National Futures Association's Business Conduct Rules

(As of August 4, 2010)

I. Exchange Traded Futures Contracts

NFA Manual / Rules

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Compliance Rules

RULE 2-9. SUPERVISION.
[Effective date of amendments: October 29, 1991; January 19, 1993; March 15, 1994; April 23, 2002; and November 1, 2007.]

(a) Each Member shall diligently supervise its employees and agents in the conduct of their commodity futures activities for or on behalf of the Member. Each Associate who has supervisory duties shall diligently exercise such duties in the conduct of that Associate's commodity futures activities on behalf of the Member.

(b) NFA's Board of Directors may require Members which meet specific criteria established by the Board relating to the employment history of its APs or principals or to the total commissions, fees and other charges paid by their customers to adopt supervisory procedures specified by the Board for the supervision of telemarketing. This requirement may, in NFA's discretion, be waived upon a showing by the Member that the Member's current supervisory procedures provide effective supervision over its employees and agents. Any Member seeking such a waiver may submit a written request to a three-member panel consisting of three members of the Business Conduct Committee and/or the Hearing Committee, said members to be appointed by the Board from time to time. Within 30 days after a Member submits a waiver request, the Compliance Director will submit a written response to the panel. The decision of the panel shall be final and shall be based upon the written submissions of the Member and of the Compliance Director.

(c) Each FCM and IB Member shall develop and implement a written anti-money laundering program approved in writing by senior management reasonably designed to achieve and monitor the Member's compliance with the applicable requirements of the Bank Secrecy Act (31 U.S.C. 5311, et. seq.), and the implementing regulations promulgated thereunder by the Department of the Treasury and, as applicable, the Commodity Futures Trading Commission. That anti-money laundering program shall, at a minimum,

(1) Establish and implement policies, procedures, and internal controls reasonably designed to assure compliance with the applicable provisions of the Bank Secrecy Act and the implementing regulations thereunder;

(2) Provide for independent testing for compliance to be conducted by Member personnel or by a qualified outside party;

(3) Designate an individual or individuals responsible for implementing and monitoring the day-to-day operations and internal controls of the program; and

(4) Provide ongoing training for appropriate personnel./p>

[See Interpretive Notice NFA Compliance Rule 2-9: FCM And IB Anti-Money Laundering Program and Interpretive Notice NFA Compliance Rule 2-29: Review of Promotional Material Prior to its First Use and Interpretive Notice Compliance Rule 2-9: Self-Audit Questionnaires and Interpretive Notice Compliance Rule 2-9: Supervision of Telemarketing Activity and Interpretive Notice Compliance Rule 2-9: Supervisory Procedures for E-Mail and the Use of Web Sites and Interpretive Notice Compliance Rule 2-29 and 2-9: NFA's Review and Approval of Certain Radio and Television Advertisements]

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Interpretive Notices

9010 - INFORMATION AVAILABLE FROM NFA REGARDING BACKGROUND OF PROSPECTIVE EMPLOYEES

(Staff, August 21, 1989; revised July 1, 2000)

INTERPRETIVE NOTICE

NFA Compliance Rule 2-9 requires Members to supervise diligently the futures-related activities of their employees and agents. Obviously, all Members should carefully screen prospective APs, both to ensure their qualifications and to determine the extent of supervision the prospective AP would require if hired. The purpose of this Notice is to remind you of the information available from NFA to aid Members in that effort.

All applicants for AP registration are required to fill out the Form 8-R, supplying, among other things, information concerning their recent employment history and any disciplinary proceedings against them. What may not be immediately apparent from the face of the application is whether any of the applicant's previous employers have been the subject to disciplinary proceedings by the Commission or by NFA. This information could be helpful to a prospective employer in determining the extent of supervision a particular applicant would require after he is hired. Certainly, if a recently hired AP has received the bulk of his professional training and experience from, for example, a number of firms which have been closed down as a result of disciplinary proceedings brought by the Commission or by NFA, that individual may well require closer supervision for a period of time than other APs.

If you have any questions whether the Commission or NFA has taken any action against a particular firm or individual, check the BASIC system on NFA's web site at www.nfa.futures.org, send a request to NFA through the "contact" feature of the web site, or call NFA's Information Center at (800) 621-3570. Summary information concerning the proceeding is available through BASIC or can be provided over the phone, and copies of any available documents relating to the proceeding can be provided upon request.

Prospective employers are also entitled to any non-public registration records regarding a prospective employee. For example, each applicant for registration as an AP must complete the disciplinary history portion of the Form 8-R, and must supply a detailed explanation of any "yes" answers to those questions. That detailed explanation is treated as non-public but is available to prospective employers under NFA Registration Rule 701(c). Thus, a prospective employer may obtain the non-public supplementary information which the applicant may have submitted in connection with any past registrations.

The supervision of employees must be an issue of paramount concern to all NFA Members. NFA recognizes that certain employees, by virtue of their past training or experience, may need more supervision than others and will gladly supply our Members with whatever information may be available to help identify those employees.

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Interpretive Notices

9019 - COMPLIANCE RULE 2-9: SUPERVISION OF BRANCH OFFICES AND GUARANTEED IBS
(Board of Directors, October 6, 1992; revised July 24, 2000)

INTERPRETIVE NOTICE

NFA Compliance Rule 2-9 places a continuing responsibility on every Member to diligently supervise its employees and agents in all aspects of their futures activities. Rule 2-9 applies not only to the supervision of branch office operations, but also imposes a direct duty on guarantor FCMs to supervise the activities of their guaranteed IBs. NFA Compliance Rule 2-23 provides that a guarantor FCM may be held jointly and severally subject to discipline by NFA for violations of NFA rules committed by the FCM's guaranteed IBs. In practice, NFA's Business Conduct Committee has charged FCMs under Rule 2-23 only where it appears that the guarantor failed to diligently supervise its guaranteed IBs.

NFA recognizes that, given the differences in the size of and complexity of the operations of NFA Members, there must be some degree of flexibility in determining what constitutes "diligent supervision" for each firm. It is NFA's policy to leave the exact form of supervision to the Member, thereby providing the Member with flexibility to design procedures that are tailored to the Member's own situation. Nevertheless, NFA's Board of Directors believes that it is appropriate to provide Members with specific minimum standards for a supervisory program for branch offices and guaranteed IBs ("remote locations") and therefore issues the following Interpretive Notice.

Though Members may tailor their supervisory procedures to meet their particular needs, any adequate program for supervision must include procedures for performing day-to-day monitoring and surveillance activities, conducting on-site visits of remote locations and conducting ongoing training for firm personnel. The firm's policies and procedures, including those for the supervision of branch offices and guaranteed IBs, should be in written form. Firm personnel and guaranteed IB personnel should be provided a copy of the appropriate policies and procedures relating to their duties, and be aware of the firm's requirements. A copy of all policies and procedures should be on file with the branch office or guaranteed IB. All supervisory personnel should be knowledgeable of the firm's requirements for supervision.

I. Day-to-Day Monitoring

On a regular basis a Member should perform a number of supervisory procedures in order to monitor the business being conducted in its remote locations. The extent of the supervision depends on a number of factors, including the volume of trading, the experience of the personnel, the nature of the customers, the trading strategies followed by the office or certain APs, the number of customer complaints and the length of time that the office has conducted business with the firm. Repeated problems in any particular area should heighten the level of scrutiny and follow-up by the main office or guarantor.

The procedures to review the day-to-day activities of an office should include the following areas.

Hiring. An adequate program for supervision must include thorough screening procedures for prospective employees to ensure they are qualified and to determine the extent of supervision the person would require if hired. The appropriate documentation to support any "yes" answers on the Form 8-R should be obtained and reviewed for potential disqualifying information. Derogatory information, which the applicant may have submitted in connection with any past regulations, should be obtained from NFA.[1] Prior employers should be contacted to confirm the person's previous work experience.

In connection with the review of the person's prior work experience, a prospective employer should check for any futures-related disciplinary proceedings against the person's prior employer.[2] This information should be used by the prospective employer to determine the extent of supervision a particular applicant would require after he or she is hired.

Due Diligence Check of Guaranteed IBs. Guarantor FCMs must do a due diligence inquiry before entering into a guarantee agreement. The due diligence review must include a check to ensure that the IB is properly registered. The FCM's due diligence review should also include inquiries concerning the disciplinary history of the IB and the disciplinary and employment history of the IB's principals and APs. This type of information could be helpful to a prospective guarantor in determining the types of difficulties, if any, experienced by an IB, its principals and APs in the past and the extent of supervision which may be required of that IB under a guarantee agreement. For example, if the APs at a certain IB have received their futures training and experience at a firm or firms that have been subject to serious disciplinary actions by NFA or the CFTC, that IB may well require more supervision. Both registration

and disciplinary information is readily available from NFA.[3]

Registration. Records of commissions payable to or generated by the branch office or guaranteed IB should be broken down by sales person and should be frequently reviewed to ensure that no commissions are being paid to unregistered individuals.

Customer Information. NFA Compliance Rules require each Member to adopt and enforce procedures regarding customer information and risk disclosure. The procedures for opening new accounts should require that the appropriate account documentation, including an acknowledgment of receipt of the required risk disclosure statement, be forwarded to the main office or guarantor.[4] The documentation should be reviewed to ensure that the appropriate supervisory personnel approved the account. The information obtained from a customer should be reviewed to determine whether additional risk disclosure should have been provided to the customer. For any customer who should have received additional risk disclosure, the main office or guarantor should ensure that additional disclosure has been given and that such disclosure has been documented. It may also be necessary to contact the customer to verify that the disclosure was provided and that the customer understood its meaning. Notwithstanding these procedures, a firm may wish to require that all new account information and documentation be forwarded to the main office or guarantor for approval before trading commences in the account.

Account Activity. The trading activity in customer and AP personal accounts should be reviewed and analyzed on a regular basis in order to highlight those accounts which may require further scrutiny. There are a number of calculations and comparisons which can be performed to flag accounts for follow-up or further monitoring. For example, significant losses, commission charges or number of trades should be reviewed for inappropriate trading strategies. The reason for error and correction entries to trading accounts should be investigated, especially if there appears to be a pattern of errors or corrections made by an office. Commission-to-equity ratios should be calculated for discretionary accounts to detect possible excessive trading. In order to identify improper trade allocations for discretionary accounts or front running, the trading results in an AP's personal account should be compared to the trading gains and losses in his or her customer accounts. Profitable customer accounts for a given AP should be reviewed for possible preferential treatment.

Appropriate supervisory personnel at the remote location should be notified of questionable account activity. Measures should be taken to follow up, such as reviewing order tickets and trade blotters, discussing the activity with the broker or contacting the customer.

Discretionary Accounts. NFA Compliance Rule 2-8 contains detailed requirements concerning the supervision and review of discretionary accounts. The written customer authorization and customer acknowledgment for third-party account controllers should be forwarded to the main office or guarantor. [5] Confirmation of the registration history of APs of FCMs and IBs exercising discretion should be made to ensure that they have been properly registered for the requisite two-year minimum.

Promotional Material. NFA Members are required by rule to adopt and enforce procedures regarding communications with the public. All promotional material should be submitted by the branch office or guaranteed IB to the home office or guarantor for review and approval prior to its first use. Review and approval of the material should be documented by the appropriate supervisory personnel.

Customer Complaints. An adequate system for handling customer complaints should require that a written record of all complaints be maintained, and that complaints which meet certain criteria be sent to the main office or guarantor. Notification of the main office of customer complaints may be based on factors including the seriousness of the allegations of wrong-doing, the monetary amount involved, and which APs or principals are subjects of the complaints. If the remote location is responsible for resolving customer complaints, the home office or guarantor should also be notified of the outcome of resolved complaints. Notwithstanding these criteria, a firm may wish to consider having all customer complaints received by a remote location submitted to the main office.

The main office or guarantor should review the complaints for possible rule violations. It should also compare the allegations in the complaint for similarity to other complaints received against the same individuals or office. Such a review may detect a pattern of sales practice or other abuses.

The status of unresolved complaints should be periodically reviewed to ensure that the branch office or guaranteed IB has promptly responded to complainants.

II. On-Site Visits

In addition to day-to-day supervisory procedures, adequate supervision of the personnel who do work in the main office must also include periodic on-site inspections. As a general matter, NFA would expect these on-site inspections of guaranteed IBs or branch offices to be performed annually.

Members should develop written procedures for the on-site review process including detailed steps to be followed during the visit. This will help ensure that the review process is performed in a consistent manner and will not vary due to the involvement of different personnel in the review process. A Member's supervisory procedures should also address the number of visits to be made to a branch office or guaranteed IB. The frequency and nature of the visits, as well as whether the visit will be announced or unannounced, will depend on a number of factors including: the amount of business generated; the number of customer complaints received; the previous training and experience of the branch office personnel; and the frequency and nature of problems or concerns that arise as the result of day-to-day monitoring and surveillance of the office's activities. The personnel who make the visits should be qualified to perform examinations and knowledgeable of the industry and the nature of the firm's business. Such personnel should be able to perform their work with an independent, objective perspective.

The length of time between visits to the remote location coupled with the size and scope of its operation also plays a role in determining the procedures for on-site review of records and account documentation.[6] In reviewing a smaller operation, it is feasible to

conduct a comprehensive review of the remote location's records and documents over the entire time period between visits, while reviewing a larger scale operation may require the selection of a sample of records and documents for given time intervals. The selection of samples should be accomplished on a random basis, for example, selecting every third account for review for randomly selected time periods.

Promptly after the completion of an on-site visit, a written report should be prepared and its findings discussed with the branch office and regional managers or guaranteed IB's principals and supervisory personnel. Follow-up procedures should also be performed to ensure that any deficiencies revealed during an on-site visit are promptly corrected. The written procedures for the on-site examination should include steps to review the following areas:

Customer Order Procedures. An on-site visit to a remote location should include a review of procedures for handling and recording customer orders. The individuals responsible for accepting customer orders should be identified and a sample of a order tickets should be selected for review. NFA recommends that order tickets be prenumbered and that the on-site review test to ensure that all order tickets within the chosen samples are accounted for. The order ticket review should also confirm that all order tickets are properly time stamped and that all information required by CFTC Regulation 1.35 is included. If option orders are placed by the branch office or guaranteed IB, those order tickets should be reviewed to ensure that they contain the additional information required by CFTC Regulation 1.35.

Discretionary Accounts. If a branch office or guaranteed IB handles discretionary accounts, the supervisory visit should confirm that the branch office or guaranteed IB identifies discretionary orders as such and that the firm's procedures regarding the supervision of discretionary trading activity are followed. In the event a branch office or guaranteed IB enters block orders, those orders should be reviewed to confirm that customer orders are not included with proprietary orders and that nondiscretionary customer orders are not included with discretionary customer orders. Split fills should be reviewed to ensure that they have been allocated according to established procedures.

Sales Practices. The on-site visit should include a review of sales solicitation practices as well as any promotional material utilized. A suggested starting point for review of the sales solicitation practices of a branch office or guaranteed IB is to identify the persons involved in sales solicitation and to confirm that they are properly registered. The individuals conducting the on-site review should also monitor sales solicitations while at the branch office or guaranteed IB. Interviews with selected customers should be conducted concerning the solicitation process and the handling of the customer's account. The individuals at the branch office or guaranteed IB responsible for supervising sales solicitations should be identified, and the method by which sales solicitations are supervised should be reviewed for adequacy.

The branch office or guaranteed IB's promotional material, including sales solicitation scripts, must be approved by appropriate supervisory personnel. Therefore, an on-site visit should be designed to ensure that the branch or guaranteed IB is not using any promotional material that has not received prior approval. If the main office or guarantor has not approved the promotional material, it should be reviewed during the on-site visit.

Customer Complaints. The on-site review should include steps to confirm that all complaints requiring notification have been reported to the main office.

Handling of Customer Funds. In order to assure that customer funds are being properly handled by a branch office, the on-site review should determine whether the branch office accepts funds from customers and, if so, whether appropriate bank accounts, including segregated accounts for customer funds, have been established by authorized personnel. In addition, for guaranteed IBs, the on-site review should confirm that if funds are accepted from customers, they are received in the name of the FCM. The branch office or guaranteed IB should make copies of any customer checks that they deposit into a qualifying or branch bank account. The check copies should be reviewed during the visit to ensure that the branch office or guaranteed IB only accepts checks made payable to the FCM. In addition, third-party checks should be scrutinized to ensure that no customers are acting as unregistered FCMs or CPOs. If the guaranteed IB receives customer funds in the FCM's name, the review should confirm that the proper authorization to do so exists, that appropriate bank accounts are maintained and that proper procedures for forwarding the funds have been established and are followed. For both branch offices and guaranteed IBs, the flow of customer funds in a sample of accounts should be reviewed to determine that all funds have been timely transmitted and properly credited.

Proprietary Trading. To the extent feasible, there should be a separation of duties between persons handling customer orders and firm employees or principals trading for the firm's proprietary accounts or their own accounts to prevent misuse of non-public information or the occurrence of other trading abuses.

III. Ongoing Training

A Member's supervisory responsibilities include the obligation to ensure that its employees are properly trained to perform their duties. Procedures must be in place to ensure that employees receive adequate training to abide by industry rules and regulations and to properly handle customer accounts and that APs have completed the ethics training required by CFTC Regulation 3.34. Employees must be educated on developments and changes in the markets, futures products, rules and regulations, technology, and firm policies and procedures. The formality of a training program will depend on the size of the firm and the nature of its business. The individuals responsible for providing the training must be qualified to do so.

Certain APs may require training for soliciting and handling customer accounts. If an AP has previously worked at firms closed through an enforcement action for sales fraud and has therefore received his or her training from such firms, that AP may need specialized training in proper sales practices.

This Notice is intended to specify minimum supervisory standards for branch offices and guaranteed IBs. A failure to adhere to the requirements specified in this Notice will be deemed a violation of NFA Compliance Rule 2-9.

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[1] The detailed explanation of any "yes" answers on an 8-R is treated as nonpublic information; however, it is available to prospective employers under NFA Registration Rule 701(c). See Interpretive Notice at ¶9010.

[2] Information concerning futures-related disciplinary proceedings can be obtained by checking the BASIC system on NFA's web site at www.nfa.futures.org, sending a request to NFA through the "contact" feature of the web site, or calling NFA's Information Center at (800) 621-3570. See Interpretive Notice at ¶9010.

[3]Registration Information is also available by checking the BASIC system on NFA's web site at www.nfa.futures.org, sending a request to NFA through the "contact" feature of the web site, or calling NFA's Information Center at (800) 621-3570. See Interpretive Notice at ¶9007.

[4] NFA Rules require that a guaranteed IB maintain a record of the information obtained from a customer and a copy of the risk disclosure acknowledgment. A branch office may wish to keep copies of this information for its files.

[5] NFA Rules require that a guaranteed IB maintain a record of the written customer authorization and customer acknowledgments for third-party account controllers. A branch office may wish to keep copies of this information for its files.

[6] If a visit is prompted by awareness of a particular problem at a remote location or if a problem is discovered during a routine visit, the Member must ensure that the scope of the review is adequate to thoroughly examine the problem area.

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Interpretive Notices

9020 - COMPLIANCE RULE 2-9: SELF-AUDIT QUESTIONNAIRES
(Board of Directors, October 6, 1992; revised July 24, 2000)

INTERPRETIVE NOTICE

NFA Compliance Rule 2-9 places a continuing responsibility on every Member to diligently supervise its employees and agents in all aspects of their futures activities. NFA recognizes that, given the differences in the size and complexity of the operations of NFA Members, there must be some degree of flexibility in determining what constitutes "diligent supervision" for each firm. It is NFA's policy to leave the exact form of supervision up to the Member, thereby providing the Member with flexibility to design procedures that are tailored to the Member's own situation. The Board of Directors adheres to this principle but feels that all Members should regularly review the adequacy of their supervisory procedures.

The Board of Directors has determined that in order to satisfy their continuing supervisory responsibilities, NFA Members must review on a yearly basis self-audit questionnaires that can be downloaded from NFA's web site at www.nfa.futures.org. The questionnaires must be reviewed by the appropriate supervisory personnel in either the home or branch office. After reviewing the questionnaire, the appropriate supervisory person must sign the questionnaire stating that the Member's operations have been evaluated based on the questionnaire and attesting that the Member's procedures comply with all applicable NFA requirements.

Members are required to retain the signed questionnaire in their files for a period of five years from the date of review, with the questionnaires being readily accessible during the first two years. In addition, guaranteed IBs must provide and guarantor FCMs must obtain copies of the signed questionnaires. Members must also provide the signed questionnaires for inspection upon request by NFA.

Review of the questionnaires should aid Members in recognizing potential problem areas and alert them to procedures which need to be revised or strengthened. The questionnaires focus on a Member's regulatory responsibilities and require a review of the adequacy of the Member's internal procedures. For example, the FCM questionnaire requires review of a Member's procedures relating to customer order flow, customer account documentation, risk disclosure, margin policies, option accounts and transactions, customer complaints, advertising, cash flow and compliance with NFA requirements. Similarly, the CPO/CTA questionnaires contain a check-list which will assist CPOs and CTAs in their review of disclosure documents.

A Member firm that does not comply with this Interpretive Notice will violate NFA Compliance Rule 2-9.

Questions regarding this Interpretation or the questionnaires should be directed to the Compliance Department at (800) 621-3570 or through the "contact" feature of NFA's web site.

[NOTE: The self-audit questionnaire is now called the Self-Examination Checklist."]

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Interpretive Notices

9021 - COMPLIANCE RULE 2-9: ENHANCED SUPERVISORY REQUIREMENTS

(Board of Directors, January 19, 1993; revised August 14, 1996, December 16, 1996; March 10, 1998; July 1, 2000; January 1, 2001; June 1, 2001; August 21, 2001; March 18, 2003; November 9, 2004; February 15, 2006; April 15, 2006; November 1, 2007; December 17, 2007; and September 18, 2008.)

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 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 the 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 ("FCM"s) 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 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 https://www.nfa.futures.org/ereg. 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 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 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 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.

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[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.

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Interpretive Notices

9037 - NFA COMPLIANCE RULE 2-9: SUPERVISORY PROCEDURES FOR E-MAIL AND THE USE OF WEB SITES
(Board of Directors, August 19, 1999)

INTERPRETIVE NOTICE

NFA Compliance Rule 2-9 requires Members and Associates with supervisory duties to diligently supervise employees and agents in the conduct of their commodity futures activities for or on behalf of the Member. The rule is broadly written to provide Members with flexibility in developing procedures tailored to meet their particular needs. On certain issues, however, NFA has issued Notices to Members to provide more specific guidance on acceptable standards for supervisory procedures. Currently, information technology is changing nearly every aspect of how Members conduct business, including how they communicate with their customers. For example, e-mail and internet-based communications have enabled Members and their employees and agents to communicate with customers more frequently and efficiently. Expanded use of this technology, however, also requires Members to re-examine their methods of supervising their communications with the public.

This Notice addresses the supervisory issues raised by use of e-mail and web sites to conduct futures-related business. Although this Notice does not specifically address every aspect of electronic communication, such as the use of chat rooms to conduct business or after-hours electronic trading activity, this is not intended to suggest that Members have no supervisory obligations regarding these types of activities. Consistent with the approach taken in this Notice, in establishing supervisory procedures for electronic communications, Members may wish to draw from their experience in supervising non-electronic communications.

E-Mail

A Member's duty to supervise the use of futures-related e-mail by its employees and agents is basically the same as its duty to supervise other forms of correspondence. NFA would expect each Member to adopt review procedures that are appropriate in light of its business activities, including the structure, size and nature of its business operations. Like other supervisory procedures, a Member's supervisory procedures with respect to e-mail must:

- be in writing; and
- identify by title or position the person responsible for conducting the review.

In addition, firms may wish to consider whether the following procedures would be appropriate as well:

- specify how and with what frequency e-mails will be reviewed and how that review will be documented; and
- categorize what type of e-mail will be pre-reviewed or post-reviewed.

Each Member is free to adopt the specific procedures that it will use to conduct its review. However, those procedures must take into consideration the nature of the communication, the relative sophistication of the recipient and the training and background of the employees and agents. In some instances, spot-checking or sampling e-mail messages representing routine communications between employees or agents and existing customers may be appropriate and in others it may not. For example, a firm dealing with sophisticated or institutional customers might choose to sample a relatively small but representative amount of the routine electronic correspondence to review. On the other hand, firms dealing with individual, relatively unsophisticated retail customers might consider using a larger sample or even reviewing all the routine e-mail. Similarly, a firm may wish to conduct a comprehensive review of employees' and agents' e-mail if they have a disciplinary history involving problems with customers or came from a firm that has been disciplined for fraud.

Members' procedures should also address whether employees and agents are permitted to use e-mail systems other than the firm's system. If a firm permits them to use other systems for business purposes, whether on their work or home computer, the firm's procedures must treat these off-system e-mails as its own records and must ensure that the firm is capable of adequately reviewing them. Given the supervisory problems which could arise, some firms may choose not to permit their employees and agents to communicate with the public outside of work through an e-mail system that is not linked to the firm's network.

In many instances e-mails may constitute promotional material. E-mail directed to the public soliciting business constitutes advertising and is subject to the same rules as any other form of promotional material. For example, an e-mail message sent to targeted individuals or groups would be considered promotional material if its ultimate purpose was to solicit funds or orders. A Member's e-mail review procedures must be designed to ensure compliance with NFA's promotional material content and review requirements. These requirements, found in NFA Compliance Rule 2-29, provide, among other things, for prior review of this type of e-mail by appropriate supervisory personnel. Additionally, this type of e-mail is subject to the specific recordkeeping requirements of Compliance Rule 2-29.

Members should properly educate and train their employees and agents on the firm's policies regarding e-mail communications - particularly on those communications that are not reviewed by supervisory personnel prior to use. Special attention should be given to those employees and agents with previous compliance or disciplinary problems. Finally, Members must periodically evaluate the effectiveness of their e-mail review procedures and modify them as necessary.

Web Sites

Both Members and their employees and agents can inexpensively and quickly create web sites to attract business. NFA's Compliance Rule 2-29 establishes the standards that web site content must meet. The procedures that Members adopt to supervise the use of web sites must be designed and enforced to ensure that the web sites comply with these standards. These supervisory procedures must:

- be written;
- require prior review and approval of the web site by an appropriate supervisor; and
- require documentation of the review.

Because the substantive content of web sites can change frequently, the Member's procedures should address how it will ensure that each substantively new version of a web page will be subject to the review procedures. Members' review procedures should adequately address features unique to electronic communications, e.g., streaming script containing real-time market news, for which neither prior review nor post-review of each bit of information may be possible.

Unless the web site limits access to a particular target audience, through an acknowledgment by the user or other means, the Member's review procedures should take into consideration the fact that the web site, like other forms of mass media advertising, is available to the public at large. If the firm permits its employees and agents to use personal web sites to attract business for the firm, these web sites will constitute firm promotional material. Consequently, the Member's procedures must be adequate to enable it to properly review the employees' and agents' web sites, including all substantive modifications, according to its procedures. Additionally, to ensure compliance with the recordkeeping requirements, the firm's procedures should provide the means to identify the time frame in which particular versions of the web page are in use. Finally, Members must periodically evaluate and modify as necessary their web site review procedures to ensure their effectiveness.

As is the case with other media, the use of agents' web sites to solicit leads may subject a firm to liability if the agents' leads were generated through deceptive materials posted on a web site. If a firm (either non-Member or Member) maintains a web site which contains deceptive information regarding futures or options trading and a Member pays that firm to provide a hyperlink to the Member's web site, the Member may well be held accountable for the content of the other firm's web site.

The fact that a Member creates a hyperlink from its web site to another web site does not, in and of itself, make the Member firm accountable for the content of the other web site. Member firms should bear in mind, though, that their supervisory obligations under Rule 2-9 and Rule 2-29 require them to diligently supervise their employees and agents who are responsible for creating and maintaining the web sites, including hyperlinks to other web sites. Members should consider whether appropriate supervisory procedures include periodic inquiries as to whether their employees and agents are monitoring the general content of the web site to which the Member links. NFA is not suggesting that firms are necessarily responsible for the virtually infinite chain of links from its web site to others. At the same time, Members who seek to circumvent NFA promotional material and supervision rules by using a chain of hyperlinks to a "remote" web site may be held accountable for that "remote" web site's content.

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Interpretive Notices

9039 - NFA COMPLIANCE RULES 2-29 AND 2-9: NFA'S REVIEW AND APPROVAL OF CERTAIN RADIO AND TELEVISION ADVERTISEMENTS
(Board of Directors, March 28, 2000)

INTERPRETIVE NOTICE

NFA Compliance Rule 2-29 governs communications between NFA Members and the public. Among other things, the rule prohibits the use of promotional material which is misleading or deceptive. The purpose of this rule is to protect the public from fraudulent advertising and sales solicitations and to provide guidance to Members on the standards by which their promotional material will be evaluated.

Over the last few years, NFA's Board of Directors ("Board") has become increasing concerned with several types of misleading radio and television advertisements that a small number of Member and non-Member firms are using with greater frequency. Though these problem ads vary somewhat, their consistent theme is that customers are likely to make substantial profits by following the sponsoring firm's recommendations. These advertisements hurt both the customers naive enough to believe the claims and the reputation of the industry. Though NFA's current compliance rules provide a basis for prosecuting the Members who either sponsor such ads or reap any benefits from the ads, the Board has always felt that it is better to prevent than prosecute fraud.

To achieve this goal, the Board recently amended NFA Compliance Rule 2-29 to add a new subsection (h) to require any Member firm using or directly benefiting from a radio or television advertisement that makes any specific trading recommendation or refers to or describes the extent of any profit obtained in the past or that can be achieved in the future to submit the advertisement to NFA's Promotional Material Review Team for its review and approval at least 10 days prior to first use. If additional information is needed, or the review cannot be completed within the 10 day period, the Member will be so notified. Obviously, NFA staff will not be able to independently verify the accuracy of every statement made in an advertisement within the 10 day review period; that responsibility remains with the Member. Therefore, submitting promotional material to NFA will not provide a "safe harbor" from NFA actions for Members if misstatements or omissions of material fact are discovered subsequently or NFA otherwise later determines that the material is in violation of standards set forth herein.

At this time, the Board also wishes to reiterate that two prior Notices to Members dated June 4, 1996 (I-96-11) and September 2, 1998 (I-98-15) describe particular fraudulent techniques that a relative handful of Members use in their radio and television advertisements. NFA's Business Conduct Committee ("BCC") has not hesitated to issue a number of Complaints against Member firms utilizing the techniques mentioned in those Notices. Furthermore, after recently reviewing the particular types of radio and television advertisements forming the basis of these BCC Complaints, the Board has directed staff to be particularly vigilant in reviewing radio and television advertisements containing specific trading recommendations and/or a description of past or future profits. In fact, the Board finds the content of certain advertisements to be inherently misleading and has further directed staff to disapprove of their usage. Typically, these advertisements include one or more of the following practices, each of which is described in the prior Notices:

- **Claims Regarding Seasonal Trades**: These ads cite seasonal data which supposedly shows that certain trades produce dramatic profits year in and year out in such products as heating oil in the winter and unleaded gas in the summer.
- **Claims Regarding Historic Price Moves** - These ads refer to historic price moves in particular commodities such as sugar when it was trading at $0.66 per pound, gold at $800 per ounce and silver at $50, with a suggestion that the same record setting move is likely to occur again.
- **Claims Regarding Price Movements** - These ads highlight the tremendous profits which will result from projected price movements which are characterized, directly or indirectly, as conservative estimates when, in fact, such price movements would be dramatic.
- **Claims Using Certain Pricing Data** - These ads use price data for a product different from the one being marketed in the promotional material. Examples of these types of ads include: ads that use pricing data relative to the cash or futures markets to sell options; ads that use pricing data for at-the-money options to sell out-of-the money options; and ads that use pricing data that do not include commissions and fees comparable to those charged by the Member.
- **Claims Containing Profit Projections** - These ads claim that customers can turn a $10,000 investment into $25,000 or make

similar types of dramatic profit projections.

- **Claims Containing "Cherry Picked" Trades** - These ads seek to entice prospective investors by claiming that their customers have made dramatic profits; however, such claims rely on isolated trades in specific customer accounts.
- **Claims Regarding Mathematical Examples of Leverage** - These ads improperly use "leverage examples" as a means of suggesting that prospective customers are likely to earn large profits trading futures and options.

It is important to note that this list of deceptive advertising techniques is not all inclusive. Each of the practices described above presents a distorted and misleading view of the likelihood of customers earning dramatic profits by investing with the Member, and each of these practices represents a clear violation of NFA's sales practice rules.

Finally, one additional issue relating to advertising occurs when a Member benefits from the use of a "blind ad." Specifically, some Members attempt to evade NFA's advertising requirements by purchasing leads from non-Members that run misleading radio and television commercials basically identical to those prosecuted by NFA's BCC. These ads do not identify any particular Member firm and invite the viewer to call a toll-free number to obtain more information. The non-Member then sells the resulting leads to a Member firm, which then claims that it has no responsibility for the content of the ad. Members can not evade their supervisory responsibilities by buying leads from such firms.

NFA Compliance Rule 2-9 requires each Member to diligently supervise its employees and agents in the conduct of their commodities futures activities. The CFTC has brought cases against companies that run "blind ads" and has alleged that they are, in fact, soliciting orders and are required to be registered as IBs. In addition to a Member's responsibilities under NFA Bylaw 1101, the Board believes that Member firms have a supervisory duty to ensure, to the extent possible, that their employees and agents are not purchasing leads from non-Members required to be registered and/or using fraudulent advertising practices.

In many instances, a Member firm will have direct knowledge of the source of leads that the Member purchases. For example, the Member firm purchases leads from a provider that generates leads solely incidental to some other business purpose (e.g., a subscription list). However, in the event a Member firm does not have direct knowledge, then the Member firm has a duty to inquire as to the source of leads. Specifically, under those circumstances, a Member firm has an affirmative duty to determine if the leads were generated from a provider using any type of advertisement soliciting investments in futures, one of whose business purposes is the generation and sale of the leads. If a Member firm purchases leads from such a provider, then the Member must ensure, prior to soliciting any customer with the leads, that the lead provider submitted the advertisement to NFA for review and approval pursuant to Compliance Rule 2-29(h). If the advertisement was not approved by NFA, then the Member is not permitted to solicit any customer with the leads purchased from that provider.

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Interpretive Notices

9051 - NFA COMPLIANCE RULE 2-9: ETHICS TRAINING REQUIREMENTS
(Board of Directors, July 1, 2003)

INTERPRETIVE NOTICE

In October 2001, the CFTC issued a Statement of Acceptable Practices ("Statement") for ethics training. This Statement replaces the Commission's prescriptive ethics training rule and allows flexibility in the format, frequency and providers of ethics training, permitting each firm to tailor its training program to better suit its own operations. By the same token, this shifted the responsibility to each firm to adopt and implement an appropriate ethics training scheme. The Commission intended that the compliance with the Statement's principles would serve as a "safe harbor" concerning acceptable procedures for ethics training programs and topics that ethics training programs should address. Because the Statement is fairly general in nature, however, Members have requested that NFA provide additional information to assist them to comply with their ethics training requirement.

Ethics training is one of a Member's supervisory obligations under NFA's Compliance Rule 2-9. The repeal of the specific regulations relating to ethics training does not diminish Members' and Associates' obligation to diligently supervise its employees. Professional ethical standards remain an essential element of each Member's business model. The use of well-designed ethics training programs supports each Member's supervision of its employees and business activities. Like any other business process, remaining aware of changing industry standards and ensuring high ethical standards is an on-going effort. Developments in technology, commercial practices and regulations and other changes will have ethical ramifications associated with them. Good business practice dictates that employees receive periodic training to keep them cognizant of these developments and their ethical implications.

PROCEDURES
The first thing that all firms should have is written procedures that outline their ethics training program. Acceptable procedures will address:

1. the topics that will be included in the training program;
2. by whom the training will be provided;
3. the format of the training, e.g., classroom instructions, software, etc.;
4. the frequency with which the Member expects its employees to obtain ethics training; and
5. how the firm will document that it has followed its written procedures.

CONTENT
The Statement lists the following as topics that an ethics training program should address:

1. An explanation of the applicable laws and regulations and rules of self-regulatory organizations or contract markets and registered derivatives transaction execution facilities;
2. The registrant's obligation to the public to observe just and equitable principles of trade;
3. How to act honestly and fairly and with due skill, care and diligence in the best interest of customers and the integrity of the markets;
4. How to establish effective supervisory systems and internal controls;
5. Obtaining and assessing the financial situation and investment experience of customers;
6. Disclosure of material information to customers; and
7. Avoidance, proper disclosure and handling of conflicts of interest.

TRAINING PROVIDERS
It is still acceptable to obtain ethics training sponsored by independent persons, firms, or industry associations. Each Member should ensure that its selected provider is qualified and obtain proof that the provider has completed relevant proficiency testing and has three years of relevant industry experience, or similar experience. NFA's Vice President of Registration may waive the testing requirement where the provider demonstrates competency comparable to satisfying proficiency testing requirements. Firms should only use providers that they reasonably in good faith believe are not subject to any investigations or bars from registration. In-house training is also acceptable; however, firms should apply these same criteria to any in-house training personnel. NFA's BASIC system, which can be found on our website, is an excellent resource to check registration and disciplinary history of providers.

TRAINING FORMAT
Ethics training may be provided through a variety of media, including the Internet, audiotapes, computer software, and videotapes, as well as in-person courses. Less formal methods of training are also permitted, including distribution of periodicals, legal cases and advisories. Each Member should choose a format or formats that best suit its business operations and the nature of its workforce. For example, firms that have a high percentage of APs with disciplinary histories or who come from firms with disciplinary histories may well decide that more structured, formal training is appropriate.

