



NATIONAL  
FUTURES  
ASSOCIATION®

# CUSTOMER PROTECTION

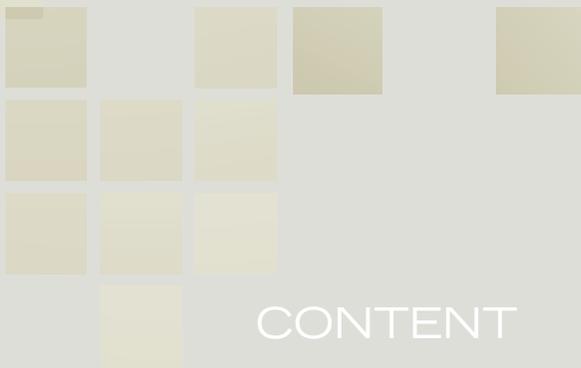
*It's in everything we do.*

## INSIDE

- FCM FINANCIAL REPORTING REQUIREMENTS
- ELECTRONIC CONFIRMATION OF CUSTOMER SEGREGATED AND SECURED FUNDS
- CPO REPORTING REQUIREMENTS
- FCM FINANCIAL DATA AVAILABLE ON NFA'S WEBSITE



2012 ANNUAL REVIEW



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## A Letter from NFA's CEO and Chairman

In October 2011, the futures industry was rocked by the collapse of MF Global Inc., one of the industry's largest futures commission merchants (FCM). The shortfall of an estimated \$1.6 billion dollars in customer funds—funds that should have been securely deposited in customer segregated fund accounts and customer secured amount accounts for customers trading on futures exchanges—dealt a severe blow to the public's confidence in the financial integrity of the futures markets.

NFA took a number of immediate measures to help Member firms affected by the MF Global bankruptcy. NFA worked closely with the FCMs for which it is the designated self-regulatory organization (DSRO) that had customer funds on deposit with MF Global to ensure that they could meet their obligations to customers and remain in compliance with all segregation and capital requirements. In addition, NFA collaborated with commodity pool operators (CPO) and introducing brokers (IB) whose businesses were impacted by MF Global.

During the months following MF Global's demise, NFA and CME Group Inc. formed an SRO Committee with representatives of other exchanges, including IntercontinentalExchange, the Kansas City Board of Trade and the Minneapolis Grain Exchange. The SRO Committee commenced a number of initiatives to further safeguard customer funds, established stronger customer protection regulations and began the process of rebuilding customer confidence in the futures markets.

However, in July 2012, another FCM, Peregrine Financial Group, filed for bankruptcy following the attempted suicide of its president and the subsequent discovery that he had defrauded Peregrine customers by using segregated funds for his personal use and submitting falsified records to NFA and the Commodity Futures Trading Commission (CFTC).

For the second time in nine months, futures customers learned that their segregated funds—funds they had long believed were secure and untouchable—were missing.

The defaults of MF Global and Peregrine caused tremendous pain and financial distress to our Members, the industry and—most significantly—to the firms' customers. Clearly, we must continuously improve our surveillance, audit and fraud detection techniques to keep pace with changing technology and an ever-more-complicated financial marketplace.

This Annual Review details the steps NFA and the industry have taken during the past few months to ensure that customer funds are protected. It also includes an update on NFA's expansion of its regulatory duties, particularly in the registration and monitoring of swap dealers (SD) and major swap participants (MSP), the preparation for the influx of new CPO and commodity trading advisor (CTA) members as a result of the CFTC's rescission of widely held registration exemptions and additional regulatory initiatives in the forex markets.

We know that we can never completely eliminate fraud, but we must continue to adopt rules and surveillance techniques to try to reduce the opportunity for fraud as much as possible. That's why the process of refining and improving regulatory protections is ongoing and constant.



Daniel J. Roth  
President and CEO



Christopher K. Hehmeyer  
Chairman of the Board



# Strengthening Customer PROTECTION

In January 2012, in response to the collapse of MF Global, NFA and CME Group Inc., in conjunction with IntercontinentalExchange, the Kansas City Board of Trade and the Minneapolis Grain Exchange, formed a committee of futures industry self-regulatory organizations (SRO). The committee held a number of intensive meetings over several months and recognized that regulators need to make better use of technology to monitor firms for compliance with regulatory requirements. The SRO committee's most significant recommendation—one that will greatly enhance customer protection—is the confirmation of customer segregated and secured amount funds on a daily basis.

### Electronic confirmation of customer segregated funds

NFA's Board of Directors agreed that NFA, in conjunction with CME Group Inc., would develop a daily segregation confirmation process. This new process would require all depositories holding customer segregated and secured amount funds to file daily reports with each FCM's DSRO reflecting the balances held in those accounts. The segregation confirmation system will perform an automated comparison of that information with the daily reports filed by the FCMs and generate immediate alerts for any material discrepancies.

By December 31, 2012, the first stage of this system—limited to daily confirmations from bank depositories—will be operational. The second phase of the system, which will be ready in 2013, will include daily confirmations from all depositories for customer segregated and secured amount funds. Depositories that are unable to report FCMs' customer segregated and secured amount balances on a daily basis will not be considered acceptable.

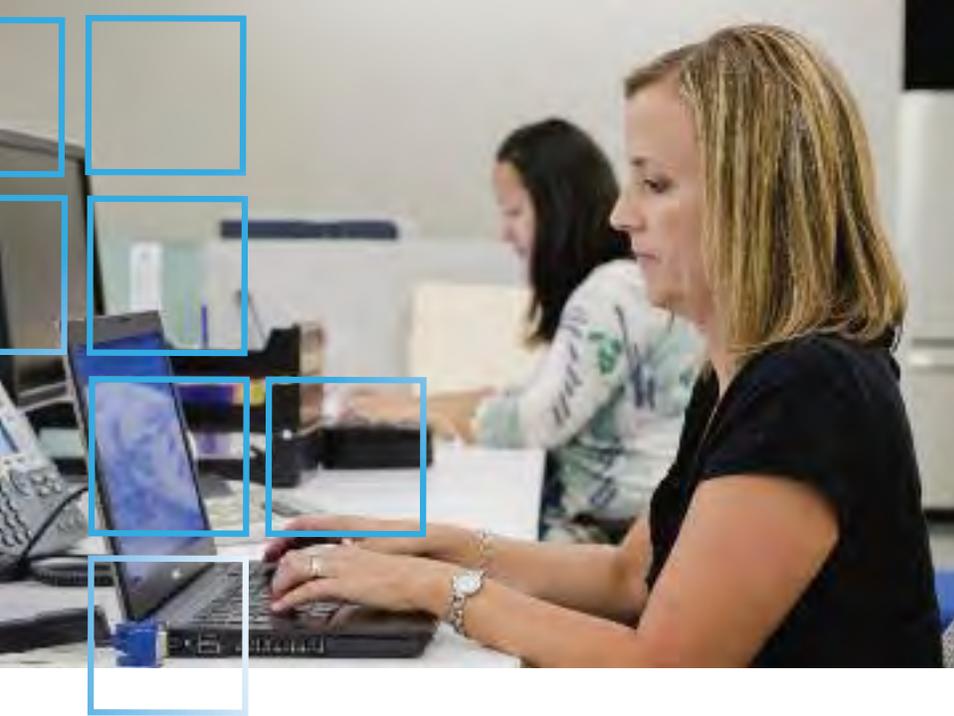
In early 2012, NFA had already begun to make better use of technology to improve its audit confirmation procedures. NFA moved to an electronic confirmation process in order to verify segregated funds balances during annual audits. It was this transition to electronic confirmations that uncovered the Peregrine fraud in July 2012.

