

March 8, 2019

**Via Federal Express**

Mr. Christopher J. Kirkpatrick  
Secretary  
Office of the Secretariat  
Commodity Futures Trading Commission  
Three Lafayette Centre  
1155 21st Street, N.W.  
Washington, DC 20581

Re: National Futures Association: Proposed Amendments to NFA Compliance Rule 2-9 to Incorporate Supervision Requirements into Certain Compliance Rules and Interpretive Notices; other Technical Amendments; and the Proposed Interpretive Notice Entitled: *NFA Compliance Rule 2-9(d): Supervision Requirements for Swap Dealer and Major Swap Participant Members*

Dear Mr. Kirkpatrick:

Pursuant to Section 17(j) of the Commodity Exchange Act ("CEA" or "Act"), as amended, National Futures Association ("NFA") hereby submits to the Commodity Futures Trading Commission ("CFTC" or "Commission") the proposed amendments to NFA Compliance Rule 2-9, the proposed amendments to several NFA Interpretive Notices under NFA Compliance Rule 2-9, the proposed Interpretive Notice entitled *NFA Compliance Rule 2-9(d): Supervision Requirements for Swap Dealer and Major Swap Participant Members* and other technical amendments to NFA Requirements. NFA's Board of Directors ("Board") unanimously approved the proposed amendments and Interpretive Notice at its meeting on February 21, 2019 and provided that NFA's Executive Committee may submit the proposed rule and Interpretive Notice amendments and the new proposed Interpretive Notice to the CFTC for approval. NFA's Executive Committee, as authorized by the Board, approved additional amendments on March 7, 2019. The Board will ratify the Executive Committee's action at its May 16, 2019 meeting.

NFA is invoking the "ten-day" provision of Section 17(j) of the CEA and plans to issue a Notice to Members establishing an effective date for this proposal as early as ten days after receipt of this submission by the Commission unless NFA is notified that the Commission has determined to review the proposal for approval.

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**PROPOSED AMENDMENTS**  
**(additions are underscored and deletions are ~~stricken through~~)**

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**COMPLIANCE RULES**

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**Part 2 – RULES GOVERNING THE BUSINESS CONDUCT OF MEMBERS  
REGISTERED WITH THE COMMISSION**

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**RULE 2-8. DISCRETIONARY ACCOUNTS.**

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**(c) Minimum Experience Requirement.**

No Member FCM or IB shall allow an Associate to exercise discretion over a customer's commodity futures account unless that Associate has been continuously registered under the Act for a minimum of two years and has worked in such registered capacity for that period of time. This requirement shall not apply to any individual registered as a CTA. This requirement may, in NFA's discretion, be waived upon a showing that the Associate has equivalent experience. Any Member seeking such a waiver may submit a written request to the Compliance Department ~~Director~~ and all such requests shall be ruled upon by a three-member panel consisting of three members of the Business Conduct Committee and/or the Hearing Committee, said members to be appointed by the Board from time to time. The decision of the panel shall be final and shall be based upon the written submissions of the Member and the views of the Compliance ~~Director~~ Department. ~~The panel shall communicate its decision to the Compliance Director or a person designated by the Compliance Director, who shall then inform the Member seeking the waiver.~~ An Associate who has been determined to have equivalent experience pursuant to the rules of any contract market Member of NFA having a similar minimum experience requirement shall be deemed to have satisfied the requirement of this Rule.

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**RULE 2-9. SUPERVISION.**

(a) Each FCM, IB, CPO or CTA Member shall diligently supervise its employees and agents in the conduct of their commodity ~~utures~~ interest activities for or on behalf of the Member. Each Associate of an FCM, IB, CPO or CTA Member who has supervisory duties shall diligently exercise such duties in the conduct of that Associate's commodity ~~utures~~ interest activities on behalf of the Member.

(b) NFA's Board of Directors may require FCM, IB, CPO and CTA Members ~~which that~~ meet specific criteria established by the Board relating to the employment history of its APs or principals or to the total commissions, fees and other charges paid by their customers to adopt enhanced supervisory requirements ~~procedures~~ specified by the Board ~~for the supervision of telemarketing~~. This requirement may, in NFA's discretion, be waived upon a showing by the FCM, IB, CPO or CTA Member that the Member's current supervisory procedures provide effective supervision over its employees and agents. Any FCM, IB, CPO or CTA Member seeking such a waiver may submit a written request to a three-member panel consisting of three members of the Business Conduct Committee and/or the Hearing Committee, said members to be appointed by the Board from time to time. Within 30 days after an FCM, IB, CPO or CTA Member submits a waiver request, the ~~Compliance-Director-Department~~ will submit a written response to the panel. The decision of the panel shall be final and shall be based upon the written submissions of the Member and of the ~~Compliance-Director-Department~~.

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(d) Each Swap Dealer or Major Swap Participant Member shall diligently supervise its employees and agents in the conduct of their swap activities for or on behalf of the Member.

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**RULE 2-29. COMMUNICATIONS WITH THE PUBLIC AND PROMOTIONAL MATERIAL.**

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**(g) Filing with NFA.**

The ~~Compliance-Director-Department~~ may require any Member for any specified period to file copies of all promotional material with NFA promptly after its first use.

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**RULE 2-36. REQUIREMENTS FOR FOREX TRANSACTIONS**

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**(e) Supervision**

(1) Each Forex Dealer Member shall diligently supervise its employees and agents in the conduct of their forex activities for or on behalf of the Forex Dealer Member. Each Associate of a Forex Dealer Member who has supervisory duties shall diligently exercise such duties in the conduct of that Associate's forex activities for or on behalf of the Forex Dealer Member.

(2) NFA's Board of Directors may require Forex Dealer Members that meet specific criteria established by the Board relating to the employment history of its APs or principals or to the total commissions, fees and other charges paid by their customers to adopt enhanced supervisory requirements specified by the Board. This requirement may, in NFA's discretion, be waived upon a showing by the Forex Dealer Member that the Forex Dealer Member's current supervisory procedures provide effective supervision over its employees and agents. Any Forex Dealer Member seeking such a waiver may submit a written request to a three-member panel consisting of three members of the Business Conduct Committee and/or the Hearing Committee, said members to be appointed by the Board from time to time. Within 30 days after a Forex Dealer Member submits a waiver request, the Compliance Department will submit a written response to the panel. The decision of the panel shall be final and shall be based upon the written submissions of the Forex Dealer Member and of the Compliance Department.

