

January 8, 1990

Ms. Jean A. Webb  
Secretariat  
Commodity Futures Trading  
Commission  
2033 K Street, N.W.  
Washington, D.C. 20581

Re: National Futures Association:  
Proposed Amendments to NFA Bylaw 503; NFA Compliance Rule 3-11; and NFA Code of Arbitration Section 10; and Proposed New NFA Bylaws 515 and 707

Dear Ms. Webb:

Pursuant to Section 17(j) of the Commodity Exchange Act, as amended, (the "Act"), National Futures Association ("NFA") hereby submits to the Commodity Futures Trading Commission ("Commission") proposed amendments to NFA Bylaw 503, NFA Compliance Rule 3-11, and NFA Code of Arbitration Section 10, and proposed new NFA Bylaws 515 and 707. These amendments and proposed Bylaws were approved by NFA's Board of Directors ("the Board") at its meeting on December 7, 1989. NFA respectfully requests Commission review and approval of the amendments and proposed Bylaws.

**I. AMENDMENTS TO NFA BYLAW 503 AND PROPOSED NFA BYLAWS 515 AND 707**

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- A. Amendments to NFA Bylaw 503 and proposed NFA Bylaws 515 and 707 to set qualification standards for service on the Board and the Regional Business Conduct Committees (additions are underscored and deletions are [bracketed]):

**BYLAWS  
OF  
NATIONAL FUTURES ASSOCIATION**

\* \* \*

**CHAPTER 5  
BOARD OF DIRECTORS**

\* \* \*

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Bylaw 503. Removal of Directors.

Notwithstanding the provisions of Bylaw 515, Directors may be removed from office as follows.

(a) Any FCM and LTM, IB or Industry Participant Director may be removed by a majority of the Members eligible to elect the Director whenever, in their judgment, the best interests of NFA will be served thereby.

(b) Upon recommendation of the Executive Committee, any [Public Representative] Director may be removed by [a majority of the Board, under the same standard] two-thirds of the Directors present and voting at a duly convened meeting of the Board whenever, in their judgment, the best interests of NFA will be served thereby.

\* \* \*

Bylaw 515. Qualifications of Directors.

(a) No individual shall be eligible to serve as a Director if any of the following disciplinary sanctions have been assessed against that individual by NFA within the prior three years, whether by finding or settlement, or if any of the following sanctions are currently outstanding or in effect:

- (1) Fine of \$20,000 or more for conduct which the Regional Business Conduct Committee imposing the fine deems to be a major rule violation;
- (2) Suspension from membership or registration of six months or more;
- (3) Denial of or expulsion from membership;
- (4) Denial of or revocation of registration;
- (5) An agreement not to apply for membership or registration for a period of six months or more; or
- (6) An agreement to withdraw from membership or registration;

and such sanction has not been stayed or overturned on appeal.

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(b) No individual shall be eligible to serve as a Director if that individual is subject to a Member Responsibility Action or Associate Responsibility Action which is currently in effect;

(c) No individual shall be eligible to serve as a Director if that individual is disqualified from serving on the governing board of any U.S. futures or securities self-regulatory organization.

(d) No individual shall be eligible to serve as a Director if that individual has been the subject of a Commission enforcement action which resulted in a civil sanction within the prior three years, whether by finding or settlement, or if such sanction is currently outstanding or in effect, and such sanction has not been stayed or overturned on appeal.

(e) No individual shall be eligible to serve as a Director if the individual has been convicted of a felony within the prior 10 years.

(f) In the event that a Director becomes disqualified after election to the Board, the vacancy shall be filled as prescribed by Article VII, Section 8. If the sanction is stayed or overturned on appeal before the vacancy is filled, the Director shall be entitled to resume his seat on the Board.

\* \* \*

CHAPTER 7  
COMMITTEES

\* \* \*

Bylaw 707. Qualifications of Members of Regional Business Conduct Committees.

(a) No individual shall be eligible to serve as a member of a Regional Business Conduct Committee if any of the following disciplinary sanctions have been assessed against that individual by NFA within the prior three years, whether by finding or settlement, or if any of the following sanctions are currently outstanding or in effect:

- (1) Fine of \$20,000 or more for conduct which the Regional Business Conduct Committee imposing the fine deems to be a major rule violation;

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- (2) Suspension from membership or registration of six months or more;
- (3) Denial of or expulsion from membership;
- (4) Denial of or revocation of registration;
- (5) An agreement not to apply for membership or registration for a period of six months or more; or
- (6) An agreement to withdraw from membership or registration;

and such sanction has not been stayed or overturned on appeal.