The daily segregation confirmation system goes well beyond the annual electronic confirmation process and will further safeguard customer funds.

### New FCM reporting requirements

In addition to the electronic confirmation process, the SRO committee also proposed a number of recommendations for changes to SRO rules and regulatory practices in an effort to prevent customer losses due to an FCM's insolvency. These recommendations were incorporated into NFA Financial Requirements Section 16, and approved by NFA's Board of Directors in May and the CFTC in July. The new financial requirements became effective on September 1, 2012.





All FCMs are now required to immediately notify regulators if their level of excess segregated funds (funds deposited by the firm into customer segregated accounts to guard against customer defaults) is reduced by 25 percent in a given day by making disbursements that are not for the benefit of customers. These disbursements also must be approved by a financial principal of the firm, and the principal must represent that the firm remains in compliance with segregation requirements. All FCMs also must provide NFA with certain financial and operational information on a monthly or semi-monthly basis. This financial information includes data on capital requirements, excess capital, segregated funds requirements, excess segregated funds and how the firms invest customer segregated funds.

To provide greater transparency about the financial condition of FCMs for futures customers and to assist customers in their due diligence of FCMs, NFA's Special Committee on the Protection of Customer Funds, which is comprised of NFA's public directors, recommended that certain FCM financial information be made publicly available on NFA's website. The infor-

mation includes an FCM's adjusted net capital, required net capital and its excess net capital. Additionally, the information includes the amount of customer segregated funds held, the amount of segregated funds required to be held, the amount of excess segregated funds and the percentage of segregated funds that are held in cash and other permitted investments. The data also includes the same details regarding secured amount funds held for trading on foreign exchanges.

This financial information can be accessed through NFA's Background Affiliation Status Information Center (BASIC) via an easy-to-read display. NFA offers three Financial Data Reports for each FCM—the FCM Capital Report, the FCM Customer Segregated Funds Report and the FCM Customer Secured Amount Funds Report. This data was made available on NFA's website on November 7, and will be updated on a monthly or semi-monthly basis. ■

# ENFORCEMENT

## Actions

**Strict enforcement of NFA rules** is critical to the effectiveness of the self-regulatory process. During NFA's most recent fiscal year, the Executive Committee issued **10 Member Responsibility Actions (MRA)**. These types of actions are taken when NFA perceives an imminent threat to customers or markets. MRAs usually result in a suspension of membership privileges, the freezing of customer and firm accounts, prohibition of accepting additional customer funds and restriction of trading except for specific purposes (such as liquidation of open positions) under close supervision.

In addition, NFA's Business Conduct Committee issued **49 Complaints against 98 respondents**. NFA's disciplinary panels issued **68 Decisions**, ordered **31 expulsions** and **39 suspensions**. They also ordered more than **\$8 million in customer restitution** and assessed over **\$3 million in fines**.

As in past years, a substantial portion of **Complaints focused on retail off-exchange foreign currency (forex) trading and sales practice abuses**. The forex cases involved price slippage practices that benefitted the firm to the detriment of its customers, improper cancelling of trades and removing profits from customer accounts. Sales practice cases involved the use of misleading promotional material and fraudulent sales solicitations. In addition, NFA issued several Complaints that involved abuses in connection with trading strategies employed by Member firms, particularly strategies that were designed to generate large commissions for the firms, but frequently made little or no financial sense for customers. ■



# SWAPS Regulation

The **regulatory landscape** is changing and many previously unregistered entities are now facing CFTC registration and NFA membership. In the area of over-the-counter (OTC) derivatives, the CFTC's final rules requiring SDs and MSPs to be members of a registered futures association will result in new NFA Members. Additionally, the Dodd-Frank Wall Street Reform and Consumer Protection Act amended the definitions of FCM, IB, CPO and CTA to include "swaps." Historically, the CFTC has delegated registration responsibility to NFA for all registration categories and, once again, has entrusted NFA with the registration responsibility for swaps firms.

Given these new responsibilities, NFA made significant updates to its online registration system to accommodate these new swaps Members, and is now positioned to accept and process their applications. These new swaps firms also will be subject to NFA's oversight programs.

## Educational initiatives

NFA developed a multifaceted educational outreach plan to provide these swaps entities with the necessary information to meet their new regulatory responsibilities. NFA employed a variety of methods to educate NFA's potential new Members, including extensive updates to its website covering swaps regulatory issues, notices to Members, webinars, video tutorials, workshops, conferences and teleconferences sponsored by law firms and trade associations. NFA also had meetings with a multitude of firms that may be required to be registered and subject to NFA oversight programs.



## WWW.NFA.FUTURES.ORG A Gateway to Information

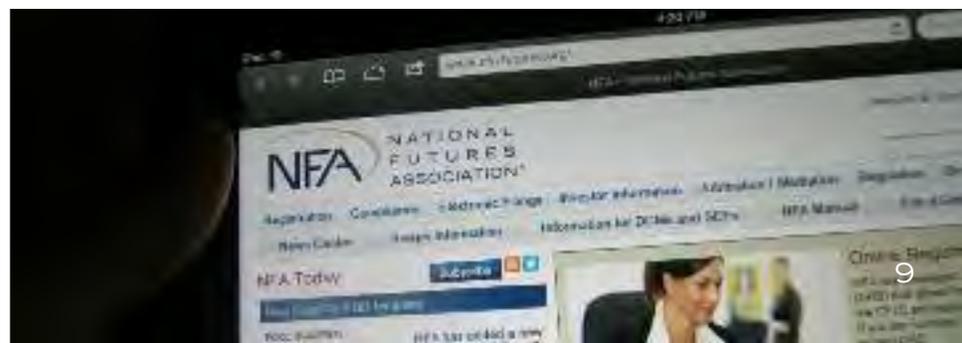
**NFA's website** is the primary source of information for both NFA Members and the investing public. During Fiscal Year 2012, **the website recorded more than 2.7 million visitor sessions.**

For NFA Members, the website provides access to NFA's online registration system and other electronic filings systems, regulatory notices and guides, as well as podcasts, webcasts and tutorial videos focusing on a variety of compliance and registration-related topics. Specifically, **NFA Members downloaded more than 30,000 copies of NFA's five regulatory guides** during the past fiscal year.