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**(g) Filing Promotional Materials with NFA.**

The ~~Compliance Director~~ Department may require any Forex Dealer Member for any specified period to file copies of all promotional material with NFA for its review and approval at least 10 days prior to its first use or such shorter period as NFA may allow. The ~~Compliance Director~~ Department may also require a Forex Dealer Member to file for review and approval copies of promotional material prepared or used by some or all of the non-Members it is responsible for under Section (d).

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**RULE 3-1. DEPARTMENT OF COMPLIANCE.****(a) Duties.**

There is hereby established a Department of Futures Compliance and a Department of OTC Derivatives Compliance (hereinafter references to the "Compliance Department" shall mean either or both the Department of Futures Compliance and/or Department of OTC Derivatives Compliance, as the context requires), ~~under the direction and control of a Director of Compliance (hereinafter "Compliance Director")~~, which shall conduct audits and examinations, and shall investigate violations of NFA requirements, prepare reports and conduct prosecutions, as provided in this Part. The Compliance Department shall commence investigations at the direction of the Commission; upon the discovery or receipt of information by NFA (such as complaints from customers or Members) that, in the ~~Compliance Director~~ Department's opinion, indicates a possible basis for finding that a violation has occurred; on the ~~Compliance Director~~ Department's own initiative. The ~~Compliance Director~~ Department shall have the authority to compel testimony, subpoena documents and require statements under oath from any Member, Associate or person connected therewith.

**(b) Prohibitions.**

~~Neither the Compliance Director~~ NFA staff ~~nor any employee or agent of the Compliance Department (including persons hired on a contract basis to perform compliance duties)~~ may not be a Member or Associate or have any connection, direct or indirect, with a Member or Associate, except as approved by the President. Except with the President's approval, ~~the Compliance Director and any employee of the Compliance Department~~ NFA staff shall not trade, directly or indirectly, any commodity interest. For purposes of this Rule 3-1(b), A commodity interest shall be defined as any commodity futures or commodity option contract traded on or subject to the rules of a contract market or linked exchange, or cash commodities traded on or subject to the rules of a board of trade which has been designated as a contract market.

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**RULE 3-2. INVESTIGATION.****(a) Initiation; Report.**

In each case in which the ~~Compliance Director~~ Department has reason to believe that any NFA requirement is being, has been or is about to be violated, the ~~Compliance Director~~ Department shall submit a written report of the matter to the Business Conduct Committee. (See NFA Bylaw 704.) The report shall include:

(i) the reason the investigation was begun;

(ii) a summary of the complaint, if the investigation was begun as the result of a complaint;

(iii) the relevant facts; and

(iv) the Compliance ~~Director~~ Department's conclusion whether the Business Conduct Committee should proceed with the matter.

**(b) Termination.**

If upon completing the investigation the Compliance ~~Director~~ Department concludes that there is no reason to believe that an NFA requirement is being, has been or is about to be violated, the Compliance ~~Director~~ Department shall submit a report to the Business Conduct Committee, containing the information specified in paragraph (a) above and, if applicable, recommending whether the Business Conduct Committee should issue or authorize the Compliance ~~Director~~ Department to issue a warning letter. The report, and any warning letter issued, shall become part of the investigation file, which may thereafter be closed as the Compliance ~~Director~~ Department deems appropriate. Investigations shall be completed within four months of commencement except for good cause.

**(c) Review of Report.**

Each investigation report shall be reviewed by the Business Conduct Committee. If, upon review of the report, the Business Conduct Committee finds that additional investigation or evidence is necessary, it shall so instruct the Compliance ~~Director~~ Department. Within 30 days after receiving a completed report the Business Conduct Committee shall either:

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**RULE 3-9. HEARING.**

If a hearing is held:

(a) The formal rules of evidence need not apply;

(b) Telephonic or video testimony shall be permitted if ordered by the Hearing Panel;

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**RULE 3-11. SETTLEMENT.**

**(a) Offer.**

(i) A subject of an investigation in which the investigation report has been completed, or a Respondent in a disciplinary proceeding, shall submit any proposed settlement of the matter to the Business Conduct Committee or its designated Panel ("BCC Panel") at any time up until a Chairman of the Hearing Panel has been appointed. A BCC Panel shall consist of no fewer than three members of the Business Conduct Committee, each of whom shall be appointed by the Chairman of the Business Conduct Committee. After that date, any proposed settlement offer shall be submitted to the Hearing Panel. Settlement offers may also be submitted to the Appeals Committee if the matter is before it on appeal or review. The Business Conduct Committee, BCC Panel, Hearing Panel or Appeals Committee may accept or reject the settlement offer as it deems appropriate. The Compliance ~~Director~~ Department shall be afforded an opportunity to express ~~the Compliance Department's~~ its views with respect to the proposed settlement;

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**FINANCIAL REQUIREMENTS**

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**SECTION 15. FOREX DEALER MEMBER INTERNAL FINANCIAL CONTROLS.**

(a) No Member may act as a Forex Dealer Member (as defined in Bylaw 306) unless it has demonstrated to NFA that the Member has adequate internal financial controls. The Forex Dealer Member must demonstrate that its system of internal controls provides reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. The Forex Dealer Member must also demonstrate that its system of internal financial controls has no material weaknesses and that it is adequate for establishing and maintaining internal controls over financial reporting by the Member. A Forex Dealer Member may satisfy this obligation by obtaining an internal control report that is prepared and certified by an independent public accountant who is registered under Section 102 of the Sarbanes-Oxley Act. The internal control report shall contain, at a minimum, a detailed explanation of the examination performed by the accountant and a representation by the accountant that it has examined and tested the Forex Dealer Member's system of internal controls and that the controls comply with the above standards.

If NFA believes that a Forex Dealer Member's internal controls are inadequate at any time, ~~NFA's the Compliance Director Department~~ may require it to provide to NFA an internal control report that is prepared and certified by an independent public accountant who is registered under Section 102 of the Sarbanes-Oxley Act. The internal control report shall meet the above standards.

