed by the U.S. government and held as an asset or to collateralize an asset (e.g., a reverse repo) divided by total capital (the sum of stockholder's equity and subordinated debt)) all computed in accordance with U.S. GAAP.
- (ii) By 11:59 P.M. Eastern time on the business day following the 15th and the last business day of each month, the following information as of the close of business on the 15th (or the following business day if the 15th falls on a weekend) and the last business day of each month:
- (1) The dollar amount of customer segregated funds held in cash and each type of permitted investments identified in CFTC Regulation 1.25(a);
  - (2) The identity of each depository holding customer segregated funds and the dollar amount held at each depository;
  - (3) The dollar amount of foreign futures and foreign options customer secured amount funds held in cash and each type of permitted investments identified in CFTC Regulation 1.25(a); and
  - (4) The identity of each depository holding foreign futures and foreign options customer secured amount funds and the dollar amount held at each depository.
- (iii) By noon of each business day, the daily segregated funds computation and the daily secured amount funds computation as of the close of the preceding business day.
- (iv) The FCM's CEO, CFO or other individual designated by the CEO or CFO to file on his/her behalf, or where applicable, a person described in CFTC Regulation 1.10(d)(4)(ii), must submit the information required by subsections (i)-(iii) above, and by submitting the information the CEO or CFO certifies that to the best of his/her knowledge and belief the information is true, correct and complete.
- (v) Any information filed after its due date shall be accompanied by a fee of \$1,000 for each business day that it is late. Payment and acceptance of the fee does not preclude NFA from filing a disciplinary action under the Compliance Rules for failure to comply with the deadlines imposed by NFA Financial Requirements.

\* \* \*

## **INTERPRETIVE NOTICE**

### **NFA FINANCIAL REQUIREMENTS SECTION 16: FCM FINANCIAL PRACTICES AND EXCESS SEGREGATED FUNDS/SECURED AMOUNT DISBURSEMENTS**

A futures commission merchant's (FCM) segregation of customer funds forms the foundation of the futures industry's customer protection regime. NFA Financial Requirements Section 16 is designed to establish requirements regarding the maintenance of an FCM's residual interest in the customer segregated funds and secured amount account(s). Additionally, to enhance transparency and regulatory risk monitoring relating to each Member FCM's protection of customer funds, Section 16 places requirements upon FCMs relating to certain withdrawals of their residual interest, and requires FCMs to report certain financial and operational information to NFA in the form and manner prescribed by NFA. This Notice provides a subsection-by-subsection analysis of Financial Requirements Section 16 and further describes certain regulatory requirements that FCMs must adopt to implement Section 16's specific requirements.

Funds that customers deposit with an FCM, or that are otherwise required to be held for the benefit of customers, to margin futures and options on futures contracts traded on futures markets located in the United States must be held in a customer segregated funds account pursuant to Section 4d(a)(2) of the Commodity Exchange Act and Commodity Futures Trading Commission (CFTC) Regulation 1.20. Funds that customers deposit with an FCM, or that are otherwise required to be held for the benefit of customers, to margin futures and options on futures contracts traded on foreign boards of trade must be held in a foreign futures and foreign options secured amount account in accordance with CFTC Regulation 30.7. CFTC Regulation 1.22 prohibits an FCM from using one customer's funds to meet the obligations of another customer. Therefore, if a customer fails to have sufficient funds on deposit with an FCM to meet the customer's obligation, then the FCM must use its own funds to make up any deficiency in a customer's account. NFA Financial Requirements Section 4 adopts by reference CFTC Regulations 1.20, 1.22 and 30.7.

To comply with Regulation 1.22, an FCM is permitted pursuant to Regulation 1.23 to maintain excess funds in the customer segregated and secured amount accounts. The excess funds in these accounts are referred to as the FCM's residual interest and the funds are for the exclusive benefit of the FCM's customers while held in these accounts.

CFTC Regulation 1.32 and Regulation 30.7 require FCMs to complete a segregated funds calculation and/or secured amount funds calculation respectively for each business day by noon of the following business day. Under Financial Requirements Section 16, in determining the FCM's secured amount requirement, the FCM must use the method that calculates net liquidating equity plus the market value of any securities held in customers' accounts.