For investors, the website contains educational brochures and online learning programs that help them understand the basics of trading on-exchange futures as well as off-exchange retail foreign currency (forex). For example, **visitors downloaded more than 44,000 copies of NFA's brochure "Trading in the Retail Off-Exchange Foreign Currency Market – What Investors Need to Know"** during the past fiscal year.

One of the most popular features of NFA's website for both NFA Members and the investing public is the **Background Affiliation Status Information Center (BASIC) system.** BASIC is a comprehensive database of registration, disciplinary and financial information about futures/forex firms and salespeople. During Fiscal Year 2012, **individuals conducted more than 1.7 million background checks** using BASIC.

Most recently, **NFA added three financial data reports** of Futures Commission Merchants (FCM)—the FCM Capital report, the FCM Customer Segregated Funds report and the FCM Customer Secured Funds report. These reports, which are updated regularly, provide greater transparency for investors. ■



## Governance

NFA's Board appointed a Special Committee on NFA Governance to review NFA's current structure and explore alternatives for structurally realigning NFA's Board, Executive Committee and other committees to include SDs and MSPs. The Special Committee presented its recommendations to the Swap Dealer Advisory Committee, the Executive Committee and the Board. The Board approved the Governance Committee's final recommendations and unanimously voted in August to amend its Articles of Incorporation to increase the size and modify the structure of the Board. The Board changes were submitted to the membership and ratified by NFA's membership in September.

In general, the Board's size will increase to 39 directors by adding seven swaps participants and four Public Representatives. Within the swaps participant category, three seats will be allocated to "large financial institution" SDs, three seats to other SDs and one seat to an MSP if one is willing to serve. Additionally, the Executive Committee will grow to 13 members, with public directors continuing to comprise 35 percent of the Board's and Committee's composition.

## Market regulation—Swap Execution Facilities

In January 2011, the CFTC issued its proposed rules for swap execution facilities (SEF). The proposed rules allow a SEF to contract with a registered futures association or other registered entity for regulatory services to assist the SEF in complying with the core principles of the Commodity Exchange Act. During the past year, a number of SEFs approached NFA to provide regulatory services.

In order to develop the necessary systems to perform SEF regulatory services in advance of when SEFs begin trading, NFA developed a pre-launch services agreement (PSA). This agreement allows NFA to collect fees from each SEF in order to recoup the costs of the pre-launch work, and provides a more accurate estimate of the number of SEFs that may outsource their regulatory services so NFA can effectively plan for the delivery of these regulatory services.

In 2012, NFA entered into PSAs with 13 potential SEFs and one designated contract market that plans to trade swaps only. The new swaps surveillance system is complete and demonstrations of the system have been provided to the CFTC, the Securities and Exchange Commission and a number of potential SEFs. Staff also has been working with the potential SEFs to complete the process of coding and testing data.

## Increasing staff, expanding space

To accommodate all of the work being done by the market regulation and swaps compliance teams, NFA has begun to expand its ranks with new staff members, including individuals with extensive swaps experience and expertise. In the coming year, NFA will continue to add new employees to implement the initiatives to further enhance customer protection, perform the oversight function of SDs and swaps intermediaries and perform regulatory services for SEFs. The new staff also will develop audit modules that will be used to monitor NFA Members for compliance with the relevant rules and regulations, as well as the information technology infrastructure to support NFA's increasing regulatory responsibilities.

Dovetailing with the increase in personnel, NFA also has begun to build additional office space and expand its data center. At its Chicago location, NFA has added considerable real estate to house the growing swaps compliance and market regulation staffs. NFA worked with architects to design an open floor plan that provides more flexibility and seating. And at its New York location, NFA also took on additional temporary office space to accommodate the swiftly growing swaps staff. As NFA's New York lease is scheduled to terminate in the near future, NFA plans to seek out a larger office space in New York in 2013 to accommodate our long-term growth needs. ■

# REGISTRATION

## Screening/Information Center

NFA thoroughly screens all firms and individuals wishing to do business with the public on any U.S. futures exchange or retail off-exchange foreign currency (forex) market. Applicants must meet stringent fitness requirements and pass comprehensive proficiency testing requirements. In Fiscal Year 2012, **NFA's Registration Department processed more than 1,200 firm registrations and more than 25,000 individual registrations.**

In many instances, fingerprint card results, answers to a disciplinary history question on the application or regulatory information obtained during NFA's background checks precipitates the opening of a fitness investigation case. **NFA's Fitness Group opened more than 2,600 such cases** in Fiscal Year 2012. More than **75 percent of those cases were closed within two weeks**, allowing applicants to complete the registration process as quickly as possible.

Many registrants have questions during the application process and turn to NFA's Information Center for answers. Every business day, the dedicated individuals of NFA's Information Center answer hundreds of calls from NFA Members and the investing public. They guide applicants through the registration process, help investors conduct background checks on a futures or forex firm and clarify compliance rules for NFA Members. **During Fiscal Year 2012, the Information Center received more than 35,000 calls.** ■





## Futures and Forex Regulation

During the past year, NFA took significant steps to improve the regulation of the futures and retail off-exchange foreign currency (forex) markets. With the enhancement of customer protection standing at the fore of NFA's rulemakings, NFA worked to, among other things, revise Members' reporting requirements, register and monitor previously unregulated entities and provide extensive educational opportunities for current and prospective Members.

### Preparing for an influx of CPO and CTA Members

The CFTC made a number of changes to its Part 4 Rules that likely will have an impact on NFA's resources in both the near and long terms. In February 2012, the CFTC modified the exclusion from CPO registration under CFTC Regulation 4.5 available to registered investment companies (RIC) to impose certain operating restrictions on operators seeking the exclusion.

The CFTC adopted amendments to Regulation 4.5 in response to NFA's August 2010 Petition for Rule-making that highlighted NFA's customer protection concerns with RICs (i.e., mutual funds) offering managed futures strategies.

NFA advocated the amendments to CFTC rules after recognizing that a number of RICs offer actively managed futures strategies. These mutual funds, which are presented and marketed as commodity futures investments to the retail public, claimed the CFTC Regulation 4.5 exclusion and, therefore, were not subject to the CFTC's jurisdiction and NFA oversight.

Concurrently, the CFTC also rescinded Regulation 4.13(a)(4)—a broadly held exemption from CPO registration. Both of these actions likely will cause a number of unregistered entities to register and become NFA Members.