FREQUENCY
Like format, Members should decide how frequently ethics training is required based on the business model, the composition of their sales force and the format of the training. For example, firms that opt for less formal training such as distribution of pertinent written materials should consider keeping the training on a more on-going basis. More formal training, such as classroom instruction, could appropriately be offered less frequently but on a periodic basis.

DOCUMENTATION
Maintaining documentation that the Member has complied with its procedures is a critical element of an acceptable ethics training program because it enables the Member to be certain that it is actually implementing the policies it has deemed necessary and appropriate for its business. The appropriate documentation will vary depending on the firm's overall ethics training program. Firms that distribute written materials should maintain documentation showing what materials were distributed, who selected them and when and to whom they were circulated. Firms that utilize more formal training programs should keep records showing who obtained the training, the date of training, and any materials used.

FUTURES EXCHANGE REQUIRMENTS
The futures exchanges have taken a variety of approaches to ethics training. Members are urged to review the ethics training requirements of the exchanges of which they are members.

CONCLUSION
Members that establish a corporate culture of high ethical behavior will provide the best service for their customers. Remaining aware of changing industry standards and adopting an appropriate ethics training program will help ensure that Members and their Associates continually adhere to the high ethical standards that the Members set for themselves.

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Interpretive Notices

9055 - NFA BYLAW 1101, COMPLIANCE RULES 2-9 AND 2-29: GUIDELINES RELATING TO THE REGISTRATION OF THIRD-PARTY TRADING SYSTEM DEVELOPERS AND THE RESPONSIBILITY OF NFA MEMBERS FOR PROMOTIONAL MATERIAL THAT PROMOTES THIRD-PARTY TRADING SYSTEM DEVELOPERS AND THEIR TRADING SYSTEMS
(Board of Directors, August 19, 2004; effective January 10, 2005)

INTERPRETIVE NOTICE

In recent years, there has been a significant increase in the number of futures trading systems being marketed to the public. These trading systems typically are computerized programs that generate signals as to when to buy and sell commodity futures and options contracts.

A number of NFA Member firms offer trade execution services to customers who use these computerized trading systems, many of which are developed by third-party trading system developers ("third-party system developers"), who are neither NFA members nor registered with the CFTC. Typically, in these situations, the customer will execute a Letter of Direction that directs the Member to place trades for the customer in strict accordance with the signals generated by the trading system. In some cases, the Letter of Direction is more limited and includes instructions to follow only certain signals (e.g., signals in given contracts or signals that meet particular parameters). In almost all cases in which a Letter of Direction is used, the Member is not permitted to use any judgment when placing orders for the customer.

This notice is designed to provide guidance as to the circumstances which may give rise to liability on the part of the Member, under NFA Bylaw 1101, for providing execution services to users of computerized trading systems developed by non-Member third-party system developers. This notice will also discuss the factors that may cause a Member to be responsible, under NFA Compliance Rule 2-29, for promotional material which promotes these trading systems and the Member's supervisory obligations under NFA Compliance Rule 2-9.

REGISTRATION REQUIREMENTS FOR
THIRD-PARTY SYSTEM DEVELOPERS

Section 1a (6) of the Commodity Exchange Act ("CEA") defines a CTA as any person who for compensation or profit, engages in the business of advising others, directly or through publications, writings, or electronic media, as to the value of or the advisability of trading commodity futures. Generally, Section 4m of the CEA requires individuals who fall within this definition to register with the CFTC. In March 2000, the CFTC adopted CFTC Rule 4.14(a)(9) to create an exemption from the CEA's registration requirements for CTAs that provide standardized advice by means of media such as newsletters, pre-recorded telephone hotlines, Internet web sites, and non-customized computer software.

To qualify for the exemption, under Rule 4.14(a)(9)(i) a CTA may not direct client accounts. As defined by Commission Rule 4.10(f), `` [d]irect, as used in the context of trading commodity interest accounts, refers to agreements whereby a person is authorized to cause transactions to be effected for a client's commodity interest account without the client's specific authorization." In a Commission Staff letter issued in May 2003, Commission Staff indicated that an agreement authorizing a person to direct a client's account - and, thus, requiring the person to be registered as a CTA - may be an informal agreement. The fact pattern addressed by the Commission's Staff letter involved a developer of a computerized trading system who was registered as an associated person ("AP") of an introducing broker ("IB"). The AP's activities on behalf of the IB consisted solely of soliciting clients to use his trading program. Such clients executed a "letter of direction" providing that the IB should execute trades for the clients' accounts and "follow [the trading program] signals as close as reasonably possible."

In analyzing the above fact pattern, Commission Staff concluded that, since the clients' contact with the AP/trading system developer included not only the trading program, but also the opening of a trading account that would be traded pursuant to a "letter of direction," there was an "informal arrangement", for which the exemption provided under Rule 4.14(a)(9) was not intended. After specifically noting that the "whole of [the AP/trading system developer's] activities as an AP of the IB consisted of the solicitation of clients for the trading program, CFTC staff determined that registration as a CTA was required of either the IB or the AP. (See CFTC staff letter, No. 03-26, May 30, 2003, re Section 4m - Interpretation with regard to Commodity Trading Advisor Registration.)

Rule 4.14(a)(9)(ii) also provides that, to qualify for the exemption, a CTA may not provide "commodity trading advice based on, or

tailored to, the commodity interest or cash market positions or other circumstances or characteristics of particular clients." So long as the CTA's advice is based on or tailored to such information, the CTA is required to register even if it gives the same advice to groups of similarly situated clients.

In determining whether advice is "based on or tailored to" within the meaning of 4.14 (a)(9)(ii), the context of the advice will be taken into account. For example, if the advice is provided in a book or a periodical, that factor may weigh against a finding that the CTA is providing advice "based on or tailored to" the characteristics of particular clients. On the other hand, if the advice is provided to a particular client in a face-to-face communication or over the telephone, that factor may weigh in favor of a finding that the CTA's advice is "based on or tailored to" that particular customer's characteristics, since such a context suggests that the CTA is being responsive to the client's individual needs.[1]

Whether a third-party system developer is required to be registered as a CTA still depends on the particular facts of each case. In some cases, the third-party system developer - or any third-party, for that matter - may be required to register as an IB, if it refers customers to an NFA Member and receives compensation for the referrals. Members who have questions concerning the application of Rule 4.14 are urged to seek advice from the CFTC.

Regardless of whether a third-party system developer is required to register as a CTA, the question sometimes arises whether the IBs involved must also register as CTAs. If the IB and the third-party system developer are operated as wholly independent entities and the IB has no authority to deviate from the third-party system developer's recommendations, generally the IB need not also register as a CTA. This is clearly the case where a customer independently selects a trading system and the IB does not solicit discretionary trading authority. However, if any of these factors change (e.g., the IB has authority to deviate from the trading system by selecting only some of the trades generated by the system), the IB may be required to register as a CTA, unless the IB is otherwise exempt because its activities related to placing trades based on the recommendations of the trading system are "solely in connection with its business as an IB."

NFA Bylaw 1101 provides, in pertinent part, that no Member may carry an account, accept an order or handle a transaction in commodity futures on behalf of any non-Member that is required to be registered as a CTA or in some other capacity. Therefore, if it appears that a third-party system developer, with whom an NFA Member does business, is required to be registered as a CTA or in some other capacity, the Member should request that the third-party system developer provide a letter from counsel stating the reasons why registration is not required.[2] In the absence of such a letter, the Member should request that the third-party system developer apply for registration and NFA membership. If the third-party system developer fails or refuses to register and become an NFA Member, the Member should terminate its relationship with the third-party system developer to avoid liability under NFA Bylaw 1101.

A MEMBER'S RESPONSIBILITY FOR MISLEADING PROMOTIONAL MATERIAL WHICH PROMOTES A THIRD-PARTY SYSTEM DEVELOPER'S TRADING PROGRAM

NFA has encountered, with increasing frequency in recent years, misleading promotional material promoting trading systems developed by third-party system developers, who are not NFA Members, and for which an NFA Member provides trade execution services. Often this promotional material uses hypothetical or simulated results - which are trading results not achieved by an actual account - that are not clearly identified as hypothetical and show impressive gains, when customers actually using the trading system have suffered substantial losses. In this and other contexts, both NFA and the Commission have brought numerous enforcement actions charging fraud in the use of such promotional material.

Following are several examples of situations where Members may be held accountable under Compliance Rules 2-29 and 2-9 for misleading promotional material that promotes third-party trading system developers and their trading systems.

Direct Responsibility

If an NFA Member or its Associates prepare or distribute the promotional material, the Member will be responsible for its misleading content under NFA Compliance Rule 2-29, which prohibits a Member from using misleading or deceptive promotional material.

Agency Responsibility

NFA's Business Conduct Committee has always recognized that each Member is responsible for the acts of its agents. This certainly applies to the preparation of advertising material. Thus, an NFA Member may be responsible, under NFA Compliance Rule 2-29, for misleading promotional material prepared and disseminated by a third-party trading system developer, whether or not the third-party trading system developer is an NFA Member or not, if there is an agency relationship between the NFA Member and the third-party trading system developer. (Of course, if the third-party trading system developer is also an NFA Member, it too would be responsible under NFA Compliance Rule 2-29 for the misleading promotional material that it prepared and distributed.)

In determining whether there is an agency relationship between the Member and the third-party system developer, which would trigger liability under NFA Compliance Rule 2-29, the central inquiry focuses on the nature of the business relationship between the parties and whether the parties have expressly or implicitly agreed that one may act for the other. As the CFTC has held, whether an agency relationship exists turns "on an overall assessment of the totality of the circumstances in each case." The more limited the contacts are between the third-party system developer and the NFA Member, the more likely it is that an agency relationship will not be found to exist between the parties.

If there is an agency relationship between the Member and the third-party system developer, then the Member has an affirmative duty, under NFA Compliance Rule 2-9, to supervise the activities of the third-party system developer/agent.

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Supervisory Responsibility Under NFA Compliance Rule 2-9

Even where no agency relationship exists, a Member whose web site links to or otherwise refers customers to a third-party system developer or has a referral agreement with a third-party trading system developer should conduct a due diligence inquiry into the system developer's advertising practices with a view towards identifying and avoiding the misleading advertising practices described earlier, i.e., the use of exaggerated profit claims, and hypothetical or simulated results which are not clearly identified as hypothetical, or which show highly profitable performance when actual customers trading the system have sustained significant losses.[3]

The fact that a Member creates a hyperlink from its web site or otherwise refers customers to a third-party system developer or has a referral agreement with a third-party system developer does not, in and of itself, make the Member firm accountable for the third-party system developer's web site or promotional material. Member firms should bear in mind, though, that their supervisory obligations under Rule 2-9 and Rule 2-29 require them to diligently supervise their employees and agents who are responsible for creating and maintaining hyperlinks to web sites of third-party system developers; or establishing referral agreements with third-party system developers. Members should consider whether appropriate supervisory procedures include periodic inquiries as to whether their employees and agents are conducting due diligence with respect to the third-party system developer's web site or advertising, and taking appropriate steps if deficiencies are found in such web site or advertising. A Member's failure to supervise its employees and agents in this regard will constitute a violation of NFA Compliance Rule 2-9 on the part of the Member. Moreover, in these situations, Member firms should not seek to circumvent NFA's promotional material requirements by relying upon the unregistered status of the third-party trading system developer.

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[1] The Commission gives a number of examples, which illustrate the application of Rule 4.14(a)(9) in specific situations, in the Rule's publication in the Federal Register. (Federal Register: March 10, 2000 (Volume 65, Number 48, pages 12938-12943.)

[2] Member firms may rely in good faith upon a copy of a letter from counsel. However, in some cases, a Member may have to perform additional due diligence to ascertain whether a third-party system developer is required to be registered.

[3] *See* also NFA's interpretive notice entitled "NFA Compliance Rule 2-9: Supervisory Procedures for E-Mail and the Use of Web Sites" (paragraph 9037).

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Compliance Rules

RULE 2-30. CUSTOMER INFORMATION AND RISK DISCLOSURE.
[Adopted effective June 1, 1986. Effective date of amendments: January 1, 1990, August 21, 2001 December 10, 2002, December 17, 2007]

(a) Each Member or Associate shall, in accordance with the provisions of this Rule, obtain information about its futures customers who are individuals and provide such customers with disclosure of the risks of futures trading.

Effective January 3, 2011, paragraph (a) will read as follows:

(a) Each Member or Associate shall, in accordance with the provisions of this Rule, obtain information from all individual customers and any other customers who are not eligible contract participants (as defined in Section 1(a)(12) of the Act) and provide such customers with disclosure of the risks of futures trading.

(b) The Member or Associate shall exercise due diligence to obtain the information and shall provide the risk disclosure at or before the time a customer first opens a futures trading account to be carried or introduced by the Member, or first authorizes the Member to direct trading in a futures account for the customer. A Member registered as a broker or dealer under Section 15(b)(11) of the Exchange Act shall provide a copy of the disclosure statement for security futures products at or before the time the Member approves the account to trade security futures products.

Effective January 3, 2011, paragraph (b) will read as follows:

(b) The Member or Associate shall exercise due diligence to obtain the information and shall provide the risk disclosure at or before the time a customer first opens a futures trading account to be carried or introduced by the Member, or first authorizes the Member to direct trading in a futures account for the customer. A Member registered as a broker or dealer under Section 15(b)(11) of the Exchange Act shall provide a copy of the disclosure statement for security futures products at or before the time the Member approves the account to trade security futures products. For an active customer who is an individual, the FCM Member carrying the customer account shall contact the customer, at least annually, to verify that the information obtained from that customer under Section (c) of this Rule remains materially accurate, and provide the customer with an opportunity to correct and complete the information. Whenever the customer notifies the FCM Member carrying the customer's account of any material changes to the information, a determination must be made as to whether additional risk disclosure is required to be provided to the customer based on the changed information. If another FCM or IB introduces the customer's account on a fully disclosed basis or a CTA directs trading in the account, then the carrying FCM must notify that Member of the changes to the customer's information. The Member or Associate who currently solicits and communicates with the customer is responsible for determining if additional risk disclosure is required to be provided based on the changed information. In some cases, this may be the Member introducing or controlling the account; in other cases, it may be the carrying FCM.

(c) The information to be obtained from the customer shall include at least the following:

(1) the customer's true name and address, and principal occupation or business;

(2) the customer's current estimated annual income and net worth;

(3) the customer's approximate age; and

(4) an indication of the customer's previous investment and futures trading experience;

In addition, Members that are not also members of the Financial Industry Regulatory Authority and their Associates must obtain the following information from each customer who is an individual if the customer trades security futures products:

(5) whether the customer's account is for speculative or hedging purposes;

(6) the customer's employment status (e.g., name of employer, self-employed, retired);

(7) the customer's estimated liquid net worth (cash, securities, other);

(8) the customer's marital status and number of dependents;

(9) such other information used or considered to be reasonable by such Member or Associate in making recommendations to the customer.

Effective January 3, 2011, paragraph (c) will read as follows:

(c) The information to be obtained from the customer shall include at least the following:

(1) The customer's true name and address, and principal occupation or business;

(2) For customers who are individuals, the customer's current estimated annual income and net worth. For all other customers, the customer's net worth or net assets and current estimated annual income, or where not available, the previous year's annual income;

(3) For individuals, the customer's approximate age or date of birth;

(4) An indication of the customer's previous investment and futures trading experience; and

(5) Such other information deemed appropriate by such Member or Associate to disclose the risks of futures trading to the customer.

In addition, Members that are not also members of the Financial Industry Regulatory Authority and their Associates must obtain the following information from each customer who is an individual if the customer trades security futures products:

(6) Whether the customer's account is for speculative or hedging purposes;

(7) The customer's employment status (e.g., name of employer, self-employed, retired);

(8) The customer's estimated liquid net worth (cash, securities, other);

(9) The customer's marital status and number of dependents;

(10) Such other information used or considered to be reasonable by such Member or Associate in making recommendations to the customer.

(d) The risk disclosure to be provided to the customer shall include at least the following:

(1) the Risk Disclosure Statement required by CFTC Regulation 1.55, if the Member is required by that Regulation to provide it;

(2) the Disclosure Document required by CFTC Regulation 4.31, if the Member is required by that Regulation to provide it;

(3) the Options Disclosure Statement required by CFTC Regulation 33.7, if the Member is required by that Regulation to provide it; and

(4) the Disclosure Document required by CFTC Regulation 31.11, if the Member is required by that Regulation to provide it.

(e) In the case of an account which is introduced by an FCM or IB or for which a CTA directs trading, and except as otherwise provided in subsections (b) and (j), it shall be the responsibility of the Member soliciting the account to comply with this Rule.

(f) A Member or Associate shall be entitled to rely on the customer [as the sole source] for the information obtained under Section (c) of this Rule and shall not be required to verify such information, except as provided in section (j)(2) of this rule.

(g) Each Member or Associate shall make or obtain a record containing the information obtained under Section (c) of this Rule at the time the information is obtained. If a customer declines to provide the information set forth in Section (c) of this Rule, the Member or Associate shall make a record that the customer declined, except that such a record need not be made in the case of a non-U.S.

customer unless such customer trades security futures products. Subject to the provisions of Section (i) of this Rule, a Member may open, introduce or agree to direct a futures trading account for a customer only upon the approval of a partner, officer, director, branch office manager or supervisory employee of the Member. Each Member shall keep copies of all records made pursuant to this Rule in the form and for the period of time set forth in CFTC Regulation 1.31.

(h) Each Member shall establish and enforce adequate procedures to review all records made pursuant to this Rule and to supervise the activities of its Associates in obtaining customer information and providing risk disclosure.

(i) Nothing herein shall relieve any Member from the obligation to comply with all applicable CFTC and SEC Regulations and NFA Requirements.

(j) Members that are not also members of the Financial Industry Regulatory Authority and their Associates shall adhere to the following additional requirements relating to accounts for customers that trade security futures products:

(1) A Member shall exercise due diligence to learn the essential facts relative to the customer, including the customer's investment objectives and financial situation and, based upon those facts (including any information obtained under subsection (c) of this Rule, if applicable), a partner, officer, director, branch office manager, or supervisory employee of the Member shall approve or disapprove the customer's account for security futures transactions. If the Member is an FCM or IB, the account must be approved or disapproved by a designated security futures principal. The approval or disapproval shall be in writing and shall identify the person approving or disapproving the account. Additionally, the customer's account records shall contain information about the account, including the name of the Associate, how the customer's information was obtained, and the date that the disclosure statement for security futures products was provided.

(2) A Member or Associate shall forward the background and financial information upon which the customer's account has been approved for trading security futures products to each customer who is an individual, unless the information has been obtained in writing from the customer, for verification of accuracy within fifteen days after the customer's account has been approved. A copy of the background and financial information on file with the Member shall also be sent to each customer who is an individual for verification within fifteen days after the Member becomes aware of any material change in the customer's financial status. In all cases, absent notice to the contrary from the customer, the information is deemed verified.

(3) No FCM or IB Member or Associate thereof shall recommend to a non-institutional customer a transaction in security futures products or a particular trading strategy relating to such products without making reasonable efforts to obtain current information regarding the customer's financial status and investment objectives; provided, however, that this requirement does not apply to transactions in discretionary accounts. For purposes of this requirement, a non-institutional customer is any customer who is not:

(i) a bank, savings and loan association, insurance company, registered investment company, a registered commodity pool operator, or a commodity pool operated by a registered commodity pool operator;

(ii) an investment advisor registered either with the Securities and Exchange Commission under Section 203 of the Investment Advisers Act of 1940 or with a state securities commission (or any agency or office performing like functions) or a registered commodity trading advisor;

(iii) an investment company exempt from registration under the Investment Company Act of 1940, a commodity pool operator exempt from registration under the Commodity Exchange Act, a commodity pool operated by a commodity pool operator exempt from registration under the Commodity Exchange Act, an investment advisor exempt from both federal and state registration under the Investment Advisers Act of 1940, or a commodity trading advisor exempt from registration under the Commodity Exchange Act;

(iv) a registered broker-dealer or futures commission merchant; or

(v) any other entity (whether a natural person, corporation, partnership, trust, or otherwise) with total assets of at least $50 million.

(4) No FCM or IB Member or Associate thereof shall recommend to any customer a transaction in security futures products or a particular trading strategy relating to such products without reasonable grounds for believing that the recommendation or strategy is not unsuitable for the customer on the basis of the customer's current investment objectives, financial situation and needs, and any other information known by the Member or Associate.

(5) No FCM or IB Member or Associate shall recommend a security futures transaction to a customer unless the person making the recommendation has a reasonable basis for believing, at the time of making the recommendation, that the customer has such knowledge and experience in financial matters that the customer may reasonably be expected to be capable of evaluating the risks of the recommended transaction, and is financially able to bear the risks of the recommended transaction.

(6) No Member or Associate exercising discretion over an account may effect security futures transactions that are excessive in size or frequency in view of the customer's investment objectives and financial situation.

[See Interpretive Notice NFA Compliance Rule 2-30: Customer Information and Risk Disclosure (Board of Directors) and Interpretive Notice NFA Compliance Rule 2-30: Customer Information and Risk Disclosure (Staff).]

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Interpretive Notices

9013 - NFA COMPLIANCE RULE 2-30: CUSTOMER INFORMATION AND RISK DISCLOSURE
(Staff, November 30, 1990; revised July 1, 2000)

INTERPRETIVE NOTICE

NFA's Know-Your-Customer Rule, which deals with customer information and risk disclosure, has been in effect since June 1, 1986. As drafted by NFA's Advisory Committees and approved by the Board of Directors, the Rule was designed to accomplish two primary objectives:

1. to define "high standards of commercial honor and just and equitable principles of trade" as applied to Member procedures for exchanging information with new customers who are individuals; and

2. to provide a useful tool to combat any unscrupulous firms attempting to take advantage of unsophisticated investors.

Given these broad purposes, some of the Rule's provisions are very specific, while others, of necessity, are more general. Since some of the Rule's provisions are stated in general terms, Members may understandably seek more specific guidance on some points. The best sources for such guidance are the Interpretive Notice to Rule 2-30 ("Interpretive Notice")[1], and the decisions NFA's Regional Business Conduct Committees ("BCCs") and Hearing Panels have made in specific disciplinary cases which allege violations of the Rule. The purpose of this Notice is to provide Members with additional guidance in complying with Rule 2-30 by summarizing how the BCCs have applied Rule 2-30 since the Rule became effective in 1986.

Since Rule 2-30 became effective, a number of complaints have been filed by NFA which allege violations of the Rule. Typical violations of the Rule generally fall into one of three categories.

1. failing to give additional risk disclosure when required or disguising the fact that additional risk disclosure may be required by inducing customers to provide false information on their account opening papers;

2. violations of recordkeeping requirements; and

3. violations of supervisory requirements.

A description of typical violations in each category is set forth below.

Inadequate Risk Disclosure

The heart of Rule 2-30 is the requirement that Members obtain certain basic information from the customer concerning his financial background, analyze that information and ensure that the customer has received adequate risk disclosure information. As discussed in the Interpretive Notice, some customers may require risk disclosure in addition to that specifically prescribed by Rule 2-30(d)[2]. For example, there may be instances where, for some customers, the only adequate risk disclosure is that futures trading is too risky for that customer. Once adequate disclosure is given, however, the customers are free to decide whether to trade in futures and the Member is free to accept the account. The Rule recognizes that the identification of customers who require additional risk disclosure can only be done on a case-by-case basis and that the determination of whether additional risk disclosure is required for a given customer is best left to the Member firm, subject to review by the BCCs.

The most serious violations of the Rule have involved either failing to provide additional risk disclosures when necessary or inducing customers to provide false information on their account opening forms. A number of the more egregious cases, which have generally resulted in expulsions from NFA membership, are summarized below. The exact factual circumstances vary from case to case, but one common thread in these cases is that the customer had no previous futures trading experience and little, if any, other investment experience. Obviously, these extreme examples do not in any way limit the circumstances which may trigger a need for additional risk disclosures:

- An AP instructed a customer, who noted on his account opening forms that he had owned his own home for 18 years, to falsify his account application by indicating that he had been involved in real estate development for 18 years.
- An AP solicited a 52-year-old retired Air Force Colonel who had no prior commodity trading experience. The AP did not advise the customer of any specific numbers to put down on his account opening form regarding his net worth, but told him to make the numbers high enough to get the account approved.
- An AP solicited a 32-year-old nurse and her husband, a 39-year-old computer operator, neither of whom had any prior investment experience in commodities or securities. The customers repeatedly informed the AP that they could not afford a minimum required investment of $10,000. The AP told them to take out a loan from their credit union and that the required investment amount would then be reduced to $5,000. The customers subsequently took out a $3,000 loan from their credit union and added $2,000 from their savings account to meet the $5,000 minimum investment requirement. The husband then went to the firm's office and signed the account forms during his 30-minute lunch break; however, he did not read the forms, nor were they explained to him by the firm or its AP.
- An AP instructed a customer to inaccurately complete his account application by stating that he was a foreman rather than a factory laborer, and by indicating that he had liquid assets in the amount of $51,000 instead of $20,000. Another of the firm's APs told a customer that his actual annual income of $12,500 was too low and that if he did not change that figure to read between $20,000 and $40,000, his account would be rejected.
- A customer who had been unemployed for two years, with a net worth of $30,000 derived from an inheritance and sale of property and no futures trading experience, was instructed by an AP to "put down anything" on the account opening form regarding her employment and income. The customer received no risk disclosure other than the Risk Disclosure Statement required by CFTC Regulation 1.55. In addition, the AP neither explained the account documents to the customer, nor gave her sufficient time to review them.
- An AP solicited a 77-year-old retired real estate investor with a net worth of $100,000 and a fixed annual income of $20,000. The customer informed the AP that both he and his wife were in ill health and that one of the reasons for his interest in investing in commodity futures contracts was his limited health insurance coverage and a desire to earn enough money to pay for his medical expenses. Rather than providing the customer with risk disclosure in addition to that contained in the risk disclosure statements, the AP informed the customer that the risk of loss involved in futures trading was slight. Another of the firm's APs instructed a customer not to put down "unemployed actor" for his occupation but rather "self-employed." This AP also advised the customer to include a net worth figure on his account forms which was sufficiently high to insure the opening of the account, and for the income figure, to put down his income prior to becoming unemployed.

Again, the cases summarized above illustrate some of the more egregious violations of the Rule involving either inadequate risk disclosure or inducing customers to provide false information on their account opening forms. However, because the determination of whether additional risk disclosure is required for a given customer can be made only on a case-by-case basis, the above scenarios should not be interpreted to limit the circumstances under which additional risk disclosure may be required.

Recordkeeping and Supervisory Requirements

Though risk disclosure is the heart of the Rule, Compliance Rule 2-30 also imposes certain recordkeeping and supervisory requirements. Violations of these requirements typically involve a failure to obtain all of the information required under the Rule (i.e., occupation, current estimated annual income and net worth, approximate age and previous investment and futures trading experience) or a failure to retain the appropriate records. Although the Rule 2-30 recordkeeping violations have never formed the sole basis of disciplinary actions, they generally are indicative of a widespread recordkeeping problem within the firm.

Rule 2-30(h) requires each Member to "establish and enforce adequate procedures to. . . supervise the activities of its Associates in obtaining customer information and providing risk disclosure." One case alleging a violation of Rule 2-30(h) involved the failure of a firm's account opening procedures to require that the firm's APs obtain the necessary information from the customer. Another case involved a firm whose APs failed to follow guidelines provided to the firm by its guarantor in order to determine whether a prospective customer needed additional risk disclosure. Rule 2-30(h) does not require Members to provide their APs with any sort of grid-like formula to identify those customers who require additional risk disclosure; however, the Rule, as applied by the BCCs and Hearing Panels, does require that a firm be able to articulate the general factors its APs are instructed to consider in determining whether additional risk disclosure is required.

In conclusion, NFA recognizes that certain provisions of Compliance Rule 2-30 are stated in general terms. Since the law in this area is developed on a case-by-case basis by NFA's Hearing Panels, no precise formula is available to Members to aid them in their interpretation of the Rule. However, in addition to the Interpretive Notice, Members may obtain guidance regarding the Rule's application by reviewing the case summaries described above. As the case law in this area continues to develop, NFA will keep Members apprised of any changes in the Rule's application.

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[1] See NFA Manual at 9004.

[2] See NFA Manual at 9004.

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Compliance Rules

RULE 2-34. CTA PERFORMANCE REPORTING AND DISCLOSURES
[Adopted effective May 1, 2004.]

(a) Performance Information

(1) Member CTAs must calculate rate of return according to CFTC Regulation 4.35(a)(6) using nominal account size as the denominator.

(2) Draw-down information reported under CFTC Regulation 4.35(a)(1)(v) and (vi) must be based on rate of return figures using nominal account size as the denominator.

(3) In calculating net performance, Member CTAs may include interest earned on actual funds but may not impute interest on other funds.

(b) Written Confirmation for Partially-Funded Accounts

(1) For partially-funded accounts, a Member CTA must either receive from a client or deliver to a client a written confirmation that contains the following information:

(i) the name or description of the trading program, and

(ii) the nominal account size agreed to by the client and the CTA.

(2) For new clients, the written confirmation must be received from or delivered to the client before the CTA places the first trade for the client.

(3) For existing clients, the written confirmation must be received from or delivered to the client before the CTA places the first trade after any of the information required under Section (b)(1) of this rule changes. The written confirmation must include the new information and the effective date of the change but need not include any information that will remain the same.

(c) Additional Disclosures for Partially-Funded Accounts

CTAs must provide the following information to clients with partially-funded accounts if the clients are not QEPs:

(1) A statement of how management fees will be computed relative to the nominal account size,

(2) An explanation of how cash additions, cash withdrawals, and net performance will affect the nominal account size,

(3) A brief explanation regarding the effect of partial funding on margin and leverage,

(4) A statement that partial funding increases the fees and commissions as a percentage of actual funds but does not increase the dollar amount of those fees, and

(5) A description, by example or formula, of the effect of partial funding on rate of return and drawdown percentages.

(d) CPO Use of CTA Performance Information

Member CPOs who are required by CFTC Regulation 4.25(c) to disclose CTA performance must report the CTA performance on the same basis as the CTA is required to report it.

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Interpretive Notices

9054 - COMPLIANCE RULE 2-34: PERFORMANCE REPORTING AND DISCLOSURES
(Board of Directors, November 20, 2003; effective May 1, 2004)

INTERPRETIVE NOTICE

In July 2003, the Commodity Futures Trading Commission adopted a core principle for calculating rate of return (ROR) for partially-funded accounts. The Commission noted, however, that its core principle approach would not preclude NFA from developing more explicit guidance or performance standards.

NFA's Board of Directors believes that Member CTAs should use a uniform calculation to make it easier for clients to compare the performance of different CTAs. The Board also believes that ROR should be based on the amount that is the basis for the CTA's trading decisions so that ROR measures the CTA's true performance rather than its client's various cash management practices. Therefore, NFA's Board has adopted NFA Compliance Rule 2-34 to provide performance standards for Member CTAs and to require certain disclosures to ensure that clients understand the consequences of partially funding their accounts. The Board has also adopted this Interpretive Notice to provide additional guidance to CTA Members regarding performance reporting and disclosure.

CTAs will not be required to restate their previous performance, although they may choose to do so. As with any other information, however, a CTA must make any additional disclosures that are necessary to ensure that its performance record is not misleading.

Documenting the Nominal Account Size

The Board recognizes a client may elect to partially fund its account by depositing less funds with the FCM carrying its account than the client has directed the CTA trading the account to use as the basis for trading decisions. The Board believes that the nominal account size should be documented to provide "discipline in the denominator" by assuring that the client and the CTA have agreed on the account size before the account begins trading. This documentation will also provide an objective audit trail to verify past performance records.

Compliance Rule 2-34(b) requires the CTA to document the trading program and nominal account size for each client who partially funds its account by either receiving a written confirmation from or providing a written confirmation to the client with the required information. For example, the information could be included in the advisory agreement or delivered to the client as a separate document. Although NFA assumes that most CTAs will receive or provide this confirmation at the same time the CTA enters into an advisory agreement to direct or guide the client's account, NFA Compliance Rule 2-34(b) only requires that it occur before the CTA places the first trade.

The Rule does not require the CTA to get the client's written acknowledgement to a confirmation provided by the CTA, although the CTA may choose to do so. If the CTA does not require a written acknowledgement, the confirmation should inform the client that the client must notify the CTA, within a reasonable period specified in the confirmation, if the client does not agree with the terms included in the confirmation. The confirmation may be delivered in any manner consistent with CFTC requirements for delivery of account statements by commodity pool operators under CFTC Regulation 4.22(i).

Disclosure

Compliance Rule 2-34(c) requires CTAs to provide certain information to clients with partially-funded accounts if those clients are not QEPs. This information is designed to ensure that less sophisticated customers understand the effects of partial funding so that they can make informed decisions when funding their accounts.

Subsection (c)(2) requires the CTA to explain how each element of cash additions, cash withdrawals, and net performance will affect the nominal account size. If these items will not affect the nominal account size, the CTA may make an affirmative statement to that effect.

Under Compliance Rule 2-34(c)(5), the CTA must provide a description, by example or formula, of the effect of partial funding on ROR and drawdown percentages. A CTA may provide this information by example using a simple matrix showing the effect of partial funding at different funding levels. In the alternative, it may provide the client with the formula for converting ROR percentages based on the nominal account size to ROR percentages based on the partial funding level, e.g.:

(nominal account size / actual funds) * n = a

where n is the ROR percentage based on the nominal account size and a is the ROR percentage based on actual funds

This same formula may, of course, be used to convert any other information that is given as a percentage of the nominal account size, such as estimated commissions and fees.

The disclosures required by Compliance Rule 2-34(c) can be included in the CTA's disclosure document or the advisory agreement. They can also be provided in a separate document delivered to the client before the CTA places the first trade for the client.

Actual Funds

Compliance Rule 1-1(b) defines actual funds as the equity in a commodity trading account over which a CTA has trading authority and funds that can be transferred to that account without the client's consent to each transfer. Funds that are not in the trading account, often referred to as committed funds, qualify as actual funds only if they meet the following four tests:[1]

1. The ownership of the accounts must be identical;

2. The funds must be available for transfer (e.g., free credit balances that are not committed to another CTA's trading program);

3. The client must agree in writing that the FCM can transfer the funds to the managed account at the CTA's request; and

4. The CTA must be able to verify the amount of these funds.[2]

Materiality Standards

As a general rule, accounts in the same trading program will be included in the same composite performance capsule.[3] Since Compliance Rule 2-34(a) requires ROR to be calculated on nominal account size, the RORs for these accounts should be materially the same. Accounts with materially different RORs should not, however, be included in the same performance capsule.[4]

Whether RORs are materially the same may vary depending on the circumstances. However, as long as the accounts are part of the same trading program, the following test provides a safe harbor for determining whether the accounts have materially the same ROR.[5]

- If the composite ROR including the account and the composite ROR excluding the account average 10 percent or more, they are materially the same if the difference between the two RORs is less than 10 percent of their average.
- If the composite ROR including the account and the composite ROR excluding the account average less than 10 percent and greater than 5 percent, they are materially the same if the absolute difference between the two RORs is no more than 1.5 percent.
- If the composite ROR including the account and the composite ROR excluding the account average 5 percent or less, they are materially the same if the absolute difference between the two RORs is no more than 1 percent.

The primary reason for this materiality test is to objectively demonstrate that each account included in the performance capsule is part of the same trading program. For that reason, the materiality test should use gross trading profits and losses rather than net performance. If a particular account in the capsule has a material effect on the capsule's net performance due to account-specific factors (e.g., commissions or interest), the CTA may continue to include that account in the capsule if it meets the materiality test using gross trading profits and losses.[6] However, the CTA should disclose the difference in net performance and identify the factors that are responsible for that difference.

Additions and Withdrawals

Large additions and withdrawals during the reporting period may distort ROR. A CTA is not required to adjust its ROR calculation unless those additions and withdrawals have a material effect on ROR under the above test.[7] If they do have a material effect, however, the CTA must use an approved method to minimize the distortion. Appendix B to the CFTC's Part 4 Rules describes two methods that CTAs can use to adjust for additions and withdrawals when calculating ROR: the compounded rate of return method and the time-weighted method. These methods are available to all CTAs under the terms described in Appendix B.

CTAs may also use a third method that adjusts for additions and withdrawals by temporarily excluding certain accounts when calculating ROR.[8] This method can be used if the following conditions are met:

1. As with any performance information, all of the accounts - whether included in or excluded from the ROR calculation - are part of the same trading program;

2. Excluding the accounts does not result in the systematic exclusion of any material costs (e.g., accounts with withdrawals or that are closed during the reporting period must be included in ROR if there is a significant exit fee that is only charged when funds are withdrawn or accounts are closed);

3. Only accounts that meet one of the following requirements are excluded:

- The account was opened during the reporting period,
- The account was closed during the reporting period,

- The account had no open positions and did not trade during the reporting period because it has not yet been approved for trading or because the client intended to - and did - close the account shortly after the reporting period ended,[9] or
- The net additions and withdrawals in the account exceeded 10% of the beginning net nominal account value for the period for that individual account;

4. Use of this method does not produce an ROR that is materially different from the ROR expected to be produced by either the compounded rate of return method or the time-weighted method over time; and

5. The method does not exclude a significant percentage of the accounts in the trading program.

In general, the CTA should use one method consistently except where that method would produce results that are materially different from the actual experience of accounts in the trading program.[10] The CTA should disclose the method that is consistently used and, if the CTA uses a different method for a particular reporting period, the CTA should disclose the method actually used for that reporting period and describe why that method was used.[11]

CTAs may use any of these three methods without obtaining prior approval from NFA or the CFTC. Appendix B to Part 4 states that "a commodity pool operator or commodity trading advisor may present to the Commission proposals regarding any alternative method of addressing the effect of additions and withdrawals on the rate of return computation, including documentation supporting the rationale for use of that alternative method." Therefore, a CTA may use another method if the CTA can demonstrate to the CFTC, prior to use, that the alternate method provides an accurate picture of the CTA's ROR and is more appropriate for that CTA.