(b) No individual shall be eligible to serve as a member of a Regional Business Conduct Committee if that individual is subject to a Member Responsibility Action or Associate Responsibility Action which is currently in effect;

(c) No individual shall be eligible to serve as a member of a Regional Business Conduct Committee if that individual is disqualified from serving on the governing board of any U.S. futures or securities self-regulatory organization.

(d) No individual shall be eligible to serve as a member of a Regional Business Conduct Committee if that individual has been the subject of a Commission enforcement action which resulted in a civil sanction within the prior three years, whether by finding or settlement, or if such sanction is currently outstanding or in effect, and such sanction has not been stayed or overturned on appeal.

(e) No individual shall be eligible to serve as a member of a Regional Business Conduct Committee if the individual has been convicted of a felony within the prior 10 years.

- B. Explanation of amendments to NFA Bylaw 503 and proposed NFA Bylaws 515 and 707 to set qualification standards for service on the Board and the Regional Business Conduct Committees.

The Board recognizes the need to adopt standards for election to and removal from the Board and the Regional Business Conduct Committees ("BCCs") which would disqualify individuals subject to serious disciplinary sanctions. The Board believes that it is desirable to set specific eligibility standards while still maintaining the flexibility to deal with unanticipated

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situations. To accomplish this the Board adopted a two-pronged approach. First, the Board adopted proposed Bylaws 515 and 707 which provide that individuals who have been subject to serious disciplinary sanctions are ineligible to serve on the Board or the BCCs. Second, the Board adopted amendments to Bylaw 503 authorizing the Board to remove Directors by a super-majority vote whenever removal is in the best interests of NFA. (Under NFA Bylaw 704, the Board already has the authority to remove members of the BCCs when removal is in the best interests of NFA.)

The Board recognizes the difficulty of establishing a "one size fits all" industry-wide standard for disciplinary actions which should serve to bar individuals from board and committee service at any self-regulatory organization ("SRO"). Both the SROs and their members vary widely in size, and what constitutes a significant sanction at one SRO may reflect a trifling violation at another.

The Board believes that a two-step approach is the best way to provide the necessary flexibility in regard to SRO disciplinary actions. First, proposed Bylaws 515(a) and 707(a) sets out those sanctions imposed by NFA which would bar an individual from serving on NFA's Board or BCCs for a three-year period. These sanctions are a fine of \$20,000 or more for a major rule violation, suspension for six months or more, denial of or expulsion from membership, denial or revocation of registration, or settlement agreements which have the same effect.

Second, proposed Bylaws 515(c) and 707(c) incorporate by reference the standards set by any other futures or securities SROs by providing that any individual not fit to serve on the board or committees of any other SRO is not qualified to serve on NFA's Board or BCCs. This approach ensures that individuals who have been subject to significant disciplinary actions are barred from serving on NFA's Board and BCCs, provides a flexible and reliable means of establishing the necessary standards, and does not bar individuals of unquestioned integrity from Board and BCC service for minor rule violations.

The Board also believes that individuals who are subject to an outstanding Member Responsibility Action or Associate Responsibility Action, who have been sanctioned by the Commission within the last three years, or who have been convicted of a felony within the last 10 years are not qualified to serve on the Board or the BCCs. Proposed Bylaws 515 and 707 prohibit service by such individuals.

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No set of specific criteria can possibly anticipate successfully the wide range of factual circumstances which could warrant the removal of an NFA director to maintain public confidence in the self-regulatory process. Therefore, NFA Bylaw 503 has been amended to provide for the removal of a Director, upon the recommendation of the Executive Committee, if two-thirds of the Directors present and voting believe that removal is in the best interest of NFA. This provision is similar to removal procedures at a number of other self-regulatory organizations (e.g. the Coffee, Sugar & Cocoa Exchange; the New York Cotton Exchange; and the National Association of Securities Dealers). Similar provisions at the New York Mercantile Exchange and the New York Futures Exchange require only a majority vote for removal.

NFA realizes that the Commission has proposed qualification standards for service on governing boards and disciplinary committees which are not entirely consistent with proposed NFA Bylaws 515 and 707. 54 Fed. Reg. 37001 (1989). However, NFA is seriously committed to maintaining high standards for service on its Board and BCCs, and the Board believes that the importance of this issue makes it appropriate to act now instead of waiting until the Commission publishes final rules.