(b) Provided ~~NFA's the Compliance Director Department~~ believes that a Forex Dealer Member's financial records are inadequate, the ~~Compliance Director Department~~ may require a Forex Dealer Member's annual certified financial statements to be prepared by an independent public accountant who is registered under Section 102 of the Sarbanes-Oxley Act.

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### INTERPRETIVE NOTICES

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#### 9010 - INFORMATION AVAILABLE FROM NFA REGARDING BACKGROUND OF PROSPECTIVE EMPLOYEES

The purpose of this Notice is to remind Members of their obligations with respect to prospective employees and the information available from NFA to help Members achieve compliance with these obligations.

##### I. Obligations of FCMs, FDMs, IBs, CPOs and CTAs

NFA Compliance Rule 2-9 requires each FCM, IB, CPO and CTA Member to supervise diligently the ~~futures-related~~ commodity interest activities of their employees and agents. Likewise, NFA Compliance Rule 2-36 imposes an obligation for each FDM to diligently supervise the forex activities of its employees and agents. Obviously, all FCM, IB, CPO and CTA Members and all FDMs should carefully screen prospective APs, both to ensure their qualifications and to determine the extent of supervision the prospective AP would require if hired. ~~The purpose of this Notice is to remind you of the information available from NFA to aid Members in that effort.~~

All applicants for AP registration are required to fill out the Form 8-R, supplying, among other things, information concerning their recent employment history and any disciplinary proceedings against them. What may not be immediately apparent from the face of the application is whether any of the applicant's previous employers have been the subject to disciplinary proceedings by the Commission or by NFA. This information could be helpful to a prospective employer in determining the extent of supervision a particular applicant would require after he is hired. Certainly, if a recently hired AP has



received the bulk of his professional training and experience from, for example, a number of firms which have been closed down as a result of disciplinary proceedings brought by the Commission or by NFA, that individual may well require closer supervision for a period of time than other APs.

## II. Obligations of SDs and MSPs

Pursuant to CFTC Regulation 23.22 and NFA Compliance Rule 2-49, SDs and MSPs are prohibited from permitting an individual who is subject to a statutory disqualification to effect or be involved in effecting swaps on behalf of the SD or MSP if the SD or MSP knows or in the exercise of reasonable care should know of such statutory disqualification. All SD and MSP Members should carefully screen individuals who will effect or be involved in effecting swaps for statutory disqualifications, including by reviewing any applicable information available from NFA.

## III. Information Available from NFA

If you have any questions regarding whether the Commission or NFA has taken any action against a particular firm or individual, check the BASIC system on NFA's web site at [www.nfa.futures.org](http://www.nfa.futures.org), send a request to NFA through the "contact" feature of the web site, or call NFA's Information Center at (800) 621-3570. Summary information concerning the proceeding is available through BASIC or can be provided over the phone, and copies of any available documents relating to the proceeding can be provided upon request.

Prospective employers are also entitled to any non-public registration records regarding a prospective employee. For example, each applicant for registration as an AP must complete the disciplinary history portion of the Form 8-R, and must supply a detailed explanation of any "yes" answers to those questions. That detailed explanation is treated as non-public but is available to prospective employers under NFA Registration Rule 701(c). Thus, a prospective employer may obtain the non-public supplementary information which the applicant may have submitted in connection with any past registrations.

The supervision of employees must be an issue of paramount concern to all NFA Members. NFA recognizes that certain employees, by virtue of their past training or experience, may need more supervision than others and will gladly supply our Members with whatever information may be available to help identify those employees.

## **9020 – NFA COMPLIANCE RULES 2-9, AND 2-36 AND 2-39: SELF-EXAMINATION AUDIT-QUESTIONNAIRES**

NFA Compliance Rule 2-9 places a continuing responsibility on every each FCM, IB, CPO and CTA Member to diligently supervise its employees and agents in all aspects of

their ~~futures commodity interest~~ activities, while Compliance Rule 2-36 (and Compliance Rule 2-39 by reference to Compliance Rule 2-36) imposes the same requirements on Members each FDM with respect to ~~its~~ their forex related activities. NFA recognizes that, given the differences in the size and complexity of the operations of NFA Members, there must be some degree of flexibility in determining what constitutes "diligent supervision" for each firm. It is NFA's policy to leave the exact form of supervision to the Member, thereby providing the Member with flexibility to design procedures that are tailored to the Member's own situation. The Board of Directors adheres to this principle but feels that all Members should regularly review the adequacy of their supervisory procedures.

The Board of Directors has determined that in order to satisfy their continuing supervisory responsibilities, NFA each FCM, IB, CPO and CTA Members and each FDM must review on a yearly basis self-examination ~~audit~~ questionnaires that can be downloaded from NFA's web site at [www.nfa.futures.org](http://www.nfa.futures.org). All Each FCM, IB, CPO and CTA Members and each FDM must review the general questionnaire and one or more of the applicable supplemental questionnaires (e.g., FCM, FDM, IB, CPO or CTA). The questionnaires must be reviewed by the appropriate supervisory personnel in the home and branch office, if applicable. After reviewing the questionnaire, an appropriate supervisory person must sign the questionnaire stating that the Member's operations have been evaluated based on the questionnaire and attesting that the Member's procedures comply with all applicable NFA requirements.

FCM, IB, CPO and CTA Members and FDMs are required to retain the signed questionnaire in their files for a period of five years from the date of review, with the questionnaires being readily accessible during the first two years. In addition, guaranteed IBs must provide and FCMs and FDMs that guarantee any IBs must obtain copies of the signed questionnaires. Members must also provide the signed questionnaires for inspection upon request by NFA.

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Any FCM, IB, CPO or CTA Member firm or FDM that does not comply with this Interpretive Notice will violate NFA Compliance Rule 2-9 or, 2-36, ~~or 2-39~~, as applicable.

