

# Supervision

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Member Workshop



# Supervision



- NFA compliance rules place the responsibility on each of its Member firms to diligently supervise its employees and agents in all aspects of their commodity interest activities, including swap activities, for or on behalf of the Member.



# Supervisory Procedures

Reasonably designed to ensure its APs' activities comply with applicable NFA/CFTC Requirements:

- Identify potential areas of non-compliance;
- Define frequency and scope of supervisory tasks performed;
- Define supervisory records maintained; and
- Procedures to escalate/resolve issues.

# Supervisory Procedures

- Tailor supervisory procedures for your operations
- Update supervisory procedures and processes as necessary
  - New systems or lines of business
  - New offices or employees
  - Remote/hybrid operations
- Use of third-party service providers, if applicable
  - Ensure on-going/periodic monitoring

# Qualifications and Hiring



## **Qualified supervisory personnel**

- Define areas of supervision and identify by title or position the person(s) responsible for performing each supervisory function.
- Ensure supervisory personnel are appropriately qualified.



# Qualifications and Hiring

## Pre-hiring due diligence

- To determine qualification and eligibility to engage in AP activity, firms should consider:
  - Background checks;
  - Confirm educational and employment information; and
  - Pending and/or prior disciplinary matters (involving derivatives or other regulators).
- Member firms should require APs to notify employer of any new disciplinary, criminal, or other matters that may require disclosure.

# Regulatory Requirements



- Keep full, complete and systematic records of all transactions, including all pertinent data and memoranda.
  - Including all orders (filled, unfilled or canceled), journals, ledgers, copies of confirmations, among others.

# Regulatory Requirements



- Keep all oral and written communications provided or received concerning quotes, solicitations, bids, offers, instructions, trading and prices leading to the execution of a transaction.
  - CFTC Regulation 1.35 – FCMs and IBs
- Adopt supervisory procedures for the use of electronic communications.

## Elements of an effective program:

- Clear policies and procedures
  - Written procedures should:
    - Identify the approved methods of communication;
    - Identify how communications are recorded and retained; and
    - Identify the person(s) responsible for conducting reviews of the activity.

## Elements of an effective program (continued):

- Clear policies and procedures
  - Written procedures should:
    - Specify how and with what frequency the activity will be reviewed;
    - Describe how the reviews will be documented; and
    - Describe how records of the review will be maintained.

# Communication Monitoring Program



## Elements of an effective program (continued):

- Ongoing training
- Defined investigation, escalation, and remediation process
- Defined disciplinary framework
- Code of conduct/attestations
- Program should periodically be re-evaluated



## Elements of an effective program (continued):

- Comprehensive reviews
  - Risk-based
  - Reasonably designed to uncover instances of non-compliance and fraud
    - Not just reviewing to ensure the record(s) exists
  - Inclusive of applicable personnel, devices, business lines, languages, and touch points with customers (i.e., solicitation process versus trade-related communications)

## Elements of an effective program (continued):

- Automated methods of detection
  - Tailored lexicons (e.g., multiple languages) or other detection methods
  - Alerts, reviews, and escalations
- Documented in a manner that demonstrates which specific communications and trades were reviewed and the results
  - Simple checklists or signoffs are **not** sufficient

# Order Handling and Trading Activities



## **Elements of an effective program (continued):**

- Supervisory measures in place to review and monitor its APs' order handling and trading activities to identify potential trading misconduct and market abuses.



# Order Handling and Trading Activities



## **Elements of an effective program (continued):**

- Outline frequency and scope of review; product coverage
- Manner (automated or manual)
- Documentation of the review and any investigation
- Escalation
- Evaluate the effectiveness of supervisory measures
- Ongoing checks to ensure that reviews are operating as intended

# Order Handling and Trading Activities



## **Elements of an effective program (continued):**

Some supervisory measures to consider:

- Review error accounts, suspense accounts, and give-up accounts;
- Monitor post trade activities (i.e., bunched order allocations, position transfers);
- Review trade discrepancies and trade data;



# Order Handling and Trading Activities



## **Elements of an effective program (continued):**

Some supervisory measures to consider:

- Monitor customer risk and position limits;
- Review complaints by customers and/or counterparties;
- Review firm/AP discretionary trading activity; and
- Review for significant losses, commission charges or large volumes of trade.



## Elements of an effective program (continued)

- Trade reconstructions
  - Helps to ensure that all required records leading up to trades are being maintained (i.e., ‘completeness’ testing).
  - Allows for additional, focused reviews of trade-related communications.
    - Should be a holistic review of broker communications to ensure all bids/offers are supported.

## Elements of an effective program (continued)

- Trade Reconstructions
  - Best practices include selecting trades after conducting risk-based review of trading activity to identify certain APs, customers, products, strategies, or other characteristics to select trades for reconstruction.

# Training



- APs should be properly trained:
  - NFA/CFTC requirements
  - Firm policies/procedures
- Training at regular intervals
- Documentation of training content and AP completion
- Best practice: periodically requiring APs to formally acknowledge their receipt, review and understanding of policies and procedures

# Common Exam Findings



- Failure to maintain records
- Failure to systematically record communications
- Failure to ingest trade or communications data into surveillance systems
- Not addressing surveillance alerts
- Disclosure of non-public information
- Lack of written procedures
- Asset class or product gaps in trade surveillance



# Q&A

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## Supervision

