

December 14, 1983

Ms. Jane K. Stuckey  
Office of the Secretariat  
Commodity Futures Trading Commission  
2033 K Street, N.W.  
Washington, D.C. 20581

Re: National Futures Association, Proposed  
Amendments to Compliance Rules, Financial  
Requirements and Code of Arbitration

Dear Ms. Stuckey:

Pursuant to Section 17(j) of the Commodity Exchange Act ("Act"), as amended, National Futures Association ("NFA") hereby submits the following amendments to Part 2 of the Compliance Rules and Sections 2, 4 and 9 of the Financial Requirements to the Commodity Futures Trading Commission ("Commission" or "CFTC") for review and approval. These amendments were unanimously approved by the NFA Board of Directors at its meeting on December 6, 1983. In the text below, where appropriate, additions are underscored and deletions are bracketed:

I. The Amendments

A. Compliance Rules

1. Option Rules

COMPLIANCE RULES

\* \* \*

Part 2 - RULES GOVERNING THE BUSINESS CONDUCT OF MEMBERS REGISTERED WITH THE COMMISSION.

\* \* \*

Rule 2-15. WRITTEN OPTION PROCEDURES.

Each Member FCM or IB which engages in the offer or sale of commodity options traded on or subject to the rules of a contract market must adopt and enforce written procedures (see Rule 2-21): [which will enable such Member FCM to:]

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- (a) Which will enable such Member FCM or IB to supervise adequately each option customer's account, including but not limited to, the solicitation by such FCM or IB of any such account and the handling of complaints received by such FCM or IB relating to any such account (for purposes of this subsection (a) the term "option customer" does not include [another] an FCM or IB.)
- (b) Which will enable such Member FCM to allocate notices of exercise received by such FCM in a fair and nonpreferential manner, and promptly notify the appropriate grantor of such allocation; and
- (c) Which will enable such Member FCM or IB to monitor adequately the solicitation and sale of deep-out-of-the-money options. For purposes of this subsection (c) such FCM or IB shall define the term "deep-out-of-the-money option" as that term is defined by the contract market on which the option is traded.

\* \* \*

Rule 2-18. OPTION CUSTOMER COMPLAINTS.

With respect to all written option customer complaints and any oral option customer complaints which result in, or which would result in, an adjustment to the option customer's account of more than \$1,000, each Member FCM or IB which engages in the offer or sale of commodity options traded on or subject to the rules of a contract market shall:

- (a) Retain all such written complaints and make and retain written records of all such oral complaints;
- (b) Make and retain a record of the date the complaint was received, the Associate who serviced the account, a general description of the matter complained of, and what, if any, action was taken in regard to the complaint; and
- (c) Immediately send a copy of such complaint to NFA and, upon final disposition thereof, immediately send a copy of the record of such disposition to NFA.



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Rule 2-19. OPTION DISCLOSURE AND OTHER REQUIREMENTS.

Each Member FCM or IB which engages in the offer or sale of commodity options traded on or subject to the rules of a contract market shall:

- (a) Give immediate written notification to NFA of any disciplinary action taken against the FCM, IB or any of its Associates by the Commission or by any other self-regulatory organization;
- (b) Comply with and enforce the disclosure requirements set forth in Commission Regulation 33.7; and
- (c) Promptly submit to NFA all promotional material, as defined in Commission Regulation 33.1, pertaining to such option trading.

Rule 2-20. DISCRETIONARY OPTION CUSTOMER ACCOUNTS.

With respect to any option customer account for which discretion is given for option trading (other than an account (i) of a commodity pool, the operator of which is registered with the Commission as a CPO; (ii) where the person who has discretionary authority is the spouse, parent or child of the option customer; or (iii) which is an omnibus account of another FCM) each Member FCM or IB shall:

- (a) Provide the option customer with an explanation of the nature and risks of the strategy or strategies to be used in connection with the option customer's account;
- (b) Ensure that an officer, general partner, sole proprietor, or branch office manager of the FCM or IB (other than any individual authorized to exercise discretion in trading the account) approves, in writing, the discretionary authority prior to any trading for the account;
- (c) Identify each order as discretionary at the time of entry and ensure that an officer, general partner sole proprietor, or branch office manager of the FCM or IB (other than any individual authorized to exercise discretion in trading the account) approves, initials and dates all orders for a discretionary account; and
- (d) Review frequently all discretionary accounts.