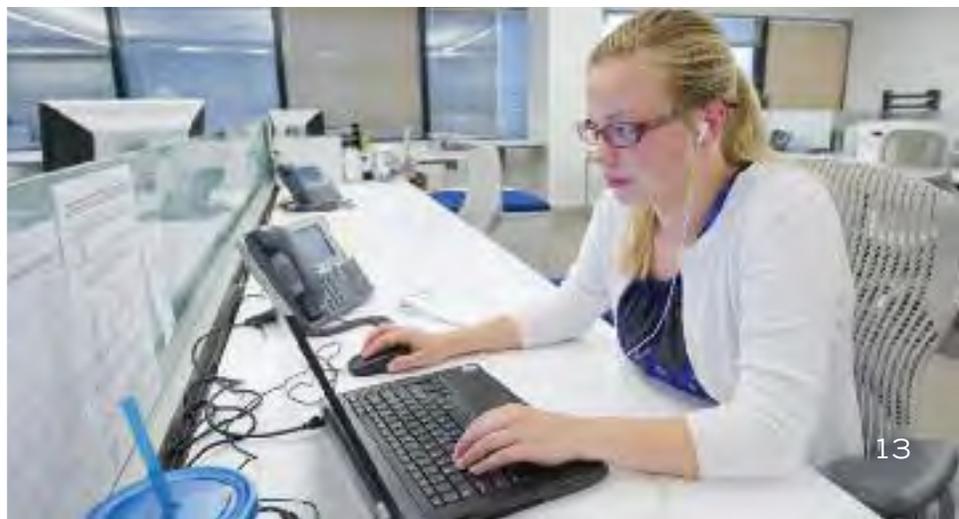
# COMPLIANCE

## Monitoring

**With more than 3,800 member firms and over 55,000 associate members,** NFA expends considerable resources throughout the year to ensure that all Members and Associates are in compliance with NFA rules and CFTC regulations. **NFA auditors conducted more than 700 audits during fiscal year 2012. NFA's Disclosure Document Review Team received approximately 1,300 disclosure documents from CPOs and 2,200 from CTAs. The Promotional Material Review Team received more than 9,000 pieces of promotional material (print ads, websites, videos and more),** either as part of the pre-review service NFA offers all Members or as a component of an ongoing audit.

In order to monitor firms more effectively, **NFA enhanced its Risk Management System to capture more data pertaining to Member firms,** allowing NFA to better identify those firms that pose the greatest threat. NFA also revised the structure within the Compliance department to dedicate staff to certain core responsibilities (e.g., financial statement analysis and investigations), freeing up other staff to concentrate on the audit function.

To accomplish these tasks, NFA has assembled an experienced group of compliance professionals. **A typical NFA auditor has an average of six years of experience.** In addition, NFA has an extensive in-house training program, and an **NFA Compliance staff member averages up to 40 hours of ongoing training every year.** ■



NFA went to great lengths to ensure these previously exempt entities were prepared for regulatory oversight. NFA hosted a series of workshops in London, New York, Chicago and San Francisco that focused on the registration process, disclosure document preparation, performance reporting, financial reporting requirements, sales practices and NFA's audit process. NFA also produced a webinar for CPOs and CTAs that presented information similar to what was covered in the workshops. Beyond these efforts, NFA also implemented several informational updates to its website, spoke at industry conferences and teleconferences and met with numerous prospective Member firms.

### Forex customer protection initiatives

Safeguarding customers also was NFA's priority this past year in the forex market. Spurred on by actions and observations that NFA had made in 2011, a series of rulemakings and additional guidance on how to remain compliant with NFA rules were issued in 2012. Specifically, NFA made amendments to requirements regarding supervision and use of electronic trading systems, addressed concerns about inappropriate price slippage settings, updated reporting requirements and implemented the same "know your customer" requirements for FDMs that NFA requires for Members to observe in the futures market.

In 2011, NFA took an enforcement action against an FDM whose price slippage practices benefitted the firm to the detriment of the customer. Often in forex trading, the price "slips" in the brief period between the time the customer places an order and the time the forex dealer executes the order. In the NFA enforcement case, similar to two cases brought against FDMs in 2010, the forex dealer would not give the customer the new price if it was favorable to the customer. However, if the new price was unfavorable to the customer, and subsequently favorable to the firm, the forex dealer would pass the new price on to the customer.

Although NFA's Business Conduct Committee found that this conduct violated existing NFA rules, NFA issued an interpretive notice for NFA Compliance Rule 2-36 to provide additional guidance on the issue. Rule 2-36 requires an FDM to act honestly, fairly and in the best interests of its customers, including how it handles customers' forex transactions. The new interpretive notice describes the specific conduct that was at issue in the disciplinary matters and makes it clear that any practice that provides an advantage to the FDM to the detriment of a forex customer would violate NFA's rules. The notice also clarifies that an FDM must provide its customers with complete information on how it handles price slippage and requires an FDM to have written supervisory procedures that describe how an FDM handles price slippage. Additionally, the notice requires an FDM to ensure that any material that discusses the mechanics of the FDM's trading system does not provide misleading or inaccurate information regarding how the system deals with price slippage and re-quoting.

Similar to amendments to NFA Financial Requirement Section 16 requiring FCMs to report certain financial data to promote greater transparency, NFA amended Financial Requirements Section 13 to require FDMs to submit additional reports to NFA in order to properly account for all funds received from and owed to customers. As a result of the amendments, FDMs must file with NFA three report types: daily electronic reports showing liabilities to customers and other financial and operational information, monthly operational and risk management reports, and quarterly reports that contain the most recent performance disclosures required under CFTC regulations.

Additionally, NFA amended an interpretive notice that reminded Members of their obligation to ensure that promotional materials concerning electronic trading systems accurately discuss the platform's function and operation. The notice also required Members to have credit and risk management controls in order to prevent customers from entering into trades that create undue financial risks for the Member or the Member's other customers. The notice also mandated that Members have policies and procedures in place to monitor their own proprietary trading, as well as the impact those positions and any potential market movement or adjustments may have on a Member's ability to meet its capital requirement. What's more, the notice requires electronic trading systems to be designed to identify trading anomalies or patterns that indicate a system malfunction, especially those that could result in undue risk to the FDM.