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## **9021 - NFA COMPLIANCE RULES 2-9 AND 2-36: ENHANCED SUPERVISORY REQUIREMENTS FOR FCMs, IBs, FDMs, CPOs AND CTAs**

### **I. INTRODUCTION**

Over the years, NFA's Board of Directors has adopted strict and effective rules to prohibit deceptive sales practices, and those rules have been vigorously enforced by

NFA's Business Conduct Committee. The Board notes, however, that by their very nature, enforcement actions occur after the customer abuse has taken place. The Board recognizes that NFA's goal must be not only to punish such deception of customers through enforcement actions but to prevent it, or minimize its likelihood, through fair and effective regulation.

One NFA rule designed to prevent abusive sales practices is NFA Compliance Rule 2-9. Subsection (a) of this rule places a continuing responsibility on every FCM, IB, CPO and CTA Member to diligently supervise its employees and agents in all aspects of their futures commodity interest activities, including sales practices. Although NFA has not attempted to prescribe a set of supervisory requirements to be followed by all NFA such Members, NFA's Board of Directors believes that Member firms ~~which that~~ are identified as having a sales force and/or principals that have been affected by questionable sales practice training and firms ~~which that~~ charge commissions, mark-ups, and fees and other charges well above the industry norm should be required to adopt enhanced supervisory requirements designed to prevent sales practice abuse. NFA Compliance Rule 2-36(e) imposes similar supervisory requirements on forex activities of FDMs. ~~Subsection (b) NFA Compliance Rules 2-9(b) and 2-36(e)(2) authorizes the Board of Directors to require FCM, IB, CPO and CTA Members and FDMs, which meet certain criteria established by the Board, to adopt specific supervisory procedures designed to prevent abusive sales practices. Subsection (b) covers all activities regulated by NFA, including the off-exchange retail forex activities of Members subject to NFA Compliance Rule 2-36.~~

The Board believes that in order for the criteria used to identify firms subject to the enhanced supervisory requirements to be useful, those criteria must be specific, objective and readily measurable. The Board also believes that any supervisory requirements imposed on an FCM, IB, CPO or CTA Member or an FDM must be designed to quickly identify potential problem areas so that the Member will be able to take corrective action before any customer abuse occurs. The purpose of this Interpretive Notice is to set forth the criteria established by the Board ~~which that~~ obligate a Member to adopt the enhanced supervisory requirements and to specify the enhanced supervisory requirements ~~which that~~ are required of firms meeting these criteria.

In developing the criteria, the Board concluded that it would be helpful to review Member firms ~~which that~~ had been disciplined through enforcement actions taken by the CFTC or NFA for deceptive sales practices. The Board's purpose was to identify factors common to these Member firms and probative of their sales practice problems, which could be used to identify other Member firms with potential sales practice problems.

One factor identified by the Board as common to these firms and directly related to their sales practice problems is the employment history and training of their ~~sales forces~~ APs and ~~firm~~ principals. For many of these Members, a significant portion of these

individuals were previously employed and trained by one or more Member firms which had been disciplined for fraud. The Board believes that the employment history of a Member's APs and principals is a relevant factor to consider in identifying firms with potential sales practice problems. If a Member firm is disciplined by NFA or the CFTC for fraud related to widespread telemarketing sales practice or promotional material problems or by the Financial Industry Regulatory Authority or the SEC for fraud related to its sales practices regarding security futures products as defined in Section 1a(45) of the Commodity Exchange Act ("Act"), it is reasonable to conclude that the training and supervision of its sales force was wholly inadequate or inappropriate. It is also reasonable to conclude that an AP or principal who received inadequate or inappropriate training and supervision may have learned improper sales tactics, which he will carry with him to his next job. Therefore, the Board believes that a Member firm employing such a sales force must have stringent supervisory procedures in place in order to ensure that the improper training its APs and principals have previously received does not taint their sales efforts on behalf of the Member.

The Board notes further that there have been instances in which Members and Associates have subverted the Board's purpose in imposing the enhanced supervisory requirements by closing a firm once it qualifies for those requirements and opening another firm or firms that have a mix of employees that does not meet the criteria for adopting the requirements. The new firms typically have individuals who have worked for firms that have been disciplined for fraud related to telemarketing sales practices or promotional material and who worked at the original qualifying firm, but they are redistributed so as to keep the employee mix below the threshold for becoming subject to the enhanced supervisory requirements. The Board has determined to apply the enhanced supervisory requirements to firms that use this strategy.

The Board also notes that Members that assess commissions, mark-ups, fees and other charges that total well above the industry norm comprise a disproportionately high share of firms that have been subject to disciplinary action for sales practice abuses. Some of the abuses that have been cited relate to the creation of a misleading impression of the likelihood of achieving profits by investing with a Member through misstatements or material omissions concerning the impact of commissions, mark-ups, and fees and other charges.

The Board believes that when an FCM, IB, CPO or CTA Member or an FDM charges its customers commissions, mark-ups, fees and other charges that total well above the industry norm it is incumbent on that Member to exercise a very high degree of supervision of solicitations made by its APs so as to ensure that customers are given accurate information regarding the impact of those expenses on the likelihood of achieving profit. Consistent with its approach in other situations involving an increased likelihood of misleading solicitations, the Board believes that the enhanced supervisory requirements provide a practical opportunity for a Member that charges commissions,

mark-ups, fees and other charges that are well above the industry norm to monitor solicitations and correct problems with those solicitations in an expeditious manner.

## **II. OBLIGATIONS OF MEMBERS SUBJECT TO THE ENHANCED SUPERVISORY REQUIREMENTS**

### **A. Recording of all conversations and maintaining electronic written communications with existing and potential customers**