* * * * *

All performance information must be presented in a manner that is balanced and is not misleading. CTAs have an obligation to disclose all material information even if it is not specifically required by CFTC or NFA rules. Compliance Rule 2-34 and this Interpretive Notice do not relieve CTAs of that obligation.

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[1] These tests are derived from CFTC Advisory 87-2, [1986-1987 Transfer Binder] Comm. Fut. L. Rep. (CCH) paragraph 23,624 (June 2, 1987).

[2] Compliance Rule 2-34(a) provides that Member CTAs may include interest earned on actual funds but may not impute interest on other funds when calculating net performance. The CTA must be able to verify the amount of interest earned on the funds if the CTA includes that interest as part of its net performance.

[3] Accounts in the same trading program generally have the same pattern of trading.

[4] Accounts that use different trading strategies should not be included in the same performance capsule even if their RORs are materially the same.

[5] This same materiality test can be used in other contexts. For example, NFA's interpretive notice entitled "NFA Compliance Rule 2-10: The Allocation of Bunched Orders for Multiple Accounts" (paragraph 9029) requires CTAs to modify their allocation methods if accounts in the same trading program have materially different performance results. This is another instance where materiality would be measured using gross trading profits and losses.

[6] As with the test for material differences in trading results, whether the account has a material effect on net performance is determined by comparing the net performance of the composite with and without the account.

[7] A CTA is also not required to adjust its ROR calculation if additions and withdrawals are each less than 10% of the beginning net nominal account value for the period.

[8] The accounts can only be excluded when calculating ROR. They must be included in the CTA's capsule performance for other purposes.

[9] An account that was open for the entire reporting period and had open positions or trading activity during the reporting period cannot be excluded even if it has not yet caught up to the performance of the other accounts in the program (unless its net additions and withdrawals exceeded 10% of its beginning net nominal account value for the period). An account with a trading pause cannot be excluded solely because of the trading pause, especially if the program dictated the trading pause. If the trading pause results from client-imposed restrictions that cause the account to be idle or traded differently from the other accounts in the trading program, however, the account may belong in a different performance capsule.

[10] These instances should be rare. If the CTA's principal method frequently produces results that are materially different from the actual experience of accounts in the trading program, the CTA should change to a more consistent method.

[11] This information should be included in a footnote to the performance capsule. If the trading program experienced an unusual change in the number or size of additions, withdrawals, accounts opened, or accounts closed during the reporting period, the CTA should also highlight that change in a footnote and should describe the reason for the change, if known.

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Compliance Rules

RULE 2-35. CPO/CTA DISCLOSURE DOCUMENTS.
[Effective dates of amendments: November 1, 2000 and December 14, 2003.]

(a) Required Delivery of Pool Disclosure Document and Statement of Additional Information

(1) The Disclosure Document required by CFTC Regulation 4.21(a) must be as clear and concise as possible, using plain English principles, and must contain only the information required or allowed by subsection (b).

(2) In addition to the Disclosure Document, the CPO of a commodity pool required to register its securities under the Securities Act of 1933 must deliver (or cause to be delivered) a separate Statement of Additional Information to a prospective participant prior to accepting or receiving funds from the prospective participant. The information that may be included in the Statement of Additional Information is described in subsection (c).

(3) The CPO of a commodity pool that is not required to register its securities under the Securities Act of 1933 may, but is not required to, prepare and distribute a Statement of Additional Information containing any or all of the information described in subsection (c). The Statement of Additional Information may be bound together with the Disclosure Document as long as the Disclosure Document comes first. If the Statement of Additional Information is separately bound, the CPO is not required to provide it to a prospective participant unless the prospective participant requests it.

(4) If a Statement of Additional Information is required under paragraph (2) of this section, the cover page of the Disclosure Document required under paragraph (1) of this section and the Statement of Additional Information required under paragraph (2) of this section shall state that the Disclosure Document is in two parts, both of which must be provided to a prospective participant prior to investing in the offered pool. If a Statement of Additional Information is prepared and separately distributed under paragraph (3) of this section, the cover page of the Disclosure Document required under paragraph (1) of this section shall state that the Statement of Additional Information is available free of charge and shall indicate how to obtain a copy of the Statement of Additional Information.

(b) Disclosures Required in the Disclosure Document

(1) The Disclosure Document required under subsection (a)(1) of this Rule must include the following:

(i) The information required by CFTC Regulation 4.24, and the performance disclosures required by CFTC Regulation 4.25, provided, however, that a CPO may provide the performance information required under CFTC Regulation 4.25 (c)(5) in the Statement of Additional Information; and

(ii) Any other information necessary to understand the fundamental characteristics of the pool or keep the Disclosure Document from being misleading.

(2) The Disclosure Document required under subsection (a)(1) for pools required to register their securities under the Securities Act of 1933 shall include any other information that the Securities and Exchange Commission or state securities administrators require to be included in Part I of a two-part disclosure document. For all other pools, Disclosure Documents required under subsection (a)(1) may include such information.

(c) Information Included in the Statement of Additional Information

(1) If the CPO of a commodity pool prepares a Statement of Additional Information, the cover page must include the following:

(i) The name of the commodity pool;

(ii) A brief statement that the Statement of Additional Information is the second part of a two-part document and that it should be read in conjunction with the pool's Disclosure Document, with instructions on how to obtain a free copy of the Disclosure Document;

(iii) The date of the most recent Disclosure Document for the pool; and

(iv) The date of the Statement of Additional Information.

(2) The cover page must be immediately followed by a table of contents.

(3) The Statement of Additional Information may also include:

(i) Disclosures, not included in the Disclosure Document, that are required by the Securities and Exchange Commission or state securities administrators;

(ii) Statements that expand on or explain the disclosures in the Disclosure Document, provided that the statements are not misleading or inconsistent with applicable statutes, rules, or regulations; and

(iii) Any other information about the commodity pool; its investments; its CPO, CTA(s), service providers, and their principals and employees; the commodity futures markets; or any other markets, including cash markets, that affect the value of the pool's investments, provided that the information is not misleading or otherwise inconsistent with applicable statutes, rules, or regulations.

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Interpretive Notices

9035 - RULE 2-35. CPO/CTA DISCLOSURE DOCUMENTS
(Board of Directors, April 30, 1999)

INTERPRETIVE NOTICE

A Disclosure Document should provide essential information about the fundamental characteristics of a pool, and it should provide the information in a way that will assist investors in making informed decisions about whether to invest in the pool. Because investors who rely on the Disclosure Document may not be sophisticated in legal or financial matters, the information in the Disclosure Document should be written in clear, concise, and understandable language using plain English principles. If a Disclosure Document uses frequent technical or legal terminology, complex language, excessive detail, and extended discussions of legal requirements, the Disclosure Document becomes difficult for many investors to understand and may, therefore, defeat its purpose.

Compliance Rule 2-35 requires the Disclosure Document to be as clear and concise as possible and to use plain English principles. In particular, Disclosure Documents should be written:

- In the active voice;
- Using short sentences and paragraphs;
- Breaking up the document into short sections, using titles and sub-titles that specifically describe the contents of each section;
- Using words that are definite, concrete, and part of everyday language;
- Avoiding legal jargon and highly technical terms;
- Using glossaries to define technical terms that cannot be avoided;
- Avoiding multiple negatives;
- Saying something once where it is most important rather than repeating information;
- Using tables and bullet lists, where appropriate.

Obviously, these are not hard and fast rules. For example, there may be times when something is so important that it should be said more than once. However, the Disclosure Document should substantially comply with the plain English principles described here.

Compliance Rule 2-35 also limits the information the CPO can include in the Disclosure Document. The Disclosure Document must include most of the information required by the CFTC's Part 4 Rules. It must also include any other information necessary to understand the fundamental characteristics of the pool or keep the Disclosure Document from being misleading. The Disclosure Document may also include information required by the Securities and Exchange Commission and state securities administrators. Such information currently includes items such as:

(i) Any cautionary statement required by the Securities and Exchange Commission or a state securities administrator for a state where the pool is required to be registered;

(ii) A concise description of the investment objectives, policies, and principal strategies of the pool, including a brief discussion of the circumstances under which these objectives or policies can be changed;

(iii) For a pool that has been in operation for a full fiscal year, the compensation paid to all major CTAs for the most recent fiscal year as a percentage of average net assets. For a pool that has not been in operation for a full fiscal year, a general statement of what the major CTAs' fees will be as a percentage of average net assets. (Major CTAs are defined in CFTC Regulation 4.1((i));

(iv) A brief description of any services provided by the major CTAs beyond those customarily provided by a CTA;

(v) The identity of any person who provides significant administrative or business affairs management services to the pool with a brief description of the services provided and the compensation paid for these services;

(vi) The name and principal address of the selling agent;

(vii) If the pool has more than one class or series of securities offered or outstanding, a description of the characteristics of each class or series of securities, including dividend rights, liquidation rights, conversion rights, and redemption provisions;

(viii) A description of how participant inquiries should be made;

(ix) A description of how an investment in the pool is made, including the identity of the principal underwriter, if applicable;

(x) The minimum initial or subsequent investment amount;

(xi) A description of how the price of pool units is determined (if the purchase price of a unit is based on the net asset value at a specified date, it is sufficient to state this); and

(xii) If applicable, a statement that information about the pool, including the Statement of Additional Information, can be reviewed and copied at the Securities and Exchange Commission's Public Reference Room in Washington, D.C.; that information on the operation of the public reference room may be obtained by calling the Securities and Exchange Commission at 1-800-SEC-0330; that reports and other information about the pool are available on the Securities and Exchange Commission's Internet site at http://www.sec.gov/; and that copies of this information may be obtained, upon payment of a duplicating fee, by writing the Public Reference Section of the Securities and Exchange Commission, Washington, D.C. 20549-6009.

The Disclosure Document may not include any additional information. The CPO can, however, provide additional information in a Statement of Additional Information.

Disclosure Documents for single-advisor pools should usually be 30 pages or less. Disclosure Documents for more complex pools, such as multi-advisor pools or principal-protected pools, should not usually exceed 40 pages. However, longer Disclosure Documents will still comply with Compliance Rule 2-35 if they use the principles listed above and contain only the information allowed by Compliance Rule 2-35(b). And shorter Disclosure Documents will still violate Compliance Rule 2-35 if they are unnecessarily hard to read and understand.

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Compliance Rules

RULE 2-13. CPO/CTA REGULATIONS.
[Adopted effective September 29, 1982. Effective date of Amendments: April 11, 1983; July 5, 1984; April 4, 1988; August 24, 1995; October 10, 1996; July 24, 2000 and December 14, 2003.]

(a) Any Member who violates any of CFTC Regulations 4.1, 4.7, 4.12 and 4.16 through 4.41 shall be deemed to have violated an NFA requirement.

(b) Each Member CPO which delivers or causes to be delivered a Disclosure Document under CFTC Regulation 4.21 must include in the Disclosure Document a break-even analysis which includes a tabular presentation of fees and expenses. The break-even analysis must be presented in the manner prescribed by NFA's Board of Directors and must be accurate as of the date of the Disclosure Document.

(c) Each Member required to file any document with or give notice to the CFTC under CFTC Regulations 4.7, 4.12, 4.22, 4.26 or 4.36 shall also file one copy of such document with or give such notice to NFA at its Chicago office no later than the date such document or notice is due to be filed with or given to the CFTC. Any CPO Member may file with NFA a request for an extension of time in which to file the annual report required by CFTC Regulation 4.22(c) or a request for approval of a change to its fiscal-year election.

[See Interpretive Notice Interpretation of NFA Compliance Rule 2-13: Guideline for the Disclosure by CPOs and CTAs of "Up Front" Fees and Organizational and Offering Expenses and Interpretive Notice Compliance Rule 2-13: Break-Even Analysis (Board of Directors).]

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Interpretive Notices

9006 - NFA COMPLIANCE RULE 2-13: GUIDELINE FOR THE DISCLOSURE BY CPOS AND CTAS OF "UP FRONT" FEES AND ORGANIZATIONAL AND OFFERING EXPENSES

(Board of Directors, effective July 1, 1986; revised November 26, 1996.)

INTERPRETIVE NOTICE

Commodity Futures Trading Commission ("CFTC") Regulation 4.24(i) states that the disclosure document of a CPO must contain a description of each expense which has been or is expected to be incurred by the pool. CFTC Regulation 4.34(i) applies to CTAs and requires that the disclosure document of a CTA describe each fee which the CTA will charge the client. In addition, CFTC Regulations 4.24(w) and 4.34(o), respectively, require CPOs and CTAs to disclose all "material" information. These requirements have been incorporated into NFA Compliance Rule 2-13. Because "up front" fees and charges can have a significant impact on the net opening equity of pools and managed accounts, the above NFA rule requires not only disclosure of the existence and the amount of the up front charges but also disclosure of how the up front charges affect the return which must be achieved to break even at the end of an investor's first year or the initial amount of capital available for trading. Furthermore, the impact of the up front charges on net performance must be included in the rate of return figures reflected on a CPO's or CTA's required past performance presentation.

A. Disclosure of Prospective Up Front Fees and Charges

The disclosure document must disclose up front fees and expenses, if any, to participants in a pool or clients in a managed account. NFA's Board of Directors believes that investors should be fully aware of not only the amount of such fees and expenses but also their impact on the return which must be achieved to break even at the end of the investor's first year or the net proceeds that will be available at the outset for futures trading. For a CPO, NFA Compliance Rule 2-13(b) provides that a CPO's disclosure document must include break-even analysis presented in the manner prescribed by NFA's Board of Directors, which is described in a separate interpretive notice. (See Interpretive Notice Compliance Rule 2-13: Break-Even Analysis.) CTAs may provide similar information either through the use of break-even analysis which complies with the requirements of Compliance Rule 2-13(b) and the accompanying interpretive notice or through the use of a dilution table.

If a CTA chooses to use a dilution table, the dilution table should be highlighted in a tabular format on the cover page of the disclosure document. The suggested format for the table would detail a standardized amount of initial investment, all up front fees and charges, including all sales and administrative fees, and the net proceeds that would be available for trading after deducting the up front expenses. If a CTA does not use standardized amounts, minimums or units for initial investments, the required table should be presented showing dilution of an investment of $1,000. Moreover, if the results in the dilution table, without further explanation, could be materially misleading as to the impact of the up front fees and charges on the amount of initial capital available for trading (for example, because the fees as a percentage of the initial investment vary depending on the amount of the investment), then explanatory footnotes should be used.

The extent to which a CTA breaks down the up front expenses into categories, including, but not limited to, fees, sales and administrative fees, is solely within the discretion of the CTA as long as the net proceeds for trading and the portion that is deducted from the initial investment are clearly delineated as such. All fees that are charged up front must be disclosed except that a CTA that charges periodic management fees on the first day of each period, including the initial period, need not describe such fees for the first period in the dilution table.

B. Treatment of Up Front Fees in the Required Past Performance Presentation

In preparing rate of return information, the beginning net asset value of a pool or managed account must be calculated before any up front fees and expenses, including organizational and offering expenses, are deducted. However, a CTA acting as an independent advisor to a commodity pool is not required to include the up front fees or expenses charged by the CPO in beginning net asset value for the purposes of calculating rate of return information for the CTA's own disclosure document. In general, a CTA is acting as an independent advisor if it is not an affiliate of the CPO and does not receive any portion of the up front fee. For these purposes, "affiliate" means any advisor which owns or controls, is owned or controlled by, or is under common ownership or control with the CPO.

All up front fees and organizational expenses must be reflected as a reduction of net performance in the period in which the contribution was made to the pool or client's managed account, unless such fees and expenses can be amortized pursuant to

Generally Accepted Accounting Principles.[1] If organization or syndication expenses can be, and are, amortized, then net performance shall be reduced each month by the monthly amortizable amount. The monthly amortizable amount shall be calculated by dividing the total amount of amortizable expenses by the total number of months over which such expenses shall be amortized.

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[1] Section 709 of the Internal Revenue Code, 26 U.S.C. §700, governs whether or not organization or syndication expenses incurred to organize and to promote the sale of interests in a partnership can be amortized.

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Interpretive Notices

9023 - COMPLIANCE RULE 2-13: BREAK-EVEN ANALYSIS
(Board of Directors, August 24, 1995; revised July 24, 2000)

INTERPRETIVE NOTICE

NFA Compliance Rule 2-13 requires, in pertinent part, that each Member CPO which delivers a disclosure document under the CFTC Regulation 4.21 must include in the disclosure document a break-even analysis which includes a tabular presentation of fees and expenses. The break-even analysis must be presented in the manner prescribed by NFA's Board of Directors. The purpose of this requirement is to ensure not only that customers will be clearly informed as to the nature and amount of fees and expenses that will be incurred, but that customers will also be made aware of the impact of those fees and expenses on the potential profitability of their investments. NFA's Board of Directors has adopted the following guidelines which must be adhered to by NFA Member CPOs when preparing the break-even analysis required by Compliance Rule 2-13:

- If fees are likely to be affected by the size of the offering, then an assumed amount of total funds raised should be stated. The document should also state what the break-even point would be if the minimum or maximum proceeds were raised.
- If there are redemption fees, they must be clearly shown and considered part of the total cost and reflected in the break-even analysis.
- Incentive fees should be stated as a percentage of profits, and the method by which profits are calculated should be described.
- All management, brokerage and other fees should reflect actual experience or contractual charges, if known. If not known, they should be based on good faith estimates. If, for example, CTAs publish their estimated number of round turns/ $1,000,000 then those published estimates should be used for estimating brokerage costs. If this is an on-going fund or if there is evidence supporting other numbers, then the other numbers should be used and explained.
- If pool participants are to receive some or all of the interest income generated by the pool, the expected interest income should be deducted from the expenses which must be covered by trading profits to return the customer to the level of his initial investment. The estimate of that interest income must include the assumed interest rate, and that rate must reflect current cash market information. If any interest income is to be paid to the pool operator, or to anyone other than the pool participants, that fact and an estimate of the amount must also be clearly disclosed.

To calculate the break-even point a CPO must first determine the amounts of all fees and expenses, exclusive of incentive fees, that are anticipated to be incurred by the pool during the first year of the investment. The total of these fees and expenses less the amount of interest income expected to be earned by the pool represents the gross trading profits before incentive fees (preliminary gross trading profits) that would be necessary for the pool to retain its initial Net Asset Value per unit at the end of the first year. In some situations the CPO must then calculate the additional trading profit that would be necessary to overcome the incentive fees that would be incurred. This situation will arise whenever the pool expects to incur expenses which would not be deducted from the CTA's net performance in calculating the CTA's incentive fee. That amount can be computed by first determining the incentive fees that would be incurred if the preliminary gross trading profits described above were achieved and then dividing that amount by (1- incentive fee rate); (e.g., if the incentive fee is 25 percent, the denominator would be 1- .25, or .75). A sample break-even presentation is shown below:

Selling Price per Unit (1)	$1,000.00
Syndication and Selling Expense (1)	$50.00
General Partner's Management Fee (2)	9.50
Fund Operating Expenses (3)	20.50
Trading Advisor's and Trading Manager's Management Fees (4)	28.50
Trading Advisor's and Trading Manager's Incentive Fees on Trading Profits (5)	17.17

Brokerage Commissions and Trading Fees (6)	38.00
Less Interest Income (7)	(28.50)
Amount of Trading Income Required for the Fund's Net Asset Value per Unit (Redemption Value) at the End of One Year to Equal the Selling Price per Unit	$135.17
Percentage of Initial Selling Price per Unit	13.52%

Explanatory Notes:

(1) Investors will initially purchase units at $1,000. After the commencement of trading, units will be purchased at the Fund's month-end Net Asset Value per unit. A five percent syndication and selling charge will be deducted from each subscription to reimburse the Fund, the General Partner and/or the Clearing Broker for the syndication and selling expenses incurred on behalf of the Fund.

(2) Except as set forth in these explanatory notes, the illustration is predicated on the specific rates or fees contracted by the Fund with the General Partner, the Trading Manager, the Trading Advisor, and the Clearing Broker, as described in "Fees, Compensation and Expenses."

(3) The Fund's actual accounting, auditing, legal and other operating expenses will be borne by the Fund. These expenses are expected to amount to approximately 2.05 percent of the Fund's Net Asset Value.

(4) The Fund's Trading Advisor will be paid a monthly management fee of 1/12 of two percent of Allocated Net Assets. The fund's Trading Manager will be paid a monthly management fee of 1/12 of one percent of allocated Net Assets.

(5) The Trading Advisor and Trading Manager will receive incentive fees of 20 percent and five percent, respectively, of Trading Profits exclusive of interest income. The $17.17 of incentive fees shown above is equal to 25 percent of the net of total trading income of $135.17, minus $38 of brokerage commissions and trading fees and $28.50 of management fees.

(6) Brokerage commissions and trading fees are estimated at four percent of Net Asset Value.

(7) The Fund will earn interest on margin deposits with its Clearing Broker. Based on current interest rates, interest income is estimated at three percent of Net Asset Value.

The above break-even analysis is a sample and the fees and expenses included in it may vary from those charged by other commodity pools. The analysis included in an actual disclosure document must include **all** of the fees and expenses of any type which affect the break-even point of that investment.

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Compliance Rules

RULE 2-4. JUST AND EQUITABLE PRINCIPLES OF TRADE.

Members and Associates shall observe high standards of commercial honor and just and equitable principles of trade in the conduct of their commodity futures business.

[See Interpretive Notice Interpretation of NFA Compliance Rule 2-4: Guideline for the Disclosure by FCMs and IBs of Costs Associated with Futures Transactions and Interpretive Notice NFA Compliance Rule 2-4:Confidentiality Language in Release Agreements.]

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Interpretive Notices

9059 - NFA COMPLIANCE RULE 2-4: DISCLOSURE GUIDELINES FOR FCMS OFFERING SWEEP ACCOUNTS

(Board of Directors, February 15, 2007; effective July 1, 2007)

INTERPRETIVE NOTICE

Due to the increasingly competitive industry environment, Futures Commission Merchants ("FCMs") may seek to develop and offer to customers sweep account programs to manage cash balances. These sweep account programs transfer a customer's excess funds from a regulated commodity account (whether a customer segregated or secured account) to a non-regulated account for the customer at the FCM, an affiliate of the FCM or another entity so that the customer can obtain a higher investment return than maintaining the funds in the FCM's customer regulated commodity accounts.

Given disclosure concerns regarding these programs, NFA's Board of Directors believes that FCMs offering sweep account programs should adopt certain disclosure guidelines. The guidelines contained in this Notice apply only to sweep account programs offered by an FCM, including those regularly recommended by the FCM. In other words, if a customer elects on its own to transfer funds to a particular sweep account program that is not offered by the FCM, then the FCM does not have any disclosure obligations pursuant to this Notice. Additionally, this Notice's disclosure guidelines are inapplicable to transfers made pursuant to an FCM's customer agreement's provisions whereby a customer authorizes the transfer of funds from a regulated commodity account to any other account maintained by the customer at the FCM or one of its affiliates as may be necessary to avoid a margin call or to reduce the debit balance in the other account, or to satisfy any other obligation to the FCM or its affiliates.

Failure to follow the disclosure guidelines contained in this Notice may be deemed conduct inconsistent with a Member's obligation under NFA Compliance Rule 2-4 to observe high standards of commercial honor and just and equitable principles of trade in the conduct of its commodity futures business. NFA recognizes, however, that FCMs offering these sweep account programs may have to modify these guidelines to address their particular programs.

Initially, FCMs should identify the entity maintaining the sweep account and whether that entity is subject to regulation, and should disclose any material terms and conditions, risks and features of their offered programs. In addition, FCMs should advise customers of any conflicts of interest in connection with the offered programs, including whether the FCM receives compensation or other benefits for customer balances maintained in the sweep account, and the FCM should advise the customer which entity to contact to gain access to any swept funds. An FCM should make these disclosures at the time a sweep account program is offered to a customer and, of course, the disclosures should be updated for participants if any material changes are made to an existing sweep program. The Board believes that if a customer elects to participate in a sweep program offered by the FCM, then the FCM must obtain the customer's written consent prior to any funds being transferred pursuant to the program.

The Board also believes that FCMs should advise customers of the consequences of transferring monies from the FCM's customer regulated accounts. Specifically, the FCM should disclose that by transferring excess funds from an FCM's customer regulated commodity accounts, the customer will not receive the preferential treatment afforded funds held in a customer regulated commodity account pursuant to Part 190 of the CFTC's Regulations and the U.S. Bankruptcy Code. The Board recognizes, however, that an FCM may offer programs that transfer monies to an account whereby customers receive certain protections (e.g. SIPC or FDIC) in the event of a bankruptcy. In this case, the FCM should disclose the nature and extent of the protection available, including any applicable SIPC or FDIC coverage. If the FCM's programs transfer funds to a non-regulated account that does not offer protections comparable to those afforded funds held in a customer regulated commodity account, then the FCM must clearly disclose this fact and describe the impact upon customer funds in the unlikely event that the entity maintaining the sweep account files for bankruptcy.

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Interpretive Notices

9005 - NFA COMPLIANCE RULE 2-4: GUIDELINES FOR THE DISCLOSURE BY FCMS AND IBS OF COSTS ASSOCIATED WITH FUTURES TRANSACTIONS

(Board of Directors, effective June 1, 1986; revised July 24, 2000)

INTERPRETIVE NOTICE

National Futures Association ("NFA") Compliance Rule 2-4 provides that "Members and Associates shall observe high standards of commercial honor and just and equitable principles of trade in the conduct of their commodity futures business." NFA Compliance Rule 2-4 requires that each FCM Member, or in the case of introduced accounts, the Member introducing the account make available to its customers, prior to the commencement of trading, information concerning the costs associated with futures transactions.[1]

If fees and charges associated with futures transactions are not determined on a per trade or round-turn trade basis, the Member must provide the customer with a complete written explanation of such fees and charges.

NFA recognizes that FCM and IB Members may employ various arrangements in assessing fees and charges associated with futures transactions to customers. Any such arrangement which is intended to or is likely to deceive customers is a violation of NFA Requirements and will subject the Member to disciplinary action.

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[1] NFA Bylaws define "futures" to include exchange-traded options. See NFA Compliance Rule 1-1(l).

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Interpretive Notices

9014 - NFA COMPLIANCE RULE 2-4: CONFIDENTIALITY LANGUAGE IN RELEASE AGREEMENTS
(Staff, February 7, 1991; revised December 17, 2007)

INTERPRETIVE NOTICE

NFA has become aware of a practice utilized in the settlement of customer complaints and arbitration proceedings whereby, as a condition of settlement, a customer is required to sign a release which limits their ability to cooperate with regulatory authorities. The language being utilized goes beyond the general confidentiality language requiring that no public statement be released with respect to the terms of the settlement. Although the scope of the language in each release differs, it is apparent that the language being incorporated by some firms requires the customer to refrain from releasing or disclosing any information to regulatory bodies except as required by court order or as otherwise required by law.

The plain meaning of such language would bar the customer from cooperating with NFA. NFA has encountered this situation in the course of conducting investigations into apparent violations by Members. Customers have been reluctant to provide information and testimony because of this type of confidentiality provision in their agreements, therefore frustrating the effectiveness of the NFA enforcement process.

While the practice of including language prohibiting the disclosure of settlement terms is acceptable, the use of language which clearly bars customer cooperation with NFA is not. Including such language in settlement agreements is viewed by NFA as an unethical practice and a failure to observe high standards of commercial honor and just and equitable principles of trade.

Therefore, NFA staff has recommended and an NFA Regional Business Conduct Committee has charged a violation of NFA Compliance Rule 2-4 when language which prohibits the customer from cooperating with NFA is used as a term of settlement. NFA staff will continue to recommend that a violation of NFA Compliance Rule 2-4 be charged when this language is used.

The Financial Industry Regulatory Authority ("FINRA") has also encountered the use of this language by some of its members. In response, the FINRA issued a notice informing its members that this practice may be viewed as unethical and would constitute a violation of FINRA rules.

An agreement containing language restricting the release of information to regulatory or law enforcement agencies may also be found to be void as against public policy by state courts. The public policy concern is implicated because the scope of this language goes beyond the private rights of the individuals involved by discouraging the release of information and potential evidence and interfering with the process of justice.

While general confidentiality language in release agreements is certainly permissible, NFA staff cautions Members against the use of settlement agreements which include language limiting or prohibiting a customer from providing information and cooperating with NFA. This is not intended to impose an affirmative duty on Members to include language explicitly permitting such cooperation, but merely to avoid explicit language barring it.

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Interpretive Notices

9057 - COMMISSIONS, FEES AND OTHER CHARGES
(Board of Directors, August 17, 2006; effective November 1, 2006)

INTERPRETIVE NOTICE

National Futures Association ("NFA") Compliance Rule 2-4 provides that Members and Associates shall observe high standards of commercial honor and just and equitable principles of trade in the conduct of their commodity futures business. NFA Compliance Rule 2-36(c) similarly provides that Forex Dealer Members and their Associates shall observe high standards of commercial honor and just and equitable principles of trade in the conduct of their forex business. Over the years, NFA's Board of Directors ("Board") has provided guidance on certain issues to ensure that Members and Associates understand their responsibilities to observe just and equitable principles of trade and to act honestly, fairly and in the best interests of their customers.

For example, in 1986, the Board issued an Interpretive Notice to provide Members with guidelines relating to the disclosure by FCMs and IBs of costs associated with futures transactions. The Board stated that Compliance Rule 2-4 requires that each FCM Member, or in the case of introduced accounts, the Member introducing the account make available to its customers, prior to commencement of trading, information concerning the costs associated with futures transactions.

NFA's 1986 Notice also recognized that Members may employ various arrangements in establishing their commissions, fees and other charges associated with futures transactions to customers. Typically, commissions for futures transactions have been set competitively since the 1970s, and Members usually base these charges on their costs plus a reasonable profit, and the services provided by the Member. The vast majority of NFA Members impose commission charges in a manner commensurate with their costs and the services provided by the Member, and adequately disclose and explain to customers commission rates, fees and other charges.

The Board has also previously recognized, however, that any fee arrangement which is intended to or is likely to deceive customers is a violation of NFA Requirements (e.g., NFA Compliance Rules 2-2 and 2-29(a)) and will subject the Member to disciplinary action. Over the years, NFA's Business Conduct Committee ("BCC") has charged several Members and their Associates with violating NFA sales practice requirements because they misled customers as to either the amount of commissions or the significant impact of the commission charges on the likelihood of obtaining any profit. Most of these cases have involved the sale to retail customers of commodity options and forex. [1]

The Board believes that it is appropriate at this time to provide guidance on the types of sales practices specifically relating to commissions, fees and other charges that have been found to be deceptive and misleading, and violate commercial honor and just and equitable principles of trade.[2] Therefore, the following are relevant factors regarding commissions, fees and other charges in determining whether a Member or Associate has presented retail customers with a distorted and misleading view of the likelihood of earning profits by investing with a Member:

- Whether the Member or Associate adequately disclosed the amount of commissions, fees and other charges before the transaction occurred. In evaluating the adequacy of disclosure, the Member or Associate should consider whether the retail customer has little or no experience trading futures, options, and forex, the customer's estimated annual income and net worth, and prior investment experience.
- Whether the Member or Associate downplayed the significance of the commissions, fees and other charges, especially in connection with any suggestion that the retail customer is likely to reap profits.
- If the Member or Associate solicits retail customers to engage in commodity option transactions and charges commissions and fees well above the industry norm, what, if any, break-even analysis or additional disclosure has been provided about the significant impact that these commissions and fees have on the likelihood of profit.
- If the Member or Associate solicits retail customers to engage in forex transactions and charges commissions and fees well above the industry norm, what, if any, break-even analysis or additional disclosure has been provided about the significant impact that commissions, fees, mark-ups and other charges have on the likelihood of profit.

- Whether the Member or Associate engages in trading practices or recommends transactions or strategies to retail customers that are intended to increase the amount of commissions and fees generated, without serving any economic or other purpose for the customers. For example, a few Members have used large spread positions, butterfly spreads or deep out-of-the money options in an apparent scheme to maximize commissions, without regard to the customers' best interests.

In conclusion, this Notice cannot and is not intended to alert Members and Associates to all of the factors regarding commissions, fees and other charges that may be considered in determining whether they have presented retail customers with a distorted and misleading view of the likelihood of earning profits by investing with a Member. Each of the factors noted above regarding commissions, fees and other charges, however, have frequently been present in sales practice cases brought by NFA, and Members and Associates should certainly be vigilant in preventing and detecting such practices.

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[1] See, e.g., In re Qualified Leverage Providers, Inc., NFA Case No. 05-BCC-003; In re Calvary Financial Group LLC, NFA Case No. 02-BCC-005; In re The Siegel Trading Co., Inc., NFA Case No. 97-BCC-007; In re Bachus & Stratton Commodities, Inc., NFA Case No. 92-BCC-015 aff'd, NFA Case No. 93-APP-002; and In re Churchill Group, Inc., NFA Case No. 90-BCC-012.

[2] This Notice does not apply to security futures products, which are governed by NFA Compliance Rule 2-37(g) and its Interpretive Notice relating to fair commissions. See NFA Manual paragraph 9047.

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Interpretive Notices

9061 - NFA COMPLIANCE RULE 2-4: MISUSE OF TRADE SECRETS AND PROPRIETARY INFORMATION
(Board of Directors, August 16, 2007; effective September 5, 2007; and December 11, 2007)

INTERPRETIVE NOTICE

National Futures Association ("NFA") Compliance Rule 2-4 provides that Members and Associates shall observe high standards of commercial honor and just and equitable principles of trade in the conduct of their commodity futures business. Over the years, NFA's Board of Directors ("Board") has provided guidance on certain issues to ensure that Members and Associates understand their responsibilities to observe just and equitable principles of trade and to act honestly, fairly, and in the best interests of customers.

Compliance Rule 2-4 prohibits Members and Associates from knowingly obtaining or seeking to obtain another Member's or Associate's confidential information or trade secrets without that person's permission. It also prohibits Members and Associates from knowingly or recklessly misusing confidential information or trade secrets in their possession. Although that rule does not seek to regulate business disputes between Members or to extend beyond commodity futures activities, it does reach conduct that could potentially harm futures customers.

Conduct that may violate Compliance Rule 2-4 includes:

- Misusing sensitive personal information, such as a social security number or purposefully or recklessly violating the firm's privacy policy;
- Disclosing customer orders prior to execution (except as permitted by exchange rules); or
- Obtaining or attempting to obtain information disclosing a CTA's historical trading positions without the CTA's permission.

These are merely examples of conduct that could potentially harm customers. Any Member or Associate that knowingly obtains or seeks to obtain confidential information or trade secrets of another Member or Associate without that person's permission or that knowingly or recklessly misuses trade secrets and/or proprietary information in the conduct of its commodity futures business violates Compliance Rule 2-4.

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Compliance Rules

RULE 2-29. COMMUNICATIONS WITH THE PUBLIC AND PROMOTIONAL MATERIAL.
[Adopted effective November 19, 1985. Effective date of Amendments: February 1, 1996; August 29, 1996; March 28, 2000; July 24, 2000; December 4, 2000; August 21, 2001; May 1, 2004 and February 1, 2010.]

(a) General Prohibition.

No Member or Associate shall make any communication with the public which:

(1) operates as a fraud or deceit;
(2) employs or is part of a high-pressure approach; or
(3) makes any statement that futures trading is appropriate for all persons.

(b) Content of Promotional Material.

No Member or Associate shall use any promotional material which:

(1) is likely to deceive the public;

(2) contains any material misstatement of fact or which the Member or Associate knows omits a fact if the omission makes the promotional material misleading;

(3) mentions the possibility of profit unless accompanied by an equally prominent statement of the risk of loss;

(4) includes any reference to actual past trading profits without mentioning that past results are not necessarily indicative of future results;

(5) includes any specific numerical or statistical information about the past performance of any actual accounts (including rate of return)

(i) unless such information is and can be demonstrated to NFA to be representative of the actual performance for the same time period of all reasonably comparable accounts and,

(ii) in the case of rate of return figures, unless such figures are calculated in a manner consistent with CFTC Regulation 4.25(a)(7) for commodity pools and with CFTC Regulation 4.35(a)(6), as modified by NFA Compliance Rule 2-34(a), for figures based on separate accounts, or

(6) includes a testimonial that is not representative of all reasonably comparable accounts, does not prominently state that the testimonial is not indicative of future performance or success, and does not prominently state that it is a paid testimonial (if applicable).

(c) Hypothetical Results.

(1) Any Member or Associate who uses promotional material which includes a measurement or description of or makes any reference to hypothetical performance results which could have been achieved had a particular trading system of the Member or Associate been employed in the past must include in the promotional material the following disclaimer prescribed by NFA's Board of Directors:

HYPOTHETICAL PERFORMANCE RESULTS HAVE MANY INHERENT LIMITATIONS, SOME OF WHICH ARE DESCRIBED BELOW. NO REPRESENTATION IS BEING MADE THAT ANY ACCOUNT WILL OR IS LIKELY TO ACHIEVE PROFITS OR LOSSES SIMILAR TO THOSE SHOWN. IN FACT, THERE ARE FREQUENTLY SHARP DIFFERENCES BETWEEN HYPOTHETICAL PERFORMANCE RESULTS AND THE ACTUAL RESULTS SUBSEQUENTLY ACHIEVED BY ANY PARTICULAR TRADING PROGRAM.