The amendments to NFA Bylaw 503 are not dependent on approval of proposed NFA Bylaws 515 and 707. Therefore, if the Commission decides to postpone consideration of proposed Bylaws 515 and 707 pending publication of the Commission's own final rules, NFA respectfully requests that the amendments to Bylaw 503, as well as the other amendments included in this submission, be severed and considered separately.

## II. AMENDMENTS TO NFA COMPLIANCE RULE 3-11

- A. Amendments to NFA Compliance Rule 3-11 to raise the maximum fine which can be imposed for violations of NFA requirements (additions are underscored and deletions are [bracketed]):

### COMPLIANCE RULES

\* \* \*

### Part 3 -- COMPLIANCE PROCEDURES

\* \* \*

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Rule 3-11. PENALTIES.

(a) Types of Penalties.

The Regional Committee or its designated Panel, or the Appeals Committee on appeal or review, may at the conclusion of the disciplinary proceeding impose one or more of the following penalties:

- (i) Expulsion, or suspension for a specified period, from NFA membership; two-thirds vote of the members of the Regional Committee or its designated Panel or the Appeals Committee present and voting shall be required for expulsion. A suspended Member shall be liable for dues and assessments but shall have no membership rights during the suspension period nor shall a suspended Member hold itself out as an NFA Member during the suspension period.
- (ii) Bar or suspension for a specified period from association with an NFA Member.
- (iii) Censure or reprimand.
- (iv) A monetary fine, not to exceed \$250,000 per violation. [\$100,000 for all violations found.]
- (v) Order to cease or desist, or any other fitting penalty or remedial action not inconsistent with this rule.

B. Explanation of amendments to NFA Compliance Rule 3-11 to raise the maximum fine which can be imposed for violations of NFA requirements:

NFA Compliance Rule 3-11 authorizes the Regional Business Conduct Committees ("BCCs") to impose sanctions, including fines, on Members violating NFA requirements. The ability of a BCC to fine violators, however, is limited in two ways. The first limitation is a ceiling of \$100,000 as the maximum fine amount which can be levied. The second restriction ties the maximum dollar amount to the aggregate of all violations found regardless of the number of separate offenses committed.

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When NFA began operation in 1982, this fining authority was consistent with industry standards and appeared to be sufficient to deter violations of NFA requirements. Changes in the industry since that time, and NFA's own experience, have shown maximum fines of \$100,000 per occurrence are no longer adequate. The amendments to Compliance Rule 3-11 raise the maximum fine to \$250,000 for each violation found.

**III. AMENDMENTS TO NFA CODE OF ARBITRATION, SECTION 10**

- A. Amendments to Section 10 of NFA's Code of Arbitration to codify NFA's policy regarding withdrawal of claims and to make it easier to close settled cases (additions are underscored and deletions are [bracketed]):

**CODE OF ARBITRATION**

\* \* \*

**Section 10. Award, Settlement and Withdrawal**

- (a) Issuance of Award.

\* \* \*

- (h) Satisfaction of Demand.

At any time during the course of an arbitration, a Respondent may satisfy a Demand for Arbitration and a Claimant may satisfy a counterclaim by payment or settlement. The arbitration proceeding will terminate upon receipt of a written notice of satisfaction and withdrawal of the Demand for Arbitration (shall be) duly executed by the parties and submitted to the Secretary. If the Secretary is notified that the Demand for Arbitration or a counterclaim has been settled, but the notification is not in writing or is not duly executed by the parties, the Secretary shall send written notice to the parties that the arbitration proceeding will terminate within 20 days of service of such notice unless the Secretary receives written notice that the Demand for Arbitration or counterclaim has not been settled.

\* \* \*



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(j) Withdrawal of Demand.

(1) At any time during the course of the arbitration, a Claimant may withdraw the Demand for Arbitration against any Respondent who has not filed an Answer. A written notice of withdrawal must be filed with the Secretary. The withdrawal will be without prejudice unless the notice states otherwise.

(2) After a Respondent has filed an Answer, a Claimant may not withdraw the Demand for Arbitration against that Respondent unless the Respondent consents. The notice and the consent must be in writing and filed with the Secretary. The withdrawal will be without prejudice unless the notice or the consent states otherwise.

(3) A Respondent may not withdraw a counterclaim against a Claimant unless the Claimant consents. The notice and the consent must be in writing and filed with the Secretary. The withdrawal will be without prejudice unless the notice or the consent states otherwise.