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Rule 2-21. SUBMISSIONS TO NFA RELATING TO OPTIONS.

Any Member FCM with respect to which NFA is the designated self-regulatory organization for purposes of Part 33 of the Commission Regulations and any Member IB the commodity option related activity of which NFA has determined to regulate pursuant to Commission Regulation 33.3(b)(1)(ii)(A) shall submit to NFA the following material at least 10 days prior to the date such FCM or IB begins the offer or sale of options traded on or subject to the rules of a contract market:

- (a) Option customer account agreement forms;
- (b) Option disclosure statements required by Rule 2-19(b);
- (c) Promotional material, as defined in Commission Regulation 33.1, (if such promotional material has been prepared); and

Documents required to be submitted to NFA under Rules 2-18, 2-19 and 2-21 will be considered submitted as of the date received by NFA at its Chicago office.

2. FCM Responsibility for Guaranteed Introducing Brokers

\* \* \*

Rule 2-23. FCM RESPONSIBILITY FOR GUARANTEED MEMBER IBs.

Any Member FCM which enters into a guarantee agreement, pursuant to CFTC Regulation 1.10(j), with a Member IB, shall be jointly and severally subject to discipline under NFA Compliance Rules for acts and omissions of the Member IB which violate NFA requirements occurring during the term of the guarantee agreement.

B. Financial Requirements (brackets do not indicate deletion)

FINANCIAL REQUIREMENTS

\* \* \*

Section 2. Designated Self-Regulatory Organization.



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In the case of a Member FCM or Introducing Broker (hereinafter "Member IB") that is a member of one or more contract markets, the Member's Designated Self-Regulatory Organization (hereinafter "DSRO") shall be the organization that has been delegated primary financial responsibility for the Member pursuant to the Delegation Plan of NFA and the contract markets. In the case of a Member FCM or Member IB that is not a member of a contract market, the Member's DSRO shall be NFA.

\* \* \*

#### Section 4. Compliance with Financial Requirements.

Each Member FCM and Member IB must be in compliance with these financial requirements at all times and must be able to demonstrate such compliance to the satisfaction of its DSRO.

\* \* \*

#### Section 9. Introducing Broker Financial and Reporting Requirements.

Each Member IB must file with its DSRO the financial reports required under CFTC Regulation 1.10(b)(1) and (2) [Financial reports of futures commission merchants and introducing brokers - Filing of financial reports]. Any Member IB who violates any of CFTC Regulations 1.10, 1.12 [Maintenance of minimum financial requirements by futures commission merchants and introducing brokers.], 1.17 [Minimum financial requirements for futures commission merchants and introducing brokers.] or 1.57 [Operations and activities of introducing brokers.] shall be deemed to have violated an NFA requirement.

[Note: CFTC Regulation 1.10(b)(1) generally requires IBs to file financial reports on a quarterly basis. In accordance with CFTC Regulation 1.10(b)(3) Section 9 requires that each Member IB for which NFA is DSRO which files financial reports must file such reports with NFA with a copy to the CFTC.

A Member IB which is also a securities broker or dealer may in lieu of a form 1-FR file a copy of its Financial and Operational Combined Uniform Single Report under the Securities Exchange Act of 1934, Part II or Part IIA, in accordance with CFTC Regulation 1.10(h). A Member IB which is also a country elevator may file a copy of a financial report prepared by a grain commission firm in accordance with CFTC Regulation 1.10(i).



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CFTC Regulation 1.12 requires, among other things, telegraphic notice to NFA in accordance with paragraph (g) when the adjusted net capital of such IBs described in that Section is less than the minimum required by Regulation 1.17 or by the capital rule of any self-regulatory organization which it is subject. CFTC Regulation 1.17 sets forth the minimum financial requirements for IBs. CFTC Regulation 1.57 requires, among other things, that each IB must: (1) open and carry all accounts on a fully disclosed basis with a carrying FCM; (2) not carry proprietary accounts or accounts in foreign futures; and (3) not accept money, securities or property of a futures customer to margin, guarantee or secure any trades or contracts of such customers.

