

September 5, 2008

Via Federal Express

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

Re: National Futures Association: Proposed Technical Amendments to the Interpretive Notice Regarding Compliance Rule 2-9: Enhanced Supervisory Requirements*

Dear Mr. Stawick:

Pursuant to Section 17(j) of the Commodity Exchange Act, as amended, National Futures Association ("NFA") hereby submits to the Commodity Futures Trading Commission ("CFTC" or "Commission") proposed amendments to the Interpretive Notice regarding Compliance Rule 2-9: Enhanced Supervisory Requirements. This proposal was approved by NFA's Board of Directors ("Board") on August 21, 2008.

NFA is invoking the "ten-day" provision of Section 17(j) of the Commodity Exchange Act ("CEA") and will make these proposals effective ten days after receipt of this submission by the Commission unless the Commission notifies NFA that the Commission has determined to review the proposals for approval.

PROPOSED AMENDMENTS

(additions are underscored and deletions are ~~stricken through~~)

**COMPLIANCE RULE 2-9: ENHANCED
SUPERVISORY REQUIREMENTS**

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INTERPRETIVE NOTICE

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 Member to diligently supervise its employees and agents in all aspects of their futures activities, including sales practices. Although NFA has not attempted to prescribe a set of supervisory requirements to be followed by all NFA Members, NFA's Board of Directors believes that Member firms which are identified as having a sales force and/or principals that have been affected by questionable sales practice training and firms which charge commissions and fees well above the industry norm should be required to adopt enhanced supervisory requirements designed to prevent sales practice abuse. Subsection (b) authorizes the Board of Directors to require Members, 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 a Member 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 obligate a Member to adopt the enhanced supervisory requirements and to specify the 2 enhanced supervisory requirements which are required of firms meeting these criteria.

In developing the criteria, the Board concluded that it would be helpful to review Member firms which 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 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 or promotional material problems or by Financial Industry Regulatory Authority or the SEC for fraud related to its sales practices regarding security futures products as defined in Section 1a (32) 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 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, 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 and fees.

The Board believes that when a Member charges its customers commissions, 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 with existing and potential customers

Those Member 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. The Board believes that recording these conversations 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 that are required to record their conversations must retain such recordings for a period of five years from the date each recording is created and the recordings shall be readily accessible during the first two years of the five-year period. In retaining the recorded conversations, Member firms must catalog the recordings 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 on each day. A Member firm must be able to promptly produce, upon request from NFA or the CFTC, all conversations relating to a specific AP, and only that AP, for a given date. Members that are required to record under this Interpretive Notice are further required to promptly provide NFA or the CFTC with appropriate resources for listening to their recordings upon request.

B. Enhanced capital requirement

Any Member introducing broker, commodity trading advisor or commodity pool operator meeting the criteria is required to either operate pursuant to a guarantee agreement, as applicable, or maintain adjusted net capital of at least \$250,000 during the entire period for which the Member is required to adopt the enhanced supervisory requirements. Eligible guarantor futures commission merchants ("FCMs") are those that meet the eligibility requirements for executing a Supplemental Guarantor Certification Statement pursuant to NFA Registration Rule 509(b)(5). Any Member opting to maintain the higher level of adjusted net capital shall also be subject to the financial record-keeping and reporting requirements applicable to FCMs.

Any Forex Dealer Member ("FDM") meeting the criteria is required to maintain adjusted net capital of at least ~~\$2,000,000~~ the early warning requirement under CFTC rules. Any FCM Member that is not an FDM is required to maintain adjusted net capital of at least \$1,000,000.

C. Filing promotional material with NFA

Those Member firms meeting the criteria will be required to file all promotional material, as defined in NFA Compliance Rule 2-29(i), with NFA at least 10 days prior to its first use.

D. Written supervisory procedures

Those Members 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 futures business, retail forex business, and applicable securities laws and regulations for the trading of security futures products. Member firms shall also maintain on an internal record the names of all persons who are designated as supervisory personnel and the dates for which the designation is or was effective. Additionally, a Member meeting the criteria shall file with NFA's Compliance Department a report relating to the Member firm's compliance with the supervisory requirements contained herein within 15 days after the end of each calendar month. Member firms shall retain the internal record and report(s) for a period of five years, the first two years in an easily accessible place.

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 meet the definition of a Disciplined Firm is maintained on NFA's Web site at www.nfa.futures.org. 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 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

Members that qualify as Disciplined Firms based on their disciplinary histories related to sales practices involving security futures products include any broker-dealer that, in connection with sales practices involving the offer, purchase, or sale of any security futures product as defined in Section 1a(32) of the Act has at any time been expelled from membership or participation in any securities industry self-regulatory organization ("Securities SRO") or is subject to an order of the SEC revoking its registration as a broker-dealer or has been sanctioned in any way within the preceding five years in connection with sales practices involving the offer, purchase, or sale of any security futures product as defined in Section 1a(32) of the Act.