Those FCM, IB, CPO and CTA Members and FDMs firms meeting the criteria requiring them to adopt the enhanced supervisory requirements will be required to make complete audio recordings of all telephone conversations that occur between their APs and both existing and potential customers, including existing and potential retail forex customers of Members subject to NFA Compliance Rule 2-36. Additionally, those FCM, IB, CPO and CTA Members and FDMs will be required to maintain a record of all electronic written communications that occur between their APs and customers or potential customers. Electronic written communications include, but are not limited to, email, text messages, instant messages conducted via any web-based messaging system (including instant messages sent via a social media application), and any other communication that occurs in a chat room or on any social media platform. The Board believes that recording these conversations and requiring FCM, IB, CPO and CTA Members and FDMs to maintain records of electronic written communications provides these Members with the best opportunity to monitor closely the activities of their APs and also provides these Members with complete and immediate feedback on each AP's method of soliciting customers. Members subject to the enhanced supervisory requirements must retain such audio recordings and records of electronic written communications for a period of five years from the date each recording is created or written electronic communication occurs and the recordings and/or records of electronic written communications shall be readily accessible during the first two years of the five-year period. In retaining the recorded conversations or records of electronic written communications, Member firms must catalog the recordings and electronic written communications by AP and date. Additionally, any Member firm meeting the criteria must require all its APs to maintain a daily log for sales solicitations which reflects at a minimum the identity of each customer or prospective customer the AP spoke with or transmitted electronic written communications to on each day and the method of communication. A Member firm must be able to promptly produce, upon request from NFA or the CFTC, all conversations or records of electronic written communications relating to a specific AP, and only that AP, for a given date. Members that are required to record or maintain records of electronic communications under this Interpretive Notice are further required to promptly provide NFA or the CFTC with appropriate resources for listening to their recordings or viewing the records of electronic communications upon request.

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#### **D. Written supervisory procedures**

Those FCM, IB, CPO and CTA Members and FDMs meeting the criteria shall have written supervisory procedures that include the titles, registration status and locations of the firm's supervisory personnel as these relate to the firm's commodity ~~business, retail forex~~ interest business and applicable securities laws and regulations for the trading of security futures products. The written procedures must include at a minimum:

- a description of the steps taken to supervise and monitor calls which identify how often monitoring of recordings will take place; who will conduct the monitoring; and how the results of monitoring will be documented;
- specific information identifying the recording equipment being used;
- a description of the steps taken to supervise and monitor APs' electronic written communications with customers which identify how the Member will monitor them, how often the Member will monitor them, who will conduct the monitoring and how the results of that monitoring will be documented;
- a description of the method for cataloging and maintaining recordings and written electronic communications; and
- a description and sample format of the daily logs prepared by APs that includes, at a minimum, the identity of each customer or prospective customer the AP spoke or transmitted an electronic written communication with on each day and the method of communication.

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### **III. QUALIFICATION FOR THE ENHANCED SUPERVISORY REQUIREMENTS**

#### **A. Definitions, treatment of individuals and firms and exemptions**

##### **1. Definition of Disciplined Firm**

A current list of the firms ~~which~~ that meet the definition of a Disciplined Firm is maintained on NFA's Web site at <https://www.nfa.futures.org/ereg>. For purposes of this Interpretive Notice, a Disciplined Firm is defined very narrowly to include those firms that fall into one of the following two groups:

- a. Firms that have been disciplined by NFA or the CFTC

Members that qualify as Disciplined Firms based on their disciplinary histories with the CFTC or NFA include those firms for which:

1. the firm has been formally charged by either the CFTC or NFA with deceptive ~~telemarketing~~ sales practices or promotional material;
2. those charges have been resolved; and
3. the firm has either been permanently barred from the industry at any time as a result of those charges or has been sanctioned in any way within the preceding five years as a result of those charges.

b. Firms that have been disciplined in connection with sales practices involving security futures products

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### 3. Treatment of FCMs and FDMs that guarantee introducing brokers

For purposes of determining whether an FCM Member or an FDM will be required to adopt the enhanced supervisory requirements, an FCM or FDM and its guaranteed introducing brokers ("GIBs") will be considered a single firm. Therefore, for FCMs and FDMs with GIBs, the APs of its GIBs will be treated as APs of the FCM or FDM for determining whether the FCM or FDM meets the requirements. If the FCM or FDM ~~Member firm~~ meets the requirements, then the FCM or FDM and all its GIBs shall be required to adopt the supervisory procedures specified herein. Of course, individual FCMs, FDMs or GIBs will be required to adopt the enhanced supervisory requirements provided the FCM, FDM or GIB meets the requirements on its own.

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## **B. Criteria that obligate an FCM, IB, CPO or CTA Member or an FDM to adopt the enhanced supervisory requirements**

FCM, IB, CPO and CTA Members and FDMs ~~firms~~ will be required to adopt the enhanced supervisory requirements if they fall into any of the categories described below.

### 1. Obligation based on employment histories of APs and principals

FCM, IB, CPO and CTA Members and FDMs ~~Firms~~ that meet any of the following numerical criteria are required to adopt the enhanced supervisory requirements:

- For firms with less than five APs, 2 or more of its APs have been employed by one or more current Disciplined Firms;
- For firms with at least 5 but less than 10 APs, 40 percent or more of its APs have been employed by one or more current Disciplined Firms;

- For firms with at least 10 but less than 20 APs, four or more of its APs have been employed by one or more current Disciplined Firms; or
- For firms with at least 20 APs, 20 percent or more of its APs have been employed by one or more current Disciplined Firms.<sup>1</sup>

## 2. Obligation based on affiliations of principals

Once an FCM, IB, CPO or CTA Member ~~or an FDM firm~~ meets the criteria to adopt the enhanced supervisory requirements, any other Members of which the principals of that Member firm are, or become, principals must also adopt the enhanced supervisory requirements or seek a waiver therefrom subject to the following exception.

As is the case with some APs, the Board recognizes that there is a limited group of individuals who have been principals of firms that have qualified for the enhanced supervisory requirements who are otherwise free of additional factors that raise concern about their ability to effectively supervise their firms. Therefore, an FCM, IB, CPO or CTA Member ~~or an FDM~~ will not qualify for the enhanced supervisory requirements under this section if the principal whose history would cause the qualification meets the following criteria:

- the principal has not been personally subject to a disciplinary action by NFA or the CFTC;
- the principal has never been a principal or an AP of a current Disciplined Firm;
- the most recent firm in the principal's history that qualified for the enhanced supervisory requirements either received a full waiver from abiding by those requirements or abided by those requirements for at least two years and is no longer subject to the enhanced supervisory requirements; and
- no firm in the principal's history that qualified for the enhanced supervisory requirements has become subject to a sales practice or promotional material based disciplinary action by NFA or the CFTC since qualifying for the enhanced supervisory requirements.

