September 6, 2016

<u>Via Federal Express</u>

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: Collection of CPO/CTA Financial Information – NFA Compliance Rule 2-46 and NFA Interpretive Notice *NFA Compliance Rule 2-46: Reporting Financial Information on NFA Forms PQR and PR**

Dear Mr. Kirkpatrick:

Pursuant to Section 17(j) of the Commodity Exchange Act, as amended, National Futures Association (NFA) hereby submits to the Commodity Futures Trading Commission (CFTC or Commission) the proposed amendment to NFA Compliance Rule 2-46 and the proposed NFA Interpretive Notice entitled *NFA Compliance Rule 2-46: Reporting Financial Information on NFA Forms PQR and PR*. NFA's Board approved the proposals on August 18, 2016, and NFA respectfully requests Commission review and approval of the proposed amendment and Interpretive Notice.

PROPOSED AMENDMENTS
(additions are <u>underscored</u>)

NATIONAL FUTURES ASSOCIATION

COMPLIANCE RULES

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Rule 2-46. CPO AND CTA QUARTERLY REPORTING REQUIREMENTS

(a) Except as provided in paragraph (b) below, each CPO Member must file NFA Form PQR, in a form and manner prescribed by NFA, on a quarterly basis with NFA, for each pool that it operates and for which it has any reporting requirement under CFTC Regulation 4.27 within 60 days after the end of the quarters ending March, June and September, and a year-end report within 90 days of the calendar year end.

(b) Each CPO Member that is required to file CFTC Form CPO-PQR on a quarterly basis pursuant to CFTC Regulation 4.27 will satisfy its NFA Form PQR filing requirements by filing CFTC Form PQR, <u>along with any additional information in a form and manner prescribed by NFA,</u> in accordance with CFTC Regulation 4.27.

(c) Each CTA Member with a reporting requirement under CFTC Regulation 4.27 must file NFA Form PR, in a form and manner prescribed by NFA, on a quarterly basis with NFA within 45 days after the quarters ended March, June and September and a year-end report within 45 days of the calendar year end.

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INTERPRETIVE NOTICES

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9071 – <u>NFA COMPLIANCE RULE 2-46: REPORTING FINANCIAL INFORMATION ON NFA FORMS PQR AND PR</u>

<u>NFA Compliance Rule 2-46 requires NFA Member CPOs and CTAs (with reporting requirements under CFTC Regulation 4.27) to file NFA Forms PQR and PR, respectively, on a quarterly basis. These forms collect certain general identifying information regarding the CPO or CTA, as well as specific information on the pools operated by the CPO and the assets directed by the CTA. NFA reviews and analyzes this information as an integral part of NFA's oversight program for CPO and CTA Members.</u>

Unlike FCM and independent IB Members, which file regular reports with NFA containing specific information on the Members' financial condition, NFA does not collect any financial information on the financial condition of CPO or CTA Members. NFA uses the information reported by FCMs and IBs in determining a firm's risk profile and to identify firms that may be facing financial difficulties.

NFA's Board of Directors (Board) has determined that this type of information is an important component of NFA's oversight program, and that each CPO and CTA Member should also report information to NFA that provides NFA with the ability to monitor the firm's financial condition and identify firms that may be facing financial difficulties. Therefore, NFA is revising Forms PQR and PR to require each CPO and CTA to report two financial ratios related to the firm's financial health. The purpose of this Interpretive Notice is to provide additional information on the requirements for providing this information.

Required Ratios

NFA Forms PQR and PR will contain data fields requiring CPOs and CTAs to report the following two ratios (reported to the nearest two decimal places):

a. Current Assets/Current Liabilities (CA/CL) Ratio

This ratio divides a firm's current assets by its current liabilities, providing a measure of a firm's liquidity. This ratio is based on a firm's current asset and current liability balances at the reporting quarter end.

The following definitions apply for the purpose of computing this ratio:

Current Assets: Cash or any asset that can be readily converted to cash within one year. Current assets for a CPO or CTA may include, but are not limited to, cash, marketable securities, short-term investments, accounts receivable, and a general partner's investment in its pool.

Current Liabilities: Obligations that are reasonably expected to be paid within one year. Current liabilities include, but are not limited to, accounts payable, accrued expenses, payroll liabilities, income tax liabilities, and interest payable. A firm's long-term financial obligations that are not due within the present accounting year are considered a noncurrent liability and should not be included in this ratio.

b. Total Revenue/Total Expenses (TR/TE) Ratio

This ratio divides a firm's total revenue by its total expenses, measuring a firm's operating margin. Although a firm will report this ratio each quarter, the ratio must reflect the total revenue earned and total expenses incurred during the prior 12 months.

The following definitions apply for the purpose of computing this ratio:

Total Revenue: Gross income earned by a firm from its normal business activities before any expenses have been deducted. Income may be received as cash or a cash equivalent and is typically generated by a CPO or CTA through management and/or incentive fees.

Total Expenses: Costs incurred in a firm's efforts to generate revenue, representing the cost of doing business. Expenses may include, but are not limited to, wages and salaries, rent, utilities, depreciation, and bad debts.