ONE OF THE LIMITATIONS OF HYPOTHETICAL PERFORMANCE RESULTS IS THAT THEY ARE GENERALLY PREPARED WITH THE BENEFIT OF HINDSIGHT. IN ADDITION, HYPOTHETICAL TRADING DOES NOT INVOLVE FINANCIAL RISK, AND NO HYPOTHETICAL TRADING RECORD CAN COMPLETELY ACCOUNT FOR THE IMPACT OF FINANCIAL RISK IN ACTUAL TRADING. FOR EXAMPLE, THE ABILITY TO WITHSTAND LOSSES OR TO ADHERE TO A PARTICULAR TRADING PROGRAM IN SPITE OF TRADING LOSSES ARE MATERIAL POINTS WHICH CAN ALSO ADVERSELY AFFECT ACTUAL TRADING RESULTS. THERE ARE NUMEROUS OTHER FACTORS RELATED TO THE MARKETS IN GENERAL OR TO THE IMPLEMENTATION OF ANY SPECIFIC TRADING PROGRAM WHICH CANNOT BE FULLY ACCOUNTED FOR IN THE PREPARATION OF HYPOTHETICAL PERFORMANCE RESULTS AND ALL OF WHICH CAN ADVERSELY AFFECT ACTUAL TRADING RESULTS.

If a Member or Associate has either less than one year of experience in directing customer accounts or trading proprietary accounts, then the disclaimer must also contain the following statement:

> (THE MEMBER) HAS HAD LITTLE OR NO EXPERIENCE IN TRADING ACTUAL ACCOUNTS FOR ITSELF OR FOR CUSTOMERS. BECAUSE THERE ARE NO ACTUAL TRADING RESULTS TO COMPARE TO THE HYPOTHETICAL PERFORMANCE RESULTS, CUSTOMERS SHOULD BE PARTICULARLY WARY OF PLACING UNDUE RELIANCE ON THESE HYPOTHETICAL PERFORMANCE RESULTS.

(2) Any Member or Associate who uses promotional material which includes a measurement or description of or makes any reference to a hypothetical composite performance record showing what a multi-advisor account portfolio or pool could have achieved in the past if assets had been allocated among particular trading advisors must include in the promotional material the following disclaimer prescribed by NFA's Board of Directors instead of the disclaimer prescribed by Section (c) (1) of this Rule:

> THIS COMPOSITE PERFORMANCE RECORD IS HYPOTHETICAL AND THESE TRADING ADVISORS HAVE NOT TRADED TOGETHER IN THE MANNER SHOWN IN THE COMPOSITE. HYPOTHETICAL PERFORMANCE RESULTS HAVE MANY INHERENT LIMITATIONS, SOME OF WHICH ARE DESCRIBED BELOW. NO REPRESENTATION IS BEING MADE THAT ANY MULTI-ADVISOR MANAGED ACCOUNT OR POOL WILL OR IS LIKELY TO ACHIEVE A COMPOSITE PERFORMANCE RECORD SIMILAR TO THAT SHOWN. IN FACT, THERE ARE FREQUENTLY SHARP DIFFERENCES BETWEEN A HYPOTHETICAL COMPOSITE PERFORMANCE RECORD AND THE ACTUAL RECORD SUBSEQUENTLY ACHIEVED.
>
> ONE OF THE LIMITATIONS OF A HYPOTHETICAL COMPOSITE PERFORMANCE RECORD IS THAT DECISIONS RELATING TO THE SELECTION OF TRADING ADVISORS AND THE ALLOCATION OF ASSETS AMONG THOSE TRADING ADVISORS WERE MADE WITH THE BENEFIT OF HINDSIGHT BASED UPON THE HISTORICAL RATES OF RETURN OF THE SELECTED TRADING ADVISORS. THEREFORE, COMPOSITE PERFORMANCE RECORDS INVARIABLY SHOW POSITIVE RATES OF RETURN. ANOTHER INHERENT LIMITATION ON THESE RESULTS IS THAT THE ALLOCATION DECISIONS REFLECTED IN THE PERFORMANCE RECORD WERE NOT MADE UNDER ACTUAL MARKET CONDITIONS AND, THEREFORE, CANNOT COMPLETELY ACCOUNT FOR THE IMPACT OF FINANCIAL RISK IN ACTUAL TRADING. FURTHERMORE, THE COMPOSITE PERFORMANCE RECORD MAY BE DISTORTED BECAUSE THE ALLOCATION OF ASSETS CHANGES FROM TIME TO TIME AND THESE ADJUSTMENTS ARE NOT REFLECTED IN THE COMPOSITE.

If a Member or Associate has less than one year of experience allocating assets among particular trading advisors, then the disclaimer must also contain the following statement:

> (THE MEMBER) HAS HAD LITTLE OR NO EXPERIENCE ALLOCATING ASSETS AMONG PARTICULAR TRADING ADVISORS. BECAUSE THERE ARE NO ACTUAL ALLOCATIONS TO COMPARE TO THE PERFORMANCE RESULTS FROM THE HYPOTHETICAL ALLOCATION, CUSTOMERS SHOULD BE PARTICULARLY WARY OF PLACING UNDUE RELIANCE ON THESE RESULTS.

(3) Any Member or Associate who uses promotional material which includes a measurement or description of or makes any reference to hypothetical performance results which could have been achieved had a particular trading system of the Member or Associate been employed in the past must include in the promotional material comparable information regarding:

> (i) past performance results of all customer accounts directed by the Member pursuant to a power of attorney over at least the last five years or over the entire performance history if less than five years;
>
> (ii) if the Member has less than one year of experience in directing customer accounts, past performance results of his proprietary trading over at least the last five years or over the entire performance history if less than five years.

(4) No Member or Associate may use promotional material which includes a measurement or description of or makes any reference to hypothetical performance results which could have been achieved had a particular trading system of the Member or Associate been employed in the past if the Member or Associate has three months of actual trading results for that system.

(5) Any Member or Associate utilizing promotional material containing hypothetical performance results must adhere to all the requirements contained in the Board's Interpretive Notice relating to this issue.

[See Interpretive Notice Compliance Rule 2-29: Use of Promotional Material Containing Hypothetical Performance Results.]

(6) These restrictions on the use of hypothetical trading results shall not apply to promotional material directed exclusively to persons who meet the standards of a "Qualified Eligible Person" under CFTC Regulation 4.7.

(d) Statements of Opinion.

Statements of opinion included in promotional material must be clearly identifiable as such and must have a reasonable basis in fact.

(e) Supervisory Requirements

Every Member shall adopt and enforce written procedures to supervise its Associates and employees for compliance with this Rule. Prior to its first use, all promotional material shall be reviewed and approved, in writing, by an officer, general partner, sole proprietor, branch office manager or other supervisory employee other than the individual who prepared such material (unless such material was prepared by the only individual qualified to review and approve such material). If the Member is registered as a broker-dealer under Section 15(b)(11) of the Exchange Act and the promotional material specifically refers to security futures products, the individual reviewing and approving the promotional material must be a designated security futures principal.

(f) Recordkeeping.

Copies of all promotional material along with a record of the review and approval required under paragraph (e) of this Rule and supporting materials for any results described under paragraphs (b)(5)-(6) or (c) of this Rule must be maintained by each Member and be available for examination for the periods specified in CFTC Regulation 1.31, measured from the date of the last use. Each Member who uses promotional material of the types described in paragraph (b)(5)-(6) or (c) of this Rule shall demonstrate the basis for any reported results to NFA upon

request.

(g) Filing with NFA.

The Compliance Director may require any Member for any specified period to file copies of all promotional material with NFA promptly after its first use.

(h) Radio and Television Advertisements.

No Member shall use or directly benefit from any radio or television advertisement or any other audio or video advertisement distributed through media accessible by the public if the advertisement makes any specific trading recommendation or refers to or describes the extent of any profit obtained in the past that can be achieved in the future unless the Member submits the advertisement to NFA's Promotional Material Review Team for its review and approval at least 10 days prior to first use or such shorter period as NFA may allow in particular circumstances.

(i) Definitions.

(1) For purposes of this Rule "promotional material" includes: (i) Any text of a standardized oral presentation, or any communication for publication in any newspaper, magazine or similar medium, or for broadcast over television, radio, or other electronic medium, which is disseminated or directed to the public concerning a futures account, agreement or transaction; (ii) any standardized form of report, letter, circular, memorandum or publication which is disseminated or directed to the public; and (iii) any other written material disseminated or directed to the public for the purpose of soliciting a futures account, agreement or transaction.

(2) "Futures account, agreement or transaction" includes futures accounts and orders, commodity pool participations, agreements to direct or guide trading in futures accounts, and agreements and transactions involving the sale, through publications or otherwise, of non-personalized trading advice concerning futures.

(j) Security Futures Products

In addition to the other requirements of this Rule, Members registered as broker-dealers under Section 15(b)(11) of the Exchange Act and their Associates shall not use any promotional material that specifically refers to security futures products unless the promotional material:

(1) prominently identifies the Member;

(2) includes the date that the material was first used;

(3) provides contact information for obtaining a copy of the disclosure statement for security futures products;

(4) states that security futures products are not suitable for all customers;

(5) does not include any statement suggesting that security futures positions can be liquidated at any time;

(6) does not include any cautionary statement, caveat, or disclaimer that is not legible, that attempts to disclaim responsibility for the content of the promotional material or the opinions expressed in the material, that is misleading, or that is otherwise inconsistent with the content of the material;

(7) discloses the source of any statistical tables, charts, graphs, or other illustrations from a source other than the Member, unless the source of the information is otherwise obvious;

(8) states that supporting documentation will be furnished upon request if it includes any claims, comparisons, recommendations, statistics or other technical data;

(9) if soliciting for a trading program that will be managed by an FCM or IB or Associate of an FCM or IB, it includes the cumulative performance history of the Member's customers who have used the trading program; provided, however, that if the Member does not have customers who have traded the program through the Member, the promotional material must state that the trading program is unproven and must include all of the information required by section (c) of this Rule and the Interpretive Notice on the Use of Promotional Material Containing Hypothetical Performance Results (9025);

(10) refers to past recommendations regarding security futures products, the underlying securities, or a derivative thereof only if it sets forth all recommendations as to the same type, kind, grade, or classification of securities (including security futures products and other security derivatives) made by the Member or Associate within the last year; which information must include the name of each security recommended with the date and nature of each recommendation (e.g., whether to buy or sell), the price at the time of the recommendation, the price at which or the price range within which the recommendation was to be acted upon, and the general market conditions during the period covered if the promotional material refers to past recommendations regarding security futures products, the underlying securities, or a derivative thereof;

(11) includes current recommendations regarding security futures products only if: (i) the Member has a reasonable basis for the recommendation; (ii) the material discloses all material conflicts of interest created by the Member's or Associate's activities in the underlying security; and (iii) the material contains contact information for obtaining the list of prior recommendations described in subsection (10);

(12) includes only a general description of the security futures products for which accounts, orders, trading authorization, or pool participations are being solicited; the name of the Member; and contact information for obtaining a copy of the current disclosure statement for security futures products; provided, however, that this subsection does not apply if the promotional material is accompanied or preceded by the disclosure statement for security futures products; and

(13) has been submitted to NFA for review and approval at least ten days prior to first use if it reaches or is designed to reach a public audience through mass media (e.g., newspapers, magazines, radio, television, or other electronic media). This requirement does not apply to any promotional material in which the only reference to security futures products is contained in a listing of the Member's services.

[See Interpretive Notice NFA Compliance Rule 2-29: Communications with the Public and Promotional Material and Interpretive Notice NFA Compliance Rule 2-29: Review of Promotional Material Prior to its First Use and Interpretive Notice Compliance Rule 2-29: Use of Promotional Material Containing Hypothetical Performance Results and Interpretive Notice NFA Compliance Rule 2-29: Deceptive Advertising (1996) and Interpretive Notice NFA Compliance Rule 2-29: Deceptive Advertising (1998) and Interpretive Notice Compliance Rule 2-29: High Pressure Sales Tactics and Interpretive Notice NFA Compliance Rules 2-29 and 2-9: NFA's Review and Approval of Certain Radio and Television Advertisements]

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Interpretive Notices

9033 - NFA COMPLIANCE RULE 2-29: DECEPTIVE ADVERTISING
(Board of Directors, June 4, 1996)

INTERPRETIVE NOTICE

NFA Compliance Rule 2-29 governs communications between NFA Members and the public. Among other things, the rule prohibits the use of promotional material which is misleading or deceptive. The Board's purposes in adopting this rule were to protect the public from fraudulent advertising and sales solicitations and to provide Members with specific guidance on the standards by which their promotional material would be judged.

Recently, a relative handful of Members have used strikingly similar promotional materials, usually in the form of radio or television advertising, which clearly violate both the letter and the spirit of NFA Compliance Rule 2-29. The core problem with all of these promotional materials is that they suggest the strong likelihood that customers will reap dramatic profits by investing with the Member firm when, in fact, nothing in the Member's experience provides any basis for those claims. Typically, these commercials employ a variety of techniques to mislead the public:

- **Claims Regarding Seasonal Trades**- Some Members have suggested almost certain profits from so-called seasonal trades in, among other things, heating oil and unleaded gas. These ads cite historical data which supposedly shows that certain trades produce dramatic profits year in and year out. Invariably, however, the "historical data" involves different products, different time frames or different fee structures. The most telling point, by far, is that the firm's customers have never experienced the types of profits touted by the Member.
- **Claims Regarding Historic Price Moves**- Another frequent theme in these misleading commercials or solicitations is the reference to historic price moves in particular commodities with a suggestion that the same record setting move is likely to occur now. For example, these promotional materials refer to times when sugar traded at $.66 per pound, gold at $800 per ounce and silver at $50 per ounce. By suggesting that a similar movement is imminent, the Member projects that customers can expect to double, triple or quadruple their investments in a short period of time. In point of fact, however, the Member has made similar claims in the past and its customers have never experienced such profits.
- **"Cherry Picked" Trades**- Occasionally, Members seek to entice prospective investors by claiming that their customers have made dramatic profits, for example, citing returns of 50 percent or more on particular trades. When asked to support these claims, the Members rely on isolated trades in specific customer accounts. What these Members fail to say in their commercials and solicitations is that those profitable trades are not at all representative of the overall performance either of that customer's account or its other customers and that, in fact, the customer referred to in the commercial has actually lost money overall.
- **Profit Projections**- Over and over, some Members claim that, based on current market conditions, customers can "turn $10,000 into $40,000," or profits of a similar magnitude. Again, however, the fact is that the Member has not produced anything like the projected profits for its customers in the past.

Each of the practices described above presents a distorted and misleading view of the likelihood of customers earning dramatic profits by investing with the Member firm, and each of these practices represents a clear violation of NFA sales practice rules. For those few firms which engage in such practices, the Board wishes to reiterate that Members may not engage in a pattern of advertising or solicitation which makes reference to dramatic profits which could be achieved in the future or could have been achieved in the past by trading futures or options contracts for a particular commodity or in the futures or options markets in general unless the Member can demonstrate to NFA that, based on the past performance of its customers, those claims are not misleading.

Any Member making the types of claims referred to above must be able to demonstrate to NFA upon request that the actual performance of its customers supports those claims. Failure to provide adequate documentation will constitute *prima facie* evidence that the promotional material is misleading.

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Interpretive Notices

9038 - NFA COMPLIANCE RULES 2-29: HIGH PRESSURE SALES TACTICS
(Staff, June 19, 1996)

INTERPRETIVE NOTICE

NFA Compliance Rule 2-29 governs Members' communications with the public and is one of the most important NFA rules in ensuring that Members observe high ethical standards in their dealings with customers. NFA Compliance Rule 2-29(a)(2) prohibits the use of "high-pressure sales practices." The rule itself does not define "high-pressure sales practices." However, there have been a significant number of NFA enforcement cases prosecuted under the rule, and those cases provide guidance to Members on the types of practices which have been found to constitute high-pressure sales practices.

A common thread in many of the high-pressure sales cases brought by the Business Conduct Committee is the sense of undue urgency which the associated person conveys to the customer. In essence, the AP is asking the customer to act now and think later. This approach can take several different forms. In some cases, the AP rushes the customer through the account opening forms, glossing over the risk disclosure in his haste to open the account. Frequently, an overnight courier service delivers the blank forms to the customer and waits while the customer completes the form. In some cases, APs have actively attempted to dissuade unsophisticated customers from seeking further advice on their investment decision from friends, relatives or advisors or have tried to threaten or intimidate customers. The purpose of NFA's rule is to ensure that the customer makes a fully informed and carefully considered investment decision. Any tactic, such as those outlined above, which presses a customer for a hasty decision will be considered a violation of NFA Compliance Rule 2-29(a)(2).

Another familiar theme in NFA's high-pressure sales cases involves a pattern of telephone calls which are unusual in their timing or frequency. In several cases, the AP barraged the customer with calls either late at night or early in the morning. In other cases, the AP's telephone solicitations to open an account occurred several times a day, several days a week for weeks on end. Phone calls made at unusual hours and with unusual frequency, unless made at the customer's request, can be an abusive practice, designed to abuse, annoy or harass a customer into opening an account and constituting a violation of NFA Compliance Rules.

Perhaps the most obvious indicator of a high-pressure sales practice is simply the tone used by the AP to address the customer. In a handful of cases, APs have shouted at customers, used profane language or otherwise berated the customer in an attempt to bully the customer into opening an account. Such conduct clearly violates NFA rules.

This notice cannot and is not intended to alert Members to all of the factors that may constitute a high-pressure sales practice. Each of the factors highlighted above, however, has frequently been present in the high-pressure sales cases brought by NFA, and Members should certainly be vigilant in preventing and detecting such practices in their own operations.

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Compliance Rules

RULE 2-29. COMMUNICATIONS WITH THE PUBLIC AND PROMOTIONAL MATERIAL.
[Adopted effective November 19, 1985. Effective date of Amendments: February 1, 1996; August 29, 1996; March 28, 2000; July 24, 2000; December 4, 2000; August 21, 2001; May 1, 2004 and February 1, 2010.]

(a) General Prohibition.

No Member or Associate shall make any communication with the public which:

(1) operates as a fraud or deceit;
(2) employs or is part of a high-pressure approach; or
(3) makes any statement that futures trading is appropriate for all persons.

(b) Content of Promotional Material.

No Member or Associate shall use any promotional material which:

(1) is likely to deceive the public;

(2) contains any material misstatement of fact or which the Member or Associate knows omits a fact if the omission makes the promotional material misleading;

(3) mentions the possibility of profit unless accompanied by an equally prominent statement of the risk of loss;

(4) includes any reference to actual past trading profits without mentioning that past results are not necessarily indicative of future results;

(5) includes any specific numerical or statistical information about the past performance of any actual accounts (including rate of return)

(i) unless such information is and can be demonstrated to NFA to be representative of the actual performance for the same time period of all reasonably comparable accounts and,

(ii) in the case of rate of return figures, unless such figures are calculated in a manner consistent with CFTC Regulation 4.25(a)(7) for commodity pools and with CFTC Regulation 4.35(a)(6), as modified by NFA Compliance Rule 2-34(a), for figures based on separate accounts, or

(6) includes a testimonial that is not representative of all reasonably comparable accounts, does not prominently state that the testimonial is not indicative of future performance or success, and does not prominently state that it is a paid testimonial (if applicable).

(c) Hypothetical Results.

(1) Any Member or Associate who uses promotional material which includes a measurement or description of or makes any reference to hypothetical performance results which could have been achieved had a particular trading system of the Member or Associate been employed in the past must include in the promotional material the following disclaimer prescribed by NFA's Board of Directors:

HYPOTHETICAL PERFORMANCE RESULTS HAVE MANY INHERENT LIMITATIONS, SOME OF WHICH ARE DESCRIBED BELOW. NO REPRESENTATION IS BEING MADE THAT ANY ACCOUNT WILL OR IS LIKELY TO ACHIEVE PROFITS OR LOSSES SIMILAR TO THOSE SHOWN. IN FACT, THERE ARE FREQUENTLY SHARP DIFFERENCES BETWEEN HYPOTHETICAL PERFORMANCE RESULTS AND THE ACTUAL RESULTS SUBSEQUENTLY ACHIEVED BY ANY PARTICULAR TRADING PROGRAM.

ONE OF THE LIMITATIONS OF HYPOTHETICAL PERFORMANCE RESULTS IS THAT THEY ARE GENERALLY PREPARED WITH THE BENEFIT OF HINDSIGHT. IN ADDITION, HYPOTHETICAL TRADING DOES NOT INVOLVE FINANCIAL RISK, AND NO HYPOTHETICAL TRADING RECORD CAN COMPLETELY ACCOUNT FOR THE IMPACT OF FINANCIAL RISK IN ACTUAL TRADING. FOR EXAMPLE, THE ABILITY TO WITHSTAND LOSSES OR TO ADHERE TO A PARTICULAR TRADING PROGRAM IN SPITE OF TRADING LOSSES ARE MATERIAL POINTS WHICH CAN ALSO ADVERSELY AFFECT ACTUAL TRADING RESULTS. THERE ARE NUMEROUS OTHER FACTORS RELATED TO THE MARKETS IN GENERAL OR TO THE IMPLEMENTATION OF ANY SPECIFIC TRADING PROGRAM WHICH CANNOT BE FULLY ACCOUNTED FOR IN THE PREPARATION OF HYPOTHETICAL PERFORMANCE RESULTS AND ALL OF WHICH CAN ADVERSELY AFFECT ACTUAL TRADING RESULTS.

If a Member or Associate has either less than one year of experience in directing customer accounts or trading proprietary accounts, then the disclaimer must also contain the following statement:

(THE MEMBER) HAS HAD LITTLE OR NO EXPERIENCE IN TRADING ACTUAL ACCOUNTS FOR ITSELF OR FOR CUSTOMERS. BECAUSE THERE ARE NO ACTUAL TRADING RESULTS TO COMPARE TO THE HYPOTHETICAL PERFORMANCE RESULTS, CUSTOMERS SHOULD BE PARTICULARLY WARY OF PLACING UNDUE RELIANCE ON THESE HYPOTHETICAL PERFORMANCE RESULTS.

(2) Any Member or Associate who uses promotional material which includes a measurement or description of or makes any reference to a hypothetical composite performance record showing what a multi-advisor account portfolio or pool could have achieved in the past if assets had been allocated among particular trading advisors must include in the promotional material the following disclaimer prescribed by NFA's Board of Directors instead of the disclaimer prescribed by Section (c) (1) of this Rule:

THIS COMPOSITE PERFORMANCE RECORD IS HYPOTHETICAL AND THESE TRADING ADVISORS HAVE NOT TRADED TOGETHER IN THE MANNER SHOWN IN THE COMPOSITE. HYPOTHETICAL PERFORMANCE RESULTS HAVE MANY INHERENT LIMITATIONS, SOME OF WHICH ARE DESCRIBED BELOW. NO REPRESENTATION IS BEING MADE THAT ANY MULTI-ADVISOR MANAGED ACCOUNT OR POOL WILL OR IS LIKELY TO ACHIEVE A COMPOSITE PERFORMANCE RECORD SIMILAR TO THAT SHOWN. IN FACT, THERE ARE FREQUENTLY SHARP DIFFERENCES BETWEEN A HYPOTHETICAL COMPOSITE PERFORMANCE RECORD AND THE ACTUAL RECORD SUBSEQUENTLY ACHIEVED.

ONE OF THE LIMITATIONS OF A HYPOTHETICAL COMPOSITE PERFORMANCE RECORD IS THAT DECISIONS RELATING TO THE SELECTION OF TRADING ADVISORS AND THE ALLOCATION OF ASSETS AMONG THOSE TRADING ADVISORS WERE MADE WITH THE BENEFIT OF HINDSIGHT BASED UPON THE HISTORICAL RATES OF RETURN OF THE SELECTED TRADING ADVISORS. THEREFORE, COMPOSITE PERFORMANCE RECORDS INVARIABLY SHOW POSITIVE RATES OF RETURN. ANOTHER INHERENT LIMITATION ON THESE RESULTS IS THAT THE ALLOCATION DECISIONS REFLECTED IN THE PERFORMANCE RECORD WERE NOT MADE UNDER ACTUAL MARKET CONDITIONS AND, THEREFORE, CANNOT COMPLETELY ACCOUNT FOR THE IMPACT OF FINANCIAL RISK IN ACTUAL TRADING. FURTHERMORE, THE COMPOSITE PERFORMANCE RECORD MAY BE DISTORTED BECAUSE THE ALLOCATION OF ASSETS CHANGES FROM TIME TO TIME AND THESE ADJUSTMENTS ARE NOT REFLECTED IN THE COMPOSITE.

If a Member or Associate has less than one year of experience allocating assets among particular trading advisors, then the disclaimer must also contain the following statement:

(THE MEMBER) HAS HAD LITTLE OR NO EXPERIENCE ALLOCATING ASSETS AMONG PARTICULAR TRADING ADVISORS. BECAUSE THERE ARE NO ACTUAL ALLOCATIONS TO COMPARE TO THE PERFORMANCE RESULTS FROM THE HYPOTHETICAL ALLOCATION, CUSTOMERS SHOULD BE PARTICULARLY WARY OF PLACING UNDUE RELIANCE ON THESE RESULTS.

(3) Any Member or Associate who uses promotional material which includes a measurement or description of or makes any reference to hypothetical performance results which could have been achieved had a particular trading system of the Member or Associate been employed in the past must include in the promotional material comparable information regarding:

(i) past performance results of all customer accounts directed by the Member pursuant to a power of attorney over at least the last five years or over the entire performance history if less than five years;

(ii) if the Member has less than one year of experience in directing customer accounts, past performance results of his proprietary trading over at least the last five years or over the entire performance history if less than five years.

(4) No Member or Associate may use promotional material which includes a measurement or description of or makes any reference to hypothetical performance results which could have been achieved had a particular trading system of the Member or Associate been employed in the past if the Member or Associate has three months of actual trading results for that system.

(5) Any Member or Associate utilizing promotional material containing hypothetical performance results must adhere to all the requirements contained in the Board's Interpretive Notice relating to this issue.

[See Interpretive Notice Compliance Rule 2-29: Use of Promotional Material Containing Hypothetical Performance Results.]

(6) These restrictions on the use of hypothetical trading results shall not apply to promotional material directed exclusively to persons who meet the standards of a "Qualified Eligible Person" under CFTC Regulation 4.7.

(d) Statements of Opinion.

Statements of opinion included in promotional material must be clearly identifiable as such and must have a reasonable basis in fact.

(e) Supervisory Requirements

Every Member shall adopt and enforce written procedures to supervise its Associates and employees for compliance with this Rule. Prior to its first use, all promotional material shall be reviewed and approved, in writing, by an officer, general partner, sole proprietor, branch office manager or other supervisory employee other than the individual who prepared such material (unless such material was prepared by the only individual qualified to review and approve such material). If the Member is registered as a broker-dealer under Section 15(b)(11) of the Exchange Act and the promotional material specifically refers to security futures products, the individual reviewing and approving the promotional material must be a designated security futures principal.

(f) Recordkeeping.

Copies of all promotional material along with a record of the review and approval required under paragraph (e) of this Rule and supporting materials for any results described under paragraphs (b)(5)-(6) or (c) of this Rule must be maintained by each Member and be available for examination for the periods specified in CFTC Regulation 1.31, measured from the date of the last use. Each Member who uses promotional material of the types described in paragraph (b)(5)-(6) or (c) of this Rule shall demonstrate the basis for any reported results to NFA upon request.

(g) Filing with NFA.

The Compliance Director may require any Member for any specified period to file copies of all promotional material with NFA promptly after its first use.

(h) Radio and Television Advertisements.

No Member shall use or directly benefit from any radio or television advertisement or any other audio or video advertisement distributed through media accessible by the public if the advertisement makes any specific trading recommendation or refers to or describes the extent of any profit obtained in the past that can be achieved in the future unless the Member submits the advertisement to NFA's Promotional Material Review Team for its review and approval at least 10 days prior to first use or such shorter period as NFA may allow in particular circumstances.

(i) Definitions.

(1) For purposes of this Rule "promotional material" includes: (i) Any text of a standardized oral presentation, or any communication for publication in any newspaper, magazine or similar medium, or for broadcast over television, radio, or other electronic medium, which is disseminated or directed to the public concerning a futures account, agreement or transaction; (ii) any standardized form of report, letter, circular, memorandum or publication which is disseminated or directed to the public; and (iii) any other written material disseminated or directed to the public for the purpose of soliciting a futures account, agreement or transaction.

(2) "Futures account, agreement or transaction" includes futures accounts and orders, commodity pool participations, agreements to direct or guide trading in futures accounts, and agreements and transactions involving the sale, through publications or otherwise, of non-personalized trading advice concerning futures.

(j) Security Futures Products

In addition to the other requirements of this Rule, Members registered as broker-dealers under Section 15(b)(11) of the Exchange Act and their Associates shall not use any promotional material that specifically refers to security futures products unless the promotional material:

(1) prominently identifies the Member;

(2) includes the date that the material was first used;

(3) provides contact information for obtaining a copy of the disclosure statement for security futures products;

(4) states that security futures products are not suitable for all customers;

(5) does not include any statement suggesting that security futures positions can be liquidated at any time;

(6) does not include any cautionary statement, caveat, or disclaimer that is not legible, that attempts to disclaim responsibility for the content of the promotional material or the opinions expressed in the material, that is misleading, or that is otherwise inconsistent with the content of the material;

(7) discloses the source of any statistical tables, charts, graphs, or other illustrations from a source other than the Member, unless the source of the information is otherwise obvious;

(8) states that supporting documentation will be furnished upon request if it includes any claims, comparisons, recommendations, statistics or other technical data;

(9) if soliciting for a trading program that will be managed by an FCM or IB or Associate of an FCM or IB, it includes the cumulative performance history of the Member's customers who have used the trading program; provided, however, that if the Member does not have customers who have traded the program through the Member, the promotional material must state that the trading program is unproven and must include all of the information required by section (c) of this Rule and the Interpretive Notice on the Use of Promotional Material Containing Hypothetical Performance Results (9025);

(10) refers to past recommendations regarding security futures products, the underlying securities, or a derivative thereof only if it sets forth all recommendations as to the same type, kind, grade, or classification of securities (including security futures products and other security derivatives) made by the Member or Associate within the last year; which information must include the name of each security recommended with the date and nature of each recommendation (e.g., whether to buy or sell), the price at the time of the recommendation, the price at which or the price range within which the recommendation was to be acted upon, and the general market conditions during the period covered if the promotional material refers to past recommendations regarding security futures products, the underlying securities, or a derivative thereof;

(11) includes current recommendations regarding security futures products only if: (i) the Member has a reasonable basis for the recommendation; (ii) the material discloses all material conflicts of interest created by the Member's or Associate's activities in the underlying security; and (iii) the material contains contact information for obtaining the list of prior recommendations described in subsection (10);

(12) includes only a general description of the security futures products for which accounts, orders, trading authorization, or pool participations are being solicited; the name of the Member; and contact information for obtaining a copy of the current disclosure statement for security futures products; provided, however, that this subsection does not apply if the promotional material is accompanied or preceded by the disclosure statement for security futures products; and

(13) has been submitted to NFA for review and approval at least ten days prior to first use if it reaches or is designed to reach a public audience through mass media (e.g., newspapers, magazines, radio, television, or other electronic media). This requirement does not apply to any promotional material in which the only reference to security futures products is contained in a listing of the Member's services.

[See Interpretive Notice NFA Compliance Rule 2-29: Communications with the Public and Promotional Material and Interpretive Notice NFA Compliance Rule 2-29: Review of Promotional Material Prior to its First Use and Interpretive Notice Compliance Rule 2-29: Use of Promotional Material Containing Hypothetical Performance Results and Interpretive Notice NFA Compliance Rule 2-29: Deceptive Advertising (1996) and Interpretive Notice NFA Compliance Rule 2-29: Deceptive Advertising (1998) and Interpretive Notice Compliance Rule 2-29: High Pressure Sales Tactics and Interpretive Notice NFA Compliance Rules 2-29 and 2-9: NFA's Review and Approval of Certain Radio and Television Advertisements]

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Interpretive Notices

9003 - NFA COMPLIANCE RULE 2-29: COMMUNICATIONS WITH THE PUBLIC AND PROMOTIONAL MATERIAL
(Board of Directors, effective November 19, 1985; revised July 24, 2000)

INTERPRETIVE NOTICE

I. Introduction

Section 17(p)(3) of the Commodity Exchange Act (7 U.S.C. §21(p)(3)) requires that the rules of a registered futures association such as NFA "establish minimum standards governing the sales practices of its members and persons associated therewith. . . ." NFA has established such minimum standards in the form of its Compliance Rules which, among other things, generally prohibit fraud and deceit and require Members and Associates to "observe high standards of commercial honor and just and equitable principles of trade in the conduct of their commodity futures business." Although these rules supply the required minimum standard, they are general in nature and may not always provide specific guidance as to what particular conduct may be prohibited. It is expected that more detailed content will be given to those general rules through the work of NFA's Business Conduct Committees, which will issue decisions in disciplinary cases applying the rules to specific conduct. It is also expected that NFA's Advisory Committees, through study and recommendation of rule changes, will further the development of uniform industrywide sales practice standards.

NFA's Board of Directors has adopted and the CFTC has approved a new Compliance Rule, 2-29, which was proposed to the Board by the FCM Advisory Committee ("The Committee"). The Committee published a notice for public comment on its proposed rule on February 21, 1985, and considered the comments received in drafting the final rule.

II. The Contemplated Relationship of Rule 2-29 With Other NFA Rules

Rule 2-29 deals specifically with communication with the public and promotional material prepared and used in the conduct of a Member's or Associate's futures business. However, Member and Associate conduct in that area, as in all others related to futures, is, and under the new rule continues to be, subject to all other NFA requirements. For example, certain other NFA Rules deal specifically with communications with the public and promotional materials in a narrower context. Compliance Rule 2-13, which incorporates CFTC Rule 4.41, regulates the advertising of Commodity Pool Operators ("CPOs") and Commodity Trading Advisors ("CTAs"). In addition, all Member and Associate conduct, including communications with the public, is subject to the requirements of Compliance Rule 2-2 (Fraud and Related Matters) and Compliance Rule 2-4 (Just and Equitable Principles of Trade).

The new Rule is not intended to supplant those or any other NFA Requirements but rather to augment them. Hence, literal compliance with Rule 2-29 will not be a "safe harbor" from NFA disciplinary action if the Member or Associate violates any other NFA Requirement.

III. The Scope of Rule 2-29

Rule 2-29 is intended to apply to all forms of communication with the public by a Member or Associate without exception if the communication relates in any way to solicitation of an account, agreement or transaction in the conduct of the Member's or Associate's business in futures as the term "futures" is now or may be defined.[1]

However, in drafting the Rule the Committee recognized that some specific standards which would be appropriate for communications prepared in advance of delivery to the public might be unenforceable and even inappropriate in the context of routine day-to-day contact with customers. The Committee was concerned that the free flow of information and advice to customers might be impeded to their detriment if spontaneous communication were subjected to rigorous and detailed content standards.

To address this problem, the final Rule distinguishes routine day-to-day communications with customers and applies a different regulatory standard to such communications. This is accomplished by providing a definition of "promotional material" to identify the kinds of communications with the public which will be subject to specific content standards and other requirements beyond those provided in Section (a) General Prohibition. Therefore, the definition of promotional material (which is a broadened version of the definition of that term in the CFTC's option pilot program rules) is intended to include all kinds of promotional communications with the public, other than routine day-to-day contact with customers. It includes, for example, any kind of written, electronic or mechanically reproduced message or presentation which is directed to any member of the public, whether broadcast over the media, delivered through the mail or presented personally. It also includes any oral presentations or statements to customers or prospective customers,

whether delivered over the telephone or in person, the substance of which is outlined or scripted in advance for delivery to such persons.

IV. Section-by-Section Analysis

Section (a) General Prohibition

This Section provides the general rule governing all communications with the public and is the only portion of the Rule applicable to routine day-to-day communication with customers. That means that routine customer contact would not run afoul of Rule 2-29 as long as it is not fraudulent or deceitful, is not high-pressure in nature and does not contain any statement that futures trading is appropriate for all persons. NFA believes that the general prohibition should not hamper free and open communication with individual customers on a day-to-day basis. In that regard, it is expected that Business Conduct Committees would not find such communications to operate as a fraud or deceit in the absence of evidence of such intent or recklessness on the part of the Member or Associate.[2]

Section (b) Content of Promotional Material

This Section sets out the specific prohibitions and requirements applicable to promotional material, as defined. Subsection (1) bans material likely to deceive the public. Proof of violation of this provision does not require proof of a specific intent to deceive. This Subsection instead places the burden on the Member to determine whether the material is likely to be deceptive in effect. Of course, to find a violation of this Subsection a Business Conduct Committee would have to find that the Member or Associate reasonably should have been able to determine that the material was likely to deceive. The fact that someone was actually deceived would not by itself be enough.