Subsection 16(a) requires each Member FCM to maintain written policies and procedures regarding the maintenance of the FCM's residual interest in the customer segregated funds account(s) as identified under CFTC Regulation 1.20 and in its foreign futures and foreign options customer secured amount funds account(s) as identified in CFTC Regulation 30.7. The FCM's policies and procedures must target an amount (either by percentage or dollars) that the FCM seeks to maintain as its residual interest in these accounts and be designed to reasonably ensure that the FCM remains in compliance with the segregation and secured amount requirements. The target amount can be expressed with descriptive terms (e.g., at least "x" dollar amount or percent of segregated/secured amount funds) or as a range (e.g., between "x" dollar amount and "y" dollar amount or percent). The FCM's Board of Directors or similar governing body, Chief Executive Officer (CEO) or Chief Financial Officer (CFO) must approve in writing the FCM's targeted residual amount and any material change in either the targeted amount or the FCM's policies and procedures regarding the maintenance of the FCM's residual interest in either the customer segregated funds account(s) or the foreign futures and foreign options customer secured amount funds account(s).

In establishing the target amount of residual interest, the Board of Directors or similar governing body, CEO, or CFO must perform a due diligence inquiry and consider various factors, if applicable, relating to the nature of the firm's business, including but not limited to: the firm's type of customers, their general creditworthiness, and trading activity; the type of markets and products traded by the firm's customers and the firm itself; the general volatility and liquidity of those markets and products; the firm's own liquidity and capital needs; and historical trends in customer segregated/secured amount funds balances and customer debits. Member FCMs are required to create a written record containing a description of the analysis of the factors used by the FCM to determine its targeted residual amount. The primary purpose of the residual interest is to ensure that sufficient funds are on deposit with an FCM to meet customer obligations and to remain in compliance at all times with the segregation requirements.

Falling below the target amount of residual interest is not, in and of itself, a violation of the segregated/secured amount requirements. In those instances where an

FCM withdraws a portion of its residual interest via disbursement(s) not for the benefit of customers thereby causing the firm to fall below its target amount of residual interest, then the FCM by the close of business on the next business day should either deposit funds into the segregated/secured amount funds account(s) necessary to restore the respective account'(s) balance to the target amount of residual interest or, if appropriate, revise the FCM's target amount of residual interest and follow the requirements in doing so set forth in subsection 16(a) and this Notice relating to establishing and changing the targeted residual amount. Unless the nature of an FCM's business materially changes, NFA would not expect material and/or frequent modifications to either an FCM's targeted amount or the FCM's policies and procedures regarding the maintenance of the FCM's targeted residual interest.

An FCM's disbursement(s) of its residual interest in any dollar amount from customer segregated funds and secured amount funds account(s) not made for the benefit of customers must be done in a manner that ensures that the FCM maintains sufficient funds to remain in continual compliance with the customer segregated funds and secured amount requirements. In making a disbursement(s) from customer segregated funds and secured amount funds account(s), an FCM's internal procedures must require the FCM to not only consider the most current calculation completed pursuant to CFTC Regulation 1.32 or CFTC Regulation 30.7, but also the impact of any known unsecured debit(s), deficit(s), and previous disbursements that could cause material adjustments to its most current segregated and secured funds calculations.

Subsection 16(b) adopts requirements relating to an FCM's internal approval and notification to NFA of any significant disbursement, as defined, of customer segregated funds that is not made for the benefit of customers. Specifically, this subsection provides that no Member FCM via a single or multiple transaction(s) may withdraw, transfer or otherwise disburse funds from any customer segregated funds account(s) as identified under CFTC Regulation 1.20 exceeding 25% of the FCM's residual interest in customer segregated funds based upon the most current daily segregated funds calculation performed pursuant to Regulation 1.32 (hereinafter the "25% threshold") unless the FCM's CEO, CFO or other designated individual(s) who holds a position with knowledge of the firm's financial requirements and financial position and is listed as a principal on the firm's Form 7-R (for purposes of Section 16 only, a "Financial Principal") pre-approves in writing the segregated funds disbursement whereby the FCM exceeds or will exceed the 25% threshold.