2. Treatment of principals who previously worked at a Disciplined Firm

For purposes of determining whether a Member will be required to adopt the enhanced supervisory requirements based on the employment histories of its APs and principals, principals of a firm, who are not also APs of that firm and who have been previously employed as an AP by one or more Disciplined Firms, shall be counted as if they were APs of the firm.

3. Treatment of FCMs that guarantee introducing brokers

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

4. Exemptions from being counted as an AP who worked at a Disciplined Firm

The Board recognizes that there are identifiable populations of APs who are included in the general population of APs who have worked at Disciplined Firms in the past who, further analysis suggests, do not raise the same concerns regarding their previous supervision and training that are raised by the majority of APs who have worked at Disciplined Firms. Generally, these APs worked at Disciplined Firms fairly long ago and are free of additional factors of concern in their employment histories.

A number of the APs in this group worked at Disciplined Firms for only a short period of time many years ago and have not worked at a Disciplined Firm since or been personally subject to disciplinary action. Others worked at a single Disciplined Firm for a somewhat lengthier period and have subsequently been employed for a substantial length of time by Members that have not shown a propensity for customer abuse and the AP has not been personally subject to disciplinary action.

The Board has determined that APs who have not been personally subject to a disciplinary action by NFA or the CFTC and who meet the following criteria shall not

be counted by a Member that hires them as having been employed by a Disciplined Firm for purposes of calculating whether the composition of the Member's sales force triggers the enhanced supervisory requirements:

- a. they have been previously employed by Disciplined Firms for a cumulative total of less than 60 days and have not been employed by any Disciplined Firm during the 5 years preceding the determination of whether a Member firm is required to employ the enhanced supervisory requirements established in this Interpretive Notice. In addition, the AP may not have been employed by a Member that has been subject to any sales practice action by NFA or the CFTC, or by any Securities SRO or the SEC in connection with sales practices involving the offer, purchase or sale of any security futures product as defined in Section 1a(32) of the Act since leaving the last Disciplined Firm by which they were employed; or
- b. they worked at only one Disciplined Firm more than 10 years preceding the determination of whether a Member firm is required to employ the enhanced supervisory requirements and they have not been employed by a Member that has been subject to any sales practice action by NFA or the CFTC, or by any Securities SRO or the SEC in connection with sales practices involving the offer, purchase or sale of any security futures product as defined in Section 1a(32) of the Act ~~since leaving the Disciplined Firm~~ within the 10 years preceding the determination, and they have been an NFA Member or Associate Member for at least eight of the ten years preceding the determination.

B. Criteria that obligate a Member to adopt the enhanced supervisory requirements

Member 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:

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 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 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 Disciplined Firms; or
- For firms with at least 20 APs, 20 percent or more of its APs have been employed by one or more Disciplined Firms.¹

2. Obligation based on affiliations of principals:

Once a Member 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.

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

Any Member firm that charges 50% or more of its active customers round-turn commissions, fees and other charges that total \$100 or more per futures, forex or option contract is required to adopt the enhanced supervisory requirements. Any Member that charges 50% or more of its active customers round-turn commissions, 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, 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

¹ The Board notes that NFA Registration Rule 206(d) requires sponsors to file a Form 8-T with NFA reporting the termination of an AP within 20 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 20 days of an AP's termination.

entitled to a monthly statement under the provisions of CFTC Regulations Section 1.33(a).

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.

- b. Members already subject to the enhanced supervisory requirements

If an NFA Business Conduct Committee disciplinary proceeding or CFTC enforcement proceeding has been filed against a Member firm required to adopt the enhanced supervisory requirements, then the enhanced supervisory requirements will remain in effect for the applicable time period specified or 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, whichever occurs latest.

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 9 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.

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, 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, fees and other charges before transactions occur in light of a retail customer's trading experience and the impact that the commissions, 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.

A Member firm that does not comply with this Interpretive Notice will violate NFA Compliance Rule 2-9(b) and will be subject to disciplinary action.

EXPLANATION OF PROPOSED AMENDMENTS

NFA's Board of Directors first adopted NFA Compliance Rule 2-9's Interpretive Notice entitled "Enhanced Supervisory Requirements" ("Notice") in January 1993. It requires a Member to undertake enhanced supervisory requirements if its sales force includes a specified number of individuals who have worked at Disciplined Firms, or if a principal of the firm has been a principal of another firm that has been subject to the enhanced supervisory requirements, or, under certain circumstances, when a Member becomes subject to a disciplinary action.