## 3. Obligation based on assessing commissions, mark-ups, fees and other charges well above the industry norm

Any FCM, IB, CPO and CTA Member ~~or FDM firm~~ that charges 50% or more of its active customers round-turn commissions, mark-ups, fees and other charges that total \$100 or more per futures, forex or option contract or cleared swap is required to adopt the enhanced supervisory requirements. Any FCM, IB, CPO or CTA Member ~~or FDM~~ that charges 50% or more of its active customers round-turn commissions, mark-ups, fees and other charges in the amount specified above must promptly inform NFA of that fact. In addition, upon request by NFA, Members shall have the burden of demonstrating to NFA that they charge more than 50% of their active customers round-turn commissions, mark-ups, fees and other charges that are less than the specified



amounts. The term "active customers" as used in this section means any customers who are entitled to a monthly statement under the provisions of CFTC Regulations Section 1.33(a). For purposes of this section, any Member whose customer initiates an options contract that would result in total commissions, mark-ups, fees and other charges of \$100 or more if the trade was liquidated will be deemed to have charged total commissions, mark-ups, fees and other charges of \$100 even if the contract is not ultimately liquidated.

#### 4. Obligation based on the initiation of disciplinary action

- a. Members that have fulfilled the enhanced supervisory requirements that become subject to subsequent disciplinary action

Any Member that has previously been required to adopt the enhanced supervisory requirements; has, in fact, fulfilled that requirement either by adopting the enhanced supervisory requirements for a prescribed period or by receiving a full or partial waiver from the enhanced supervisory requirements from the ~~Telemarketing Procedures~~ Waiver Committee; and subsequently becomes subject to a CFTC or NFA enforcement or disciplinary proceeding alleging deceptive sales practices, shall, within 30 days of being served with notice of the action, adopt all of the enhanced supervisory requirements and may not seek a waiver therefrom. This obligation shall continue until after the disciplinary or enforcement proceeding is closed and all appeals are completed or the time for appeal has passed without an appeal being filed or perfected.

\* \* \*

#### IV. WAIVER PROCEDURE

Any Member required to adopt the enhanced supervisory requirements may seek a waiver by filing a petition with the ~~Telemarketing Procedures~~ Waiver Committee within 30 days of the date of being notified by NFA that it is required to adopt the enhanced supervisory requirements. NFA may grant such a waiver upon a satisfactory showing that the Member's current supervisory procedures provide effective supervision over its employees, including enabling the Member to identify potential problem areas before customer abuse occurs. Additionally, if a Member meets the criteria and trades security futures products, then the Member firm must also make a satisfactory showing that the Member's supervisory procedures ensure compliance with all applicable securities laws and regulations. Should a Member fail to file a petition seeking a waiver within 30 days or should it file a petition that is denied by the ~~Telemarketing Procedures~~ Waiver Committee, either in whole or in part, the Member may not petition for a full or partial waiver again until at least two years have elapsed since the Member adopted the required enhanced procedures. Members that meet the criteria to adopt the enhanced supervisory requirements and receive either a full or partial waiver of their obligation to

adopt those requirements are, nevertheless, deemed to be a Member that qualified for the requirements for the purposes of this Interpretive Notice.

Some of the factors that the three-member Waiver Committee may consider in evaluating a waiver request include:

- the total number and the backgrounds of APs sponsored by the Member;
- number of branch offices and GIBs operated by the Member;
- the experience and background of the Member's supervisory personnel;
- the number of the Member's APs who had received training from firms which have been closed for fraud, the length of time those APs worked for those firms and the amount of time which has elapsed since those APs worked for the disciplined firms;
- the results of any previous NFA examinations;
- the cost effectiveness of the taping requirement in light of the firm's net worth, operating income and related ~~telemarketing~~ expenses;
- whether the Member assesses commissions, mark-ups, fees and other charges that are based on all of the relevant circumstances, including the expense of executing orders and the value of services the Member renders based on its experience and knowledge; and
- whether the Member adequately discloses the amount of commissions, mark-ups, fees and other charges before transactions occur in light of a retail customer's trading experience and the impact that the commissions, mark-ups, fees and other charges may have on the likelihood of profit.

Conditions that the ~~Telemarketing Procedures~~ Waiver Committee shall impose on any Member to which it grants a full or partial waiver include requirements that the firm: notify NFA of any action charging the firm with a violation of CFTC, SEC or Self Regulatory Organization ("SRO") regulations or rules; notify NFA of any customer complaint involving sales practices or promotional material; not change ownership; not have any material deficiencies noted during any SRO examination; not hire additional APs from Disciplined Firms; execute a written acknowledgement that the firm understands the conditions of the waiver; and may include any other conditions deemed by the Committee to be appropriate in consideration of a total or partial waiver from the enhanced supervisory requirements. Violation of any of those conditions may serve as cause for the ~~Telemarketing Procedures~~ Waiver Committee to review and amend or revoke the waiver.

Any FCM, IB, CPO and CTA Member or FDM firm that does not comply with this Interpretive Notice will violate NFA Compliance Rule 2-9(b) or 2-36(e) and will be subject to disciplinary action.

<sup>1</sup> The Board notes that NFA Registration Rule 214(a) requires sponsors to file a Form 8-T with NFA reporting the termination of an AP within 30 days of their termination. Members should be aware that,

notwithstanding that Rule, a Member's obligation to adopt the enhanced supervisory requirements is conclusively established on any day on which its sales force meets one of the listed numerical criteria and that the obligation shall not be extinguished by the effect of the subsequent filing of a Form 8-T for a terminated AP even if the form is filed within 30 days of an AP's termination.

## **9051 - NFA COMPLIANCE RULES 2-9 and 2-36: ETHICS TRAINING REQUIREMENTS**

\* \* \*

Ethics training is one of a Member's supervisory obligations under NFA's Compliance Rules 2-9 and 2-36. The repeal of the specific regulations relating to ethics training does not diminish Members' and Associates' obligation to diligently supervise its employees. Professional ethical standards remain an essential element of each Member's business model. The use of well-designed ethics training programs supports each Member's supervision of its employees and business activities. Like any other business process, remaining aware of changing industry standards and ensuring high ethical standards is an on-going effort. Developments in technology, commercial practices and regulations and other changes will have ethical ramifications associated with them. Good business practice dictates that employees receive periodic training to keep them cognizant of these developments and their ethical implications.