B. Explanation of amendments to Section 10 of NFA's Code of Arbitration to codify NFA's policy regarding withdrawal of claims and to make it easier to close settled cases:

It is NFA's policy to allow a party to withdraw its claim unilaterally if an Answer has not been filed. After an Answer has been filed, however, the claim cannot be withdrawn without the written consent of all parties who have filed a Demand or Answer. This policy is patterned after the Federal Rules of Civil Procedure. The Division of Trading and Market's Rule Enforcement Review of the Arbitration Program of the National Futures Association, dated September 26, 1989, recommended that NFA codify this policy to insure that all parties are aware of their rights with respect to withdrawal.

NFA currently requires all requests for withdrawal to specify whether they are with or without prejudice so that all parties understand the effect of the withdrawal. This practice is necessary because the effect of withdrawal is not spelled out in the Code of Arbitration ("the Code"). However, delays often result when NFA receives a request that does not specify whether withdrawal is to be with or without prejudice.

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Proposed Section 10(j) of the Code codifies the current policy, with one exception. The proposed language provides that, unless the request states otherwise, the withdrawal will be without prejudice. This practice is consistent with the Federal Rules of Civil Procedure and will serve to protect pro se claimants from inadvertently relinquishing their rights.

Section 10(h) of the Code currently requires that NFA be notified of any settlement in writing and that the notice be signed by all parties to the settlement. If NFA does not receive this notice, the case is kept open and the hearing is scheduled.

There have been a number of instances where the Arbitration Department is told that a case has been settled but one or more of the parties does not provide written confirmation to NFA. In many cases, the parties just do not get around to sending in written notice. In most of these cases an arbitration panel has been selected and a hearing has already been scheduled. In fact, the Arbitration Department usually finds out about the settlement when one party calls to cancel the hearing.

The problem is that these cases cannot be formally closed until NFA receives the written notice of settlement. The arbitrators cannot be released from service and, therefore, are not available to serve on another case. NFA sometimes has to reschedule and proceed with a hearing that nobody wants just to be able to close the case. Obviously, this is an inefficient use of NFA's resources.

In order to alleviate the problems cause by parties who do not provide NFA with written notice of a settlement, Section 10(h) of the Code has been amended to allow NFA to terminate a proceeding upon oral notice or written notice from less than all parties if the other parties do not dispute that the case has been settled. NFA will send a notice to the parties telling them that NFA has been informed that the case has been settled. The parties will have 20 days after the notice is mailed to notify NFA, in writing, that the case has not been settled. Otherwise, NFA will close the case.


NFA respectfully requests Commission approval of the proposed amendments to NFA Bylaw 503, NFA Compliance Rule 3-11, and NFA Code of Arbitration Section 10, and proposed new NFA Bylaws 515 and 707. NFA further requests that the amendments and proposed Bylaws be declared effective upon Commission approval.

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Finally, if necessary for the prompt approval of the amendments to Bylaw 503, Compliance Rule 3-13, and Code of Arbitration Section 10, NFA requests that these amendments be considered separately from proposed new Bylaws 515 and 707.

Respectfully submitted,

  
Daniel J. Roth  
General Counsel

DJR:jac

cc: Chairman Wendy L. Gramm  
Commissioner Kalo A. Hineman  
Commissioner Fowler C. West  
Commissioner William P. Albrecht  
Andrea M. Corcoran, Esq.  
Joanne T. Medero, Esq.  
Dennis P. Klejna, Esq.  
Alan L. Siefert, Esq.  
Susan C. Ervin, Esq.  
Lawrence B. Patent, Esq.

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

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



July 30, 1990

Daniel J. Roth, Esq.  
General Counsel  
National Futures Association  
200 West Madison Street  
Chicago, Illinois 60606


Re: The National Futures Association's Proposed  
Amendments to Bylaw 503, Compliance Rule 3-11  
and Code of Arbitration Section 10

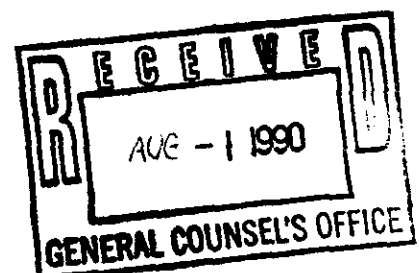
Dear Mr. Roth:

By letters dated January 8, 1990 and June 15, 1990, the National Futures Association ("NFA") submitted pursuant to Section 17(j) of the Commodity Exchange Act ("Act") proposed amendments to its Bylaw 503, Compliance Rule 3-11 and Code of Arbitration Section 10. The Commission understands that NFA intends to implement the proposed amendments upon receipt of notice of Commission approval.