CFTC Regulations 1.10, 1.12, 1.17 and 1.57 impose other regulatory requirements on IBs. The full text of those Regulations should be consulted.]

Pursuant to Section 17(j) of the Act, NFA also hereby submits to the Commission the following proposed amendment to Section 9 of the Code of Arbitration ("Code") which NFA intends to make effective ten days after receipt of this submission by the Commission. This amendment was unanimously approved by the NFA Board of Directors at its meeting on December 6, 1983.

C. Code of Arbitration

CODE OF ARBITRATION

\* \* \*

Section 9. Award.

\* \* \*

b) Relief.

The award may grant or deny any of the relief requested, and may include an assessment of interest, costs or fees (see Sections 10 and 11). Relief requested shall not include punitive damages.



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## II. EXPLANATION OF AMENDMENTS

### A. Compliance Rules

#### 1. Option Rules

Under Part 33 of the CFTC's Regulations introducing brokers ("IBs") may not solicit or accept orders for exchange traded options unless the IB is a member of, or has been guaranteed by an FCM member of, a contract market or futures association that has adopted rules and undertaken to regulate such IB's option activity in a manner substantially equivalent to their regulation of FCMs. At its meeting on August 18, 1983 the Board determined to undertake the option regulation of IBs guaranteed by FCMs for which NFA is the designated self-regulatory organization ("DSRO"). That action did not amend NFA's option rules to apply directly to IBs but instead regulated those IBs through the guarantor FCM. That action also leaves independent IBs and IBs guaranteed by contract market members subject to the option ban. In order to provide a framework in the rules to apply direct option regulation to IBs and to permit NFA to undertake (in the future when resources permit) additional option regulation of the independent IBs, NFA believes such modification to its existing option rules is necessary. NFA will notify the Commission when it is able to undertake additional regulation of IBs under Part 33 of the Commission's regulations.

#### 2. FCM Responsibility for Guaranteed Introducing Brokers

Under the CFTC's regulations concerning IBs an IB need not maintain its own net capital at any minimum level if the IB obtains a written guarantee, in a form as provided by the CFTC, from an FCM. Under the form guarantee the FCM agrees to be liable, along with the IB, for violations of the Commodity Exchange Act or the rules of the CFTC committed by the IB.

Under NFA's current Bylaws it is not clear that the FCM would also be subject to NFA disciplinary action for violations of NFA requirements committed by the IB. In view of the fact that the required guarantee will generally make the FCM responsible for the compliance procedures of its guaranteed IBs, it is important that it is made clear that NFA compliance jurisdiction extends to the FCM for the acts of the guaranteed IB.



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B. Financial Requirements

The proposed amendments to the Financial Requirements incorporate the Commission's regulations regarding introducing brokers. These amendments will establish financial standards and reporting requirements for introducing brokers consistent with the Commission's regulations.

C. Code of Arbitration

Section 9 of the Code presently allows an arbitrator to grant or deny any of the relief requested. Generally punitive damages are awarded by courts as a public benefit in order to punish a particular party and to serve as a deterrent to others. Such punitive damages, however, are, under the laws of certain states, not available in arbitration of commercial disputes which are viewed as a private solution to a business dispute. Nevertheless, NFA has received a number of arbitration claims for punitive in addition to compensatory damages. NFA believes it would lend efficiency to the arbitration system if NFA arbitrators were specifically prohibited from granting punitive damages in an arbitration award. This would be accomplished by precluding future requests for punitive damages.

NFA respectfully requests that the amendments described herein to Sections 2, 4 and 9 of the Financial Requirements and Compliance Rules 2-15, 2-18 through 2-21 and 2-23 be declared effective upon approval by the Commission and that the amendment to Section 9 of the Code of Arbitration become effective ten days after receipt by the Commission.