Subsection (2) deals with facts only. It requires that the facts which a Member or Associate chooses to include must be true and that no facts knowingly be left out which are necessary to make the facts stated not misleading. With that exception, this Subsection does not require the disclosure of facts. As with Subsection (1), a negligence standard would be applied in finding violations of Subsection (2) for making material misstatements of fact in promotional material. However, because evaluating omissions is a much more difficult task, this Subsection applies only to knowing omissions (i.e., instances where the person preparing or reviewing the promotional material knew the omitted fact and failed to include it). This knowledge requirement may complicate the proof necessary to establish a violation of this Subsection. However, knowledge can be inferred from a pattern of failures to include a material fact, the omission of which makes the promotional material misleading. Once knowledge is established, the decision whether the failure to include a fact makes the promotional material misleading in violation of Rule 2-29 will be made by a Business Conduct Committee under a standard of reasonableness.

Subsection (3) requires a statement of risk to "balance" any discussion of the possibility of profit. The requirement that the statement of risk have equal prominence is not intended to mean that the reference to risk must be as long as the discussion of the possibility of profit or indeed to impose any unbending measure of prominence. It is intended to mean only that in the context of the particular promotional material the reference to risk of loss must not be downplayed or hidden.

Subsection (4) requires the Member or Associate to make a statement in the promotional material concerning the predictive value of past results if reference is made in the material to past trading results.

Subsection (5) does not require disclosure of past performance of managed accounts.[3] It does require that if performance information is given, it must be representative of the actual performance for the same time period of all reasonably comparable accounts. Hence, under Subsection (5) a Member could not advertise the performance of a "model" account unless that performance is representative of all reasonably comparable accounts.[4] Subsection (5) also makes explicit in this context the Members' existing responsibility to be able to demonstrate that performance information is accurate and representative.

The use of performance information in promotional material is, of course, subject to all of the content standards of Rule 2-29, and compliance with Subsection (b)(5) will not excuse violations of other Subsections. If in presenting performance information for an account or group of accounts, a Member omits facts about those accounts or the differences between those accounts and the account being promoted, and the omission makes the material misleading, the use of the material violates Subsection (b)(2) even though the performance information given is accurate and is representative of all reasonably comparable accounts in compliance with (b)(5). This interaction of the requirements of Subsections (b)(2) and (b)(5) will come into play whenever a Member chooses to present performance information about an account or program which differs materially from the account or program being promoted; for example, where performance information about a house account is used, or where trading control or strategies, commission rates or account sizes which applied in the account or program for which performance is being shown differ from those which will apply in the account or program for which the customer is being solicited. Under the Rule, a Member is free to use a sales tool performance information about accounts which differ from the accounts being promoted, but must take care to ensure first, that the performance information complies with Subsection (b)(5), and second, that the differences are explained to the extent necessary to make the promotional material not misleading.

Finally, Subsection (5) requires that the rate of return must not be calculated in a manner inconsistent with that required under the CFTC's Part 4 Rules, which define rate of return as the ratio between net performance and beginning net asset value for the period. This is not intended to require that the precise Part 4 formula be used in all cases but rather to prohibit the use of methods which lead to rates of return which are materially higher than those produced by the Part 4 method.

Section (e) Written Supervisory Procedures

In recognition of the fact that promotional material may be prepared by many individuals within a Member's organization, this Section requires that promotional material be reviewed and approved by someone in a supervisory position before it is used. It should be emphasized, however, that even communications with the public which do not fall within the definition of promotional material must be

diligently supervised under other existing NFA and CFTC rules.

Section (f) Recordkeeping

This Section is intended to provide a way in which NFA can conduct meaningful sales practice audits which will reveal both the content of promotional material and whether the supervisory procedures required under Section (e) are being carried out. In addition, this Section contains a requirement that Members who use hypothetical performance results be prepared to demonstrate to NFA's satisfaction the basis for such results. This means that Members must maintain the records necessary to document how the hypothetical results were calculated.

[NOTE: This requirement was extended to all performance results effective July 24, 2000.]

Section (g) Filing with NFA

This Section is intended to allow NFA to maintain close review of promotional material in circumstances where special scrutiny is warranted.

[NOTE: This interpretive notice was amended effective July 24, 2000 to conform it to subsequent changes in NFA rules. In particular, the amendments eliminate the discussion of hypothetical results and update section references within Compliance Rule 2-29 based on changes to Compliance Rule 2-29's treatment of hypothetical results; eliminate references to options rules that are no longer in effect; and make other technical amendments to correspond to subsequent changes to other NFA rules. Furthermore, adjudicated disciplinary decisions are now issued by NFA Hearing Panels rather than Business Conduct Committees. Therefore, all references to Business Conduct Committees, while not changed in the notice, now refer to Hearing Panels. In all other respects, this interpretive notice remains an interpretation adopted by the Board of Directors contemporaneously with the adoption of NFA Compliance Rule 2-29.]

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[1] Article XVIII(k) of NFA's Articles of Incorporation defines futures to include "options contracts traded on a contract market, and such other commodity-related instruments as the Board may from time to time declare by Bylaw to be properly the subject of NFA regulation and oversight." Currently, the only NFA Bylaw expanding that definition is Bylaw 1507, which states that " 'futures' as used in these Bylaws shall include option contracts granted by a person that has registered with the Commission under Section 4c(d) of the Act as a grantor of such option contracts or has notified the Commission under the Commission's rules that it is qualified to grant such option contracts." [Bylaw 1507 has since been amended to include foreign futures and options contracts and leverage transactions.]

[2] However, it must be noted that much, if not all, of the benefits to customers of the disclosures and cautionary statements required to be included in promotional material by other sections of Rule 2-29 and other disclosure statements required by CFTC and NFA Rules (e.g., the risk disclosure statements required by CFTC Rule 1.55 and NFA Compliance Rule 2-27) can be intentionally diminished in the course of oral communications with customers. To avoid that result it is expected that Business Conduct Committees will presume intentional or reckless deceit in instances where a Member or Associate specifically contradicts or downplays any disclosure statement required to be made by CFTC or NFA rules.

[3] CPOs and CTAs are, however, subject to such a requirement through the CFTC's Part 4 Rules.

[4] The Committee expects that a Member or Associate could exclude from "reasonably comparable accounts" those that were actually traded pursuant to a different trading strategy or those that were traded independently of the accounts in the program for which performance is cited. With respect to the question of independence the indicia of independence listed in the CFTC's statement of policy concerning when accounts should be aggregated for position limit purposes would be useful guides for Members, Associates and Business Conduct Committees. *Statement of Aggregation Policy* (1977-80 Transfer Binder) Comm. Fut. L. Rep. (CCH) 20.837 (June 13, 1979); 44 *Fed. Reg.* 33839.

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Interpretive Notices

9009 - NFA COMPLIANCE RULE 2-29: REVIEW OF PROMOTIONAL MATERIAL PRIOR TO ITS FIRST USE
(Staff, May 1, 1989; revised July 1, 2000)

INTERPRETIVE NOTICE

As a service to its Members and the investing public, NFA offers a program for the review of promotional material prior to its first use. This program is voluntary and no Member must file promotional material with NFA unless otherwise required to do so by rule or directive. In addition, this program in no way lessens the requirement that Members supervise the preparation of and review all promotional material. Members may not attempt to use NFA staff's review as a substitute for its own.

Members wishing to avail themselves of the pre-review program may submit promotional material to the Compliance Department at least 21 calendar days prior to its first intended use. This material should be directed to:

National Futures Association
Compliance Department
Advertising Regulation Team
Suite 1800
300 S. Riverside Plaza
Chicago, IL 60606

In addition, Members may ask general questions about promotional material or Compliance Rule 2-29 by contacting NFA's Information Center at (312) 781-1410 or (800) 621-370 or through the "contact" feature of NFA's web site at www.nfa.futures.org. Such inquiries will be forwarded to the appropriate personnel for response.

Submitted material must be accompanied by a cover letter signed by a supervisory employee responsible for the review of the Member's promotional material. NFA staff will not pre-review material received directly from APs.

NFA staff will review submissions as expeditiously as possible. If additional information is needed, or the review cannot be completed within the 21 day period, the Member will be so notified. (In our experience, most reviews take far less than 21 days, and reviews take more than 21 days only in highly unusual circumstances.) At the conclusion of the review the comments of NFA staff will be conveyed to the Member, generally by telephone. Obviously NFA staff will not be able to independently verify the accuracy of every statement or numerical claim made in a piece of promotional material within the 21 day review period; that responsibility remains with the Member. Therefore, submitting promotional material to NFA will not provide a "safe harbor" for Members if misstatements or omissions of material facts are discovered subsequently. However, NFA staff review will provide valuable guidance to Members, particularly with regard to such areas as balance and the proper use of disclaimers.

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Interpretive Notices

9025 - COMPLIANCE RULE 2-29: USE OF PROMOTIONAL MATERIAL CONTAINING HYPOTHETICAL PERFORMANCE RESULTS
(Board of Directors, February 1, 1996; revised August 29, 1996.)

INTERPRETIVE NOTICE

Over the years the use of hypothetical performance results has repeatedly produced highly misleading promotional material. By their very nature, such performance results have certain limitations. For example, hypothetical performance results do not represent actual trading and are generally designed with the benefit of hindsight which may under- or over-compensate for the impact of certain market factors, including lack of liquidity and price slippage. Furthermore, since hypothetical trading does not involve financial risk, no hypothetical performance results can completely account for the impact of certain factors associated with risk, including the ability of the customer or the advisor to withstand losses or to adhere to a particular trading program in the face of trading losses. Despite these limitations, there have been numerous instances in which Members in one form or another have attempted to induce customers to place undue reliance on hypothetical results. NFA's Business Conduct Committee has not hesitated to issue charges against Members engaging in such practices and will continue to pay close attention to advertising materials which display hypothetical results.

The use of hypothetical results has been the subject of regulatory scrutiny before. In 1981, the Commodity Futures Trading Commission ("CFTC" or "Commission") considered a total ban on the use of such results. Ultimately, the Commission determined to require CPOs and CTAs displaying hypothetical results to display the disclaimer set forth in CFTC Regulation 4.41. The Commission noted at the time that it might well impose sterner measures if the disclaimer proved ineffective at preventing abuses. NFA subsequently required all NFA Members and Associates to display Regulation 4.41's disclaimer in any promotional material which contains such results.

In NFA's experience, however, the use of the mandated disclaimer has not prevented recurring abuses in the presentation of hypothetical results. In some instances Members have touted dramatic hypothetical profits without revealing that their actual performance is much worse. This situation has been addressed by an amendment to NFA Compliance Rule 2-29(c)(2) which requires Members advertising hypothetical results to disclose their actual results as well. In other cases Members have effectively diminished the impact of the disclaimer by grossly over-emphasizing the significance of very dramatic hypothetical profits. For example, some Members have utilized promotional material which presents hypothetical rates of return in large, bold face print while the disclaimer can be read only with a magnifying glass. In other advertising pieces the disclaimer is so far removed from the touted hypothetical profits that customers may never find it. There have also been instances in which Members or Associates have attempted to disguise hypothetical performance results as actual performance results.

Due to these problems, NFA's Board of Directors recently reviewed whether NFA Members and Associates should be permitted to utilize hypothetical performance results in promotional material. During this review, the Board considered a complete ban on the presentation of these results in promotional material due to its potentially abusive and misleading nature. However, in considering such a ban, the Board also recognized that the presentation of hypothetical performance results in promotional material may have some limited utility in certain circumstances, for example, where a Member has developed a new trading program for which there are no actual trading results. As a result, the Board decided to continue to allow Members and Associates to utilize promotional material containing hypothetical performance results under very stringent restrictions. Hypothetical results will not be allowed, however, for any trading program for which the Member has three months of actual trading results. Any Member or Associate utilizing promotional material which includes hypothetical results shall, at a minimum, adhere to the following requirements.

First, any Member or Associate utilizing promotional material which presents hypothetical performance results must provide to customers the disclaimer contained in NFA Compliance Rule 2-29(c)(1). The Board has expanded the required disclaimer to provide a more thorough discussion of the limitations of hypothetical results and of the dangers in placing undue reliance upon them. To prevent the over-emphasis of hypothetical performance results, the disclaimer must be displayed as prominently as the hypothetical results themselves. Generally, this would require that the disclaimer be printed in a type size at least as large as that used for the hypothetical results. Similarly, to avoid circumstances where hypothetical performance results are presented in one section of the promotional material with the disclaimer buried in another, the disclaimer must now immediately precede or follow the performance results. Whenever the Member or Associate has less than 12 months of actual results, the disclaimer must immediately precede the hypothetical performance results. Furthermore, if the promotional material contains several pages of hypothetical performance results, then the Member or Associate may need to include this disclaimer more than once in the material.

Second, any Member or Associate utilizing promotional material which presents hypothetical performance results must also describe in the promotional material all of the material assumptions that were made in preparing the hypothetical results. At a minimum, the description of material assumptions must cover points such as initial investment amount, reinvestment or distribution of profits, commission charges, management and incentive fees, and the method used to determine purchase or sale prices for each trade. Members must also make all material disclosures necessary to place the hypothetical results in their proper context, which in some instances may go well beyond the prescribed disclaimer. Furthermore, Members and Associates must calculate hypothetical performance results in a manner consistent with that required under the CFTC's Part 4 Regulations.

Third, when any Member or Associate utilizes promotional material which contains both hypothetical and actual performance results, then the actual results must be presented with at least the same prominence devoted to the hypothetical results. Both the hypothetical and actual performance results must be appropriately identified, separately formatted, discussed in an equally balanced manner and calculated pursuant to the same rate of return method. Furthermore, the promotional material must not contain any statement which places undue emphasis on the hypothetical performance results, for example, by discounting or downplaying the significance of any actual performance results.

NFA's Board of Directors further notes that, as explained above, the preceding requirements also apply to a Member or Associate's use of promotional material containing a composite performance record showing what a multi-advisor managed account or pool could have achieved if the account's or pool's assets had been allocated among particular trading advisors. In the past, Members have often referred to these composite performance records as pro forma results; however, NFA's Board of Directors believes the pro forma label is misleading. Although the performance for each individual trading advisor is based upon actual results, the selection of and allocation among trading advisors has been done with the benefit of hindsight and, thus, the composite performance record is hypothetical in nature. Therefore, in addition to the preceding requirements, Members and Associates must appropriately label any composite performance record for a multi-advisor managed account or pool as hypothetical and not pro forma. Additionally, because the composite performance record is hypothetical in nature, Members must include a description of all the material assumptions noted above and, in this context, also describe the method used to select and allocate assets among particular trading advisors. The Board also notes that if a Member or Associate previously used promotional material containing hypothetical composite performance records for multi-advisor managed accounts or pools and the hypothetical results were substantially higher than the actual results subsequently obtained by the Member or Associate in allocating assets among the multi-advisors, then this fact must be disclosed in the promotional material.

The presentation of hypothetical performance results in promotional material is, of course, subject to all other NFA Requirements. Pursuant to NFA Compliance Rule 2-29 (b)(1) and (2), the ultimate test of any promotional material is whether the overall impact of the material is misleading or is likely to deceive the public. Although NFA has issued this Interpretive Notice, the Board recognizes that it cannot describe every manner in which promotional material containing hypothetical performance results may be misleading. The fact that an NFA Member or Associate has printed the disclaimer required pursuant to NFA Compliance Rule 2-29 and that the promotional material is in facial compliance with this Interpretive Notice does not ensure that material is not misleading.

Promotional material which contains hypothetical performance results will continue to be carefully scrutinized by NFA staff. Pursuant to NFA Compliance Rule 2-29(f), Members and Associates presenting hypothetical results in their promotional material must be able to demonstrate to NFA's satisfaction the validity of the presentation of the results. The greater the emphasis on dramatic hypothetical profits, the greater the Member's burden in demonstrating the validity of the presentation.

Addressing a different concern, the Board of Directors also believes that hindsight analysis may be misleading as applied to the presentation of *extracted performance* in which a Member or Associate selects one component of its overall past trading results to highlight to customers. In order to prevent the misleading use of such results, the use of extracted performance is permitted only when a CPO's or CTA's previous disclosure documents designated the percentage of assets which would be committed toward that particular component of the overall trading program. For example, if the previous disclosure document stated that 25 percent of a fund's assets would be dedicated to trading financial futures contracts, and if 25 percent of the fund's assets were in fact dedicated to trading financial futures contracts, the CPO would be allowed to present the extracted performance of its financial futures trading based on net asset values equal to 25 percent of the fund's total net asset value. Performance may also be extracted from a managed account program run by an FCM or IB if these same requirements are met. In other words, the FCM or IB must have previously prepared and distributed to all customers participating in the trading program a written report or similar document which designated the percentage of assets which would be committed toward that particular component of the overall trading program. Oral representations, or written documents which were not distributed to the customers, are not sufficient. Furthermore, any promotional material referring to extracted results must clearly label those results as such and must disclose in an equally prominent fashion the overall actual trading results from which the extracted results were drawn.

Lastly, the Board of Directors believes that the use of pro forma performance histories can present useful information to customers, particularly when used to show how the past performance of a given Member or Associate would have been affected by the commission or fee structure which applies to the futures or options contracts, commodity pool, or trading program the Member or Associate is offering, recommending, or providing information on. Therefore, a Member or Associate may use pro forma results to adjust for differences in commissions and fees as long as the pro forma results are not calculated in a misleading manner.

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Interpretive Notices

9033 - NFA COMPLIANCE RULE 2-29: DECEPTIVE ADVERTISING
(Board of Directors, June 4, 1996)

INTERPRETIVE NOTICE

NFA Compliance Rule 2-29 governs communications between NFA Members and the public. Among other things, the rule prohibits the use of promotional material which is misleading or deceptive. The Board's purposes in adopting this rule were to protect the public from fraudulent advertising and sales solicitations and to provide Members with specific guidance on the standards by which their promotional material would be judged.

Recently, a relative handful of Members have used strikingly similar promotional materials, usually in the form of radio or television advertising, which clearly violate both the letter and the spirit of NFA Compliance Rule 2-29. The core problem with all of these promotional materials is that they suggest the strong likelihood that customers will reap dramatic profits by investing with the Member firm when, in fact, nothing in the Member's experience provides any basis for those claims. Typically, these commercials employ a variety of techniques to mislead the public:

- **Claims Regarding Seasonal Trades-** Some Members have suggested almost certain profits from so-called seasonal trades in, among other things, heating oil and unleaded gas. These ads cite historical data which supposedly shows that certain trades produce dramatic profits year in and year out. Invariably, however, the "historical data" involves different products, different time frames or different fee structures. The most telling point, by far, is that the firm's customers have never experienced the types of profits touted by the Member.
- **Claims Regarding Historic Price Moves-** Another frequent theme in these misleading commercials or solicitations is the reference to historic price moves in particular commodities with a suggestion that the same record setting move is likely to occur now. For example, these promotional materials refer to times when sugar traded at $.66 per pound, gold at $800 per ounce and silver at $50 per ounce. By suggesting that a similar movement is imminent, the Member projects that customers can expect to double, triple or quadruple their investments in a short period of time. In point of fact, however, the Member has made similar claims in the past and its customers have never experienced such profits.
- **"Cherry Picked" Trades-** Occasionally, Members seek to entice prospective investors by claiming that their customers have made dramatic profits, for example, citing returns of 50 percent or more on particular trades. When asked to support these claims, the Members rely on isolated trades in specific customer accounts. What these Members fail to say in their commercials and solicitations is that those profitable trades are not at all representative of the overall performance either of that customer's account or its other customers and that, in fact, the customer referred to in the commercial has actually lost money overall.
- **Profit Projections-** Over and over, some Members claim that, based on current market conditions, customers can "turn $10,000 into $40,000," or profits of a similar magnitude. Again, however, the fact is that the Member has not produced anything like the projected profits for its customers in the past.

Each of the practices described above presents a distorted and misleading view of the likelihood of customers earning dramatic profits by investing with the Member firm, and each of these practices represents a clear violation of NFA sales practice rules. For those few firms which engage in such practices, the Board wishes to reiterate that Members may not engage in a pattern of advertising or solicitation which makes reference to dramatic profits which could be achieved in the future or could have been achieved in the past by trading futures or options contracts for a particular commodity or in the futures or options markets in general unless the Member can demonstrate to NFA that, based on the past performance of its customers, those claims are not misleading.

Any Member making the types of claims referred to above must be able to demonstrate to NFA upon request that the actual performance of its customers supports those claims. Failure to provide adequate documentation will constitute *prima facie* evidence that the promotional material is misleading.

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Interpretive Notices

9034 - NFA COMPLIANCE RULE 2-29: DECEPTIVE ADVERTISING
(Board of Directors, September 2, 1998)

INTERPRETIVE NOTICE

NFA Compliance Rule 2-29 prohibits the use of promotional material which is misleading or deceptive. The purpose of the rule is to protect the public from fraudulent advertising and sales solicitations and provide guidance to Members on the standards by which their promotional material will be evaluated.

In June 1996, NFA issued a Notice to Members (I-96-11) entitled "Deceptive Advertising." The notice described certain misleading advertising practices that some Members were employing, mainly in radio and TV ads. These included claims suggesting that so-called seasonal trades produce dramatic profits year-in and year-out; claims regarding historic price moves in particular commodities that suggested that the same record setting move was likely to occur again; claims of dramatic profits made by customers based on isolated trades in specific customer accounts (so-called "cherry picked" trades); and claims concerning projected profits, (e.g., "turn $10,000 into $40,000").

The June 1996 Notice made clear that NFA would regard these types of claims to be misleading and a clear violation of NFA sales practice rules unless the Member can demonstrate that based on the actual performance of its customers those claims are not misleading. Since the issuance of the June 1996 Notice, NFA has brought a number of disciplinary cases against Members who have employed misleading advertising techniques of the type described in the Notice. Recently, however, NFA has encountered variations of these types of advertising problems. Due to these recent developments, NFA considers it advisable to issue this supplemental Notice.

"MATHEMATICAL EXAMPLES OF LEVERAGE" AND DISCLAIMER STATEMENTS

NFA has consistently maintained that: 1) it is a violation of NFA's sales practice rules for a Member to mislead customers by suggesting that they have a high probability of achieving dramatic profits trading futures and options unless the Member's customers' performance validates such a claim; and 2) it is permissible for Members to use examples in their advertising to illustrate the effect of leverage in futures and options trading.

A problem that has developed is that some Members are improperly using "leverage examples" as a means of suggesting that prospective customers are likely to earn large profits trading futures and options when the past performance of the Members' customers does not support this claim. In some cases, Members will include disclaimer statements in their ads indicating that references to future profits are only "mathematical examples" of the effect of leverage and that no representation is made that any of the Member's customers has achieved or is likely to achieve profits similar to those in the example. Notwithstanding these disclaimers, the entire thrust of the ad is to convey exactly the opposite message. In these circumstances, disclaimer statements will not provide a safe harbor or insulate the Member from liability for a misleading ad which presents a distorted picture of the probability of success trading futures and options.

A variation of this technique involves highlighting the tremendous profits which will result from projected price movements which are characterized, directly or indirectly, as conservative estimates when, in fact, such price movements would be dramatic. Ads that use this technique are highly misleading.

USING PRICE MOVES FOR ONE PRODUCT TO SOLICIT INVESTORS FOR A DIFFERENT PRODUCT

An additional problem that NFA has noted with some recent ads, particularly those which refer to seasonal trades and historical prices, is that they refer to historical price data for different products than the investment products being sold. For example, ads for options often cite price data relating not to options but to cash or futures prices of the underlying commodity. This practice can be highly misleading. Options prices do not necessarily move in tandem with cash or futures prices. In fact, in many of these ads, the price of the options which are being sold only move a fraction of the price move in the underlying futures.

Historical pricing data must be for the product being marketed. Thus, if a Member is soliciting for options, then any pricing data that is used must refer to the historical premium value of the option that most closely resembles the type of option that is being marketed; it would be improper, for example, to cite historical price moves relating to at-the-money options when marketing out-of-the-money

options. Promotional material that uses historical price data for a product different from the one being marketed in the promotional material will be considered per se misleading and a violation of NFA's sales practice rules.

Examples of the types of ads that NFA will regard as misleading include:

- ads that use pricing data relative to the cash or futures markets to sell options
- ads that use pricing data for at-the-money options to sell out-of-the-money options
- ads that use pricing data which does not include commissions and fees comparable to those charged by the Member

An ad touting seasonal trades can also be misleading, even if it uses historical pricing data for the same product that is being offered for sale, if it cherry picks optimal entry and exit prices and suggests that they demonstrate a consistent price trend when no such consistent price trend exists. For example, it is misleading to claim that heating oil options always go up in value from summer lows to winter highs when heating oil - like all commodity markets - has peaks and valleys and one would incur losses during purported seasonal periods by buying at the high and selling at the low.

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Interpretive Notices

9039 - NFA COMPLIANCE RULES 2-29 AND 2-9: NFA'S REVIEW AND APPROVAL OF CERTAIN RADIO AND TELEVISION ADVERTISEMENTS
(Board of Directors, March 28, 2000)

INTERPRETIVE NOTICE

NFA Compliance Rule 2-29 governs communications between NFA Members and the public. Among other things, the rule prohibits the use of promotional material which is misleading or deceptive. The purpose of this rule is to protect the public from fraudulent advertising and sales solicitations and to provide guidance to Members on the standards by which their promotional material will be evaluated.

Over the last few years, NFA's Board of Directors ("Board") has become increasing concerned with several types of misleading radio and television advertisements that a small number of Member and non-Member firms are using with greater frequency. Though these problem ads vary somewhat, their consistent theme is that customers are likely to make substantial profits by following the sponsoring firm's recommendations. These advertisements hurt both the customers naive enough to believe the claims and the reputation of the industry. Though NFA's current compliance rules provide a basis for prosecuting the Members who either sponsor such ads or reap any benefits from the ads, the Board has always felt that it is better to prevent than prosecute fraud.

To achieve this goal, the Board recently amended NFA Compliance Rule 2-29 to add a new subsection (h) to require any Member firm using or directly benefiting from a radio or television advertisement that makes any specific trading recommendation or refers to or describes the extent of any profit obtained in the past or that can be achieved in the future to submit the advertisement to NFA's Promotional Material Review Team for its review and approval at least 10 days prior to first use. If additional information is needed, or the review cannot be completed within the 10 day period, the Member will be so notified. Obviously, NFA staff will not be able to independently verify the accuracy of every statement made in an advertisement within the 10 day review period; that responsibility remains with the Member. Therefore, submitting promotional material to NFA will not provide a "safe harbor" from NFA actions for Members if misstatements or omissions of material fact are discovered subsequently or NFA otherwise later determines that the material is in violation of standards set forth herein.

At this time, the Board also wishes to reiterate that two prior Notices to Members dated June 4, 1996 (I-96-11) and September 2, 1998 (I-98-15) describe particular fraudulent techniques that a relative handful of Members use in their radio and television advertisements. NFA's Business Conduct Committee ("BCC") has not hesitated to issue a number of Complaints against Member firms utilizing the techniques mentioned in those Notices. Furthermore, after recently reviewing the particular types of radio and television advertisements forming the basis of these BCC Complaints, the Board has directed staff to be particularly vigilant in reviewing radio and television advertisements containing specific trading recommendations and/or a description of past or future profits. In fact, the Board finds the content of certain advertisements to be inherently misleading and has further directed staff to disapprove of their usage. Typically, these advertisements include one or more of the following practices, each of which is described in the prior Notices:

- **Claims Regarding Seasonal Trades**: These ads cite seasonal data which supposedly shows that certain trades produce dramatic profits year in and year out in such products as heating oil in the winter and unleaded gas in the summer.
- **Claims Regarding Historic Price Moves** - These ads refer to historic price moves in particular commodities such as sugar when it was trading at $0.66 per pound, gold at $800 per ounce and silver at $50, with a suggestion that the same record setting move is likely to occur again.
- **Claims Regarding Price Movements** - These ads highlight the tremendous profits which will result from projected price movements which are characterized, directly or indirectly, as conservative estimates when, in fact, such price movements would be dramatic.
- **Claims Using Certain Pricing Data** - These ads use price data for a product different from the one being marketed in the promotional material. Examples of these types of ads include: ads that use pricing data relative to the cash or futures markets to sell options; ads that use pricing data for at-the-money options to sell out-of-the money options; and ads that use pricing data that do not include commissions and fees comparable to those charged by the Member.
- **Claims Containing Profit Projections** - These ads claim that customers can turn a $10,000 investment into $25,000 or make

similar types of dramatic profit projections.

- **Claims Containing "Cherry Picked" Trades** - These ads seek to entice prospective investors by claiming that their customers have made dramatic profits; however, such claims rely on isolated trades in specific customer accounts.
- **Claims Regarding Mathematical Examples of Leverage** - These ads improperly use "leverage examples" as a means of suggesting that prospective customers are likely to earn large profits trading futures and options.

It is important to note that this list of deceptive advertising techniques is not all inclusive. Each of the practices described above presents a distorted and misleading view of the likelihood of customers earning dramatic profits by investing with the Member, and each of these practices represents a clear violation of NFA's sales practice rules.

Finally, one additional issue relating to advertising occurs when a Member benefits from the use of a "blind ad." Specifically, some Members attempt to evade NFA's advertising requirements by purchasing leads from non-Members that run misleading radio and television commercials basically identical to those prosecuted by NFA's BCC. These ads do not identify any particular Member firm and invite the viewer to call a toll-free number to obtain more information. The non-Member then sells the resulting leads to a Member firm, which then claims that it has no responsibility for the content of the ad. Members can not evade their supervisory responsibilities by buying leads from such firms.

NFA Compliance Rule 2-9 requires each Member to diligently supervise its employees and agents in the conduct of their commodities futures activities. The CFTC has brought cases against companies that run "blind ads" and has alleged that they are, in fact, soliciting orders and are required to be registered as IBs. In addition to a Member's responsibilities under NFA Bylaw 1101, the Board believes that Member firms have a supervisory duty to ensure, to the extent possible, that their employees and agents are not purchasing leads from non-Members required to be registered and/or using fraudulent advertising practices.

In many instances, a Member firm will have direct knowledge of the source of leads that the Member purchases. For example, the Member firm purchases leads from a provider that generates leads solely incidental to some other business purpose (e.g., a subscription list). However, in the event a Member firm does not have direct knowledge, then the Member firm has a duty to inquire as to the source of leads. Specifically, under those circumstances, a Member firm has an affirmative duty to determine if the leads were generated from a provider using any type of advertisement soliciting investments in futures, one of whose business purposes is the generation and sale of the leads. If a Member firm purchases leads from such a provider, then the Member must ensure, prior to soliciting any customer with the leads, that the lead provider submitted the advertisement to NFA for review and approval pursuant to Compliance Rule 2-29(h). If the advertisement was not approved by NFA, then the Member is not permitted to solicit any customer with the leads purchased from that provider.

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Interpretive Notices

9055 - NFA BYLAW 1101, COMPLIANCE RULES 2-9 AND 2-29: GUIDELINES RELATING TO THE REGISTRATION OF THIRD-PARTY TRADING SYSTEM DEVELOPERS AND THE RESPONSIBILITY OF NFA MEMBERS FOR PROMOTIONAL MATERIAL THAT PROMOTES THIRD-PARTY TRADING SYSTEM DEVELOPERS AND THEIR TRADING SYSTEMS
(Board of Directors, August 19, 2004; effective January 10, 2005)

INTERPRETIVE NOTICE

In recent years, there has been a significant increase in the number of futures trading systems being marketed to the public. These trading systems typically are computerized programs that generate signals as to when to buy and sell commodity futures and options contracts.

A number of NFA Member firms offer trade execution services to customers who use these computerized trading systems, many of which are developed by third-party trading system developers ("third-party system developers"), who are neither NFA members nor registered with the CFTC. Typically, in these situations, the customer will execute a Letter of Direction that directs the Member to place trades for the customer in strict accordance with the signals generated by the trading system. In some cases, the Letter of Direction is more limited and includes instructions to follow only certain signals (e.g., signals in given contracts or signals that meet particular parameters). In almost all cases in which a Letter of Direction is used, the Member is not permitted to use any judgment when placing orders for the customer.

This notice is designed to provide guidance as to the circumstances which may give rise to liability on the part of the Member, under NFA Bylaw 1101, for providing execution services to users of computerized trading systems developed by non-Member third-party system developers. This notice will also discuss the factors that may cause a Member to be responsible, under NFA Compliance Rule 2-29, for promotional material which promotes these trading systems and the Member's supervisory obligations under NFA Compliance Rule 2-9.

REGISTRATION REQUIREMENTS FOR
THIRD-PARTY SYSTEM DEVELOPERS

Section 1a (6) of the Commodity Exchange Act ("CEA") defines a CTA as any person who for compensation or profit, engages in the business of advising others, directly or through publications, writings, or electronic media, as to the value of or the advisability of trading commodity futures. Generally, Section 4m of the CEA requires individuals who fall within this definition to register with the CFTC. In March 2000, the CFTC adopted CFTC Rule 4.14(a)(9) to create an exemption from the CEA's registration requirements for CTAs that provide standardized advice by means of media such as newsletters, pre-recorded telephone hotlines, Internet web sites, and non-customized computer software.

To qualify for the exemption, under Rule 4.14(a)(9)(i) a CTA may not direct client accounts. As defined by Commission Rule 4.10(f), `` [d]irect, as used in the context of trading commodity interest accounts, refers to agreements whereby a person is authorized to cause transactions to be effected for a client's commodity interest account without the client's specific authorization." In a Commission Staff letter issued in May 2003, Commission Staff indicated that an agreement authorizing a person to direct a client's account - and, thus, requiring the person to be registered as a CTA - may be an informal agreement. The fact pattern addressed by the Commission's Staff letter involved a developer of a computerized trading system who was registered as an associated person ("AP") of an introducing broker ("IB"). The AP's activities on behalf of the IB consisted solely of soliciting clients to use his trading program. Such clients executed a "letter of direction" providing that the IB should execute trades for the clients' accounts and "follow [the trading program] signals as close as reasonably possible."

In analyzing the above fact pattern, Commission Staff concluded that, since the clients' contact with the AP/trading system developer included not only the trading program, but also the opening of a trading account that would be traded pursuant to a "letter of direction," there was an "informal arrangement", for which the exemption provided under Rule 4.14(a)(9) was not intended. After specifically noting that the "whole of [the AP/trading system developer's] activities as an AP of the IB consisted of the solicitation of clients for the trading program, CFTC staff determined that registration as a CTA was required of either the IB or the AP. (See CFTC staff letter, No. 03-26, May 30, 2003, re Section 4m - Interpretation with regard to Commodity Trading Advisor Registration.)

Rule 4.14(a)(9)(ii) also provides that, to qualify for the exemption, a CTA may not provide "commodity trading advice based on, or

tailored to, the commodity interest or cash market positions or other circumstances or characteristics of particular clients." So long as the CTA's advice is based on or tailored to such information, the CTA is required to register even if it gives the same advice to groups of similarly situated clients.

In determining whether advice is "based on or tailored to" within the meaning of 4.14 (a)(9)(ii), the context of the advice will be taken into account. For example, if the advice is provided in a book or a periodical, that factor may weigh against a finding that the CTA is providing advice "based on or tailored to" the characteristics of particular clients. On the other hand, if the advice is provided to a particular client in a face-to-face communication or over the telephone, that factor may weigh in favor of a finding that the CTA's advice is "based on or tailored to" that particular customer's characteristics, since such a context suggests that the CTA is being responsive to the client's individual needs.[1]

Whether a third-party system developer is required to be registered as a CTA still depends on the particular facts of each case. In some cases, the third-party system developer - or any third-party, for that matter - may be required to register as an IB, if it refers customers to an NFA Member and receives compensation for the referrals. Members who have questions concerning the application of Rule 4.14 are urged to seek advice from the CFTC.

Regardless of whether a third-party system developer is required to register as a CTA, the question sometimes arises whether the IBs involved must also register as CTAs. If the IB and the third-party system developer are operated as wholly independent entities and the IB has no authority to deviate from the third-party system developer's recommendations, generally the IB need not also register as a CTA. This is clearly the case where a customer independently selects a trading system and the IB does not solicit discretionary trading authority. However, if any of these factors change (e.g., the IB has authority to deviate from the trading system by selecting only some of the trades generated by the system), the IB may be required to register as a CTA, unless the IB is otherwise exempt because its activities related to placing trades based on the recommendations of the trading system are "solely in connection with its business as an IB."

NFA Bylaw 1101 provides, in pertinent part, that no Member may carry an account, accept an order or handle a transaction in commodity futures on behalf of any non-Member that is required to be registered as a CTA or in some other capacity. Therefore, if it appears that a third-party system developer, with whom an NFA Member does business, is required to be registered as a CTA or in some other capacity, the Member should request that the third-party system developer provide a letter from counsel stating the reasons why registration is not required.[2] In the absence of such a letter, the Member should request that the third-party system developer apply for registration and NFA membership. If the third-party system developer fails or refuses to register and become an NFA Member, the Member should terminate its relationship with the third-party system developer to avoid liability under NFA Bylaw 1101.

A MEMBER'S RESPONSIBILITY FOR MISLEADING PROMOTIONAL MATERIAL WHICH PROMOTES A THIRD-PARTY SYSTEM DEVELOPER'S TRADING PROGRAM

NFA has encountered, with increasing frequency in recent years, misleading promotional material promoting trading systems developed by third-party system developers, who are not NFA Members, and for which an NFA Member provides trade execution services. Often this promotional material uses hypothetical or simulated results - which are trading results not achieved by an actual account - that are not clearly identified as hypothetical and show impressive gains, when customers actually using the trading system have suffered substantial losses. In this and other contexts, both NFA and the Commission have brought numerous enforcement actions charging fraud in the use of such promotional material.

Following are several examples of situations where Members may be held accountable under Compliance Rules 2-29 and 2-9 for misleading promotional material that promotes third-party trading system developers and their trading systems.