In addition to obtaining the CEO's, CFO's or Financial Principal's approval, subsection 16(b)(ii) requires the FCM to file a written notice with NFA immediately after the FCM's CEO, CFO or Financial Principal pre-approves in writing the disbursement whereby the FCM exceeds or will exceed the 25% threshold. The notice to NFA must

be signed by the FCM's CEO, CFO or Financial Principal and subsection 16(b)(ii)(1)-(4) provides that the notice must include the following: (1) notification that the FCM has made or intends to make a disbursement(s) from segregated funds that exceeds or will exceed 25% of the FCM's residual interest in customer segregated funds based upon the most current daily segregated funds calculation performed pursuant to CFTC Regulation 1.32; (2) a description of the reason(s) for, the amount and recipients of the single or multiple transaction(s) that results or will result in the disbursement(s) that exceeds the 25% threshold; (3) confirmation that the FCM's CEO, CFO, or Financial Principal (and the identity of that person if different from the person who signed the notice) pre-approved in writing the disbursement whereby the FCM exceeds or will exceed the 25% threshold; and (4) the current estimate of the FCM's remaining total residual interest in the customer segregated funds account(s) after the disbursement, and representation that to the best of the person's (i.e., notice signatory's) knowledge and reasonable belief the FCM remains in compliance with the segregation requirements after the disbursement.

Financial Requirements subsection 16(b)(iv) addresses disbursement(s) made from an FCM's segregated funds account(s) subsequent to an FCM making a disbursement(s) that exceeds the 25% threshold that required the approval and notice described in subsections 16(b)(i) and (b)(ii). In those circumstances, from the time of the original disbursement that exceeds the 25% threshold until the FCM completes its next required daily segregated funds calculation, the firm may not make any subsequent disbursement(s) in any amount from the segregated funds account(s), except to or for the benefit of commodity and options customers, without obtaining for each disbursement the pre-approval of the CEO, CFO or Financial Principal and filing a written notice signed by the CEO, CFO or Financial Principal that discloses the amount and recipient(s) of the disbursement and the reasons for the disbursement, and which confirms that the CEO, CFO or Financial Principal (and the identity of that person if different from the person who signed the notice) pre-approved the disbursement in writing, indicates the current estimate of the FCM's remaining total residual interest in the customer segregated funds account(s) after the disbursement, and contains a representation that to the best of the person's (i.e., notice signatory's) knowledge and reasonable belief the FCM remains in compliance with the segregation requirements after the disbursement.

Financial Requirements subsection 16(c) replicates subsection 16(b)'s internal approval and notice requirements applicable to customer segregated funds account(s) for foreign futures and foreign options customer secured amount funds account(s) as identified under CFTC Regulation 30.7.

Once the CFTC finalizes its requirements applicable to cleared OTC derivatives, then NFA will adopt similar approval and notice requirements for disbursements that exceed 25% of the FCM's residual interest in sequestered account(s).

Importantly, Financial Requirements subsections 16(b)(iii) and (c)(iii) place a key qualification on the disbursements utilized to calculate whether an FCM has or will exceed the 25% threshold. Specifically, subsections (b)(iii) and (c)(iii) provide that for purposes of calculating the 25% threshold an FCM shall exclude any segregated funds disbursement(s) or secured amount funds disbursement(s) that are made to or for the benefit of customers.

Therefore, certain disbursements, transactions and/or occurrences for the benefit of customers should not be included in an FCM's calculation of the 25% threshold. Specifically, a reduction in segregated or secured amount funds caused by, for example—a loss in the market value of the segregated or secured amount funds' investments; an increase in customer unsecured debits/deficits from one day to the next; the transfer of a particular futures customer's cash from a segregated funds account for the customer's domestic futures trading to a secured amount account for that customer's trading on foreign markets or vice-versa; the transfer of a particular futures customer's cash from a segregated funds account to a delivery account for that customer to take delivery of a commodity; the transfer of a particular futures customer's equity and cash to that customer's securities or foreign exchange account at either the FCM/broker-dealer (BD) or a BD affiliate of the FCM; and the simultaneous exchange of cash for the same dollar value of securities allowable pursuant to Regulation 1.25 or vice-versa—are not the type of disbursements, transactions and/or occurrences to be considered by an FCM in calculating the 25% threshold. The aforementioned examples are not intended to encompass all transactions, disbursements or occurrences that are for the benefit of a customer.

