

June 18, 2014

**Via Federal Express**

Ms. Melissa D. Jurgens  
Secretary  
Office of the Secretariat  
Commodity Futures Trading Commission  
Three Lafayette Centre  
1155 21st Street, N.W.  
Washington, DC 20581

Re: National Futures Association: Enhanced Supervisory Procedures –  
Proposed Amendments to NFA's Interpretive Notice Entitled "Compliance  
Rule 2-9: Enhanced Supervisory Procedures"\*

Dear Ms. Jurgens:

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 amendments to NFA's Interpretive Notice entitled "Compliance Rule 2-9: Enhanced Supervisory Procedures." NFA's Board of Directors ("Board") approved the proposal on May 15, 2014.

NFA is invoking the "ten-day" provision of Section 17(j) of the Commodity Exchange Act ("CEA") and plans to 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.

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

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

\* \* \*

**INTERPRETIVE NOTICE**

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

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#### **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 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 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 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, a Member 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 been a principal of only one firm that has qualified for the enhanced supervisory requirements;~~
- the principal has never been a principal or an AP of a current Disciplined Firm;
- the ~~one~~ 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
- ~~the on~~ no firm in the principal's history that qualified for the enhanced supervisory requirements has not 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, 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 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, fees and other charges of \$100 or more if the trade was liquidated will be deemed to have charged total commissions, 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.

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.

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### EXPLANATION OF PROPOSED AMENDMENTS

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NFA Compliance Rule 2-9's Interpretive Notice entitled "Enhanced Supervisory Requirements" (Notice) requires Member firms that trigger the Requirements of the Notice to record all telephone conversations with customers and prospects, pre-submit promotional material, adopt written supervisory procedures and either operate under a guarantee agreement or maintain an enhanced capital level. One of the triggers of the Requirements is based on the regulatory background of the Member firm's APs and/or principals. Recently, NFA's Telemarketing Procedures Waiver Committee (Waiver Committee) asked NFA to make a minor modification to the Notice to provide limited additional relief to a limited number of individual principals who would currently qualify for the Requirements based on their previous affiliation with a Member firm that was subject to the Requirements.<sup>1</sup>

As way of background, NFA amended the Notice in 2006 after recognizing that the principals of several firms that had triggered the Requirements had avoided them by simply closing their firms and opening other firms that had a mix of APs that did not trigger the Requirements. The new firms typically had APs from a closed firm who had worked at Disciplined Firms, but their percentage ratios to the overall AP population of the new firms were below the triggering point for imposing the Requirements.<sup>2</sup> The amendments to the Notice dealt with this issue by providing that, once a firm had triggered the Requirements, then any other firms of which the principals of the qualifying firm are also principals would become subject to the Requirements.

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<sup>1</sup> NFA's Telemarketing Procedures Waiver Committee was established pursuant to the Notice and acts on petitions for full or partial waivers from the Requirements submitted by Members that become subject to them.

<sup>2</sup> Historically, the only way that a Member could have triggered the Requirements was to have a defined percentage of APs who had previously worked for a firm that had been disciplined for misleading sales practices or promotional material (Disciplined Firm).

In 2011, NFA revised the strict criteria that caused a principal's background to trigger the Requirements in recognition that the 2006 criteria affected some individuals and firms whose backgrounds suggested that they were not part of the population that the amendment was designed to impact. Specifically, the revision exempted individuals who had been principals of firms that had qualified for the Requirements from triggering an obligation to abide by the Requirements for additional firms of which they became principals if they met the following criteria.

- the principal has not been personally subject to a disciplinary action by NFA or the CFTC;
- the principal has been a principal of only one firm that has qualified for the enhanced supervisory requirements;
- the principal has never been a principal or an AP of a current Disciplined Firm;
- the one 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
- the one firm in the principal's history that qualified for the enhanced supervisory requirements has not become subject to a sales practice or promotional material based disciplinary action by NFA or the CFTC since qualifying for the enhanced supervisory requirements.

NFA's Waiver Committee has dealt with the practical application of the exemption created in 2011 for three years. During that time it has encountered a number of instances involving individual principals and Members who are similarly situated to the exempt group but who do not benefit from the relief contemplated in creating the exemption. This is the result, in part, of language in the current Notice which provides that the exemption is available to individuals who were principals at only one firm that had qualified for the Requirements.

Ms. Melissa D. Jurgens

June 18, 2014

A representative example of the situation occurs when a firm qualifies for the Requirements by virtue of having a significant percentage of APs who had formerly worked at firms that had been disciplined for sales practice or promotional material deficiencies. If the principals of that firm are also principals of another Member firm, then the second firm automatically qualifies for the Requirements simultaneously with the original firm as the second firm now has principals who were principals of another firm (i.e. the first firm) that qualified for the Requirements. There have been several instances where both firms have successfully petitioned the Waiver Committee for full waivers; however, the principals of those firms do not qualify for the 2011 exemption because they have been principals of more than one such firm meeting the Requirements.

The Waiver Committee requested NFA staff to explore whether it would be possible and prudent to slightly expand the 2011 exemption to provide an exemption to those principals who were previously a principal of a Member firm that previously received a full waiver from the Waiver Committee. In other words, once the Waiver Committee has determined that a Member firm that triggers the Requirements based on the background of its principals is deserving of a waiver from the Requirements, then going forward firms for which these individuals are listed principals are presumed to be without the need of the Requirements. These principals will therefore be exempt from triggering the Requirements at their future firms.

NFA found that 36 Members have qualified for the Requirements in the past five years based on having a principal who was previously a principal at a firm that had qualified for the Requirements. The Waiver Committee granted full waivers to ten of those 36 Member firms. None of the ten firms have been subject to any disciplinary action by NFA or the Commission. Moreover, the ten firms obtaining a full waiver had 21 listed individual principals who became principals of five subsequent firms. None of these five firms or 21 individuals has been subject to any disciplinary action by NFA or the Commission. These 21 individual principals are the ones who would qualify for the new exemption.

NFA determined that the current exemption can be slightly broadened so that once the Waiver Committee has determined that a Member firm that triggers the Requirements based on the background of its principals is deserving of a waiver from

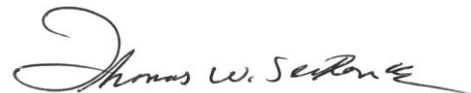
Ms. Melissa D. Jurgens

June 18, 2014

the Requirements, then the firm's principals will be exempt from triggering the Requirements at their future firms. The proposed amendments do not suggest any changes to the other criteria for qualifying for the exemption – the individual principal must never have been personally subject to CFTC or NFA disciplinary action; must never have been a principal or an AP of a current Disciplined Firm; and that no firm in their history that qualified for the Requirements has become subject to a sales practice or promotional material based disciplinary action by NFA or the CFTC since qualifying for the Requirements.

As mentioned earlier, NFA is invoking the “ten-day” provision of Section 17(j) of the Commodity Exchange Act. NFA intends to make the proposed amendments to NFA's Interpretive Notice entitled "Compliance Rule 2-9: Enhanced Supervisory Procedures" 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  
Senior Vice President and  
General Counsel

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\*The proposed amendments to NFA's Interpretive Notice Entitled "Compliance Rule 2-9: Enhanced Supervisory Procedures" became effective October 1, 2014.