The Board has amended the Notice from time to time based on various changes affecting the membership and on practical lessons learned from administering the Notice. Over the past several years, the Board has recognized that some APs who were counted as having worked at a Disciplined Firm under the original version of the Notice had personal employment histories that indicated that they posed no more risk to the public than the AP population at large. The Board recognized that employers may be wary of hiring such individuals despite years of Associate membership without disciplinary problems. This is particularly true with small firms, where hiring one of these individuals might trigger the enhanced supervisory procedures and require the firm to apply for a waiver. In addition, some firms are simply loath to hire any individual who would be counted as having come from a Disciplined Firm, even if doing so would not trigger the enhanced supervisory procedures.

Currently, the Notice provides for two types of exemptions, which focus on an AP's length of employment at a Disciplined Firm (i.e., less than sixty days) and the time since an AP has been employed at a Disciplined Firm (i.e., more than ten years). The Board decided to grant relief to these defined groups because staff's analysis showed that given their background they pose minimal risk. With regard to the second type of exemption, the Notice currently provides that APs are exempt from being counted as having worked at a Disciplined Firm if: 1) they worked at only one Disciplined Firm; 2) that employment terminated more than ten years ago, 3) they have not personally been subject to a disciplinary action by NFA or the CFTC; 4) they have been registered as APs and

Associate Members of NFA for eight of the last ten years; and 5) since working for the Disciplined Firm they have not worked for any other firm that has been subject to a sales practice action.

In practice, this latter condition acts as a de facto perpetual bar to receiving the exemption even if the AP's employment at the second firm subject to a sales practice action also occurred many years in the past.

NFA performed an analysis of the effect of applying a ten-year time limit not only to the length of time since an AP was employed at a Disciplined Firm but also to the condition that the AP not work at a firm that had a sales practice action since being employed at the Disciplined Firm. This analysis showed that the current exemption could prudently be revised to include APs who met the other existing criteria, and who had worked more than ten years ago at a firm that was subject to a sales practice action. This change would afford this exemption to approximately 85 additional individuals who, based upon their employment histories, do not appear to pose any greater risk of using fraudulent sales tactics than the general population of APs.²

Excluding these APs from the calculation that triggers a firm's obligation to comply with the enhanced supervisory procedures is consistent with the reasoning behind the existing exemptions. Ultimately, the proposed expanded exemption would have the effect of removing some non-problematic individuals and Member firms from the waiver process.

The Notice also provides that one of the enhanced supervisory requirements is an increased adjusted net capital ("ANC") level. The Notice currently provides that FDMs that are required to undertake the enhanced supervisory requirements are obligated to maintain ANC of at least \$2,000,000. When the Board adopted that provision, FDMs that were not subject to the enhanced supervisory requirements had a minimum ANC of \$1,000,000. However, revisions to NFA Financial Requirements Section 11 in December 2007 raised the required minimum level of ANC for all FDMs to \$5,000,000, thus rendering the \$2,000,000 requirement irrelevant. Furthermore, the CFTC Reauthorization Act of 2008 further increases the ANC for FDMs, phasing in the increase to an eventual \$20 million.

² There are more than 13,000 individuals who have ever worked as an AP at a Disciplined Firm. Approximately 2,100 of those individuals are exempted from having to be included in a firm's calculation of whether it has triggered enhanced supervision under the current exemptions provided for in the Notice.

Mr. David A. Stawick

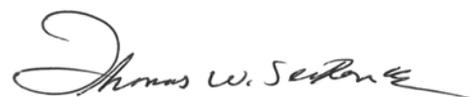
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The proposed revisions to the enhanced supervisory requirements would reinstate an increased ANC level for FDMs and make the provision more flexible in addressing future changes. These revisions tie the enhanced ANC level for FDMs to the early warning requirement under CFTC rules, which is currently 150% of the required ANC.

Under the proposal (and assuming the CFTC's early warning percentage remains unchanged), a triggering FDM would currently have to maintain an enhanced ANC of \$7,500,000, increasing to \$30,000,000 as the minimum ANC for FDMs increases from \$5,000,000 to \$20,000,000 over the next year. This revision would not only have the effect of bringing the current enhanced ANC obligation into harmony with the revisions made to NFA Financial Requirements Section 11 in December 2007, it would also keep the obligation in harmony with any future changes to the level of ANC required of FDMs without requiring further amendments to the Notice.

As mentioned earlier, NFA is invoking the "ten-day" provision of Section 17(j) of the Commodity Exchange Act. NFA intends to make the amendments to the Interpretive Notice regarding Compliance Rule 2-9: Enhanced Supervisory Requirements effective ten days after receipt of this submission by the Commission, unless the Commission notifies NFA that the Commission has determined to review the proposal for approval.

Respectfully submitted,



Thomas W. Sexton
Vice President and General Counsel

* The amendments to the Interpretive Notice regarding Compliance Rule 2-9: Enhanced Supervisory Requirements became effective September 18, 2008.