Additionally, subsections 16(b)(ii)(1) and (c)(ii)(1) require an FCM to utilize the most current daily segregated funds and secured amount funds calculations, respectively, to determine whether the FCM has made or intends to make disbursement(s) that exceeds or will exceed 25% of the FCM's residual interest in segregated funds and secured amount funds. CFTC Regulations 1.32 and 30.7 require FCMs to complete these calculations of segregated and secured amount funds, respectively, by noon of each business day as of the close of business of the preceding business day. Any FCM that fails to complete either of these calculations in a timely manner by noon is prohibited from making any disbursement(s) from the account for which the calculation has not been completed (i.e., the customer segregated or secured amount funds account(s)), unless the disbursement is to or for the benefit of customers.

until the required calculation(s) is completed and submitted to NFA as required by subsection 16(d)(iii).

Lastly, Subsection 16(d) requires Member FCMs to submit certain financial and operational information to NFA on a monthly or semi-monthly basis. Subsection 16(d)(i)(1)-(3) requires FCMs on a monthly basis, within 17 business days after the end of each month, to submit the following information as of the close of business on the last business day of the month: (1) total adjusted net capital, minimum net capital and excess net capital (listed in dollar figures); (2) whether any depository used to hold customer segregated funds or secured amount funds during the month is an affiliate of the FCM; and (3) the firm's measure of leverage (i.e., total balance sheet assets, less any instruments guaranteed by the U.S. government and held as a asset or to collateralize an asset (e.g., reverse repo) divided by total capital (the sum of stockholder's equity and subordinated debt) all computed in accordance with U.S. GAAP.

Subsection 16(d)(ii) requires FCMs by 11:59 P.M. Eastern time on the business day following the 15th (or the business day following the "as of" reporting day if the 15th falls on a weekend) and the last business day of each month to submit the following information as of the close of business on the 15th (or the following business day if the 15th falls on a weekend) and the last business day of each month: (1) the dollar amount of customer segregated funds held in cash and each permitted investment identified in CFTC Regulation 1.25(a); (2) the identity of each depository holding customer segregated funds and the dollar amount held at each depository; (3) the dollar amount of foreign futures and foreign options customer secured amount funds held in cash and each permitted investment identified in CFTC Regulation 1.25(a); and (4) the identity of each depository holding foreign futures and foreign options customer secured amount funds and the dollar amount held at each depository. Subsection 16(d)(iii) requires FCMs to submit by noon of each business day, the daily segregated funds and secured amount funds computations as of the close of the preceding business day.

Member FCMs will be held liable for willfully submitting materially false or misleading information to NFA in connection with the information required to be submitted pursuant to Financial Requirements Section 16. Moreover, to the extent that an FCM purposefully manipulates the information submitted pursuant to subsection 16(d) so that the information is not reflective of the firm's general financial condition during the month, then the FCM may be liable for submitting misleading information to NFA and for a violation of just and equitable principles of trade.

Pursuant to subsection 16(d)(iv), either the FCM's CEO, CFO or other individual designated by the CEO or CFO to file on his/her behalf, or where applicable, a person described in CFTC Regulation 1.10(d)(4)(ii) is required to submit the information required by subsections 16(d)(i)-(iii). For purposes of submitting the information, the FCM's CEO or CFO must complete a User Identification Request Form (Form). If the CEO or CFO designates a person on this Form to submit the information on his/her behalf, the CEO/CFO must identify that person on the Form and acknowledge that he/she remains responsible for the accuracy of the information submitted by the designated submitter. Additionally, the CEO or CFO will have to represent that with respect to the electronic submission of certain financial reports, supplemental information and regulatory notifications the use of his/her User ID or his/her designated submitter's User ID is a representation in accordance with any applicable CFTC or other federal agency requirement that, to best of her/his knowledge and belief, all information contained in the reports and supplemental information is true, correct and complete.