Another amendment, set forth in Compliance Rule 2-36, requires Members to comply with the same "know your customer" requirements for forex customers as are currently required for futures customers. Additionally, amendments to NFA Compliance Rule 2-10 require FDMs to maintain an office in the continental U.S., Alaska, Hawaii or Puerto Rico that is responsible for preparing and maintaining CFTC- and NFA-required financial records and reports, and be under the supervision of a listed principal and registered associated person of the FDM who resides in that office. ■



# Officers

# & Board of Directors

As of June 30, 2012

## Officers



**Daniel J. Roth\***  
*President & CEO*



**Daniel A. Driscoll**  
*Exec. Vice-President  
Chief Operating Officer*



**Kenneth F. Haase**  
*Sr. Vice-President  
Information Systems*



**Thomas Sexton III**  
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& Secretary*



**Regina Thoele**  
*Sr. Vice-President  
Compliance*



**Karen K. Wuertz**  
*Sr. Vice-President  
Strategic Planning  
and Communications*



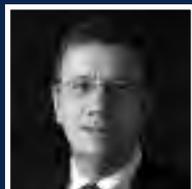
**Edward J. Dasso**  
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Market Regulation*



**David Hawrysz**  
*Vice-President  
Chief Financial Officer  
Treasurer*



**Jamila Piracci**  
*Vice-President  
OTC Derivatives*



**Gregory C. Prusik**  
*Vice-President  
Registration*

## Directors



**Christopher K. Hehmeyer\***  
*Chairman of the Board  
Non-executive Vice Chairman  
Knight Futures*

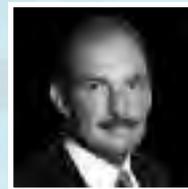


**Paul J. Georgy\***  
*Vice-Chairman of the Board  
President  
Allendale Inc.*

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Northfield Trading LP*



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*Vice Chairman  
Campbell & Company Inc.*



**George E. Crapple\***  
*Co-Chairman & Co-CEO  
Millburn Ridgefield Corp.*



**Ernest L. Jaffarian**  
*President and CEO  
Efficient Capital Management LLC*

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*President  
Allendale Inc.*



**John A. Vassallo**  
*President  
Coquest Inc.*

\* Member of the Executive Committee

## Futures Commission Merchant Representatives



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*Chief Executive Officer*  
 R.J. O'Brien &  
 Associates Inc.



**Scott A. Cordes**  
*President*  
 Country Hedging Inc.



**Michael C. Dawley**  
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**Maureen C. Downs**  
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 JPMorgan Securities LLC



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*Non-executive Vice Chairman*  
 Knight Futures



**William F. McCoy**  
*Managing Director*  
 Morgan Stanley



**Leo Melamed**  
 Permanent Special Advisor to the  
 Board & Executive Committee

## Special Advisor

## Public Representatives



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*Director*  
 Center on Financial  
 Services Law



**William N. Goetzmann**  
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*International Center for Finance*  
 Yale School of Management



**Douglas E. Harris\***  
*Managing Director*  
 Promontory Financial  
 Group L.L.C.



**Silas Keehn**  
*Past President*  
 Federal Reserve Bank  
 of Chicago



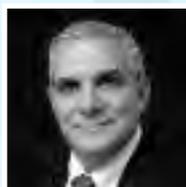
**Jim Marshall**  
*President & CEO*  
 U.S. Institute of Peace



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*Vice Chairman and*  
*Senior Fellow on the*  
*Global Economy*  
 The Chicago Council  
 on Global Affairs



**Charles P. Nastro\***  
 New York, N.Y.



**Ronald S. Oppenheimer**  
*Senior Vice President and*  
*General Counsel*  
 Vitrol Inc.

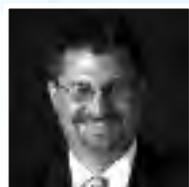


**Todd E. Petzel\***  
*Chief Investment Officer*  
 Offit Capital  
 Advisors LLC



**Susan M. Phillips\***  
*Former Chairman*  
 Commodity Futures  
 Trading Commission

## Exchange Representatives



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*President & CEO*  
 Minneapolis Grain  
 Exchange



**Jeffrey C. Borchardt**  
*President & CEO*  
 Kansas City Board  
 of Trade



**David S. Goone**  
*Senior Vice President &*  
*Chief Strategic Officer*  
 IntercontinentalExchange Inc.



**John F. Sandner\***  
*Special Policy Advisor*  
*& Retired Chairman*  
*of the Board*  
 CME Group Inc.

# 2012 FINANCIALS

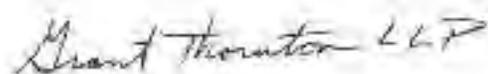
## Report of Independent Certified Public Accountants

Board of Directors  
National Futures Association

We have audited the accompanying statements of financial position of National Futures Association (the Association) as of June 30, 2012 and 2011, and the related statements of unrestricted revenues, expenses and changes in unrestricted net assets, and cash flows for the years then ended. These financial statements are the responsibility of the Association's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America as established by the American Institute of Certified Public Accountants. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Association's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of National Futures Association as of June 30, 2012 and 2011, and the changes in its net assets and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.



Chicago, Illinois  
October 9, 2012

NATIONAL FUTURES ASSOCIATION

STATEMENTS OF FINANCIAL POSITION

JUNE 30, 2012 AND 2011

	2012	2011
<b>Assets</b>		
<b>Current assets:</b>		
Cash and cash equivalents	\$ 17,287,655	\$ 6,966,367
Short-term investments	33,584,908	33,288,655
Assessments receivable	3,792,519	4,763,454
Other current assets, net	2,370,750	1,530,808
<b>Total current assets</b>	<b>57,035,832</b>	<b>46,549,284</b>
<b>Furniture, fixtures, equipment, leasehold improvements and software, net</b>	<b>10,049,388</b>	<b>7,909,835</b>
<b>Other assets</b>	<b>1,050,985</b>	<b>968,501</b>
<b>Total assets</b>	<b>\$ 68,136,205</b>	<b>\$ 55,427,620</b>
<b>Liabilities and Net Assets</b>		
<b>Current liabilities:</b>		
Unearned dues and fees	\$ 2,295,880	\$ 1,359,768
Accounts payable, accrued expenses and other current liabilities	5,811,881	3,156,333
<b>Total current liabilities</b>	<b>8,107,761</b>	<b>4,516,101</b>
<b>Deferred rent credit</b>	<b>4,125,417</b>	<b>3,097,619</b>
<b>Other long-term liabilities</b>	<b>5,062,204</b>	<b>4,738,534</b>
<b>Total liabilities</b>	<b>17,295,382</b>	<b>12,352,254</b>
<b>Unrestricted net assets</b>	<b>50,840,823</b>	<b>43,075,366</b>
<b>Total Liabilities and Unrestricted Net Assets</b>	<b>\$ 68,136,205</b>	<b>\$ 55,427,620</b>