Very truly yours,

NATIONAL FUTURES ASSOCIATION

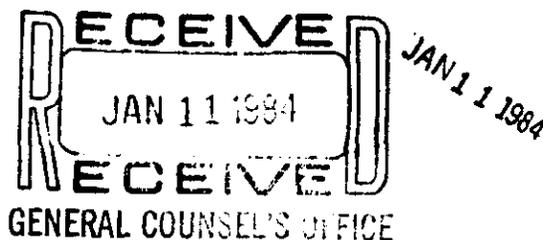
By: Joseph H. Harrison, Jr.  
Joseph H. Harrison, Jr.  
General Counsel and Secretary

JHH:dmc

cc: Chairman Susan M. Phillips  
Commissioner Kalo A. Hineman  
Commissioner Fowler C. West  
Commissioner William E. Seale  
Andrea M. Corcoran, Esq.  
Theodore W. Urban, Esq.  
Linda Kurjan, Esq.



COMMODITY FUTURES TRADING COMMISSION  
2033 K STREET, N.W., WASHINGTON, D.C. 20581



January 9, 1984

Mr. Joseph H. Harrison, Jr.  
General Counsel and Secretary  
National Futures Association  
200 West Madison Street  
Chicago, Illinois 60606

Dear Mr. Harrison:

On December 19, 1983, the Commission received your December 14 letter submitting, among other proposals, an amendment to Section 9(b) of the Code of Arbitration to preclude the inclusion of punitive damages in the relief requested in arbitration. This particular proposal was submitted under the provision in section 17(j) of the Act that permits a rule change proposed by a registered futures association to take effect ten days after Commission receipt unless the Commission notifies the association in writing that the Commission determined to review the proposal for approval. This is to advise you that the Division has not recommended that the Commission review the proposal for approval and that accordingly the proposed rule may be made effective.

Very truly yours,

Theodore W. Urban  
Commission Liaison to NFA  
and Deputy Division Director

February 24, 1984

Ms. Jane K. Stuckey  
Office of the Secretariat  
Commodity Futures Trading Commission  
2033 K Street, N.W.  
Washington, D.C. 20581

Re: National Futures Association;  
Proposed Amendment to Compliance Rules  
Submission Dated December 14, 1983

Dear Ms. Stuckey:

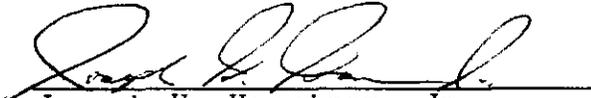
By letter dated December 14, 1983 National Futures Association ("NFA") submitted to the Commodity Futures Trading Commission ("CFTC") pursuant to Section 17(j) of the Commodity Exchange Act ("Act") certain amendments to its Option compliance rules (Compliance Rules 2-15 through 2-21) in order to make those Rules applicable to Introducing Brokers ("IBs"). It has come to our attention that in making that submission subparagraph (d) of Compliance Rule 2-21 was inadvertently omitted from the text of that Rule as amended. Please accept this letter as notice that following the text of subparagraph (c) of Compliance Rule 2-21 as set forth in NFA's letter to you of December 14, 1983 there should appear the following:

(d) Written procedures required under Rule 2-15.

Please amend your records accordingly.

Very truly yours,  
NATIONAL FUTURES ASSOCIATION

By:

  
Joseph H. Harrison, Jr.  
General Counsel and Secretary

JHH:dc

cc: Chairman Susan M. Phillips  
Commissioner Kalo A. Hineman  
Commissioner Fowler C. West  
Commissioner William E. Seale  
Andrea M. Corcoran, Esq.  
Theodore W. Urban, Esq.  
Linda Kurjan, Esq.

UNITED STATES OF AMERICA  
**COMMODITY FUTURES TRADING COMMISSION**

2033 K Street, N.W.  
Washington, D.C. 20581



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February 27, 1984

Mr. Joseph H. Harrison, Jr.  
General Counsel and Secretary  
National Futures Association  
200 West Madison Street  
Chicago, Illinois 60606

Re: Compliance Rules 2-15, 2-18 to 2-21, and 2-23;  
Financial Requirements §§2, 4 and 9

Dear Mr. Harrison:

This is to inform you that on February 27, 1984, the Commission approved the captioned rule amendments pursuant to section 17(j) of the Act, as you submitted by letter dated December 14, 1983. The amendments may be made effective immediately.

Very truly yours,

A handwritten signature in cursive script that reads "Jane K. Stuckey".

Jane K. Stuckey  
Secretary of the Commission