Direct Responsibility

If an NFA Member or its Associates prepare or distribute the promotional material, the Member will be responsible for its misleading content under NFA Compliance Rule 2-29, which prohibits a Member from using misleading or deceptive promotional material.

Agency Responsibility

NFA's Business Conduct Committee has always recognized that each Member is responsible for the acts of its agents. This certainly applies to the preparation of advertising material. Thus, an NFA Member may be responsible, under NFA Compliance Rule 2-29, for misleading promotional material prepared and disseminated by a third-party trading system developer, whether or not the third-party trading system developer is an NFA Member or not, if there is an agency relationship between the NFA Member and the third-party trading system developer. (Of course, if the third-party trading system developer is also an NFA Member, it too would be responsible under NFA Compliance Rule 2-29 for the misleading promotional material that it prepared and distributed.)

In determining whether there is an agency relationship between the Member and the third-party system developer, which would trigger liability under NFA Compliance Rule 2-29, the central inquiry focuses on the nature of the business relationship between the parties and whether the parties have expressly or implicitly agreed that one may act for the other. As the CFTC has held, whether an agency relationship exists turns "on an overall assessment of the totality of the circumstances in each case." The more limited the contacts are between the third-party system developer and the NFA Member, the more likely it is that an agency relationship will not be found to exist between the parties.

If there is an agency relationship between the Member and the third-party system developer, then the Member has an affirmative duty, under NFA Compliance Rule 2-9, to supervise the activities of the third-party system developer/agent.

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Supervisory Responsibility Under NFA Compliance Rule 2-9

Even where no agency relationship exists, a Member whose web site links to or otherwise refers customers to a third-party system developer or has a referral agreement with a third-party trading system developer should conduct a due diligence inquiry into the system developer's advertising practices with a view towards identifying and avoiding the misleading advertising practices described earlier, i.e., the use of exaggerated profit claims, and hypothetical or simulated results which are not clearly identified as hypothetical, or which show highly profitable performance when actual customers trading the system have sustained significant losses.[3]

The fact that a Member creates a hyperlink from its web site or otherwise refers customers to a third-party system developer or has a referral agreement with a third-party system developer does not, in and of itself, make the Member firm accountable for the third-party system developer's web site or promotional material. Member firms should bear in mind, though, that their supervisory obligations under Rule 2-9 and Rule 2-29 require them to diligently supervise their employees and agents who are responsible for creating and maintaining hyperlinks to web sites of third-party system developers; or establishing referral agreements with third-party system developers. Members should consider whether appropriate supervisory procedures include periodic inquiries as to whether their employees and agents are conducting due diligence with respect to the third-party system developer's web site or advertising, and taking appropriate steps if deficiencies are found in such web site or advertising. A Member's failure to supervise its employees and agents in this regard will constitute a violation of NFA Compliance Rule 2-9 on the part of the Member. Moreover, in these situations, Member firms should not seek to circumvent NFA's promotional material requirements by relying upon the unregistered status of the third-party trading system developer.

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[1] The Commission gives a number of examples, which illustrate the application of Rule 4.14(a)(9) in specific situations, in the Rule's publication in the Federal Register. (Federal Register: March 10, 2000 (Volume 65, Number 48, pages 12938-12943.)

[2] Member firms may rely in good faith upon a copy of a letter from counsel. However, in some cases, a Member may have to perform additional due diligence to ascertain whether a third-party system developer is required to be registered.

[3] *See* also NFA's interpretive notice entitled "NFA Compliance Rule 2-9: Supervisory Procedures for E-Mail and the Use of Web Sites" (paragraph 9037).

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Compliance Rules

RULE 2-30. CUSTOMER INFORMATION AND RISK DISCLOSURE.
[Adopted effective June 1, 1986. Effective date of amendments: January 1, 1990, August 21, 2001 December 10, 2002, December 17, 2007]

(a) Each Member or Associate shall, in accordance with the provisions of this Rule, obtain information about its futures customers who are individuals and provide such customers with disclosure of the risks of futures trading.

Effective January 3, 2011, paragraph (a) will read as follows:

(a) Each Member or Associate shall, in accordance with the provisions of this Rule, obtain information from all individual customers and any other customers who are not eligible contract participants (as defined in Section 1(a)(12) of the Act) and provide such customers with disclosure of the risks of futures trading.

(b) The Member or Associate shall exercise due diligence to obtain the information and shall provide the risk disclosure at or before the time a customer first opens a futures trading account to be carried or introduced by the Member, or first authorizes the Member to direct trading in a futures account for the customer. A Member registered as a broker or dealer under Section 15(b)(11) of the Exchange Act shall provide a copy of the disclosure statement for security futures products at or before the time the Member approves the account to trade security futures products.

Effective January 3, 2011, paragraph (b) will read as follows:

(b) The Member or Associate shall exercise due diligence to obtain the information and shall provide the risk disclosure at or before the time a customer first opens a futures trading account to be carried or introduced by the Member, or first authorizes the Member to direct trading in a futures account for the customer. A Member registered as a broker or dealer under Section 15(b)(11) of the Exchange Act shall provide a copy of the disclosure statement for security futures products at or before the time the Member approves the account to trade security futures products. For an active customer who is an individual, the FCM Member carrying the customer account shall contact the customer, at least annually, to verify that the information obtained from that customer under Section (c) of this Rule remains materially accurate, and provide the customer with an opportunity to correct and complete the information. Whenever the customer notifies the FCM Member carrying the customer's account of any material changes to the information, a determination must be made as to whether additional risk disclosure is required to be provided to the customer based on the changed information. If another FCM or IB introduces the customer's account on a fully disclosed basis or a CTA directs trading in the account, then the carrying FCM must notify that Member of the changes to the customer's information. The Member or Associate who currently solicits and communicates with the customer is responsible for determining if additional risk disclosure is required to be provided based on the changed information. In some cases, this may be the Member introducing or controlling the account; in other cases, it may be the carrying FCM.

(c) The information to be obtained from the customer shall include at least the following:

(1) the customer's true name and address, and principal occupation or business;

(2) the customer's current estimated annual income and net worth;

(3) the customer's approximate age; and

(4) an indication of the customer's previous investment and futures trading experience;

In addition, Members that are not also members of the Financial Industry Regulatory Authority and their Associates must obtain the following information from each customer who is an individual if the customer trades security futures products:

(5) whether the customer's account is for speculative or hedging purposes;

(6) the customer's employment status (e.g., name of employer, self-employed, retired);

(7) the customer's estimated liquid net worth (cash, securities, other);

(8) the customer's marital status and number of dependents;

(9) such other information used or considered to be reasonable by such Member or Associate in making recommendations to the customer.

Effective January 3, 2011, paragraph (c) will read as follows:

(c) The information to be obtained from the customer shall include at least the following:

(1) The customer's true name and address, and principal occupation or business;

(2) For customers who are individuals, the customer's current estimated annual income and net worth. For all other customers, the customer's net worth or net assets and current estimated annual income, or where not available, the previous year's annual income;

(3) For individuals, the customer's approximate age or date of birth;

(4) An indication of the customer's previous investment and futures trading experience; and

(5) Such other information deemed appropriate by such Member or Associate to disclose the risks of futures trading to the customer.

In addition, Members that are not also members of the Financial Industry Regulatory Authority and their Associates must obtain the following information from each customer who is an individual if the customer trades security futures products:

(6) Whether the customer's account is for speculative or hedging purposes;

(7) The customer's employment status (e.g., name of employer, self-employed, retired);

(8) The customer's estimated liquid net worth (cash, securities, other);

(9) The customer's marital status and number of dependents;

(10) Such other information used or considered to be reasonable by such Member or Associate in making recommendations to the customer.

(d) The risk disclosure to be provided to the customer shall include at least the following:

(1) the Risk Disclosure Statement required by CFTC Regulation 1.55, if the Member is required by that Regulation to provide it;

(2) the Disclosure Document required by CFTC Regulation 4.31, if the Member is required by that Regulation to provide it;

(3) the Options Disclosure Statement required by CFTC Regulation 33.7, if the Member is required by that Regulation to provide it; and

(4) the Disclosure Document required by CFTC Regulation 31.11, if the Member is required by that Regulation to provide it.

(e) In the case of an account which is introduced by an FCM or IB or for which a CTA directs trading, and except as otherwise provided in subsections (b) and (j), it shall be the responsibility of the Member soliciting the account to comply with this Rule.

(f) A Member or Associate shall be entitled to rely on the customer [as the sole source] for the information obtained under Section (c) of this Rule and shall not be required to verify such information, except as provided in section (j)(2) of this rule.

(g) Each Member or Associate shall make or obtain a record containing the information obtained under Section (c) of this Rule at the time the information is obtained. If a customer declines to provide the information set forth in Section (c) of this Rule, the Member or Associate shall make a record that the customer declined, except that such a record need not be made in the case of a non-U.S. customer unless such customer trades security futures products. Subject to the provisions of Section (i) of this Rule, a Member may open, introduce or agree to direct a futures trading account for a customer only upon the approval of a partner, officer, director, branch office manager or supervisory employee of the Member. Each Member shall keep copies of all records made pursuant to this Rule in the form and for the period of time set forth in CFTC Regulation 1.31.

(h) Each Member shall establish and enforce adequate procedures to review all records made pursuant to this Rule and to supervise the activities of its Associates in obtaining customer information and providing risk disclosure.

(i) Nothing herein shall relieve any Member from the obligation to comply with all applicable CFTC and SEC Regulations and NFA Requirements.

(j) Members that are not also members of the Financial Industry Regulatory Authority and their Associates shall adhere to the following additional requirements relating to accounts for customers that trade security futures products:

(1) A Member shall exercise due diligence to learn the essential facts relative to the customer, including the customer's investment objectives and financial situation and, based upon those facts (including any information obtained under subsection (c) of this Rule, if applicable), a partner, officer, director, branch office manager, or supervisory employee of the Member shall approve or disapprove the customer's account for security futures transactions. If the Member is an FCM or IB, the account must be approved or disapproved by a designated security futures principal. The approval or disapproval shall be in writing and shall identify the person approving or

disapproving the account. Additionally, the customer's account records shall contain information about the account, including the name of the Associate, how the customer's information was obtained, and the date that the disclosure statement for security futures products was provided.

(2) A Member or Associate shall forward the background and financial information upon which the customer's account has been approved for trading security futures products to each customer who is an individual, unless the information has been obtained in writing from the customer, for verification of accuracy within fifteen days after the customer's account has been approved. A copy of the background and financial information on file with the Member shall also be sent to each customer who is an individual for verification within fifteen days after the Member becomes aware of any material change in the customer's financial status. In all cases, absent notice to the contrary from the customer, the information is deemed verified.

(3) No FCM or IB Member or Associate thereof shall recommend to a non-institutional customer a transaction in security futures products or a particular trading strategy relating to such products without making reasonable efforts to obtain current information regarding the customer's financial status and investment objectives; provided, however, that this requirement does not apply to transactions in discretionary accounts. For purposes of this requirement, a non-institutional customer is any customer who is not:

(i) a bank, savings and loan association, insurance company, registered investment company, a registered commodity pool operator, or a commodity pool operated by a registered commodity pool operator;

(ii) an investment advisor registered either with the Securities and Exchange Commission under Section 203 of the Investment Advisers Act of 1940 or with a state securities commission (or any agency or office performing like functions) or a registered commodity trading advisor;

(iii) an investment company exempt from registration under the Investment Company Act of 1940, a commodity pool operator exempt from registration under the Commodity Exchange Act, a commodity pool operated by a commodity pool operator exempt from registration under the Commodity Exchange Act, an investment advisor exempt from both federal and state registration under the Investment Advisers Act of 1940, or a commodity trading advisor exempt from registration under the Commodity Exchange Act;

(iv) a registered broker-dealer or futures commission merchant; or

(v) any other entity (whether a natural person, corporation, partnership, trust, or otherwise) with total assets of at least $50 million.

(4) No FCM or IB Member or Associate thereof shall recommend to any customer a transaction in security futures products or a particular trading strategy relating to such products without reasonable grounds for believing that the recommendation or strategy is not unsuitable for the customer on the basis of the customer's current investment objectives, financial situation and needs, and any other information known by the Member or Associate.

(5) No FCM or IB Member or Associate shall recommend a security futures transaction to a customer unless the person making the recommendation has a reasonable basis for believing, at the time of making the recommendation, that the customer has such knowledge and experience in financial matters that the customer may reasonably be expected to be capable of evaluating the risks of the recommended transaction, and is financially able to bear the risks of the recommended transaction.

(6) No Member or Associate exercising discretion over an account may effect security futures transactions that are excessive in size or frequency in view of the customer's investment objectives and financial situation.

[See Interpretive Notice NFA Compliance Rule 2-30: Customer Information and Risk Disclosure (Board of Directors) and Interpretive Notice NFA Compliance Rule 2-30: Customer Information and Risk Disclosure (Staff).]

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Interpretive Notices

9004 - NFA COMPLIANCE RULE 2-30: CUSTOMER INFORMATION AND RISK DISCLOSURE
(Board of Directors, effective June 1, 1986)

INTERPRETIVE NOTICE

I. Introduction

NFA Compliance Rule 2-4 requires Members to observe high standards of commercial honor and just and equitable principles of trade in the conduct of their futures business. NFA's FCM Advisory Committee ("the Committee") has been considering ways in which the general standard of Rule 2-4 can be further defined in order to develop uniform industrywide standards which will offer guidance to the Members. In the course of its work the Committee noted the increasing level of commentary, in public and regulatory forums, on the absence of a "know your customer" or "suitability" rule in the futures industry and a perception on the part of some that there is a concomitant lack of protection for futures customers. NFA's Executive Committee also became aware of these comments and asked the Committee to study the matter and make appropriate recommendations. Based on its knowledge and experience in the industry, the Committee believed that any careful consideration of this issue would have to take into account the important role that risk disclosure plays whenever a customer opens a futures account or selects a commodity trading advisor, and the extent to which futures professionals were already obtaining information about their customers.

To learn more about the current level of inquiry conducted through the new account opening procedures now being used in the industry, NFA sent a questionnaire to all of its Members. The Committee also reviewed research on the evolution of the suitability and "know your customer" doctrines in the securities industry and noted that although there are several different formulations of the rule, all are based on the same premise: that different types of securities can have widely varying degrees of risk potential and serve very different investment objectives. For that reason, the securities suitability rules are cast in terms of the suitability of a particular transaction.

The Committee noted that the futures industry differs from the securities industry in several crucial ways. Most importantly, futures contracts in general are recognized as highly volatile instruments. It therefore makes little sense to presume that a certain futures trade may be appropriate for a customer while others are not. An appreciation of the risks of futures trading must be gained and a determination of its appropriateness made at the time each customer makes a decision to trade futures in the first place. This is true regardless of whether the customer will rely on recommendations by futures professionals or the customer will make his or her own trading decisions.

The futures industry has traditionally met this need through risk disclosure designed to encourage the customer to make an informed decision as to whether futures trading is suitable for that customer. The Risk Disclosure Statement and the Options Disclosure Statement mandated by CFTC Regulations 1.55 and 33.7, respectively, and the Disclosure Document required by the CFTC Part 4 Regulations each are designed to bring the suitability issue to the customer's attention.[1]

In the specific area of exchange-traded options, the CFTC has previously noted the importance of risk disclosure and the need for the futures professional to learn enough about the customer in order to provide risk disclosure. When the Options Disclosure Statement requirement was enacted in 1981 as part of the options pilot program, the CFTC stated in its Federal Register release [46 Fed. Reg. 54500 (1980-82 Transfer Binder) Comm. Fut. L. Rep. (CCH) 21,263] that:

> ". . . the FCM must acquaint itself sufficiently with the personal circumstances of each option customer to determine what further facts, explanations and disclosures are needed in order for that particular option customer to make an informed decision whether to trade options . . . . While this requirement is not a "suitability" rule as such rules have been composed in the securities industry, before the opening of an option account the FCM has a duty to acquaint itself with the personal circumstances of an option customer."

The CFTC went on to state that "the extent of the inquiry should be left to the prudent judgment of the FCM."

NFA was concerned that allowing suitability or know your customer standards to develop outside of the self-regulatory framework carried with it the possibility that a poorly defined or inappropriate duty would be fashioned on a case-by-case basis, perhaps by ill-considered analogy to the securities industry rules. Because NFA construes its rules on a case-by-case basis through the decisions of

the Business Conduct Committees ("BCCs") which are composed of informed futures professionals, NFA is uniquely positioned to set an ethical business standard which will be construed by Members evaluating the conduct of other Members.

The Committee determined that the exchange of information between a new customer and a futures professional -- the customer providing personal data and the Member providing disclosure about the risks of futures trading -- was the focal point around which to structure a sound customer protection rule. On August 9, 1985, the Committee released for public comment a Proposed Rule on Customer Information and Risk Disclosure. The comments received were considered in the drafting of the Rule in final form, and Rule 2-30 was adopted by NFA's Board of November 21, 1985.

When the CFTC declined in 1978 to adopt a "suitability" rule, after releasing a proposed rule for comment, it stated that it was unable "to formulate meaningful standards of universal application." [43 Fed. Reg. 31886 (1977-1979 Transfer Binder) Comm. Fut. L. Rep. (CCH) 20,642] NFA found the same difficulty, and for that reason the Rule is premised on NFA's conclusion that the customer is in the best position to determine the suitability of futures trading if the customer receives an understandable disclosure of risks from a futures professional who "knows the customer." NFA believes that the approach taken in Rule 2-30 is preferable to one which would erect an inflexible standard that would bar some persons from using the futures markets.

Effective January 3, 2011, section I. Introduction will read as follows:

I. Introduction

NFA Compliance Rule 2-4 requires Members to observe high standards of commercial honor and just and equitable principles of trade in the conduct of their futures business. NFA's Advisory Committees ("the Committees") have been considering ways in which the general standard of Rule 2-4 can be further defined in order to develop uniform industrywide standards which will offer guidance to the Members. In the course of their work, the Committees noted the increasing level of commentary, in public and regulatory forums, regarding the comparability between the futures industry's "know your customer" requirements and the "suitability" rules in the securities industry. The Committees noted that suitability has a tendency to act as a recurrent red herring to criticize customer protection in the futures industry. NFA's Executive Committee also became aware of these comments and asked the Committees to study the matter and make appropriate recommendations. Based on their knowledge and experience in the industry, the Committees believe that any careful consideration of this issue should continue to take into account the important role that risk disclosure plays whenever a customer opens a futures account or selects a commodity trading advisor.

In addressing this issue, the Committees reviewed research on the evolution of the suitability and "know your customer" doctrines in the securities industry and noted that although there are several different formulations of the rule, all are based on the same premise: that different types of securities can have widely varying degrees of risk potential and serve very different investment objectives. For that reason, the securities suitability rules are cast in terms of the suitability of a particular transaction.

The Committees noted that the futures industry differs from the securities industry in several crucial ways. Most importantly, futures contracts in general are recognized as highly volatile instruments. It therefore makes little sense to presume that a certain futures trade may be appropriate for a customer while others are not. An appreciation of the risks of futures trading must be gained and a determination of its appropriateness made at the time each customer makes a decision to trade futures in the first place. This is true regardless of whether the customer will rely on recommendations by futures professionals or the customer will make his or her own trading decisions.

The futures industry has traditionally met this need through risk disclosure designed to encourage the customer to make an informed decision as to whether futures trading is suitable for that customer. The Risk Disclosure Statement and the Options Disclosure Statement mandated by CFTC Regulations 1.55 and 33.7, respectively, and the Disclosure Document required by the CFTC Part 4 Regulations each are designed to bring the suitability issue to the customer's attention.[1]

In the specific area of exchange-traded options, the CFTC has previously noted the importance of risk disclosure and the need for the futures professional to learn enough about the customer in order to provide risk disclosure. When the Options Disclosure Statement requirement was enacted in 1981 as part of the options pilot program, the CFTC stated in its Federal Register release [46 Fed. Reg. 54500 (1980-82 Transfer Binder) Comm. Fut. L. Rep. (CCH) 21,263] that:

> ". . . the FCM must acquaint itself sufficiently with the personal circumstances of each option customer to determine what further facts, explanations and disclosures are needed in order for that particular option customer to make an informed decision whether to trade options . . . . While this requirement is not a "suitability" rule as such rules have been composed in the securities industry, before the opening of an option account the FCM has a duty to acquaint itself with the personal circumstances of an option customer."

The CFTC went on to state that "the extent of the inquiry should be left to the prudent judgment of the FCM."

NFA has always been concerned that allowing suitability or know your customer standards to develop outside of the self-regulatory framework carries with it the possibility that a poorly defined or inappropriate duty would be fashioned on a case-by-case basis, perhaps by an ill-considered analogy to the securities industry rules. Because NFA construes its rules on a case-by-case basis through the decisions of the Business Conduct Committee ("BCC") which is composed of informed futures professionals and non-Members, NFA is uniquely positioned to set an ethical business standard to evaluate the conduct of other Members.

The Committees determined that the exchange of information between a new customer and a futures professional -- the customer providing personal data and the Member providing disclosure about the risks of futures trading -- was the focal point around which to structure a sound customer protection rule. On August 9, 1985, the FCM Advisory Committee released for public comment a

Proposed Rule on Customer Information and Risk Disclosure. The comments received were considered in the drafting of the Rule in final form, and Rule 2-30 was adopted by NFA's Board on November 21, 1985. In 2010, in an effort to tighten the Rule's requirements in light of the changes in the futures industry, NFA adopted modifications to NFA Compliance Rule 2-30 that: (1) expand the customers covered by the rule to reach all non-ECPs rather than just individuals; (2) require Members to at least annually refresh customer information and reassess appropriate risk disclosure, including a determination of whether futures trading is too risky for the customer, based on any materially changed information; and (3) prohibit Members and Associates from making individualized recommendations to those customers whom the Member or Associate has or should have advised that futures trading is too risky for them.

When the CFTC declined in 1978 to adopt a "suitability" rule, after releasing a proposed rule for comment, it stated that it was unable "to formulate meaningful standards of universal application." [43 Fed. Reg. 31886 (1977-1979 Transfer Binder) Comm. Fut. L. Rep. (CCH) 20,642] NFA found the same difficulty, and for that reason the Rule is premised on NFA's conclusion that the customer is in the best position to determine the suitability of futures trading if the customer receives an understandable disclosure of risks from a futures professional who "knows the customer." NFA believes that the approach taken in Rule 2-30 is preferable to one which would erect an inflexible standard that would bar some persons from using the futures markets.

II. Section-by-Section Analysis

Section (a): General Rule

Rule 2-30 is intended to define "high standards of commercial honor and just and equitable principles of trade" as applied to a Member's procedures for exchanging information with new futures customers at the time they become customers[2]. Section (a) sets forth the basic requirement: obtain information and provide risk disclosure which includes the disclosures required by the Rule plus, in some cases, additional disclosure. Rule 2-30 is a "know your customer" rule; however, it does not require the Member or Associate to make the final determination that a customer should be barred from futures trading on suitability grounds. Some "know your customer" rules in the securities industry (New York Stock Exchange Rule 405, for example) have been construed in that manner; these interpretations do not apply to Rule 2-30.

NFA's enactment of the Rule 2-30 should not be construed to expose Members to increased potential liability for damages in customer litigation or reparation proceedings, for several reasons. First, a business conduct standard promulgated by a self-regulatory organization does not create a private cause of action. Furthermore, Rule 2-30 is not an antifraud rule. In order to prove a violation, there is no requirement to prove any intent on the part of the Member to deceive. Therefore, evidence of a violation of Rule 2-30 would not in and of itself constitute evidence of a violation of any antifraud rule or statute. Finally, to the extent that personal information about a customer is germane to the issues in a reparations or arbitration case, it is undoubtedly already being considered even in the absence of a formal rule requiring Members to obtain it.

Section (a) provides that the Rule applies only to customers who are individuals; this includes individuals who open accounts jointly with others. Although accounts opened by business entities such as corporations and partnerships present other concerns (such as compliance with NFA Bylaw 1101, which prohibits Members from transacting customer business with non-Members who are required to be registered), the scope of Rule 2-30 is limited to natural persons, who may lack the sophistication of institutional customers.

Effective January 3, 2011, Section (a) will read as follows:

Section (a): General Rule

Rule 2-30 is intended to define "high standards of commercial honor and just and equitable principles of trade" as applied to a Member's procedures for exchanging information with new futures customers at the time they become customers[2]. Section (a) sets forth the basic requirement: obtain information and provide risk disclosure, which includes the disclosures required by the Rule plus, in some cases, additional disclosure. Rule 2-30 is a "know your customer" rule; however, it does not require the Member or Associate to make the final determination that a customer should be barred from futures trading on suitability grounds.

NFA's enactment of the Rule 2-30 should not be construed to expose Members to increased potential liability for damages in customer litigation or reparation proceedings, for several reasons. First, a business conduct standard promulgated by a self-regulatory organization does not create a private cause of action. Furthermore, Rule 2-30 is not an antifraud rule. In order to prove a violation, there is no requirement to prove any intent to deceive on the part of the Member. Therefore, evidence of a violation of Rule 2-30 would not in and of itself constitute evidence of a violation of any antifraud rule or statute. Finally, to the extent that personal information about a customer is germane to the issues in a reparations or arbitration case, it is undoubtedly already being considered even in the absence of a formal rule requiring Members to obtain it.

Section (a) provides that the Rule applies to all individual customers and any other customers who are not eligible contract participants (as defined in Section 1(a)(12) of the Act), including all parties to a joint account. Members should be aware that regardless of whether they collect information from certain non-individual customers pursuant to Rule 2-30, accounts opened by business entities such as corporations and partnerships may also present other concerns (such as compliance with NFA Bylaw 1101, which prohibits Members from transacting customer business with non-Members who are required to be registered).

Section (b): New Customers

The Member's obligation to obtain information and provide risk disclosure under the Rule is limited to the first time the customer

establishes a futures account with the Member. This limitation was the result of the balancing of the benefits of repeated information exchange against the burden of imposing additional requirements on the already extensive account-opening procedures for subsequent accounts for the same customers[3].

Effective January 3, 2011, Section (b) will read as follows:

Section (b): Customer Information - Frequency

For customers who are individuals, the Member's obligation to obtain information and provide risk disclosure under the Rule is not limited to the first time the customer establishes a futures account with the Member. At least annually, the FCM Member that carries the customer account is also required to request updated information from any active customer who is an individual. The term active customer means any customer who was entitled to a monthly account statement under the provisions of CFTC Regulation 1.33(a) at any time during the preceding year[3]. Members may satisfy this requirement by contacting the customer in writing (by electronic or any other means reasonably designed to reach the customer) and requesting that the customer notify the Member of any material changes to the information provided under Section (c) of Rule 2-30.[4] Absent advice to the contrary from the customer, the information previously provided is deemed verified. Whenever the customer notifies the FCM Member carrying the customer's account of any material changes to the information (whether through the update process or through the customer's own initiative), a determination must be made as to whether additional risk disclosure is required to be provided to the customer based on the changed information. If another FCM or IB introduces the customer's account on a fully disclosed basis or a CTA directs trading in the account, then the carrying FCM must notify that Member of the changes to the customer's information. Consistent with Section (e) of this Rule, the Member or Associate who currently solicits and communicates with the customer is responsible for determining if additional risk disclosure is required to be provided based on the changed information. In some cases, this may be the Member introducing or controlling the account; in other cases, it may be the carrying FCM.

Section (c): Information To Be Obtained

Item (1) is essentially the information required by CFTC Regulation 1.37(a), which applies to FCMs and IBs. Item (2) includes estimated annual income and net worth, information which the Committee found is commonly sought from new customers. Item (3), the customer's age, is also a commonly sought item which the Committee thought would be helpful in putting the customer's financial condition, ability to understand and level of sophistication into perspective for the Member. Most Members responding to the questionnaire indicated that they require information about previous futures trading experience; a smaller number responded that they ask about securities or options trading experience. NFA believes that experience with these types of investments may be relevant and has therefore included it.

Information on age, estimated annual income and net worth may be obtained through the use of brackets or "in excess of" descriptions so long as these are reasonably designed to elicit the required information in a meaningful manner.

The information specified in Section (c) is a minimum requirement, intended to serve as a core of basic information that should always be obtained. Some Members routinely elicit additional items, such as liquid net worth, risk capital, or number of dependents, which may be quite useful, and NFA received comments on the Rule when it was drafted suggesting that these items be required by the Rule. NFA concluded, however, that the better approach was to adopt a Rule that would specify the minimum required information and allow Members to obtain other information as they deemed appropriate.

Effective January 3, 2011, Section (c) will read as follows:

Section (c): Information To Be Obtained

Item (1) is essentially the information required by CFTC Regulation 1.37(a), which applies to FCMs and IBs. Item (2) includes estimated annual income and net worth or net assets. For individuals, Members must obtain both estimated annual income and net worth. For all other customers, Members must obtain estimated annual income and net worth or net assets, however, if the customer is unable to provide a current estimated annual income figure, the Member may satisfy the Rule by obtaining the customer's pervious year's annual income. Item (3), the customer's age or date of birth (for individuals), helps the Member put the customer's financial condition, ability to understand and level of sophistication into perspective. Information about previous futures trading experience and securities or options trading experience may also be relevant and, therefore, have been included. The information set forth in items (6) through (10) must be obtained if a customer who is an individual traders security futures products.

Information on age, estimated annual income and net worth may be obtained through the use of brackets or "in excess of" descriptions so long as these are reasonably designed to elicit the required information in a meaningful manner.

The information specified in Section (c) is a minimum requirement, intended to serve as a core of basic information that should always be obtained. Some Members routinely elicit additional items, such as liquid net worth, risk capital, or number of dependents, which may be quite useful, and NFA received comments on the Rule when it was drafted in 1985 suggesting that these items be required by the Rule. NFA concluded, however, that the better approach was to adopt a Rule that would specify the minimum required information and allow Members to obtain other information as they deemed appropriate. Therefore, item (5) specifies that the Member or Associate should obtain any other information used or considered to be reasonable in providing the customer with adequate disclosure of the risks of futures trading.

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Section (d): Risk Disclosure

The risk disclosures incorporated into this Section are required by CFTC Regulations. (There are other disclosures required by CFTC Regulations, such as the Regulation 32.5 dealer options disclosure statement and the Regulation 190.10(c) disclosure statement for non-cash margin, which may apply to particular accounts.) These disclosures are only the minimum required. NFA believes that the decision with respect to what additional disclosure, if any, should be given to the customer is best left to the Member, whose conduct is subject to review by the BCCs. There may be some customers for whom the additional disclosure will portray futures trading as too risky for that customer. However, NFA believes that a determination of who those customers are cannot be made except on a case-by-case basis, because no objective criteria can be established that will apply to all customers. The essential feature of the Rule is the link between "knowing the customer" and providing risk disclosure. Once that has been done, the customer is free to make the decision whether to trade futures.

Effective January 3, 2011, Section (d) will read as follows:

Section (d): Risk Disclosure

The risk disclosures incorporated into this Section are required by CFTC Regulations. (There are other disclosures required by CFTC Regulations, such as the Regulation 32.5 dealer options disclosure statement and the Regulation 190.10(c) disclosure statement for non-cash margin, which may apply to particular accounts.) These disclosures are only the minimum required. NFA believes that the decision with respect to what additional disclosure, if any, should be given to the customer is best left to the Member or Associate, whose conduct is subject to review by the BCC. There may be some customers for whom the additional disclosure will portray futures trading as too risky for that customer. In these instances, the only adequate risk disclosure by the Member and Associate is that futures trading is too risky for that customer. However, NFA believes that a determination of who those customers are cannot be made except on a case-by-case basis, because no objective criteria can be established that will apply to all customers. The essential feature of the Rule is the link between "knowing the customer" and providing risk disclosure. Once that has been done and the customer has been given adequate disclosure, the customer is free to make the decision whether to trade futures and the Member is permitted to accept the account. Members and Associates, however, are prohibited from making individualized recommendations to any customer for which the Member or Associate has or should have advised that futures trading is too risky for that customer.

Section (e): Introduced and Third-Party Controller Accounts

The purpose of this Section is to place the obligation to obtain information and provide risk disclosure on the Member who deals directly with the customer when an account is introduced to a carrying FCM by an IB or another FCM doing business on a fully disclosed basis, or when a CTA controls the trading in a customer's account pursuant to written authorization. NFA believes that the Member or Associate who solicits the customer and communicates with the customer in the process of the account opening is the appropriate party to comply with the Rule. In some cases, this may be the Member introducing or controlling the account; in other cases, it may be the carrying FCM.

Of course, each Member remains responsible for compliance with all applicable CFTC Regulations and NFA Requirements. For example, an FCM (or, in the case of an introduced account, the IB) must furnish a Regulation 1.55 Risk Disclosure Statement to each customer, including those whose accounts were solicited by and will be traded by CTAs. Similarly, a CTA must deliver a Disclosure Document to each customer, including those who were solicited by the FCM. Section (i), which is discussed below, clarifies each Member's obligation to comply with other requirements.

Section (f): Reliance on the Customer as the Source of the Information

Some Members confirm financial data because of concern about the creditworthiness of the customer. NFA believes, however, that the decision whether to confirm customer data is best left to the Member's sound business judgment and is irrelevant to a customer protection rule aimed at providing information to a customer.

Rule 2-30 contemplates a good faith exchange of information between the customer and the Member or Associate. A customer who gives incorrect information would still receive all the required risk disclosure statements but would have impaired the Member's ability to consider fully the customer's ability to understand the risk disclosures or whether additional disclosure was necessary. However, Section (f) will not operate as a "safe harbor" for a Member or Associate who falsifies information or who induces or suggests falsification by the customer. Information invented by the Member or Associate does not constitute "information about the customer" as required by the general rule. Members and Associates engaging in such conduct will be subject to appropriate disciplinary action.

Section (g): Recordkeeping: Customers Who Decline to Provide Information

In order to allow NFA to audit for compliance with the Rule, Section (g) requires that a timely record be made or obtained which contains the information obtained from the customer. Customers who decline to provide information (beyond that required by CFTC Regulation 1.37(a), which must always be obtained) may still open accounts, but NFA would expect Members to take appropriate action upon learning that an inordinate number of a particular Associate's customers apparently "decline" to provide basis information. Because Section (a) imposes an affirmative duty on Members to obtain information, a Member who engages in (or allows Associates to engage in) a course of conduct which is designed to or has the effect of eliciting or prompting refusals by customers to provide that information would not have discharged that duty and could not use Section (g) as a shield from disciplinary action.

The approval requirement has been broadened to apply to all new accounts. This is consistent with the Member's responsibility to

supervise the futures activities of its employees diligently pursuant to NFA Compliance Rule 2-9.

In the case of non-U.S. customers (those who neither reside in nor are citizens of the United States) a record that the customer declined to provide the information need not be made.

Section (h): Review Procedures

The requirement that a Member establish adequate review and compliance procedures provides Members with the flexibility to design procedures that are tailored to the way the Member does business. NFA's audit staff will, in the routine course of an examination, check these procedures for adequacy, taking into account the facts and circumstances of the particular Member.

Section (i): Relationship to Other Requirements

Rule 2-30 incorporates certain CFTC Regulations, but its requirements are in addition to any imposed by those Regulations or other NFA Requirements. For example, the Rule requires a CTA to provide a Disclosure Document, if required to do so by CFTC Regulation 4.31, at the time a customer first authorizes the Member to direct trading in a futures account for the customer.

This is because Rule 2-30 is intended to apply to "account opening" or its equivalent. However, CFTC Regulation 4.31 requires that the Disclosure Document be delivered at the time of solicitation. Other examples of CFTC Regulations which affect the process covered by the Rule have been cited in the discussion of Sections (b), (d), (e) and (g) above. Section (i) serves to clarify the ongoing obligation of Members to comply with all CFTC Regulations and NFA Requirements.

Effective January 3, 2011, Section (i) will read as follows:

Section (i): Relationship to Other Requirements

Rule 2-30 incorporates certain CFTC Regulations, but its requirements are in addition to any imposed by those Regulations or other NFA Requirements. For example, the Rule requires a CTA to provide a Disclosure Document, if required to do so by CFTC Regulation 4.31, at the time a customer first authorizes the Member to direct trading in a futures account for the customer.

This is because Rule 2-30 is intended initially to apply to "account opening" or its equivalent. However, CFTC Regulation 4.31 requires that the Disclosure Document be delivered at the time of solicitation. Other examples of CFTC Regulations which affect the process covered by the Rule have been cited in the discussion of Sections (b), (d), (e) and (g) above. Section (i) serves to clarify the ongoing obligation of Members to comply with all CFTC Regulations and NFA Requirements.

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[1] The risk disclosure statements required by CFTC Regulations 1.55 and 4.31 direct the customer to "carefully consider whether [futures] trading is suitable for you in light of your financial condition": the one required by CFTC Regulation 33.7 informs the customer that "commodity option transactions are not suitable for many members of the public."

[2] NFA Bylaws define "futures" to include domestic exchange-traded options and dealer options. See Compliance Rule 1-1(g).

[3] Certain CFTC Regulations and NFA Requirements will apply with respect to each account or interest entered into: the discussion above refers to those aspects of Rule 2-30 which are additional requirements. See Section (i) of the Rule.

Effective January 3, 2011, the footnotes above will read as follows:

[1] The risk disclosure statements required by CFTC Regulations 1.55 and 4.31 direct the customer to "carefully consider whether [futures] trading is suitable for you in light of your financial condition": the one required by CFTC Regulation 33.7 informs the customer that "commodity option transactions are not suitable for many members of the public."