*The accompanying notes are an integral part of these statements.*

NATIONAL FUTURES ASSOCIATION

STATEMENTS OF UNRESTRICTED REVENUES,  
EXPENSES AND CHANGES IN UNRESTRICTED NET ASSETS

JUNE 30, 2012 AND 2011

	2012	2011
<b>Unrestricted Revenues</b>		
Assessments	\$ 38,408,823	\$ 28,561,176
Membership dues	8,823,913	7,519,517
Registration and other fees	4,165,412	3,564,380
Regulatory services outsourcing	4,640,662	2,959,410
Investment income	296,253	3,021,312
<b>Total unrestricted revenues</b>	<b>56,335,063</b>	<b>45,625,795</b>
<b>Unrestricted Expenses</b>		
Salaries, wages and employee benefits	35,279,476	30,184,990
Space rental and related expenses	2,214,930	2,074,759
Travel and meetings	2,439,091	1,932,697
Computer expenditures	1,237,443	998,761
Depreciation and amortization	3,174,855	3,291,455
Outside consulting fees and services	1,959,445	1,651,910
Supplies, postage and telephone	243,333	240,982
Outside printing and publications	54,018	65,453
Board and committee fees and expenses	622,735	596,411
Insurance, recruiting, education, dues and other	1,344,280	1,254,767
<b>Total unrestricted expenses</b>	<b>48,569,606</b>	<b>42,292,185</b>
<b>Change in Unrestricted Net Assets</b>	<b>7,765,457</b>	<b>3,333,610</b>
<b>Unrestricted net assets at beginning of year</b>	<b>43,075,366</b>	<b>39,741,756</b>
<b>Unrestricted net assets at end of year</b>	<b>\$ 50,840,823</b>	<b>\$ 43,075,366</b>

*The accompanying notes are an integral part of these statements.*

NATIONAL FUTURES ASSOCIATION

STATEMENTS OF CASH FLOWS

JUNE 30, 2012 AND 2011

	2012	2011
<b>Reconciliation of Change in Unrestricted Net Assets to Net Cash Provided by Operating Activities</b>		
Change in unrestricted net assets	\$ 7,765,457	\$ 3,333,610
Adjustments to reconcile change in unrestricted net assets to net cash provided by operating activities		
Net unrealized loss (gain) on investments	226,643	(2,165,199)
Depreciation and amortization	3,174,855	3,291,455
Changes in assets and liabilities		
Assessments receivable	970,935	(2,922,457)
Accrued interest	—	9,144
Other assets	(922,426)	2,028,212
Unearned dues and fees	936,112	(338,264)
Accounts payable, accrued expenses and other liabilities	2,979,218	(330,940)
Deferred rent credit	1,027,798	(299,240)
<b>Net Cash provided by Operating Activities</b>	<b>16,158,592</b>	<b>2,606,321</b>
<b>Cash Flows from Investing Activities</b>		
Purchases of fixed assets and software	(5,314,406)	(2,304,700)
Purchase of investments	(1,978,410)	(27,106,443)
Proceeds from sale of investments	1,455,512	26,250,388
Maturities of U.S. Treasury securities	—	475,594
<b>Net Cash used in Investing Activities</b>	<b>(5,837,304)</b>	<b>(2,685,161)</b>
<b>Net Change in Cash and Cash Equivalents</b>	<b>10,321,288</b>	<b>(78,840)</b>
<b>Cash and Cash Equivalents at beginning of year</b>	<b>6,966,367</b>	<b>7,045,207</b>
<b>Cash and Cash Equivalents at end of year</b>	<b>\$ 17,287,655</b>	<b>\$ 6,966,367</b>

*The accompanying notes are an integral part of these statements.*

### NOTE A ORGANIZATION

The Commodity Futures Trading Commission has designated National Futures Association (the Association) as a registered futures association. Among the Association's activities are qualification screening and registration, financial and trade practice surveillance, enforcement of customer protection rules and uniform business standards, arbitration of disputes and educational activities. The Association is financed through the payment of assessments and dues by its members and registration fees by registrants.

### NOTE B SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

**Use of Estimates**—The financial statements of the Association have been prepared, using the accrual basis of accounting, in conformity with accounting principles generally accepted in the United States of America (US GAAP). The preparation of financial statements in conformity with US GAAP requires management to use estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from these estimates.

**Assessments**—Assessments are reported monthly and are due within 30 days. They are recognized as revenue in the month to which they apply. Amounts reported, but not yet collected, are recognized as assessments receivable on the accompanying statements of financial position.

**Membership Dues**—Membership dues are non-refundable and are recognized as revenue on a pro rata basis over each member's membership year. Amounts received, but not yet earned, are recognized in unearned dues and fees on the accompanying statements of financial position.

**Registration Renewal Fees**—Registration renewal fees are non-refundable and are recognized as revenue on a pro rata basis over each registrant's renewal period. Amounts received prior to the event are recognized in unearned dues and fees on the accompanying statements of financial position.

**Regulatory Services Outsourcing**—Regulatory services outsourcing revenue relates to the Association's trade practice and market surveillance services. This revenue consists of one-time non-refundable fees and monthly fees for ongoing services for each customer. One-time fees are used by the Association to purchase hardware and software necessary to perform surveillance services for a given customer and are recognized as revenue when paid by the customer. Monthly fees and a transaction fee for ongoing surveillance and other regulatory services are recognized as revenue on a monthly basis as services are performed.

**Furniture, Fixtures, Equipment and Leasehold Improvements**—The Association capitalizes individual purchases greater than \$1,000 and group purchases greater than \$10,000.

Furniture, fixtures, equipment and leasehold improvements are depreciated over three to seven years or the term of the lease, if applicable, on a straight-line basis. The Association uses the half-year convention so that the first and last years of depreciation and amortization are one half the straight-line amount and all middle years are in direct proportion to the useful life of the capitalized item. Additionally, the Association has artwork that is considered non-depreciable included in Note E valued at \$246,307 for 2012 and 2011.

**Purchased Software**—Purchased software is included in fixed assets, and is capitalized and amortized over three years on a straight-line basis using the half-year convention.

**Software Design and Development Costs**—Software design and development costs consist of salaries and benefits of the Association's personnel involved in projects to develop software for internal use. Software design and development costs incurred in the preliminary stage of a project, as well as training and maintenance costs, are expensed as incurred. Software design and development costs associated with the application development stage of software projects are capitalized until such time as the software is substantially complete and ready for its intended use. Capitalized software design and development costs are amortized over three years on a straight-line basis using the half-year convention.

**Deferred Rent Credit**—Due to the terms of the Association's primary office space leases, a deferred rent credit was generated. The deferred rent credit is amortized over the remaining terms of the respective leases, which range from 2 to 11 years. The Association has computed an average monthly rental for the entire term of each lease and charges this amount to rental expense each month. The difference between the average monthly rental and the actual monthly rental payment is accounted for as either an increase or reduction of the deferred rent credit on the accompanying statements of financial position.