Subsection 16(v) is designed to ensure that the information required to be submitted pursuant to subsections 16(d)(i)-(iii) is actually submitted in a timely manner. Therefore, any information filed after its due date shall be accompanied by a fee of \$1,000 for each business day that it is late. Payment and acceptance of the fee does not preclude NFA from filing a disciplinary action under NFA's Compliance Rules for failure to comply with the required time periods.

As noted above, NFA Financial Requirements Section 16 is designed to establish requirements regarding the maintenance of an FCM's residual interest in the customer segregated funds and secured amount account(s). Additionally, to enhance transparency and regulatory risk monitoring relating to each Member FCM's protection of customer funds, Section 16 places requirements upon FCMs relating to certain withdrawals of their residual interest, and requires FCMs to report certain financial and operational information to NFA in the form and manner prescribed by NFA. NFA and a Member FCM's designated self-regulatory organization will closely monitor the information submitted pursuant to Financial Requirements Section 16 to ensure that an FCM maintains sufficient funds to remain in continual compliance with the customer segregated funds and secured amount requirements. If NFA believes that an FCM's financial condition poses a concern that it may not have sufficient funds to remain in continual compliance with these obligations, then NFA's President, with the concurrence of NFA's Board of Directors or Executive Committee, may issue a Member Responsibility Action against the Member FCM pursuant to NFA Compliance Rule 3-15. This emergency action may suspend or restrict the FCM's operations or otherwise direct the firm to take remedial action, which may include infusing additional residual interest

funds into the customer segregated funds and/or secured amount accounts or additional capital into the firm's operating accounts.

\* \* \*

---

## EXPLANATION OF PROPOSED AMENDMENTS

---

The recent demise of MF Global has dealt a severe blow to the public's confidence in the financial integrity of our futures markets. This is much more than an academic argument. Thousands of customers have suffered and continue to suffer from a breakdown in the regulatory protections they have come to expect. Reestablishing the public's confidence is essential to our futures market and all of us involved in the regulatory process have to work to restore that confidence and that effort must begin with identifying and implementing regulatory changes to try to prevent such insolvencies from occurring. At NFA we began that process by identifying a broad range of possible responses. Those possible responses fell into three categories: changes that would require coordination with other self-regulatory organizations, changes which we could accomplish by amending NFA rules and changes that would require action by either the CFTC or by Congress.

To deal with the first category of possible regulatory changes we formed a committee of futures industry self-regulatory organizations. The committee included representatives of NFA, the CME Group, the InterContinental Exchange, the Kansas City Board of Trade and the Minneapolis Grain Exchange. The committee held a number of intensive meetings over a period of several months and in early March 2012 announced its initial recommendations, which called for significant safeguards in the way that we monitor our members for compliance with duties regarding customer segregated funds. Specifically, this committee reached prompt agreement on four proposed changes to SRO rules or regulatory practices—requiring all FCMs to file daily segregation reports; requiring all FCMs to file semi-monthly Segregated Investment Detail Reports (SIDR) reflecting how customer segregated funds are invested and where those funds are held; performing more frequent periodic spot checks to monitor FCM compliance with segregation requirements; and adopting certain approval and notice requirements for any disbursement of customer segregated/secured amount funds that is not made for the benefit of customers and that exceeds 25% of excess segregated funds.

In addition, at its February 2012 meeting, NFA's Board formally appointed the Special Committee on the Protection of Customer Funds (Special Committee) comprised of NFA's public directors to determine changes that could be accomplished through NFA's own rulemaking process most notably in the area of an FCM's disclosure

of certain financial and operational information to facilitate due diligence inquiries by customers. NFA has always believed that the disclosure of material information is key to customers making an informed investment decision. The disclosure of information should not only relate to the risks of futures trading but also to financial data that customers should consider in their due diligence process of selecting an FCM. In the past, NFA certainly has educated customers about the importance of reviewing a firm's disciplinary background, but the MF Global Inc. bankruptcy has highlighted the need for customers to review relevant information regarding the financial condition of FCM Member firms.