\* \* \*

### **CONTENT**

The Statement lists the following as topics that an ethics training program should address:

1. An explanation of the applicable laws and regulations and rules of self-regulatory organizations or contract markets and registered derivatives transaction execution facilities;<sup>1</sup>
2. The registrant's obligation to the public to observe just and equitable principles of trade;
3. How to act honestly and fairly and with due skill, care and diligence in the best interest of customers and the integrity of the markets;
4. How to establish effective supervisory systems and internal controls;
5. Obtaining and assessing the financial situation and investment experience of customers;
6. Disclosure of material information to customers; and
7. Avoidance, proper disclosure and handling of conflicts of interest.

The Statement provides that ethics training should be focused to some extent on a person's registration category. Likewise, NFA believes it is appropriate for Members to

tailor their ethics training programs to the specific obligations of their membership category and the roles of their personnel.

\* \* \*

### **FUTURES EXCHANGE REQUIREMENTS OF OTHER SELF-REGULATORY ORGANIZATIONS**

Other self-regulatory organizations The futures exchanges have taken a variety of approaches to ethics training. Members are urged to review the ethics training requirements of the exchanges other self-regulatory organizations of which they are members.

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<sup>1</sup> The regulatory category for derivatives transaction execution facilities was removed by the Dodd-Frank Wall Street Reform and Consumer Protection Act. NFA believes it is appropriate for an ethics training program to explain the rules of swap execution facilities applicable to a Member's business.

### **9053 - FOREX TRANSACTIONS**

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NFA Compliance Rule 2-36 sets out the general standards that apply to Forex Dealer Members and their Associates in connection with forex transactions. Subsection (b) prohibits Forex Dealer Members and their Associates from engaging in fraudulent activities, subsection (c) requires Forex Dealer Members and their Associates to observe high standards of commercial honor and just and equitable principles of trade in connection with their forex business, subsection (d) prohibits Members from accepting forex orders or accounts from, handling a forex transaction for or on behalf of, receiving compensation for forex transactions from, or paying compensation for forex transactions to any non-Member of NFA that is required to be registered with the Commission as a FCM, RFED, IB, CPO, or CTA in connection with its forex activities, subsection (e) requires Forex Dealer Members and their Associates with supervisory duties to supervise their employees and agents, subsection (f) requires Forex Dealer Members to provide customers (at account opening and annually thereafter) with written information regarding NFA's BASIC, subsection (g) provides that the Compliance ~~Director~~ Department may require a Forex Dealer Member to file copies of all promotional material with NFA for NFA's review and approval before it is used, subsection (h) requires Members to comply with Compliance Rule 2-29 with respect to any promotional material that includes a measurement or description or makes reference to hypothetical forex performance results, subsection (i) requires Forex Dealer Members to notify NFA prior to commencing customer business, subsection (j) requires Forex Dealer Members to designate a Chief Compliance Officer and

subsection (l) requires Members and Associates to obtain specific customer information and provide required risk disclosure at the time of account opening. Compliance Rule 2-39 extends these provisions to other Members and their Associates who solicit, introduce or manage forex accounts.

\* \* \*

### **9070 - NFA COMPLIANCE RULES 2-9, 2-36 AND 2-49: INFORMATION SYSTEMS SECURITY PROGRAMS<sup>1</sup>**

\* \* \*

NFA Compliance Rule 2-9 places a continuing responsibility on every Member futures commission merchant (FCM), commodity trading advisor (CTA), commodity pool operator (CPO), and introducing broker (IB) to diligently supervise its employees and agents in all aspects of their commodity interest futures activities. Compliance Rule 2-36 places identical supervisory obligations on retail foreign exchange dealers (RFED) for their forex activities. Additionally, NFA Compliance Rules 2-9(d) and 2-49, which adopts by reference CFTC Regulation 23.602, places a continuing responsibility on every Member swap dealer (SD) and major swap participant (MSP) to diligently supervise ~~its~~ their business. These rules are broadly written to provide Members with flexibility in developing procedures tailored to meet their particular needs. On certain issues, however, NFA issues Interpretive Notices to provide more specific guidance on acceptable standards for supervisory procedures.

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<sup>1</sup> Nothing in this Interpretive Notice is intended to relieve Members from or reduce the obligations to which Members are subject under other state or federal statutes or regulations related to data security and privacy.

### **XXXX - NFA COMPLIANCE RULE 2-9(d): SUPERVISION REQUIREMENTS FOR SWAP DEALER AND MAJOR SWAP PARTICIPANT MEMBERS**

NFA Compliance Rule 2-9(d) places a continuing responsibility on each swap dealer (SD) and major swap participant (MSP) Member (collectively, SD Member) to diligently supervise its employees and agents in all aspects of their swap activities for or on behalf of the Member. Compliance Rule 2-9(d) is broadly written to provide each firm with some degree of flexibility in determining what constitutes "diligent supervision" and to develop and implement supervisory procedures tailored to meet the Member's particular needs. Although NFA does not dictate the specific supervisory procedures that a Member must implement, all SD Members are required to develop and implement

written supervisory procedures designed to achieve ongoing compliance with applicable NFA and CFTC requirements.

NFA recognizes that the CFTC has issued Interpretive Guidance (Guidance)<sup>1</sup> permitting certain non-U.S. SD Members to substitute compliance with the requirements of their home jurisdiction's law and regulation for compliance with certain CFTC entity-level requirements under the Commission's regulations. In particular, under the Guidance, the CFTC permits certain non-U.S. SDs to substitute compliance with a non-U.S. jurisdiction's supervisory requirements for the CFTC's diligent supervision requirement under CFTC Regulation 23.602. Similarly, this Guidance provides that, depending on the status of the counterparty, certain non-U.S. SDs and foreign branches of U.S. banks that are SDs may substitute compliance with their home jurisdiction's law and regulation for compliance with certain CFTC transaction-level requirements under the Commission's regulations. The CFTC's substituted compliance framework for both entity-level and transactional-level requirements is contingent on the CFTC finding that the home jurisdiction's requirements are comparable with and as comprehensive as the corollary area(s) of regulations contained in the applicable CFTC entity-level and/or transaction-level requirements. Importantly, the CFTC has retained examination and enforcement authority over SD Members in areas of substituted compliance, and NFA retains similar authority.