**Allowance for Doubtful Accounts**—The allowance for doubtful accounts, which is related to membership dues receivable, registration revenue receivable and regulatory fines, is maintained at a level that management deems adequate to provide for estimated uncollectible receivables and is based on the length of time receivables have been outstanding, historical experience and an assessment of business economic conditions. At June 30, 2012 and 2011, the allowance for doubtful accounts is \$360,784 and \$85,066, respectively. This allowance is a reduction of receivables, which are included in other current assets on the accompanying statements of financial position.

**Fair Value Measurements**—The Financial Accounting Standards Board (FASB) has issued guidance that defines fair value, establishes a framework for measuring fair value, establishes a fair value hierarchy based on the inputs used to measure fair value and specifies disclosure requirements for fair value measurements. This guidance maximizes the use of observable inputs and minimizes the use of unobservable inputs by requiring that the observable inputs be used when available.

Observable inputs are inputs that market participants would use in pricing the asset or liability based on market data obtained from independent sources. Unobservable inputs reflect assumptions that market participants would use in pricing the asset or liability based on the best information available in the circumstances. The fair value hierarchy is broken down into three levels based on the transparency of inputs as follows:

**Level 1** - Quoted prices are available in active markets for identical assets or liabilities as of the report date. A quoted price for an identical asset or liability in an active market provides the most reliable fair value measurement because it is directly observable to the market.

**Level 2** - Pricing inputs are other than quoted prices in active markets for identical assets or liabilities, which are either directly or indirectly observable as of the report date. These securities include investments for which quoted prices are available but which are traded in an inactive market or investments that are fairly valued using other securities, the inputs for which can be directly observed.

**Level 3** - Securities that are valued using significant unobservable inputs. These securities are measured using management's best estimate of fair value, where the inputs into the determination of fair value are not observable and require significant management judgment or estimation.

Inputs are used in applying the various valuation techniques and broadly refer to the assumptions that market participants use to make valuation decisions, including assumptions about risk. Inputs may include price information, volatility statistics, specific and broad credit data, liquidity statistics, and other factors. A financial instrument's level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement. However, the determination of what constitutes "observable" requires significant judgment by the Association. The Association considers observable data to be that market data that is readily available, regularly distributed or updated, reliable and verifiable, not proprietary, and provided by independent sources that are actively involved in the relevant market. The categorization of a financial instrument within the fair value hierarchy is based upon the pricing transparency of the instrument and does not necessarily correspond to the Association's perceived risk of that instrument.

All of the Association's investments have values that are based on quoted market prices in active markets and are therefore classified as Level 1. These investments include active listed equities, U.S. government and sovereign obligations, and money market securities. The Association does not adjust the quoted price for such instruments, even in situations where the Association may hold a large position and a sale could reasonably impact the quoted price.

**Federal Income Taxes**—The Association has received a favorable determination letter from the Internal Revenue Service, stating that they are exempt from federal income taxes under the provisions of Section 501(c)(6) of the Internal Revenue Code of 1986 (IRC), except for income taxes pertaining to unrelated business income. The FASB issued guidance that requires tax effects from uncertain tax positions to be recognized in the financial statements only if the position is more likely than not to be sustained if the position were to be challenged by a taxing authority. Management has determined there are no material uncertain positions that require recognition in the financial statements, and has properly accrued a provision for excise taxes. There is no interest or penalties recognized in the statement of activities or statement of position. The tax years ending 2008, 2009, 2010 and 2011 are still open to audit for both federal and state purposes.

## **NOTE C CASH AND CASH EQUIVALENTS**

The Association considers money market accounts and investments with an original maturity of less than three months to be cash equivalents. The Association maintains cash balances at financial institutions insured by the Federal Deposit Insurance Corporation up to \$250,000. At times, the balances in these accounts may exceed the insured limits. The Association has not experienced any losses in such accounts and believes it is not exposed to any significant credit risk on its cash balances.

## NOTE D INVESTMENTS

The Association's investment portfolio is classified on the statements of financial position as short-term and long-term investments. Short-term investments consist of securities with maturity dates of one year or less. Long-term investments consist of securities with maturity dates greater than one year. Also included as short-term investments is the Association's investment in equity and fixed income mutual funds. As of June 30, 2012 and 2011, the Association did not own any long-term investments.

The aggregate fair value of investments by major type as of June 30, 2012 and 2011, are as follows:

<b>Short-term investments:</b>	<b>2012</b>	<b>2011</b>
Developed Markets Index Fund	\$ 1,463,057	\$ 1,693,832
Extended Markets Signal Index Fund	1,668,743	1,710,363
Short Term Treasury Fund	26,890,441	26,505,180
S&P 500 Index Mutual Fund	3,562,667	3,379,280
<b>Total short-term investments</b>	<b>\$ 33,584,908</b>	<b>\$ 33,288,655</b>

For its four mutual funds, the Association immediately reinvests all interest income, dividend income and capital gains back into the funds. The Association also holds self-directed government securities, which it anticipates holding until maturity. For the years ended June 30, 2012 and 2011, the activities in the funds and the self-directed securities were as follows:

	<b>2012</b>	<b>2011</b>
Income reinvested back into mutual funds	\$ 522,896	\$ 856,054
Net unrealized (loss) gain mutual funds	(226,643)	2,165,199
Interest income from self-directed investments	—	653
Realized loss from self-directed investments	—	(594)
<b>Total investment return</b>	<b>\$ 296,253</b>	<b>\$ 3,021,312</b>

## NOTE E FURNITURE, FIXTURES, EQUIPMENT, LEASEHOLD IMPROVEMENTS AND SOFTWARE

At June 30, 2012 and 2011, furniture, fixtures, equipment, leasehold improvements and software, and the related accumulated depreciation and amortization are as follows:

	<b>2012</b>	<b>2011</b>
Furniture and fixtures	\$ 2,802,585	\$ 2,143,283
Equipment	3,320,806	2,066,709
Leasehold improvements	6,555,565	5,472,036
Software	5,096,830	5,285,840
<b>Total</b>	<b>\$ 17,775,786</b>	<b>\$ 14,967,868</b>
Less accumulated depreciation and amortization	7,726,396	7,058,033
<b>Furniture, fixtures, equipment, leasehold improvements and software, net</b>	<b>\$ 10,049,390</b>	<b>\$ 7,909,835</b>

## NOTE F COMMITMENTS & CONTINGENCIES

The Association leases office space in Chicago and New York. The current Chicago lease expires on August 31, 2023. The current New York lease expires on June 30, 2013. The following is a schedule of future payments under both of the operating leases and the disaster recovery service contract that have remaining non-cancellable payment terms as of June 30, 2012:

<i>Years ending June 30,</i>	
2013	\$ 2,058,020
2014	1,300,057
2015	1,334,454
2016	1,369,776
2017	1,406,036
Thereafter	10,635,787
<b>Total operating lease commitments</b>	<b>\$ 18,104,130</b>

In the normal course of business, the Association is, at times, involved in pending legal proceedings. Management, after consultation with outside legal counsel, believes that the resolution of current proceedings will not have a material effect on the Association's net assets.