A CPO or CTA that has a fiscal year end that does not align with the Form PQR or PR reporting quarters may report the ratios as of the firm's most recently ended fiscal quarter. For example, the regular quarterly financial reporting quarters for a firm with a July 31 fiscal year end would be July 31, October 31, January 31 and April 30. The firm may report the ratio information as of July 31 on the September 30 Form PQR or PR, the ratio information as of October 31 on the December 31 PQR, etc.

The components of current assets, current liabilities, total revenue, and total expenses should be based on the requirements of generally accepted accounting principles or another internationally recognized accounting standard, consistently applied.

The ratios must be reported using the accrual method of accounting. Accrual accounting requires that the firm record revenue when it is earned rather than when it is received in cash and record an expense when it is incurred rather than when it is actually paid. For example, a CTA charges a monthly management fee of 2%, which equates to a $24,000 fee earned as of March 31. The CTA, however, does not actually receive payment of the fee until April 15. Under the accrual method of accounting, the CTA would record the $24,000 fee as part of its revenue for the month of March and not for the month of April. Similarly, a CTA receives a utility bill in March for services it has already received. The CTA, however, does not pay the bill until April. The CTA should record the amount of the bill as an expense for the month of March and not for the month of April.

CPOs and CTAs that are part of a holding company/subsidiary structure may elect to report the ratios at the parent level. However, firms will be required to notify NFA that it is part of a holding company structure and indicate its reporting level election (i.e., parent/holding company level or subsidiary Member firm level) on Form PQR or PR.

The Board is not establishing any minimum ratio percentages that a firm must meet. Rather, NFA will incorporate the financial information collected on Forms PQR and PR into its oversight program and use it to identify trends that indicate that a firm may be facing financial difficulties which could impair its ability to act in the best interests of its customers.

Recordkeeping

Each CPO and CTA must be able to demonstrate to NFA how it calculated the ratios reported in Form PQR or PR. Therefore, each CPO and CTA must maintain financial records supporting the calculation of these ratios, which, for those Member firms that are part of a holding company structure, may include relevant financial records of the holding company, in accordance with NFA Compliance Rule 2-10 and make those records available to NFA during an examination or otherwise upon request.

EXPLANATION OF PROPOSED AMENDMENTS

NFA Compliance Rule 2-46 requires Member CPOs and CTAs to report certain information to NFA on a quarterly basis on NFA Forms PQR and PR regarding pools operated by a CPO and assets directed by a CTA. NFA utilizes this information as part of its compliance oversight program for these Members.

NFA does not, however, currently collect any financial information on the financial condition of CPO or CTA Members. NFA's Board of Directors has determined that information on the financial condition of CPO and CTA Members should be part of NFA's compliance oversight program. Therefore, NFA is proposing an amendment to Compliance Rule 2-46 and the adoption of a new Interpretive Notice entitled *NFA Compliance Rule 2-46: Reporting Financial Information on NFA Forms PQR and PR* that will require CPOs and CTAs to report on Forms PQR and PR two financial ratios that will provide NFA with information on the financial condition of a CPO or CTA Member.

The mere fact that a firm's reported financial ratios indicate that it may be facing financial difficulties is not a rule violation. However, if a CPO or CTA provides NFA with materially false or misleading information as to its financial condition, then the CPO or CTA has violated NFA requirements. NFA will use the financial ratio information to monitor the CPO's or CTA's financial condition and identify firms that may be facing financial difficulties.

Under the proposed Interpretive Notice, NFA Member CPOs and CTAs will be required to report the following ratios on the quarterly Form PQR or PR: current assets to current liabilities, which is designed to measure the firm's liquidity and total revenue to total expenses, which is designed to measure the firm's operating margin. CPOs and CTAs that are part of a holding company/subsidiary structure may elect to report the ratios at the parent level, but will be required to indicate on Form PQR or PR whether the firm is reporting on the parent/holding company level or the subsidiary Member firm level. Further, the proposed Interpretive Notice sets forth financial record keeping requirements that CPOs and CTAs must meet to demonstrate to NFA how the ratios reported on Form PQR or PR were calculated. Specifically, all CPOs and CTAs must retain financial records supporting the ratios' calculations and for those Member firms that are part of a holding company structure this may include making available the relevant financial records of the holding company.

The proposed amendment to Compliance Rule 2-46 is necessary to require firms that satisfy their NFA Form PQR filing requirements by filing CFTC Form PQR to provide NFA with the additional financial ratio information each quarter on Form PQR.

NFA's CPO/CTA Advisory Committee fully supported NFA's collection of these two financial ratios from CPO or CTA Members. The Board unanimously approved the proposed amendment and Interpretive Notice on August 18, 2016. NFA respectfully requests the Commission's review and approval of the proposed amendment to NFA Compliance Rule 2-46 and the Interpretive Notice to NFA Compliance Rule 2-46 regarding the reporting of financial information on NFA Forms PQR and PR.

Respectfully submitted,

Thomas W. Sexton

Thomas W. Sexton
Senior Vice President and
General Counsel

*The proposed amendment to NFA Compliance Rule 2-46 and the adoption of the related Interpretive Notice became effective June 30, 2017.