In considering what information NFA should make available to the public, the Special Committee focused in particular on the needs of smaller, less sophisticated customers and recognized that the most meaningful disclosure would have to focus on the information most relevant and most understandable for those customers. Some of the potential disclosure items discussed included the FCM's capital requirements and excess capital; segregation requirements and excess segregated funds; how the firm invests customer segregated funds and whether those funds are held at an affiliate of the FCM; whether the firm engages in proprietary trading; and the degree of leverage employed by the firm.

The committee also concluded that FCMs should be required to file the data with NFA on a periodic basis, and NFA in the future would have a section on our website publicly displaying this information for all FCMs. The Special Committee also encouraged staff to provide a brief description on NFA's website of the disclosed items when they are made publicly available. Staff is working on the operational changes necessary to display this information on NFA's website and plans to present to the Board in August a view of how this information will be displayed. At that time, we will seek the Board's approval of a resolution that authorizes certain FCM financial and operational information to be made publicly available.

NFA Financial Requirements Section 16 and the Interpretive Notice entitled *FCM Financial Practices and Excess Segregated Funds/Secured Amount Disbursements* were approved by NFA's Board to codify recommendations designed, in light of MF Global Inc.'s bankruptcy, to bolster public confidence in the protection of customer segregated funds. The recommendations emanated from both the SRO Committee and NFA's Special Committee.

Additionally, as explained below, NFA previously discussed proposed Financial Requirement's Section 16 with NFA's Advisory Committees.

### **The Advisory Committees' Views**

NFA's IB and CPO/CTA Advisory Committees were supportive of the Special Committee's recommendation to display the aforementioned FCM financial information on NFA's website. The FCM Advisory Committee was also supportive of the Special Committee's recommendation but requested that NFA utilize the same definition of leverage as the Financial Industry Regulatory Authority (FINRA) uses to measure broker-dealer leverage. Specifically, the FCM Advisory Committee noted that in September 2010 FINRA amended its FOCUS report information to add additional criterion that is designed to measure a broker-dealer's leverage. The FINRA leverage ratio is computed by dividing total balance sheet assets, less any instruments guaranteed by the U.S. government and held as an asset or to collateralize an asset (e.g., a reverse repo) divided by total capital (the sum of stockholder's equity and subordinated debt) all computed in accordance with U.S. GAAP.

The Advisory Committees were also supportive of the SRO Committee's recommendations, including the approval and notice requirements triggered when an FCM disburses customer segregated/secured amount funds that are not for the benefit of customers and that exceed 25% of excess segregated funds. The FCM Advisory Committee requested, however, that the SRO Committee's original recommendation be modified slightly to permit not only the FCM's CFO and CEO to approve these type of disbursements but also other individuals as long as the individual is a person with sufficient authority within the firm. The committee explained that a firm's CEO and CFO may not always be available. After considering this request, NFA's Board had no objection to providing this additional flexibility to firms. Ultimately, the Board decided that an FCM's CEO, CFO or other designated individual(s) who holds a position with knowledge of the firm's financial requirements and financial position and is listed as a principal on the firm's Form 7-R must pre-approve in writing the segregated funds or secured amount disbursement.

### **Proposed Financial Requirements Section 16**

Proposed NFA Financial Requirements Section 16 is divided into four subparts.

Proposed subsection 16(a) adopts, in part, recommendations F and G contained in FIA's Futures Markets Financial Integrity Task Force's February 28, 2012 Report entitled "Initial Recommendations for Customer Funds Protection." Specifically, proposed subsection 16(a) requires each Member FCM to maintain written policies and procedures regarding the maintenance of the FCM's residual interest in the customer segregated funds account(s) as identified under CFTC Regulation 1.20 and in its foreign

futures and foreign options customer secured amount funds account(s) as identified in CFTC Regulation 30.7. The FCM's policies and procedures must target an amount (either by percentage or dollars) that the FCM seeks to maintain as its residual interest in these accounts and be designed to reasonably ensure that the FCM remains in compliance with the segregation and secured amount requirements. The FCM's Board of Directors or similar governing body, CEO or CFO must approve in writing the FCM's targeted residual amount, any change(s) thereto, and any material change(s) in the FCM's written policies and procedures regarding the maintenance of the FCM's residual interest in either the customer segregated funds account(s) or the foreign futures and foreign options customer secured amount funds account(s).