## NOTE G EMPLOYEE BENEFIT PLANS

The Association sponsors an Employee Retirement Savings Plan (the Savings Plan). Contributions to the Savings Plan of up to 100% of employees' compensation can be made through payroll deductions. The Association will match employee contributions up to 6% of the employee's eligible compensation. The Association may also contribute to the Savings Plan an additional profit-sharing contribution expressed as a percent of the calendar year's compensation of participants who are employed on the last day of the calendar year. A profit-sharing contribution for 2011 of \$1,200,636 was made in 2012. A profit-sharing contribution for 2010 of \$1,097,029 was made in 2011. Employees are eligible to participate in the Savings Plan upon their date of hire. Employee contributions and any vested employer contributions are payable upon termination or retirement as stipulated in the Savings Plan.

The Association also sponsors the Retiree Medical Benefits Plan (the Plan), which covers substantially all retirees and their dependents. Effective December 31, 1993, employees who retire from the Association on or after attaining age 55 and who have at least 10 years of full-time service with the Association are entitled to receive benefits from the Plan. Individuals who attained age 65 on or before December 31, 1993, who have been employed by the Association on a full-time basis for at least five years, and who retired after July 1, 1993, were grandfathered under the Plan. The Plan pays a stated percentage of the cost of medical coverage for employees who retire prior to age 65. Coverage for employees who have retired and have reached age 65 is provided under a Medicare Supplemental Plan. Under the Medicare Supplemental Plan, the Association pays a stated percentage of the supplemental costs. Subsequent to July 1, 2003, the eligibility requirement was amended to reflect that employees can retire at age 55 or older but must have at least 10 years of service since their 45th birthday. All employees will retire having at least 10 years of service preceding their retirement.

*Subsequent to July 1, 2003, the structure is based on age at retirement as follows:*

Age	Retiree's Share	
	Pre-65	Post-65
55-59	70%	40%
60-64	60%	30%
65 plus	50%	20%

At June 30, 2012 and 2011, the actuarial and recorded liabilities for the Plan, none of which has been funded, and the net periodic post-retirement benefit cost and benefits paid for the Plan that are included in other long-term liabilities, were as follows:

	2012	2011
<i>Amounts recognized in the statements of financial position</i>		
Accumulated post-retirement benefit obligations	\$ (5,748,832)	\$ (3,907,712)
Unrecognized prior service cost	—	(217,903)
Unrecognized net loss (gain)	634,726	(677,913)
Unrecognized transition obligation	57,737	76,984
<b>Accrued post-retirement benefit cost</b>	<b>\$ (5,056,369)</b>	<b>\$ (4,726,544)</b>

The estimated net periodic post-retirement benefit cost for the Plan for the year ended June 30, 2012, is \$370,138 assuming a discount rate of 4.00%. The breakdown of the cost is as follows:

<i>Net periodic post-retirement benefit cost</i>	
Service cost	\$ 366,916
Interest cost	233,055
Amortization of gain	(31,177)
Amortization of transition obligation	19,247
Amortization of prior service cost	(217,903)
<b>Total net period post-retirement benefit cost</b>	<b>\$ 370,138</b>

The accumulated post-retirement benefit obligation was determined using an assumed weighted-average discount rate of 4.00% at June 30, 2012 and 5.50% at June 30, 2011. The rate of increase in the gross cost of covered healthcare benefits was assumed to be 7.5% for fiscal year 2012. The rate of increase is assumed to decline by 0.50% for each year after 2012 to 5.00% in 2017 and after.

The Association also participates in the purchase of life insurance on behalf of certain executive officers (Executives) as part of the National Futures Association split-dollar life insurance plan (the Split-Dollar Plan). The purpose of the Split-Dollar Plan is to provide participating Executives with an insured death benefit during employment and after retirement. The insurance policy also allows for capital accumulation through the buildup of cash value.

Upon termination of employment, death or maturity of the policy, the Association receives cash value equal to the cumulative premium paid by the Association. As of June 30, 2012 and 2011, the cumulative premium paid on behalf of the Executives is \$997,499 and \$915,014, respectively, and is classified in other assets on the statements of financial position in 2012 and other current assets in 2011.

#### **NOTE H DEFERRED RENT CREDIT**

Effective November 2001, the Association executed a 10-year operating lease for office premises in New York. Also, effective January 2008, the Association executed a 12-year operating lease for office premises in Chicago. In December 2011, the Association extended its Chicago lease 44 months to August 2023. Also in December 2011, the Association extended its New York lease by 8 months to June 2013. The leases include rent incentives and, accordingly, the Association recognizes such abatement as an adjustment to a deferred rent credit over the terms of the lease on a straight-line basis. The total deferred rent credit at June 30, 2012 and 2011, was \$4,435,750 and \$3,432,528, respectively, of which \$310,333 and \$334,909, respectively, are included in accounts payable, accrued expenses and other current liabilities on the statements of financial position. For the years ended June 30, 2012 and 2011, the Association's rent expense was as follows:

	2012	2011
Cash payments for rent	\$ 2,353,124	\$ 2,193,222
Less amortization of deferred rent credits	(325,579)	(328,583)
<b>Rent expense</b>	<b>\$ 2,027,545</b>	<b>\$ 1,864,639</b>

#### **NOTE I SUBSEQUENT EVENTS**

The Association evaluated its June 30, 2012, financial statements for subsequent events through October 9, 2012, the date the financial statements were available to be issued. The Association is not aware of any subsequent events that would require recognition or disclosure in the financial statements.

National Futures Association has been designated by the Commodity Futures Trading Commission (CFTC) as a registered futures association.

NFA is the premier independent provider of innovative and efficient regulatory programs that safeguard the integrity of the futures markets.

## Accountability and Organization

### POLICY DEVELOPMENT

28-member Board of Directors

- 14 FCM, IB, CPO, and CTA representatives
- 4 exchange representatives
- 10 public representatives

### POLICY SUPERVISION

12-member Executive Committee

- NFA President
- 3 FCM or IB representatives (including the Chairman of the Board)
- 2 exchange representatives
- 2 CPO/CTA representatives
- 4 public representatives

### POLICY IMPLEMENTATION

NFA officers and staff

### FUNDING

NFA is totally self-financed with funds derived from membership dues and fees and from assessments paid by Members and users of the futures markets.

TOTAL EMPLOYEES (As of June 30, 2012)

322



Winner  
2006 – 2012  
Awarded by the  
National Association  
for Business Resources



Winner  
2007 – 2012  
Awarded by the  
Best Companies Group



Winner  
2010 – 2012  
Awarded by the  
Chicago Tribune



Winner  
2007 – 2012  
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Foundation for Adoption



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