NFA reminds non-U.S. SD Members that in those instances where NFA finds a violation of applicable CFTC requirements and/or NFA requirements that indicate a non-U.S. SD Member has failed to diligently supervise its employees and agents in the conduct of their swap activities for or on behalf of the Member, NFA may find that the SD Member has also violated NFA's supervision requirement under NFA Compliance Rule 2-9(d). For example, if NFA determines that a non-U.S. SD Member failed to set up the appropriate framework to comply and monitor for compliance with NFA's requirement that the firm file monthly risk data reports under NFA Financial Requirements Section 17, if appropriate, NFA could also charge the firm with failing to meet its supervisory obligations under NFA Compliance Rule 2-9(d).

NFA's Board of Directors recognizes the importance that all NFA Members, regardless of their geographic location, have an appropriate supervisory framework to oversee the swap related activities of their employees and agents and their ongoing compliance with applicable NFA and CFTC requirements. Therefore, the Board determined to adopt NFA Compliance Rule 2-9(d) to ensure that SD Members are fully aware of their obligation and to provide NFA with clear authority to enforce this requirement.

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<sup>1</sup> See, Commodity Futures Trading Commission – Interpretive Guidance and Policy Statement Regarding Compliance with Certain Swap Regulations, 78 Fed. Reg. 45292 (July 26, 2013).

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## EXPLANATION OF PROPOSED AMENDMENTS

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As described more fully below, NFA's Board has approved amendments incorporating supervision requirements for NFA Members' swap activities into certain NFA Rules and Interpretive Notices. Specifically, the Board amended NFA Compliance Rule 2-9(a) to specifically apply to the commodity interest activities of FCM, IB, CPO and CTA Members, thereby covering the swaps activities of those member categories. Additionally, the Board adopted NFA Compliance Rule 2-9(d), which requires SD and MSP Members to diligently supervise the swaps activities of their employees and agents.

The Board also approved the following amendments to clarify the applicability of several Interpretive Notices issued pursuant to NFA Compliance Rule 2-9:

- 9010 – *Information Available from NFA Regarding Background of Prospective Employees* to separately address the obligations of FCMs, FDMs, IBs, CPOs and CTAs and the obligations of SDs and MSPs.
- 9020 – *Compliance Rules 2-9, 2-36 and 2-39: Self-Audit Questionnaires* to specify that it applies to FCMs, FDMs, IBs, CPOs and CTAs.
- 9021 – *Compliance Rule 2-9: Enhanced Supervisory Requirements* to specify that it applies to FCMs, FDMs, IBs, CPOs and CTAs.<sup>1</sup>
- 9051 – *NFA Compliance Rule 2-9: Ethics Training Requirements* to clarify that Members may tailor their ethics training programs to the specific obligations of their membership category and the roles of their personnel.
- 9070 – *NFA Compliance Rules 2-9, 2-36 and 2-49: Information Systems Security Programs* to incorporate a reference to Compliance Rule 2-9(d) and to specify that the supervision obligations for FCMs, IBs, CPOs and CTAs apply to all commodity interests.

In addition, the Board adopted a new Interpretive Notice titled *NFA Compliance Rule 2-9(d): Supervision Requirements for Swap Dealer and Major Swap Participant Members*. The Interpretive Notice clarifies that, similar to the CFTC, NFA retains examination and enforcement authority over SD and MSP Members relying on substituted compliance, and that under the appropriate facts and circumstances, NFA may find that an SD and MSP Member relying on substituted compliance has violated NFA's supervision requirement under NFA Compliance Rule 2-9.

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<sup>1</sup> The Board also approved amendments that were intended to improve the clarity of this Interpretive Notice and consistency of NFA Compliance Rules 2-9(b) and 2-36(e).

Finally, the Board approved technical amendments to several NFA Rules. NFA Compliance Rule 3-9 will be modified to expressly permit video testimony if ordered by a Hearing Panel. NFA Compliance Rule 3-1 will be amended to expand the definition of "Compliance Department" and clarify that the definition of "commodity interest" in NFA Compliance Rule 3-1(b) only applies for purposes of that rule. To better reflect NFA's current practices and procedures, the defined term "Compliance Director" has been eliminated and replaced with "Compliance Department" in NFA Compliance Rules 2-8, 2-9, 2-29, 2-36, 3-1, 3-2 and 3-11; NFA Financial Requirements Section 15; and Interpretive Notice 9053 – *Forex Transactions*.

NFA staff presented these proposed amendments to all four advisory committees. The IB, FCM, CPO/CTA and Swap Participant Advisory Committees supported the proposed amendments. As stated earlier, NFA's Board unanimously approved the proposed amendments on February 21, 2019.

As mentioned earlier, NFA is invoking the "ten-day" provision of Section 17(j) of the CEA. NFA intends to issue a Notice to Members establishing an effective date for the proposed amendments to NFA Compliance Rules 2-8, 2-9, 2-29, 2-36, 3-1, 3-2, 3-9 and 3-11; Financial Requirements Section 15; the following six Interpretive Notices entitled: 9010 – *Information Available from NFA Regarding Background of Prospective Employees*; 9020 – *Compliance Rules 2-9, 2-36 and 2-39: Self-Audit Questionnaires*; 9021 – *Compliance Rule 2-9: Enhanced Supervisory Requirements*; 9051 – *NFA Compliance Rule 2-9: Ethics Training Requirements*; 9053 – *Forex Transactions*; and 9070 – *NFA Compliance Rules 2-9, 2-36 and 2-49: Information Systems Security Programs*; as well as the proposed Interpretive Notice entitled: *NFA Compliance Rule 2-9(d): Supervision Requirements for Swap Dealer and Major Swap Participant Members*, as early as ten days after receipt of this submission by the Commission, unless NFA is notified that the Commission has determined to review the proposal for approval.

Respectfully submitted,

Carol A. Wooding



Vice President and General Counsel