Proposed subsection 16(b) seeks to adopt the SRO Committee's recommendation regarding the internal approval process and notification of any disbursement of customer segregated funds that is not made for the benefit of customers and that exceeds 25% of the FCM's residual interest in customer segregated funds. This proposed subsection provides that no Member FCM via a single or multiple transaction(s) may withdraw, transfer or otherwise disburse funds from any customer segregated funds account(s) as identified under CFTC Regulation 1.20 exceeding 25% of the FCM's residual interest in customer segregated funds based upon the most recent daily segregated funds calculation performed pursuant to CFTC Regulation 1.32 unless the FCM's CEO, CFO or other designated individual(s) who holds a position with knowledge of the firm's financial requirements and financial position and is listed as a principal on the firm's Form 7-R (for purposes of this Section only, a "Financial Principal") pre-approves in writing the segregated funds disbursement whereby the FCM exceeds the 25% threshold. Importantly, proposed subsection 16(b)(iii) makes clear that for purposes of calculating the 25% threshold, an FCM Member shall exclude any segregated funds disbursement(s) that are made to or for the benefit of commodity and option customers.

In addition to obtaining the CEO's, CFO's or Financial Principal's approval, proposed subsection 16(b)(ii) requires the FCM to file written notice immediately after the FCM's CEO, CFO or Financial Principal pre-approves in writing the disbursement whereby the FCM exceeds the 25% threshold. Proposed subsection 16(b)(ii)(1)-(4) provides that the notice must include the following: (1) notification that the FCM has or will make a disbursement from segregated funds that exceeds 25% of the FCM's residual interest in customer segregated funds based upon the most current daily segregated funds calculation performed pursuant to CFTC Regulation 1.32; (2) a description of the reason(s) for, the amount and recipients of the single or multiple transaction(s) that results or will result in the disbursement(s) that exceeds the twenty-five percent (25%) threshold; (3) confirmation that the CEO, CFO or Financial Principal pre-approved in writing the disbursement; and (4) the current estimate of the FCM's

remaining total residual interest in the customer segregated funds account(s) after the disbursement, and a representation that to the best of the person's (i.e., notice signatory's) knowledge and reasonable belief the FCM remains in compliance with the segregation requirements after the disbursement.

Financial Requirements subsection 16(b)(iv) addresses an FCM's disbursement(s) from a segregated funds account(s) subsequent to an FCM making a disbursement(s) that exceeds the 25% threshold that required the approval and notice described in subsections 16(b)(i) and (b)(ii). In those circumstances, from the time of the original disbursement that exceeds the 25% threshold until the FCM completes its next required daily segregated funds calculation, Member FCMs may not make any subsequent disbursement(s) in any amount from any customer segregated funds accounts (except to or for the benefit of commodity and option customers) without for each disbursement obtaining the approval required in subsection (b)(i) and filing a written notice signed by the CEO, CFO or Financial Principal that discloses the amount and recipient(s) of the disbursement and the reason(s) for the disbursement, confirming that the CEO, CFO or Financial Principal (and the identity of that person if different from the person who signed the notice) pre-approved the disbursement in writing, indicating the current estimate of the FCM's remaining total residual interest in the customer segregated funds account(s) after the disbursement, and containing a representation that to the best of the person's (i.e., notice signatory's) knowledge and reasonable belief the FCM remains in compliance with the segregation requirements after the disbursement.