[2] NFA Bylaws define "futures" to include domestic exchange-traded options and dealer options. See Compliance Rule 1-1(g).

[3] For any customer who was not considered active at the time of the annual update of information, the Member who currently solicits and communicates with the customer must refresh the customer information prior to accepting any new funds or orders from the customer.

[4] If the customer informs the FCM that he/she cannot verify the information because the information previously provided to the carrying FCM is not currently available to the customer, then the carrying FCM shall promptly provide any necessary information to the customer.

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NFA Manual / Rules

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Interpretive Notices

9013 - NFA COMPLIANCE RULE 2-30: CUSTOMER INFORMATION AND RISK DISCLOSURE
(Staff, November 30, 1990; revised July 1, 2000)

INTERPRETIVE NOTICE

NFA's Know-Your-Customer Rule, which deals with customer information and risk disclosure, has been in effect since June 1, 1986. As drafted by NFA's Advisory Committees and approved by the Board of Directors, the Rule was designed to accomplish two primary objectives:

1. to define "high standards of commercial honor and just and equitable principles of trade" as applied to Member procedures for exchanging information with new customers who are individuals; and

2. to provide a useful tool to combat any unscrupulous firms attempting to take advantage of unsophisticated investors.

Given these broad purposes, some of the Rule's provisions are very specific, while others, of necessity, are more general. Since some of the Rule's provisions are stated in general terms, Members may understandably seek more specific guidance on some points. The best sources for such guidance are the Interpretive Notice to Rule 2-30 ("Interpretive Notice")[1], and the decisions NFA's Regional Business Conduct Committees ("BCCs") and Hearing Panels have made in specific disciplinary cases which allege violations of the Rule. The purpose of this Notice is to provide Members with additional guidance in complying with Rule 2-30 by summarizing how the BCCs have applied Rule 2-30 since the Rule became effective in 1986.

Since Rule 2-30 became effective, a number of complaints have been filed by NFA which allege violations of the Rule. Typical violations of the Rule generally fall into one of three categories.

1. failing to give additional risk disclosure when required or disguising the fact that additional risk disclosure may be required by inducing customers to provide false information on their account opening papers;

2. violations of recordkeeping requirements; and

3. violations of supervisory requirements.

A description of typical violations in each category is set forth below.

Inadequate Risk Disclosure

The heart of Rule 2-30 is the requirement that Members obtain certain basic information from the customer concerning his financial background, analyze that information and ensure that the customer has received adequate risk disclosure information. As discussed in the Interpretive Notice, some customers may require risk disclosure in addition to that specifically prescribed by Rule 2-30(d)[2]. For example, there may be instances where, for some customers, the only adequate risk disclosure is that futures trading is too risky for that customer. Once adequate disclosure is given, however, the customers are free to decide whether to trade in futures and the Member is free to accept the account. The Rule recognizes that the identification of customers who require additional risk disclosure can only be done on a case-by-case basis and that the determination of whether additional risk disclosure is required for a given customer is best left to the Member firm, subject to review by the BCCs.

The most serious violations of the Rule have involved either failing to provide additional risk disclosures when necessary or inducing customers to provide false information on their account opening forms. A number of the more egregious cases, which have generally resulted in expulsions from NFA membership, are summarized below. The exact factual circumstances vary from case to case, but one common thread in these cases is that the customer had no previous futures trading experience and little, if any, other investment experience. Obviously, these extreme examples do not in any way limit the circumstances which may trigger a need for additional risk disclosures:

- An AP instructed a customer, who noted on his account opening forms that he had owned his own home for 18 years, to falsify his account application by indicating that he had been involved in real estate development for 18 years.
- An AP solicited a 52-year-old retired Air Force Colonel who had no prior commodity trading experience. The AP did not advise the customer of any specific numbers to put down on his account opening form regarding his net worth, but told him to make the numbers high enough to get the account approved.
- An AP solicited a 32-year-old nurse and her husband, a 39-year-old computer operator, neither of whom had any prior investment experience in commodities or securities. The customers repeatedly informed the AP that they could not afford a minimum required investment of $10,000. The AP told them to take out a loan from their credit union and that the required investment amount would then be reduced to $5,000. The customers subsequently took out a $3,000 loan from their credit union and added $2,000 from their savings account to meet the $5,000 minimum investment requirement. The husband then went to the firm's office and signed the account forms during his 30-minute lunch break; however, he did not read the forms, nor were they explained to him by the firm or its AP.
- An AP instructed a customer to inaccurately complete his account application by stating that he was a foreman rather than a factory laborer, and by indicating that he had liquid assets in the amount of $51,000 instead of $20,000. Another of the firm's APs told a customer that his actual annual income of $12,500 was too low and that if he did not change that figure to read between $20,000 and $40,000, his account would be rejected.
- A customer who had been unemployed for two years, with a net worth of $30,000 derived from an inheritance and sale of property and no futures trading experience, was instructed by an AP to "put down anything" on the account opening form regarding her employment and income. The customer received no risk disclosure other than the Risk Disclosure Statement required by CFTC Regulation 1.55. In addition, the AP neither explained the account documents to the customer, nor gave her sufficient time to review them.
- An AP solicited a 77-year-old retired real estate investor with a net worth of $100,000 and a fixed annual income of $20,000. The customer informed the AP that both he and his wife were in ill health and that one of the reasons for his interest in investing in commodity futures contracts was his limited health insurance coverage and a desire to earn enough money to pay for his medical expenses. Rather than providing the customer with risk disclosure in addition to that contained in the risk disclosure statements, the AP informed the customer that the risk of loss involved in futures trading was slight. Another of the firm's APs instructed a customer not to put down "unemployed actor" for his occupation but rather "self-employed." This AP also advised the customer to include a net worth figure on his account forms which was sufficiently high to insure the opening of the account, and for the income figure, to put down his income prior to becoming unemployed.

Again, the cases summarized above illustrate some of the more egregious violations of the Rule involving either inadequate risk disclosure or inducing customers to provide false information on their account opening forms. However, because the determination of whether additional risk disclosure is required for a given customer can be made only on a case-by-case basis, the above scenarios should not be interpreted to limit the circumstances under which additional risk disclosure may be required.

Recordkeeping and Supervisory Requirements

Though risk disclosure is the heart of the Rule, Compliance Rule 2-30 also imposes certain recordkeeping and supervisory requirements. Violations of these requirements typically involve a failure to obtain all of the information required under the Rule (i.e., occupation, current estimated annual income and net worth, approximate age and previous investment and futures trading experience) or a failure to retain the appropriate records. Although the Rule 2-30 recordkeeping violations have never formed the sole basis of disciplinary actions, they generally are indicative of a widespread recordkeeping problem within the firm.

Rule 2-30(h) requires each Member to "establish and enforce adequate procedures to. . . supervise the activities of its Associates in obtaining customer information and providing risk disclosure." One case alleging a violation of Rule 2-30(h) involved the failure of a firm's account opening procedures to require that the firm's APs obtain the necessary information from the customer. Another case involved a firm whose APs failed to follow guidelines provided to the firm by its guarantor in order to determine whether a prospective customer needed additional risk disclosure. Rule 2-30(h) does not require Members to provide their APs with any sort of grid-like formula to identify those customers who require additional risk disclosure; however, the Rule, as applied by the BCCs and Hearing Panels, does require that a firm be able to articulate the general factors its APs are instructed to consider in determining whether additional risk disclosure is required.

In conclusion, NFA recognizes that certain provisions of Compliance Rule 2-30 are stated in general terms. Since the law in this area is developed on a case-by-case basis by NFA's Hearing Panels, no precise formula is available to Members to aid them in their interpretation of the Rule. However, in addition to the Interpretive Notice, Members may obtain guidance regarding the Rule's application by reviewing the case summaries described above. As the case law in this area continues to develop, NFA will keep Members apprised of any changes in the Rule's application.

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[1] See NFA Manual at 9004.

[2] See NFA Manual at 9004.

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Compliance Rules

RULE 2-10. RECORDKEEPING.
[Effective date of amendments: April 11, 1983; April 1, 2006 and July 1, 2007.]

(a) Each Member shall maintain adequate books and records necessary and appropriate to conduct its business including, without limitation, the records required to be kept under CFTC Regulations 1.18 and 1.32 through 1.37 for the period required under CFTC Regulation 1.31.

(b) Each FCM Member must either:

(1) Maintain an office in the continental United States, Alaska, Hawaii, or Puerto Rico responsible for preparing and maintaining financial and other records and reports required by CFTC and/or NFA rules under the supervision of a listed principal and registered associated person of the FCM who is resident in that office; or

(2) Maintain an office in a jurisdiction that the CFTC has found to have a comparable regulatory scheme for purposes of Part 30 of the CFTC's rules and be subject to that regulatory scheme. This foreign office must be responsible for preparing and maintaining financial and other records and reports required by CFTC and/or NFA rules under the supervision of a listed principal and registered associated person of the FCM who is resident in that office, and the Member must agree to reimburse NFA for any travel, translation, telephone, and similar expenses incurred in connection with inquiries, examinations and investigations of the Member that exceed the normal expenses incurred by NFA in examining an FCM Member located at the closest point in the continental United States, Alaska, Hawaii, or Puerto Rico.

(c) Each Member subject to minimum capital requirements must:

(1) prepare financial reports required to be filed with the CFTC and/or NFA in English, using U.S. dollars, and according to U.S. accounting standards; and

(2) maintain a general ledger in English using U.S. dollars.

(d) Each Member must:

(1) file reports, requests for extensions, and other documents required to be filed with the CFTC and/or NFA in English;

(2) maintain English translations of all foreign-language promotional material, including disclosure documents and Web sites, distributed to or intended for viewing by customers located in the United States, its territories, or possessions;

(3) maintain written procedures required by CFTC or NFA rules in English (as well as in any other language if necessary for them to be understood by the Member's employees and agents);

(4) provide English translations of other foreign-language documents and records and file financial information in U.S. dollars when requested by NFA; and

(5) make available to NFA (during an examination or to respond to other inquiries) an individual who is authorized to act on the Member's behalf, is fluent in English, and is knowledgeable about the Member's business and about financial matters.

[See Interpretive Notice NFA Compliance Rule 2-10: The Allocation of Block Orders for Multiple Accounts.]

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Interpretive Notices

9029 - NFA COMPLIANCE RULE 2-10: THE ALLOCATION OF BUNCHED ORDERS FOR MULTIPLE ACCOUNTS
(Board of Directors, June 9, 1997; revised September 15, 2003)

INTERPRETIVE NOTICE

NFA Compliance Rule 2-10 adopts by reference CFTC Regulation 1.35, which, among other things, imposes on FCMs recordkeeping requirements relating to customer orders on futures and options on futures contracts. The purpose of the regulation is to prevent various forms of customer abuse, such as fraudulent allocation of trades, by providing an adequate audit trail that allows customer orders to be tracked at every step of the order processing system. In general, Regulation 1.35 requires a futures commission merchant ("FCM") receiving a customer order to prepare a written record of the order immediately upon receipt, including an appropriate account identifier.

With respect to bunched orders placed by an account manager on behalf of multiple clients, the CFTC had interpreted Regulation 1.35 to require that, at or before the time the order is placed, the account manager must provide the FCM with information that identified the accounts included in the bunched order and specified the number of contracts to be allotted to each account.[1 2] An exception to this requirement was set forth in Regulation 1.35(a-1)(5), which authorized certain eligible account managers to enter bunched orders for a limited class of eligible clients and to allocate them to individual accounts no later than the end of the day ("post-execution allocation procedures").

How the basic requirements of CFTC Regulation 1.35 applied to bunched orders for multiple accounts had been the source of considerable difficulty and confusion. In June 1997, therefore, NFA published an Interpretive Notice to provide guidance to its Members in complying with these requirements ("1997 Notice"). While this Notice did not attempt to address all of the issues that can arise in this context, it provided guidance on recurring questions.

The CFTC recently adopted an amendment to Regulation 1.35(a-1)(5). This amendment effectively removes the limitations on the account managers that may take advantage of post-execution allocation procedures as well as the limitations on the types of clients on whose behalf the account managers may employ post-execution allocation procedures. In particular, all registered commodity trading advisors ("CTAs") that are Members of NFA may take advantage of the procedures in Regulation 1.35(a-1)(5) for the accounts of all clients who grant written investment discretion to the CTA.

The amendment also clarifies the obligations imposed on account managers that wish to take advantage of these post-execution allocation procedures as well as the FCMs that execute or clear these transactions. Among other things, the rule requires that contracts executed pursuant to bunched orders be allocated in a fair and equitable manner so that no account or group of accounts consistently receives favorable or unfavorable treatment over time. The rule further provides that the account manager bears the responsibility for the fair and equitable allocation of bunched orders, while FCMs retain the responsibility to monitor for unusual allocation activity.

Because all NFA CTA Members may now take advantage of post-execution allocation procedures under Regulation 1.35(a-1)(5), NFA has determined to revise the 1997 Notice. This revised Notice sets out certain core principles that govern all allocation methodologies and the respective responsibilities of CTAs and FCMs that execute or carry the accounts of the CTAs' clients. The Notice then restates certain methodologies described in the 1997 Notice. Although these methodologies were developed to assure compliance with the requirement that a CTA provide allocation instructions at or before the time a bunched order is placed, they also apply to CTAs that elect to use post-execution allocation procedures.

Core Principles and Responsibilities

Allocation instructions for trades made through bunched orders for multiple accounts must deal with two separate issues. The first, which arises in all such orders, involves the question of how the total number of contracts should be allocated to the various accounts included in the bunched order. For some CTAs, this allocation may remain relatively constant. For others, although their basic allocation methodology does not change, the specific allocation instructions produced by the methodology may change on a daily basis.

The second issue involves the allocation of split or partial fills. For example, a CTA may place a bunched order of 100 contracts for multiple accounts. In many instances, however, a market order for 100 contracts may be filled at a number of different prices.

Similarly, if an order is to be filled at a particular price, the FCM may be able to execute some but not all of the 100 lot order. In either example, the question arises of how the different prices or the contracts in the partial fill should be allocated among the accounts included in the block order.

The same set of core principles govern the procedures to be used in handling both of these issues. Any procedure for the general allocation of trades or the allocation of split and partial fills must be:

- designed to meet the overriding regulatory objective that allocations are non-preferential and are fair and equitable over time, such that no account or group of accounts receive consistently favorable or unfavorable treatment;[3]
- sufficiently objective and specific to permit independent verification of the fairness of the allocations over time and that the allocation methodology was followed for any particular bunched order; and
- timely, in that the CTA must provide the allocation information to FCMs as soon as practicable after the order is filled and, in any event, sufficiently before the end of the trading day to ensure that clearing records identify the ultimate customer for each trade.

As noted above, the responsibility for allocating contracts executed through a bunched order rests solely with the CTA.[4] The CTA must confirm, on a daily basis, that all its accounts have the correct allocation of contracts. A CTA must also analyze each trading program at least once a quarter to ensure that the allocation method has been fair and equitable (i.e., customers in the same trading program achieve similar allocation results over time). Allocation fairness over time, rather than trade-by-trade, is the critical element in this evaluation. If materially divergent performance results exist over time among accounts in the same trading program, such results must be shown to be attributable to factors other than the CTA's trade allocation procedures. Applicable CFTC and NFA interpretations have addressed permitted reasons for divergent performance results among accounts in the same trading program. If those results indicate that the allocation method has not been fair and equitable over time, however, then the CTA must revise its allocation methodology or adopt a different allocation method for application on a prospective basis only. A CTA must document its internal audit procedures and results and maintain these audit procedures and results as firm records subject to review during an NFA audit.

Although the CTA is responsible for the allocation of each bunched order, the FCM has certain obligations as well. In particular, each FCM must receive from an account manager sufficient information to allow it to perform its functions. For executing FCMs in a give-up arrangement, this includes, at a minimum, information that identifies the account manager at the time the order is placed and instructions, which the FCM may receive following execution of the order, for the contracts to be given up to each clearing FCM. Information concerning the number of contracts to be allocated to each account included in the bunched order along with instructions for the allocation of split and partial fills among accounts must be provided to the clearing FCM.[5]

Regulation 1.35(a-1)(5) requires each FCM that executes or carries accounts eligible for post-execution allocation to maintain records that, as applicable, identify each order subject to post-execution allocation and the accounts to which the contracts were allocated. One means by which an FCM can meet this recordkeeping requirement is to maintain a copy of the allocation instructions provided by the account manager by facsimile, e-mail, or other form of electronic transmission. If the allocation is provided orally, however, the FCM must create a written record and maintain that record.

Also, if the FCM has actual or constructive notice that allocations for its customers may be fraudulent, the FCM must take appropriate action. For example, if an FCM has notice of unusual allocation activity, the FCM must make a reasonable inquiry into the matter and, if appropriate, refer the matter to the proper regulatory authorities (e.g., the CFTC or NFA or its DSRO). Whether an FCM has such notice depends upon the particular facts involved.

Obviously, one of the most significant factors is the amount of information available to the FCM. An FCM that both executes and clears an entire bunched order will possess more information than an FCM that executes or clears only a portion of an order. Where there are multiple FCMs executing and clearing the bunched order, some FCMs may have more information available than others, and it is likely that no single FCM would have enough information to determine if there is unusual allocation activity. Likewise, in situations where an investment adviser uses bunched orders for hedging purposes, the FCM may not possess adequate information to evaluate the allocation activity. However, if the FCM has actual or constructive notice that the allocations may be fraudulent, the FCM must take appropriate action.

Examples of Allocation Methodologies

In the 1997 Notice, NFA set out the following examples of procedures for the allocation of split and partial fills that generally satisfy the core principles described above. These methodologies were the most common that NFA observed in performing audits. NFA believes they are still relevant. However, they are not the exclusive means of achieving compliance with Regulation 1.35(a-1)(5). The appropriateness of any particular method, of course, will depend on the CTA's trading strategy.[6]

Example #1 - Rotation of Accounts
One basic allocation procedure involves a rotation of accounts on a regular cycle, usually daily or weekly, which receive the most favorable fills. For example, if a firm has 100 accounts trading a particular trading program, in the first phase of the cycle, Account #1 receives the best fill, Account #2 the second best, etc. In phase 2 of the cycle, Account #2 receives the best fill and Account #1 moves to the end of the line and receives the least favorable fill.

Example #2 - Random Allocation
Some firms prepare on a daily basis a computer generated random order of accounts and allocate the best price to the first account on the list and the worst to the last. This method would satisfy the standards stated above.

Example #3 - Highest Prices to the Highest Account Numbers
Some firms rank accounts in order of their account numbers and then allocate the highest fill prices to the accounts with the highest account numbers. Any advantage the higher numbered accounts enjoy on the sell order are theoretically offset by the disadvantage on the buy orders. Although under certain market conditions this may not always be true, the method generally complies with the standards.

Example #4 - Average Price
With regard to split fills, firms may have internal programs which calculate the average price for each bunched order. The program will then assign the average price to each allocated contract. In the alternative, the program will allocate the actual fill prices among the accounts included in the order to approximate, as closely as possible, the average fill price. Either average price allocation method offers a consistent non-preferential method for allocating trades.

If any Member has questions concerning how this Interpretive Notice would apply to its operations, please contact NFA's Compliance Department.

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[1]Bunched orders can provide customers with the advantages of better pricing and more efficient execution of orders. With the explosive growth of the managed funds business, the frequency of "give-ups" and the increasing use of electronic order entry systems, it is not at all uncommon for some account managers to place bunched orders for hundreds of accounts on markets around the world, with orders executed by one or more FCMs and cleared by other FCMs.

[2]Consistent with the provisions of CFTC Regulation 1.35(a-1)(1), account managers that place orders for a single account must still provide account identification information at the time of order entry.

[3]Because customers must have access to information that allows them to assess the fairness of the allocation process, CTAs are required to make the following information available to customers upon request: (1) the general nature of the CTA's allocation methodology; (2) whether accounts in which the CTA may have an interest may be included with customer accounts in bunched orders; and (3) summary or composite data sufficient for that customer to compare its allocation results with the allocation results of other comparable customers and, if applicable, any account in which the account manager has an interest.

[4]However, NFA rules do not preclude an FCM from agreeing to undertake this responsibility, whether it clears or executes the trades, pursuant to either its own procedures or to those supplied by the CTA. For example, the CTA and FCM may agree that the FCM will allocate a bunched order in accordance with instructions that the CTA files with the FCM either prior to or concurrently with placing the bunched order. Any division of responsibilities agreed to by the FCM and CTA should be clearly documented.

[5]As noted, an account manager must provide all of this information to the appropriate FCM as soon as practicable after the order is filled and sufficiently before the end of the trading day during which the order is executed to ensure that clearing records identify the ultimate customer for each trade.

[6]For example, certain allocation methodologies may satisfy the general standards for CTAs who trade on a daily basis but be inappropriate for CTAs who trade less frequently.

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Interpretive Notices

9028 - NFA FINANCIAL REQUIREMENTS: THE ELECTRONIC FILING OF FINANCIAL REPORTS
(Board of Directors, March 24, 1997; revised July 1, 2000; July 24, 2000 and December 31, 2001)

INTERPRETIVE NOTICE

NFA Financial Requirements require each FCM for which NFA is DSRO and each IB which is not operating pursuant to a guarantee agreement to file financial reports with NFA. FCMs must file reports monthly while IBs file on a semi-annual basis. FCMs file reports on CFTC Form 1-FR-FCM while IBs use Form 1-FR-IB. FCMs or IBs which are also registered as securities brokers or dealers may use the SEC FOCUS Report in lieu of the Form 1-FR for their financial reports.

NFA, in partnership with the Chicago Mercantile Exchange and the Chicago Board of Trade, has developed computer software which allows FCMs and IBs to electronically file financial reports with NFA, the CME, CBOT and the CFTC. This software is being used industry-wide. The software accommodates filing of the Form 1-FR-FCM, Form 1-FR-IB, FOCUS II and FOCUS IIA Reports. All FCMs and IBs for which NFA is the DSRO must file their financial reports electronically using this software.

NFA's filing software also includes procedures for the appropriate representative of the NFA Member FCM or IB to attest to the completeness and accuracy of the financial report in order to comply with NFA and CFTC certification and attestation requirements. Each authorized signer must apply to NFA for a Personal Identification Number using an application form approved by NFA.

Full details about the software and electronic filing procedures and the application form for obtaining a PIN number are are available by accessing the Compliance Section, Issues for FCMs and IBs, of NFA's web site at http://www.nfa.futures.org/ or by contacting the Information Center at (312) 781-1410. Information is also available on the Joint Audit Committee's web site at www.wjammer.com/jac/.

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Compliance Rules

RULE 2-11. CUSTOMER ACCOUNTS.
[Adopted effective September 30, 1982. Effective date of amendments: July 24, 2000.]

No Member FCM, unless a member of a contract market, shall carry customer accounts without prior notice to NFA.

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Compliance Rules

RULE 2-33. FCM RECEIPT OF FUNDS FROM OMNIBUS ACCOUNTS.
[Adopted effective July 24, 1990.]

Each FCM must give notice to its DSRO or, if so directed by its DSRO, to NFA whenever the FCM accepts other than immediately available funds from an FCM doing business on an omnibus basis. Notice must be received within 24 hours of such acceptance. For purposes of this Rule, wire transfers and certified checks shall be considered immediately available funds for which notice is not required.

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Compliance Rules

RULE 2-38. BUSINESS CONTINUITY AND DISASTER RECOVERY PLAN.
[Adopted effective April 7, 2003.]

(a) Each Member must establish and maintain a written business continuity and disaster recovery plan that outlines procedures to be followed in the event of an emergency or significant business disruption. The plan shall be reasonably designed to enable the Member to continue operating, to reestablish operations, or to transfer its business to another Member with minimal disruption to its customers, other Members, and the commodity futures markets.

(b) Each Member must provide NFA with the name of and contact information for an individual who NFA can contact in the event of an emergency, and the Member must update that information upon request. Each IB, CPO, and CTA Member that has more than one principal and each FCM Member must also provide NFA with the name of and contact information for a second individual who can be contacted if NFA cannot reach the primary contact, and the Member must update that information upon request. These individuals must be authorized to make key decisions in the event of an emergency.

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Compliance Rules

RULE 2-46. CPO QUARTERLY REPORTING REQUIREMENTS
[Adopted effective March 31, 2010.]

Each CPO Member must report on a quarterly basis to NFA, for each pool that it operates and for which it has any reporting requirement under CFTC Regulation 4.22, the following information in a form and manner prescribed by NFA within 45 days after the end of each quarterly reporting period:

(a) The identity of the pool's administrator, carrying broker(s), trading manager(s); and custodian(s);

(b) A statement of changes in net asset value for the quarterly reporting period;

(c) Monthly performance for the three months comprising the quarterly reporting period;

(d) A schedule of investments identifying any investment that exceeds 10% of the pool's net asset value at the end of the quarterly reporting period.

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Compliance Rules

RULE 2-34. CTA PERFORMANCE REPORTING AND DISCLOSURES
[Adopted effective May 1, 2004.]

(a) Performance Information

(1) Member CTAs must calculate rate of return according to CFTC Regulation 4.35(a)(6) using nominal account size as the denominator.

(2) Draw-down information reported under CFTC Regulation 4.35(a)(1)(v) and (vi) must be based on rate of return figures using nominal account size as the denominator.

(3) In calculating net performance, Member CTAs may include interest earned on actual funds but may not impute interest on other funds.

(b) Written Confirmation for Partially-Funded Accounts

(1) For partially-funded accounts, a Member CTA must either receive from a client or deliver to a client a written confirmation that contains the following information:

(i) the name or description of the trading program, and

(ii) the nominal account size agreed to by the client and the CTA.

(2) For new clients, the written confirmation must be received from or delivered to the client before the CTA places the first trade for the client.

(3) For existing clients, the written confirmation must be received from or delivered to the client before the CTA places the first trade after any of the information required under Section (b)(1) of this rule changes. The written confirmation must include the new information and the effective date of the change but need not include any information that will remain the same.

(c) Additional Disclosures for Partially-Funded Accounts

CTAs must provide the following information to clients with partially-funded accounts if the clients are not QEPs:

(1) A statement of how management fees will be computed relative to the nominal account size,

(2) An explanation of how cash additions, cash withdrawals, and net performance will affect the nominal account size,

(3) A brief explanation regarding the effect of partial funding on margin and leverage,

(4) A statement that partial funding increases the fees and commissions as a percentage of actual funds but does not increase the dollar amount of those fees, and

(5) A description, by example or formula, of the effect of partial funding on rate of return and drawdown percentages.

(d) CPO Use of CTA Performance Information

Member CPOs who are required by CFTC Regulation 4.25(c) to disclose CTA performance must report the CTA performance on the same basis as the CTA is required to report it.

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Interpretive Notices

9054 - COMPLIANCE RULE 2-34: PERFORMANCE REPORTING AND DISCLOSURES
(Board of Directors, November 20, 2003; effective May 1, 2004)

INTERPRETIVE NOTICE

In July 2003, the Commodity Futures Trading Commission adopted a core principle for calculating rate of return (ROR) for partially-funded accounts. The Commission noted, however, that its core principle approach would not preclude NFA from developing more explicit guidance or performance standards.

NFA's Board of Directors believes that Member CTAs should use a uniform calculation to make it easier for clients to compare the performance of different CTAs. The Board also believes that ROR should be based on the amount that is the basis for the CTA's trading decisions so that ROR measures the CTA's true performance rather than its client's various cash management practices. Therefore, NFA's Board has adopted NFA Compliance Rule 2-34 to provide performance standards for Member CTAs and to require certain disclosures to ensure that clients understand the consequences of partially funding their accounts. The Board has also adopted this Interpretive Notice to provide additional guidance to CTA Members regarding performance reporting and disclosure.

CTAs will not be required to restate their previous performance, although they may choose to do so. As with any other information, however, a CTA must make any additional disclosures that are necessary to ensure that its performance record is not misleading.

Documenting the Nominal Account Size

The Board recognizes a client may elect to partially fund its account by depositing less funds with the FCM carrying its account than the client has directed the CTA trading the account to use as the basis for trading decisions. The Board believes that the nominal account size should be documented to provide "discipline in the denominator" by assuring that the client and the CTA have agreed on the account size before the account begins trading. This documentation will also provide an objective audit trail to verify past performance records.

Compliance Rule 2-34(b) requires the CTA to document the trading program and nominal account size for each client who partially funds its account by either receiving a written confirmation from or providing a written confirmation to the client with the required information. For example, the information could be included in the advisory agreement or delivered to the client as a separate document. Although NFA assumes that most CTAs will receive or provide this confirmation at the same time the CTA enters into an advisory agreement to direct or guide the client's account, NFA Compliance Rule 2-34(b) only requires that it occur before the CTA places the first trade.

The Rule does not require the CTA to get the client's written acknowledgement to a confirmation provided by the CTA, although the CTA may choose to do so. If the CTA does not require a written acknowledgement, the confirmation should inform the client that the client must notify the CTA, within a reasonable period specified in the confirmation, if the client does not agree with the terms included in the confirmation. The confirmation may be delivered in any manner consistent with CFTC requirements for delivery of account statements by commodity pool operators under CFTC Regulation 4.22(i).

Disclosure

Compliance Rule 2-34(c) requires CTAs to provide certain information to clients with partially-funded accounts if those clients are not QEPs. This information is designed to ensure that less sophisticated customers understand the effects of partial funding so that they can make informed decisions when funding their accounts.

Subsection (c)(2) requires the CTA to explain how each element of cash additions, cash withdrawals, and net performance will affect the nominal account size. If these items will not affect the nominal account size, the CTA may make an affirmative statement to that effect.

Under Compliance Rule 2-34(c)(5), the CTA must provide a description, by example or formula, of the effect of partial funding on ROR and drawdown percentages. A CTA may provide this information by example using a simple matrix showing the effect of partial funding at different funding levels. In the alternative, it may provide the client with the formula for converting ROR percentages based on the nominal account size to ROR percentages based on the partial funding level, e.g.:

(nominal account size / actual funds) * n = a

where n is the ROR percentage based on the nominal account size and a is the ROR percentage based on actual funds

This same formula may, of course, be used to convert any other information that is given as a percentage of the nominal account size, such as estimated commissions and fees.

The disclosures required by Compliance Rule 2-34(c) can be included in the CTA's disclosure document or the advisory agreement. They can also be provided in a separate document delivered to the client before the CTA places the first trade for the client.

Actual Funds

Compliance Rule 1-1(b) defines actual funds as the equity in a commodity trading account over which a CTA has trading authority and funds that can be transferred to that account without the client's consent to each transfer. Funds that are not in the trading account, often referred to as committed funds, qualify as actual funds only if they meet the following four tests:[1]

1. The ownership of the accounts must be identical;

2. The funds must be available for transfer (e.g., free credit balances that are not committed to another CTA's trading program);

3. The client must agree in writing that the FCM can transfer the funds to the managed account at the CTA's request; and

4. The CTA must be able to verify the amount of these funds.[2]

Materiality Standards

As a general rule, accounts in the same trading program will be included in the same composite performance capsule.[3] Since Compliance Rule 2-34(a) requires ROR to be calculated on nominal account size, the RORs for these accounts should be materially the same. Accounts with materially different RORs should not, however, be included in the same performance capsule.[4]

Whether RORs are materially the same may vary depending on the circumstances. However, as long as the accounts are part of the same trading program, the following test provides a safe harbor for determining whether the accounts have materially the same ROR.[5]

- If the composite ROR including the account and the composite ROR excluding the account average 10 percent or more, they are materially the same if the difference between the two RORs is less than 10 percent of their average.
- If the composite ROR including the account and the composite ROR excluding the account average less than 10 percent and greater than 5 percent, they are materially the same if the absolute difference between the two RORs is no more than 1.5 percent.
- If the composite ROR including the account and the composite ROR excluding the account average 5 percent or less, they are materially the same if the absolute difference between the two RORs is no more than 1 percent.

The primary reason for this materiality test is to objectively demonstrate that each account included in the performance capsule is part of the same trading program. For that reason, the materiality test should use gross trading profits and losses rather than net performance. If a particular account in the capsule has a material effect on the capsule's net performance due to account-specific factors (e.g., commissions or interest), the CTA may continue to include that account in the capsule if it meets the materiality test using gross trading profits and losses.[6] However, the CTA should disclose the difference in net performance and identify the factors that are responsible for that difference.

Additions and Withdrawals

Large additions and withdrawals during the reporting period may distort ROR. A CTA is not required to adjust its ROR calculation unless those additions and withdrawals have a material effect on ROR under the above test.[7] If they do have a material effect, however, the CTA must use an approved method to minimize the distortion. Appendix B to the CFTC's Part 4 Rules describes two methods that CTAs can use to adjust for additions and withdrawals when calculating ROR: the compounded rate of return method and the time-weighted method. These methods are available to all CTAs under the terms described in Appendix B.

CTAs may also use a third method that adjusts for additions and withdrawals by temporarily excluding certain accounts when calculating ROR.[8] This method can be used if the following conditions are met:

1. As with any performance information, all of the accounts - whether included in or excluded from the ROR calculation - are part of the same trading program;

2. Excluding the accounts does not result in the systematic exclusion of any material costs (e.g., accounts with withdrawals or that are closed during the reporting period must be included in ROR if there is a significant exit fee that is only charged when funds are withdrawn or accounts are closed);

3. Only accounts that meet one of the following requirements are excluded:

- The account was opened during the reporting period,
- The account was closed during the reporting period,

- The account had no open positions and did not trade during the reporting period because it has not yet been approved for trading or because the client intended to - and did - close the account shortly after the reporting period ended,[9] or
- The net additions and withdrawals in the account exceeded 10% of the beginning net nominal account value for the period for that individual account;

4. Use of this method does not produce an ROR that is materially different from the ROR expected to be produced by either the compounded rate of return method or the time-weighted method over time; and

5. The method does not exclude a significant percentage of the accounts in the trading program.

In general, the CTA should use one method consistently except where that method would produce results that are materially different from the actual experience of accounts in the trading program.[10] The CTA should disclose the method that is consistently used and, if the CTA uses a different method for a particular reporting period, the CTA should disclose the method actually used for that reporting period and describe why that method was used.[11]

CTAs may use any of these three methods without obtaining prior approval from NFA or the CFTC. Appendix B to Part 4 states that "a commodity pool operator or commodity trading advisor may present to the Commission proposals regarding any alternative method of addressing the effect of additions and withdrawals on the rate of return computation, including documentation supporting the rationale for use of that alternative method." Therefore, a CTA may use another method if the CTA can demonstrate to the CFTC, prior to use, that the alternate method provides an accurate picture of the CTA's ROR and is more appropriate for that CTA.

* * * * *

All performance information must be presented in a manner that is balanced and is not misleading. CTAs have an obligation to disclose all material information even if it is not specifically required by CFTC or NFA rules. Compliance Rule 2-34 and this Interpretive Notice do not relieve CTAs of that obligation.

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[1] These tests are derived from CFTC Advisory 87-2, [1986-1987 Transfer Binder] Comm. Fut. L. Rep. (CCH) paragraph 23,624 (June 2, 1987).

[2] Compliance Rule 2-34(a) provides that Member CTAs may include interest earned on actual funds but may not impute interest on other funds when calculating net performance. The CTA must be able to verify the amount of interest earned on the funds if the CTA includes that interest as part of its net performance.

[3] Accounts in the same trading program generally have the same pattern of trading.

[4] Accounts that use different trading strategies should not be included in the same performance capsule even if their RORs are materially the same.

[5] This same materiality test can be used in other contexts. For example, NFA's interpretive notice entitled "NFA Compliance Rule 2-10: The Allocation of Bunched Orders for Multiple Accounts" (paragraph 9029) requires CTAs to modify their allocation methods if accounts in the same trading program have materially different performance results. This is another instance where materiality would be measured using gross trading profits and losses.

[6] As with the test for material differences in trading results, whether the account has a material effect on net performance is determined by comparing the net performance of the composite with and without the account.

[7] A CTA is also not required to adjust its ROR calculation if additions and withdrawals are each less than 10% of the beginning net nominal account value for the period.

[8] The accounts can only be excluded when calculating ROR. They must be included in the CTA's capsule performance for other purposes.

[9] An account that was open for the entire reporting period and had open positions or trading activity during the reporting period cannot be excluded even if it has not yet caught up to the performance of the other accounts in the program (unless its net additions and withdrawals exceeded 10% of its beginning net nominal account value for the period). An account with a trading pause cannot be excluded solely because of the trading pause, especially if the program dictated the trading pause. If the trading pause results from client-imposed restrictions that cause the account to be idle or traded differently from the other accounts in the trading program, however, the account may belong in a different performance capsule.

[10] These instances should be rare. If the CTA's principal method frequently produces results that are materially different from the actual experience of accounts in the trading program, the CTA should change to a more consistent method.

[11] This information should be included in a footnote to the performance capsule. If the trading program experienced an unusual change in the number or size of additions, withdrawals, accounts opened, or accounts closed during the reporting period, the CTA should also highlight that change in a footnote and should describe the reason for the change, if known.

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Compliance Rules

RULE 2-9. SUPERVISION.
[Effective date of amendments: October 29, 1991; January 19, 1993; March 15, 1994; April 23, 2002; and November 1, 2007.]

(a) Each Member shall diligently supervise its employees and agents in the conduct of their commodity futures activities for or on behalf of the Member. Each Associate who has supervisory duties shall diligently exercise such duties in the conduct of that Associate's commodity futures activities on behalf of the Member.