Please be advised that on this date the Commission has approved the above-referenced proposed rule amendments under Section 17(j) of the Act. The Commission has approved the proposed amendment to Bylaw 503 in its current form, although the Bylaw does not address issues related to participation in deliberations or voting by the affected Board member. The staff believes that the Board member should be recused from these proceedings.

Sincerely,

  
Lynn K. Gilbert  
Deputy Secretary  
of the Commission



July 12, 1990

David Van Wagner, Esq.  
Division of Trading and Markets  
Commodity Futures Trading Commission  
2033 K Street, N.W.  
Washington, D.C. 20581

Re: National Futures Association; Proposed Amendments to  
NFA Bylaw 503, NFA Compliance Rule 3-11, and NFA Code  
of Arbitration Section 10

Dear Mr. Van Wagner:

By letter dated January 8, 1990, National Futures Association ("NFA") submitted a number of proposed changes to NFA Requirements to the Commodity Futures Trading Commission ("Commission") for review and approval pursuant to Section 17(j) of the Commodity Exchange Act, as amended. Included were proposed amendments to NFA Bylaw 503, NFA Compliance Rule 3-11, and NFA Code of Arbitration Section 10. As we discussed over the telephone yesterday, July 11, 1990, NFA agrees to extend the time for Commission review and approval of these proposed amendments until July 31, 1990.

If I can be of any further assistance, please contact me.

Very truly yours,



Kathryn Page Camp  
Assistant General Counsel

KPC:jac(Ltrs\VanWagnr.KPC)

June 15, 1990

David Van Wagner, Esq.  
Division of Trading and Markets  
Commodity Futures Trading Commission  
2033 K Street, N.W.  
Washington, D.C. 20581

Re: National Futures Association: Proposed Amendment to NFA  
Bylaw 503

Dear Mr. Van Wagner:

As you are aware, by letter dated January 8, 1990, National Futures Association ("NFA") submitted proposed amendments to NFA Bylaw 503 to the Commodity Futures Trading Commission ("Commission") for review and approval pursuant to Section 17(j) of the Commodity Exchange Act, as amended. The proposed amendments would authorize NFA's Board of Directors ("Board") to remove a Director by a super-majority vote whenever removal is in the best interests of NFA. This letter responds to questions you have raised regarding participation by a Director in the Board's discussions about his removal and his right to vote on the question of his own removal.

As written, Bylaw 503 does not prohibit a Director from participating in deliberations regarding his removal, nor does it bar him from voting on the issue. This position is consistent with Delaware law which, while not directly addressing the issue of participation in a removal decision, supports director participation in issues in which the director has an interest. For example, Section 144 of the Delaware General Corporation Law allows a director to participate in a meeting about and vote on a contract with the director or an entity with which the director has a relationship as long as the relationship is disclosed. Delaware law also holds that a director cannot be removed for cause without notice of specific charges and a full opportunity to meet the accusation. *Bossier v. Connell*, No. 8624 (Ch. Ct., 11/12/86).

As you suggested, we have contacted the futures exchanges with rules which authorize the governing board to remove a director. None of these exchanges has been confronted with the

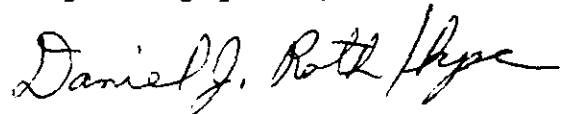
question of whether to allow a director subject to removal to participate in deliberations and vote on his own removal.

It should be noted that the Commission has already approved rules of four exchanges which provide for removal of directors by the governing body while remaining silent on whether the director subject to removal can participate in discussions and vote on his own removal. The Commission also approved NFA Bylaw 503 as originally written, which provided for the removal of a Public Director by the Board while remaining silent on the Director's ability to participate and vote.

NFA understands the Commission staff's concerns that allowing a Director subject to removal proceedings to participate in deliberations could inhibit an open discussion by the other Directors. If the Commission so requests, NFA staff does not object to further amending Bylaw 503 to bar the Director from participating in deliberations and voting on his removal, and we believe that the Board would be willing to pass such an amendment. However, we respectfully request that the Commission approve the amendment to Bylaw 503 in its current form rather than holding it up while the Board makes further amendments.

If you have any questions, please contact Kathryn Camp or me.

Very truly yours,



Daniel J. Roth  
General Counsel