Proposed Financial Requirements subsection 16(c) replicates subsection 16(b)'s approval and notice requirements applicable to segregated funds account(s) for foreign futures and foreign options customer secured amount funds account(s) as identified under CFTC Regulation 30.7. NFA plans to add similar approval and notice requirements for disbursements that exceed 25% of the FCM's residual interest in sequestered account(s) once the rules for cleared OTC derivatives are finalized.

Lastly, proposed subsection 16(d) seeks to adopt the Special Committee's recommendation that NFA obtain certain information from FCMs that the Board in August could decide to make publicly available on NFA's website. Although NFA currently receives daily segregated funds calculations, monthly FCM Form 1-FRs and Focus Reports regarding a firm's capital computations, and monthly SIDR reports from FCMs for which NFA is the DSRO, proposed subsection 16(d) will require that all FCM Members provide NFA this information and certain additional financial and operational information, in a form and manner to be prescribed by NFA. Therefore, proposed subsection 16(d)(i)(1)-(3) requires FCMs on a monthly basis, within 17 business days after the end of each month, to submit the following information as of the close of

business on the last business day of the month: (1) total adjusted net capital, minimum net capital, and excess net capital (listed in U.S. dollar figures); (2) whether any depository used to hold customer segregated funds or secured amount funds during the month is an affiliate of the FCM; and (3) the firm's measure of leverage (i.e., total balance sheet assets, less any instruments guaranteed by the U.S. government and held as an asset or to collateralize an asset (e.g., a reverse repo) divided by total capital (the sum of stockholder's equity and subordinated debt)) all computed in accordance with U.S. GAAP.

Proposed subsection 16(d)(ii) requires FCMs by 11:59 P.M. Eastern time on the business day following the 15th and the last business day of each month to submit the following information as of the close of business on the 15th (or the following business day if the 15th falls on a weekend) and the last business day of each month: (1) the dollar amount of customer segregated funds held in cash and each type of permitted investment identified in CFTC Regulation 1.25(a); (2) the identity of each depository holding customer segregated funds and the dollar amount held at each depository; (3) the dollar amount of foreign futures and foreign options customer secured amount funds held in cash and each type of permitted investment identified in CFTC Regulation 1.25(a); and (4) the identity of each depository holding foreign futures and foreign options customer secured amount funds and the dollar amount held at each depository.

Lastly, proposed subsection 16(d)(iii) requires FCMs to submit by noon of each business day, the daily segregated funds and secured amount funds computations as of the close of the preceding business day.

As previously noted, the Board also approved an Interpretive Notice to Proposed NFA Financial Requirements Section 16 entitled *NFA Financial Requirements Section 16: FCM Financial Practices and Excess Segregated Funds/Secured Amount Disbursements*, which provides a subsection-by-subsection analysis of Section 16 and further describes certain regulatory requirements that FCMs must adopt to implement Section 16's specific requirements. The Notice also provides specific guidance on certain transactions and/or occurrences that are not included in an FCM's calculation of the 25% threshold. NFA believes that any obligations imposed by the Notice's requirements upon FCMs are consistent with Financial Requirements Section 16 and existing NFA and CFTC regulatory requirements.

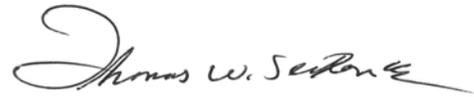
Finally, the Board approved a minor amendment to NFA Financial Requirements Section 4 to codify the requirement that any FCM that violates CFTC Regulation 30.7 shall be deemed to be in violation of an NFA Requirement.

Mr. David A. Stawick

May 29, 2012

NFA respectfully requests that the Commission review and approve the proposed adoption of NFA Financial Requirements Section 16 and its related Interpretive Notice entitled *NFA Financial Requirements Section 16: FCM Financial Practices and Excess Segregated Funds/Secured Amount Disbursements*, as well as the proposed amendment to NFA Financial Requirements Section 4.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Thomas W. Sexton". The signature is fluid and cursive, with a long horizontal flourish extending to the right.

Thomas W. Sexton  
Senior Vice President and  
General Counsel

---

\*The proposed amendment to Financial Requirements Section 4, adoption of Financial Requirements Section 16 and its related Interpretive Notice becomes effective September 1, 2012.