(b) NFA's Board of Directors may require Members which meet specific criteria established by the Board relating to the employment history of its APs or principals or to the total commissions, fees and other charges paid by their customers to adopt supervisory procedures specified by the Board for the supervision of telemarketing. This requirement may, in NFA's discretion, be waived upon a showing by the Member that the Member's current supervisory procedures provide effective supervision over its employees and agents. Any Member seeking such a waiver may submit a written request to a three-member panel consisting of three members of the Business Conduct Committee and/or the Hearing Committee, said members to be appointed by the Board from time to time. Within 30 days after a Member submits a waiver request, the Compliance Director will submit a written response to the panel. The decision of the panel shall be final and shall be based upon the written submissions of the Member and of the Compliance Director.

(c) Each FCM and IB Member shall develop and implement a written anti-money laundering program approved in writing by senior management reasonably designed to achieve and monitor the Member's compliance with the applicable requirements of the Bank Secrecy Act (31 U.S.C. 5311, et. seq.), and the implementing regulations promulgated thereunder by the Department of the Treasury and, as applicable, the Commodity Futures Trading Commission. That anti-money laundering program shall, at a minimum,

(1) Establish and implement policies, procedures, and internal controls reasonably designed to assure compliance with the applicable provisions of the Bank Secrecy Act and the implementing regulations thereunder;

(2) Provide for independent testing for compliance to be conducted by Member personnel or by a qualified outside party;

(3) Designate an individual or individuals responsible for implementing and monitoring the day-to-day operations and internal controls of the program; and

(4) Provide ongoing training for appropriate personnel./p>

[See Interpretive Notice NFA Compliance Rule 2-9: FCM And IB Anti-Money Laundering Program and Interpretive Notice NFA Compliance Rule 2-29: Review of Promotional Material Prior to its First Use and Interpretive Notice Compliance Rule 2-9: Self-Audit Questionnaires and Interpretive Notice Compliance Rule 2-9: Supervision of Telemarketing Activity and Interpretive Notice Compliance Rule 2-9: Supervisory Procedures for E-Mail and the Use of Web Sites and Interpretive Notice Compliance Rule 2-29 and 2-9: NFA's Review and Approval of Certain Radio and Television Advertisements]

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Interpretive Notices

9045 - NFA COMPLIANCE RULE 2-9: FCM AND IB ANTI-MONEY LAUNDERING PROGRAM
(Revised November 16, 2006; January 15, 2008; and March 28, 2008)

INTERPRETIVE NOTICE

The *International Money Laundering Abatement and Anti-Terrorist Financing Act of 2001* ("Title III"),[1] which was signed into law on October 26, 2001, imposed significant new anti-money laundering requirements on all "financial institutions," as so defined under the Bank Secrecy Act (BSA),[2] including FCMs.[3] In particular, Section 352 of Title III and NFA Compliance Rule 2-9(c) requires all financial institutions to establish anti-money laundering (AML) programs which, at a minimum, must include internal policies, procedures and controls; a designated compliance officer to oversee day-to-day operations of the program; an ongoing training program for employees; and an independent audit function to test the program.

NFA's Board of Directors adopted NFA Compliance Rule 2-9(c) to impose these requirements on NFA Member FCMs and IBs.[4] NFA recognizes, of course, that the exact form of program adopted by a Member will vary based on a Member's type of business, the size and complexity of its operations, the breadth and scope of its customer base, the number of firm employees, its risks and vulnerabilities to money-laundering and the firm's resources. Nevertheless, the Board believes that certain minimum standards must be a part of any adequate program. The purpose of this interpretive notice (Notice) is to highlight those minimum standards and provide Members with additional guidance on satisfying the requirements of Compliance Rule 2-9(c). Members must be aware, however, that the laws in this area are changing rapidly and that they need to conduct a regular review of their anti-money laundering program to ensure that the program is in compliance with any subsequent changes to the federal law or NFA Rules.

Many of the procedures discussed in the Notice are practices that firms may already employ in their businesses. In particular, bank or bank holding company-owned FCMs or IBs are already required to comply with certain components of the anti-money laundering programs of the banks. FCMs should also have procedures in place related to deposits of cash or cash-like instruments and procedures to obtain identifying information on customers. FCMs and IBs should use their existing programs and procedures as the building blocks for their anti-money laundering compliance programs. Moreover, FCMs and IBs that are registered as broker-dealers under the federal securities laws are subject to similar anti-money laundering requirements. In most cases, programs that comply with requirements applicable to the securities industry will comply with the requirements of this Notice.

Money laundering occurs when funds from an unlawful activity are moved through the financial system in such a way as to make it appear that the funds have come from legitimate sources. Money laundering usually follows three stages. First, cash or cash equivalents are placed into the financial system. Second, the money is transferred or moved to other accounts (e.g. futures accounts) through a series of financial transactions designed to obscure the origin of the money (e.g. executing trades with little or no financial risk or transferring account balances to other accounts). Finally, the funds are reintroduced into the economy so that the funds appear to have come from legitimate sources (e.g. closing a futures account and transferring the funds to a bank account). Trading accounts that are carried by FCMs are one vehicle that can be used to launder illicit funds. In particular, a trading account could be used to execute financial transactions that help obscure the origin of the funds. FCMs and IBs need to be aware of potential money laundering abuses that could occur in a customer account and implement a compliance program to, among other things, deter, detect and report potentially suspicious activity.

DEVELOPING POLICIES, PROCEDURES AND INTERNAL CONTROLS

The starting point for an FCM and IB is to adopt a policy statement that clearly outlines the firm's policy against money laundering and its commitment to follow all applicable laws and regulations to ensure that its business is not used to facilitate money laundering. The policy statement should also make clear that all employees of the firm have a responsibility to follow the firm's written anti-money laundering procedures and controls, and to abide by all applicable laws and regulations involving anti-money laundering programs. The policy statement also should discuss the consequences of not following these procedures. The firm's procedures and controls should enable appropriate personnel to form a reasonable belief that they know the true identity of each customer; recognize suspicious customers and transactions; and require personnel to report suspicious or unusual activity to appropriate supervisory personnel, including senior management, and to FinCEN when appropriate. The firm's procedures and controls should also ensure that the firm maintains an adequate audit trail to assist law enforcement agencies in any investigation. The key components of these policies, procedures and controls are discussed below.

A. Customer Identification Program

As part of its AML program, each FCM and IB Member must adopt a written customer identification program (CIP) that meets the requirements of the BSA.[5] For purposes of the CIP requirements, a customer includes individuals or entities opening new accounts[6] as of October 1, 2003. FCMs and IBs do not have to apply the CIP requirements to existing customers[7] opening additional accounts provided the FCM or IB has a reasonable belief that it knows the true identity of the customer.[8] FCMs and IBs should consider the following guidelines when determining whether it is required to apply its CIP requirements:

- For an omnibus account where the intermediary is the account holder, the FCM should treat the intermediary as the customer and does not have to apply its CIP requirements to the underlying beneficiaries. *See* FIN-2006-G004, *Frequently Asked Question Regarding Customer Identification Programs for Futures Commission Merchants and Introducing Brokers* (31 CFR 103.123), February 14, 2006.
- If an intermediary opens an account in the name of a collective investment vehicle such as a commodity pool, the FCM or IB is not required to apply its CIP to the pool's underlying participants.
- In a give-up arrangement, the clearing FCM, not an FCM acting solely as an executing broker, is required to apply its CIP to the customer. *See* FIN-2007-G001, *Application of the Customer Identification Program Rule to Futures Commission Merchants Operating as Executing and Clearing Brokers in Give-Up Arrangements*, April 20, 2007.

As discussed more fully below, the CIP must include the following elements:

- Required Identifying Information and Identity Verification Procedures
- Recordkeeping Procedures
- Comparison with Government List Procedures
- Customer Notice Procedures
- Reliance on Other Financial Institutions Procedures (if applicable)

Required Identifying Information and Identity Verification Procedures - These procedures should be designed to enable the FCM or IB to form a reasonable belief that it knows the true identity of each customer. In designing the procedures, the FCM or IB should consider the various types of accounts it maintains, the various account opening methods it uses, the various types of identifying information available and the firm's size, location and customer base.

Each CIP must specify the identifying information the FCM or IB will require from each customer. Although the type of identifying information a firm may require will vary based on, among other things, the nature of the firm's business and the type of customer, all firms must obtain certain minimum information prior to opening an account. For all customers, a firm must obtain the customer's name. For an individual, the firm must obtain the customer's date of birth and a residential or business address[9] and for non-natural persons, the customer's principal place of business, local office or other physical location. For a U.S. person, a firm must obtain the customer's social security number or taxpayer identification number (TIN). For a non-U.S. person, the firm must obtain one or more of the following: a TIN, a passport number and country of issuance, an alien identification card number, or the number and country of issuance of any other government-issued document evidencing nationality or residence and bearing a photograph or similar safeguard. For a non-U.S., non-natural person, the firm must obtain a government issued identification number.[10] A firm may also choose to include procedures that provide for an exception for a person who has applied for a TIN. The CIP must include procedures to confirm that the application was filed before the customer opens the account and to obtain the TIN within a reasonable period of time after the account is opened.

The CIP must also include risk-based procedures to verify the identity of each customer to the extent reasonable and practicable. Verification may occur within a reasonable time before or after the customer's account is opened.[11] Accounts may be verified using documentary methods, non-documentary methods or a combination of both. The CIP, however, must describe under what circumstances the firm will use each of these methods. In addition, the CIP must identify situations where the firm will require additional verification based on the FCM's or IB's risk assessment of the new account.

Each firm's CIP should identify the documents that will be used for documentary verification. These documents may vary from firm to firm based on the firm's own risk-based analysis of the types of documents that it believes will enable it to verify customer identity. A firm is encouraged, however, to obtain more than one type of documentary verification to ensure that it has a reasonable belief that it knows its customer's true identity. Documents that would be appropriate for verification include, for an individual, an unexpired government-issued identification that evidences nationality or residence and bears a photograph or similar safeguard (e. g. driver's license or passport); and for a non-individual (e.g. corporation, partnership or trust), documents that show the existence of the entity, such as certified articles of incorporation, a government issued business license, a partnership agreement or a trust instrument. In most instances, once an FCM or IB verifies the identity of a customer through documentary evidence, the FCM or IB does not have to determine whether the document is valid. However, if the document shows an obvious indication of fraud, then the FCM or IB must determine whether the document is sufficient for the firm to form a reasonable belief that it knows the customer's true identity.

In some situations, it may be appropriate to use non-documentary methods in addition to or in lieu of documentary methods. For example, a firm may want to use non-documentary methods in addition to documentary methods when a firm is not familiar with the documentary evidence provided. Non-documentary methods in lieu of documentary methods may be appropriate when the account is opened over the Internet or telephone. If a firm will rely on non-documentary methods, the firm's CIP must describe the non-documentary methods that will be used. These procedures must address situations where an individual is unable to present an unexpired government issued identification document that bears a photograph or similar safeguard; the FCM or IB is not familiar with

the documents presented; the account is opened without obtaining documents; the customer opens the account without appearing in person; or where the FCM or IB is otherwise presented with circumstances that increase the risk that the FCM or IB will be unable to verify the identity of a customer through documents. Appropriate non-documentary methods include contacting a customer; independently verifying the customer's identity through the comparison of information provided by the customer with information obtained from a consumer reporting agency, public database or other source; checking references with other financial institutions; or obtaining a financial statement. A firm may also want to examine whether there is a logical consistency between the customer's name, street address, ZIP code, telephone number, date of birth and social security number.

A firm's procedures should also include a mechanism to identify potentially high-risk accounts in the account opening process. Although attempts to launder money or finance terrorism can come from numerous sources, FCMs and IBs should be aware that certain types of entities or entities or individuals from certain geographic locations may pose a greater risk. FCMs and IBs should consult the Financial Action Task Force's (FATF) list of non-cooperative countries and territories (NCCT list)[12] to determine whether a customer is from one of those countries or territories. If the customer is from one of the countries/territories identified on the NCCT list, the FCM or IB should determine what, if any additional due diligence is necessary in deciding whether to open the account, and if the account is accepted, what if any additional monitoring of the account activity is appropriate.

Accounts opened in the name of a corporation, partnership or trust that is created or conducts substantial business in a jurisdiction that has been designated by Treasury as a primary money laundering concern or has been designated as non-cooperative by FATF may pose additional risks. An FCM's and IB's CIP must also include additional procedures that address under what circumstances the firm will require, for a customer that is not an individual, information about individuals with authority or control over the account in order to verify the customer's identity. These procedures would be used only in situations where the FCM or IB is unable to adequately verify the customer's identity after using documentary and non-documentary methods.

Finally, there may be situations where an FCM or IB cannot form a reasonable belief that it knows the true identity of the customer. The firm's CIP must include procedures for handling this situation. At a minimum, these procedures should address: (1) when an account should not be opened; (2) the terms under which a customer may conduct transactions while the FCM or IB attempts to verify the customer's identity; (3) when an account should be closed after attempts to verify a customer's identity have failed; and (4) when the FCM or IB should file a Suspicious Activity Report (SAR) in accordance with applicable law and regulation.[13]

Recordkeeping Procedures - The firm's CIP must also describe the firm's recordkeeping policies regarding information and documents obtained during the identification and verification process. At a minimum, the CIP must require that a record be kept for: (1) all identifying information obtained from a customer; (2) either a copy or a description of any document that was relied on to verify identity, noting the type of document, any identification number contained in the document, the place of issuance, and if any, the date of issuance and expiration date; (3) a description of the non-documentary verification methods or additional verification methods used and the results; and (4) a description of the resolution of each substantive discrepancy discovered when verifying the identifying information obtained. Although firms are required to keep a record of the identifying information, they do not have to maintain copies of the documents used to verify identity. However, if a firm elects to maintain copies of documents, then the copies themselves may serve as records of the identifying information that was relied upon to verify a customer's identity.

The CIP should also outline the firm's procedure for retaining records. FCMs and IBs must maintain a record of the identifying information collected from a customer for five years after the account is closed, and records of the description of the documents used to verify identity, description of the non-documentary methods or additional verification methods used and the results, and the resolution of any discrepancies for five years after the record is made.

Comparison with Government Lists Procedures - The firm's CIP must also include procedures for determining whether a customer appears on any list of known or suspected terrorists or terrorist organizations issued by any Federal government agency and designated as such by Treasury in consultation with the Federal functional regulators. The firm's procedures must require the FCM or IB to make this determination within a reasonable period of time after the account is opened or earlier if required by another Federal law or regulation or Federal directive issued in connection with the applicable list. The CIP must also require the FCM or IB to follow all Federal directives issued in connection with such lists. No lists have yet been designated under the CIP rules.[14]

Customer Notice Procedures - An FCM's and IB's CIP must also include procedures that require the firm to provide customers with adequate notice that the firm is requesting information to verify their identity. An adequate notice describes the identification requirements of the final rule and provides notice in a manner reasonably designed to ensure that a customer is able to view the notice, or is otherwise given notice, before opening the account. For example, depending on how an account is opened, notice could be provided by the firm posting notice in its office lobby or on its website, including the notice on its account application or using other forms of oral or written notice.[15]

Reliance on Other Financial Institutions' Procedures - An FCM or IB may share a customer relationship with one or more financial institutions. For example, in the FCM/IB relationship, although the customer is a customer of both the FCM and IB, the IB often has primary contact with the customer. This type of relationship may give rise to circumstances where it would be appropriate for an FCM or IB to reasonably rely on the customer identification and verification procedures of another financial institution that has an account or similar relationship with the customer. If an FCM or IB intends to reasonably rely on another financial institution, it must specify in its CIP when the firm will satisfy its obligations by relying upon another financial institution (including an affiliate).

An FCM or IB may rely on another financial institution if: (1) the reliance is reasonable under the circumstances; (2) the other financial institution is subject to an AML compliance program requirement under the BSA and is regulated by a Federal functional regulator;[16] and (3) the other financial institution enters into a contract requiring it to certify annually to the FCM or IB that it has implemented an AML program and that it will perform the specified requirements of its own CIP. If the FCM or IB meets these requirements, it will not be held responsible for the failure of the other financial institution to adequately fulfill the FCM's or IB's CIP obligations.

An FCM or IB may also delegate some or all CIP implementation to a third party service provider or an agent. In those instances, the FCM or IB should have a written agreement with the other entity outlining the other entity's responsibilities. Under these

circumstances, however, the FCM or IB remains solely responsible for assuring compliance with the CIP requirements. As a result, if an FCM or IB delegates any of its CIP responsibilities, it should actively monitor the delegation, assure that the procedures are being conducted in an effective manner and ensure that NFA and other appropriate regulatory bodies are able to obtain information and records relating to the CIP.

B. Detection and Reporting of Suspicious Activity

Another essential component of an effective anti-money laundering compliance program is a set of systems and procedures designed to detect and report suspicious activity. As with most components of a firm's compliance program, the manner in which a firm monitors for suspicious activity will vary based on the firm's size and the nature of its business.

For some firms, appropriate manual monitoring of transactions in excess of a certain dollar amount may constitute acceptable review for suspicious transactions, while other firms may need to implement an automated monitoring process. Although in some instances the carrying FCM may be in the best position to monitor accounts for suspicious transactions, an FCM or IB that is involved in the account opening process or the order flow process should be alert to suspicious transactions and, where appropriate, refuse to open an account or accept a suspicious order and report such suspicious activity to the carrying FCM and FinCEN where required.

Examples of suspicious transactions are those that have no business or apparent lawful purpose, are unusual for the customer, or lack any reasonable explanation. As discussed above, recognizing suspicious transactions requires familiarity with the firm's customers, including the customer's business practices, trading activity and patterns. What constitutes a suspicious transaction will vary depending on factors such as the identity of the customer and the nature of the particular transaction.

Since suspicious transactions may occur at the time an account is opened or at any time throughout the life of an account, FCMs and IBs must train appropriate staff to identify suspicious behavior during the account opening process and monitor cash activity and trading activity in order to detect unusual transactions. Identifying suspicious activity may prove difficult and often requires subjective evaluation because the activity may be consistent with lawful transactions.

One area that firms should give heightened scrutiny is wire transfer activity. Monitoring of this area should include review of unusual wire transfers, including those that involve an unexpected or extensive number of transfers by a particular customer during a particular period and transfers involving certain countries identified as high risk or non-cooperative.[17]

Firms should provide employees with examples of behavior or activity that should raise a "red flag" and cause further inquiry. These "red flags" may alert employees to possible suspicious activity. Some examples of "red flags" that could cause further investigation include:[18]

- A customer exhibits an unusual level of concern for secrecy, particularly with regard to the customer's identity, type of business or source of assets;
- A corporate customer lacks general knowledge of its own industry;
- A customer is unconcerned with risks, commissions or other costs associated with trading;
- A customer appears to be acting as an agent for another entity or individual but is evasive about the identity of the other entity or individual (except situations involving the identity of ownership interests in a collective investment vehicle);
- A customer is from, or has accounts in a country identified as, a haven for bank secrecy, money laundering or narcotics production;
- A customer engages in extensive, sudden or unexplained wire activity (especially wire transfers involving countries with bank secrecy laws);[19]
- A customer engages in transactions involving more than $5,000 in currency or cash equivalents (in one transaction or a series of transactions in one or more days and in any number of accounts); and[20]
- A customer makes a funds deposit followed by a request that the money be wired out or transferred to a third party, or to another firm, without any apparent business purpose.

Monitoring accounts for suspicious activities is a fruitless activity without timely and effective follow-up and investigative procedures. Although the internal structure for reporting suspicious activities will vary from firm to firm, each firm's compliance program must require employees to promptly notify identified firm personnel of any potential suspicious activity. Appropriate supervisory personnel must evaluate the activity and decide whether the activity warrants reporting to FinCEN. In making this determination, an IB should consult with its carrying FCM.[21]

For transactions occurring after May 18, 2004, FCMs and IBs[22] are required[23] to file form SAR-SF[24] with FinCEN to report suspicious transactions that are conducted, or attempted by, at, or through an FCM or IB, involve an aggregate of at least $5,000 in funds or other assets (not limited to currency), and the FCM or IB knows, suspects or has reason to suspect that the transaction or pattern of transactions:

- Involves funds that come from illegal activity or are part of a transaction designed to conceal that the funds are from illegal activity;
- Is designed, such as through structuring, to evade the reporting requirements of the BSA;

- Does not appear to serve any business or apparent lawful purpose; or
- Involves the use of the FCM or IB to facilitate a criminal transaction. [25]

FCMs and IBs are not required to file form SAR-SF for activity related to a robbery or burglary, provided the activity is reported to the appropriate law enforcement agency. FCMs and IBs are also relieved of the filing requirement for a violation of the Commodity Exchange Act, CFTC Regulations, Exchange or NFA rules that is otherwise required to be reported under the Commodity Exchange Act, CFTC regulations, Exchange or NFA rules committed by the FCM/IB or any of its officers, directors, employees or associated persons, provided that the activity is properly reported to the appropriate regulatory authority. If this activity also involves a violation of the BSA, a firm must file the form SAR-SF with FinCEN regardless of whether it has reported the activity to the CFTC or other appropriate regulator. If more than one FCM and/or IB is involved in a particular situation, firms may satisfy the filing requirement by filing one form, provided that the form contains all relevant information. The two firms involved in the transaction may consult with each other and share information, including the SAR-SF itself, to enable the firms to file a single report.[26]

Although the BSA and the implementing regulations prohibit an FCM or IB from sharing both the SAR itself and the fact that a SAR has been filed,[27] firms may share a SAR with parent entities, both domestic and foreign, for the purpose of the parent entity fulfilling its obligation to review compliance by its subsidiaries in meeting the legal requirements to identify and report suspicious activity. FCMs and IBs, however, must have written confidentiality agreements or other arrangements in place specifying that the parent entity (or entities) must protect the confidentiality of the SARs through appropriate internal controls.[28]

C. Section 314(a) Information Requests[29]

FCM Members are also required to develop procedures to access and respond to FinCEN's 314(a) subject lists that are published bi-weekly on FinCEN's secure web-site.[30] These lists identify individuals, entities or organizations that are suspected by various law enforcement agencies of engaging in money laundering or terrorist financing. FCMs are required to access FinCEN's secure website to obtain the most recent lists and search their records for any current accounts and accounts maintained by a named subject during the preceding 12 months and for transactions not linked to an account conducted by a named subject during the preceding 6 months. FCMs must report any matches to FinCEN through the web based system within the required time-frames (generally within 14 days of the lists being posted on the secure web-site). For matches involving an introduced account, FCMs should inform FinCEN or the appropriate law enforcement agency that the match involves an introduced account (and identify the IB) during any follow up conducted by FinCEN or the law enforcement agency. FCMs are not required to respond to FinCEN if no matches are found.

FCMs should maintain the following records to verify that they are complying with 314(a) request requirements: a record of the date of the request, the tracking numbers within the request, and the date the request was searched; and for positive matches, the date the match was reported to FinCEN. FCMs should also maintain information concerning the identified accounts and transactions in a positive match in a manner that can be easily accessed when requested by law enforcement.

FCMs are required to designate a point of contact (POC) person(s) for matters involving 314(a) and provide NFA with that information. Any changes to POC information must be immediately reported to NFA.[31]

D. Section 312 Foreign Private Banking and Correspondent Accounts

FCMs and IBs are also required to establish due diligence programs for correspondent accounts established or maintained for foreign financial institutions (correspondent account rule) and private banking accounts established or maintained for non-U.S. persons (private banking rule). [32]

Correspondent Account Rule - As part of its anti-money laundering program, FCMs and IBs must establish a due diligence program that includes appropriate, specific, risk based, and where necessary, enhanced policies, procedures and controls that are reasonably designed to enable the FCM/IB to detect and report, on an ongoing basis, any known or suspected money laundering activity conducted through or involving any correspondent account[33] established, maintained, administered or managed by the FCM or IB in the United States for a foreign financial institution. However, an IB that only solicits or accepts orders for the purchase or sale of commodity futures contracts does not establish, maintain or administer a correspondent account for the foreign financial institution and therefore is not subject to the requirements of Section 312 (including the enhanced due diligence requirements for certain foreign banks described below) with respect to correspondent accounts. To the extent an IB performs additional services for the account, the IB may be administering or managing the correspondent account and would be subject to Section 312. Similarly, for give-up transactions involving correspondent accounts, the carrying FCM, and not the executing FCM, is subject to compliance with the due diligence provisions of the correspondent account rule.[34]

In assessing the risk presented by a correspondent account, FCM and IBs should consider a number of factors, as appropriate. These factors include: (1) the nature of the foreign financial institution's business and the markets it serves; (2) the type, purpose and anticipated activity of the correspondent account; (3) the nature and duration of the FCM's or IB's relationship with the foreign financial institution; (4) the anti-money laundering and supervisory regime in which the foreign financial institution is chartered or licensed; and (5) information known or reasonably available to the FCM or IB about the foreign financial institution's anti-money laundering record.35 The due diligence program should also require the FCM or IB to conduct a periodic review of the activity in the correspondent account.

FCMs and IBs[36] are required to apply enhanced due diligence measures to correspondent accounts maintained for a foreign bank operating under an offshore banking license, under a license issued by a country designated as being non-cooperative with international money laundering principles by FATF (and the U.S. concurs with the designation)[37], or under a license issued by a country that has been designated by the Secretary of Treasury as a primary money laundering concern and as warranting special measures under Section 311. At a minimum, these measures must include taking reasonable steps to (1) conduct risk-based enhanced scrutiny of correspondent accounts established or maintained for this type of foreign bank to guard against money

laundering and to identify and report suspicious activity, (2) determine whether any such foreign bank maintains correspondent accounts for other foreign banks that enable those other foreign banks to gain access to the foreign bank's correspondent account with the FCM or IB, and if so, to take reasonable steps to obtain information to assess and mitigate the money laundering risks associated with such accounts, and (3) identify the owners of the foreign bank if the bank's shares are not publicly traded, and the nature and extent of each owner's ownership interest.

Enhanced scrutiny should require the FCM or IB, (1) to obtain and consider information related to the anti-money laundering program of the foreign bank to assess the risk of money laundering presented by the bank's correspondent account in appropriate circumstances; (2) to monitor transactions to, from or through the correspondent account in a manner reasonably designed to detect money laundering and suspicious activity; and (3) to obtain information from the foreign bank about the identity of any person with authority to direct transactions through any correspondent account that is a payable-through account, and the sources and beneficial owner of the funds and other assets in the payable-through account.

An FCM/IB's due diligence program should include procedures for situations where the FCM/IB cannot perform the enhanced due diligence, including when the FCM/IB should refuse to open an account, suspend transaction activity, file a suspicious activity report or close the account.

Private Banking Rule - FCMs and IBs must also include in their AML program a due diligence program that includes policies, procedures and controls that are reasonably designed to detect and report any known or suspected money laundering or suspicious activity conducted through or involving any private banking account[38] that is established, maintained, administered, or managed in the United States by the financial institution for a non-U.S. person. The due diligence program should ensure that FCMs and IBs take reasonable steps to (1) ascertain the identity of all nominal and beneficial owners of a private banking account; (2) ascertain whether any owner of the account is a senior foreign political figure; (3) ascertain the source(s) of funds deposited into a private banking account and the purpose and expected use of the account; and (4) review the activity of the account to ensure that it is consistent with the information obtained about the client's source of funds and with the stated purpose and expected use of the account.[39]

An FCM's/IB's due diligence program must include procedures for enhanced scrutiny of a private banking account where a senior foreign political figure is a nominal or beneficial owner. This scrutiny must be reasonably designed to detect and report transactions that may involve the proceeds of foreign corruption.

An FCM's/IB's due diligence program should also include procedures for situations where the FCM/IB cannot perform appropriate due diligence with respect to a private banking account, including when the FCM/IB should refuse to open the account, suspend transaction activity, file a SAR or close the account.

E. Ongoing Compliance Responsibilities

Office of Foreign Assets Control - FCMs and IBs, like other financial institutions, also have obligations under regulations issued by the Office of Foreign Assets Control (OFAC). FCMs and IBs are currently restricted from engaging in certain transactions with individuals or entities located in countries that are under a sanction program administered by OFAC. If the customer is located in one of these countries, the FCM or IB needs to review the sanctioning document or contact OFAC to determine the breadth of the restrictions.[40] FCMs and IBs are also required to block funds from individuals or entities identified on OFAC's list of Specially Designated Nationals and Blocked Persons (SDN list).[41] If the customer's name appears on this list, the firm should immediately notify OFAC.[42] To avoid violating the economic sanctions laws administered by OFAC, FCMs and IBs need to check the OFAC lists for new customers and also recheck their existing customer base against the lists when the lists are updated and new countries or Specially Designated Nationals and Blocked Persons are added to the lists. Otherwise FCMs and IBs risk violating the laws by engaging in prohibited transactions with persons who were not subject to sanction when they became customers, but became subject to sanctions later.

Section 311 Special Measures - Section 311 of the USA Patriot Act gives the Secretary of the Treasury the authority to designate a foreign jurisdiction, institution(s), class(es) of transactions, or type(s) of account(s) as a "primary money laundering concern" and to impose certain "special measures" with respect to such jurisdiction, institution(s), class(es) of transaction, or type(s) of account(s). FCMs and IBs should monitor FinCEN's website (http://www.fincen.gov/) for information on foreign jurisdiction(s), institution(s), class (es) of transactions, or type(s) of account(s) that have been designated as a primary money laundering concern and any special measures that have been imposed.

F. Hiring Qualified Staff

It is also important for the firm to ensure that the individuals that staff areas that are susceptible to money-laundering schemes are trained to work in these areas. A firm may also want to conduct background checks on key employees to screen employees for criminal or disciplinary histories.

G. Recordkeeping

An adequate compliance program for money laundering must also include written requirements on the types of records that should be maintained. The program also must specify where the records should be maintained and that, unless the BSA rules otherwise require, the records must be maintained in accordance with CFTC recordkeeping and record retention requirements under Regulation 1.31 (e.g., maintained for five years and be readily accessible for the first two years). The ultimate goal of the recordkeeping requirements is to provide an adequate audit trail for law enforcement officials investigating potential money laundering schemes.

DESIGNATION OF A COMPLIANCE OFFICER

NFA Compliance Rule 2-9(c) also requires that FCMs and IBs designate an individual or individuals to oversee the anti-money laundering program, including the firm's CIP. This person may be the compliance officer that is responsible for other compliance areas of the firm. Although the compliance officer need not be a designated principal or Associate Member, the person should ultimately report to the firm's senior management.

The firm must provide this compliance officer with sufficient authority and resources to effectively implement the firm's anti-money laundering program. Among other duties with respect to the firm's CIP and suspicious activity reporting, this person should:

- Receive reports of suspicious activity from firm personnel;
- Gather all relevant business information to evaluate and investigate suspicious activity; and
- Determine whether the activity warrants reporting to senior management, and, if authorized to do so, the firm's DSRO or FinCEN.

Obviously, the person responsible for overseeing the anti-money laundering procedures should not be the same employee responsible for the functional areas where money-laundering activity may occur.

EMPLOYEE TRAINING PROGRAM

Another important component of NFA Compliance Rule 2-9(c) is the requirement that FCM and IB Members provide ongoing education and training for all appropriate personnel. This training program should include annual training on the firm's policies and procedures, the relevant federal laws and NFA guidance issued in this area. Firms should also maintain records to evidence their compliance with this requirement.

INDEPENDENT AUDIT FUNCTION

NFA Compliance Rule 2-9(c) also requires that FCM and IB Members[43] provide for independent testing of the adequacy of their anti-money laundering compliance programs. Most FCMs and IBs must conduct this independent testing annually. FCMs and IBs that engage solely in proprietary trading or are inactive, however, may satisfy this requirement by conducting the independent test every two years. All firms, however, are required to test the adequacy of their AML program more frequently than the minimum requirements if circumstances warrant.

A firm may satisfy the independent testing requirement with its own personnel (such as an internal audit staff) or others who do not perform or oversee AML functions.[44] In either circumstance, the audit function should test all affected areas to ensure that personnel understand and are complying with the anti-money laundering policies and procedures and that these policies and procedures are adequate. The results of any audit should be documented and reported to the firm's senior management or an internal audit committee or department, and follow up should be done to ensure that any deficiencies in the firm's anti-money laundering program are addressed and corrected.

ALLOCATION OF COMPLIANCE PROGRAM RESPONSIBILITIES[45]

NFA Compliance Rule 2-9(c) requires all FCMs and IBs to establish and implement anti-money laundering compliance programs. NFA recognizes, however, that given the inter-business relationships between and among some Members, the interests of business efficiency and anti-money laundering effectiveness may be best served if Members cooperate with each other in order to meet their respective obligations. Members may allocate between themselves elements of their anti-money laundering compliance programs. Any allocation agreement, however, must be clearly set forth in writing and any Member allocating anti-money laundering responsibilities to another Member must have a reasonable basis for believing that the other party is properly performing the required functions. Members should keep in mind, however, that Treasury takes the position that these allocation arrangements do not relieve an FCM or IB Member from its independent obligation to comply with anti-money laundering requirements.

CONCLUSION

Money-laundering schemes in the financial services industry lessen the public's faith in the integrity of the system. Therefore, NFA Members must ensure that they take adequate steps to identify and verify the identity of their customers and to detect, deter and report suspicious transactions that could be part of a money-laundering scheme. The guidelines set forth in this Notice should provide FCMs and IBs with the tools needed to develop an effective anti-money laundering program. Member firms should keep in mind, however, that this is an evolving area and NFA expects to provide further guidance as additional requirements in this area are imposed.

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[1] Pub. L. 107-56, 115 Stat. 296, 324 (2001). This Act is Title III of the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism (USA PATRIOT) Act of 2001.

[2] 31 U.S.C. 5311 *et seq.* (2000). Title III amended the BSA, adding certain entities to the definition of financial institution. Regulations implementing the BSA can be found in Part 103 of Title 31 of the Code of Federal Regulations.

[3] Title III also defines CPOs and CTAs as "financial institutions" under the BSA; however, the Secretary of the Treasury (Treasury) temporarily deferred application of these requirements to certain financial institutions, including CTAs and CPOs, pending further review and analysis of the money laundering risks posed by these entities. On September 26, 2002, Treasury issued a proposed regulation that would require certain unregistered investment companies to develop and implement a written anti-money laundering program. Commodity pools are included in the definition of unregistered investment companies. *See* 67 FR 60617 (September 26, 2002). A final rule has not been issued. In addition, on May 5, 2003, Treasury issued a proposed regulation concerning anti-money laundering programs for certain CTAs. *See* 68 FR 23640 (May 5, 2003). A final rule has not yet been issued. NFA will issue separate anti-money laundering program guidance for CPOs and CTAs, at such time as they become subject to the requirements of section 352.

[4] Although IBs are not explicitly defined as "financial institutions" under the BSA, Treasury has clarified that IBs fall within the BSA's "financial institution" definition, which includes "a broker or dealer in securities or commodities." *See* 68 FR 25149 n.3 (May 9, 2003).

[5] *See* 31 U.S.C. 5318(l) and the implementing regulation jointly promulgated by Treasury and the CFTC at 31 CFR 103.123.

[6] *See* 31 CFR 103.123(a)(1)(i)-(ii) for a definition of what does and does not constitute an account.

[7] For purposes of these requirements, a customer with an existing securities account with a dually registered securities broker-dealer and FCM who elects to open a futures account with the dually registered firm may be treated as an existing customer of the firm.

[8] *See* 31 CFR 103.123(a)(5)(i) for the complete definition of who is and who is not a customer. The rule specifically excludes (1) financial institutions regulated by a Federal functional regulator; (2) banks regulated by a state bank regulator; and (3) persons described in 31 CFR 103.123(d)(2)(ii)-(iv) (entities such as governmental agencies and instrumentalities and the domestic operations of a publicly traded company).

[9] For an individual that does not have a residential or business street address, an Army Post Office or Fleet Post Office box number, or the residential or business street address of a next of kin or another contact individual should be obtained.

[10] In situations where a foreign business or enterprise does not have an identification number, an FCM or IB must request alternative government issued documentation certifying the existence of the business or enterprise.

[11] A reasonable amount of time may depend on various factors such as the type of account opened, whether the customer opens the account in person, and the type of identifying information that is available. A firm may choose to place limits on an account, such as restricting the number of transactions or the dollar value of transactions, until a customer's identity is verified. *See Customer Identification Program for Futures Commission Merchants and Introducing Brokers*, 67 FR 48328, 48333 (July 23, 2002). A firm should also keep in mind the regulations of Treasury's Office of Foreign Assets Control (OFAC) (see 31 CFR Part 500 *et.seq.*) prohibiting transactions involving designated foreign countries, their nationals, and other specially designated persons. *See Customer Identification Programs for Futures Commission Merchants and Introducing Brokers*, 68 FR 25149, 25154 (May 9, 2003).

[12] FATF is an inter-governmental body whose purpose is the development and promotion of policies, both at national and international levels, to combat money laundering. FATF publishes a list of non-cooperative countries/territories in the fight against money laundering. This list can be found at http://www.fatf-gafi.org/.

[13] *See* Section B of this Notice for details regarding SARs.

[14] Firms are required to comply with OFAC's list of blocked persons, restricted countries and specially designated nationals, for example, which can be found at www.ustreas.gov/ofac. Firms should also establish policies and procedures for consulting such lists and other publicly available information as part of their anti-money laundering programs. *See, e.g.*, In the Matter of the Federal Branch of Arab Bank PLC, No. 2005-2 at 5,7, available at www.fincen.gov/reg-enforcement.html . However, firms do not have an affirmative duty to seek out the lists of known or suspected terrorists or terrorist organizations issued by the Federal government under the CIP rules. Firms will receive notification by separate guidance regarding the lists they must consult for CIP purposes.

[15] If appropriate, an FCM or IB may use the following sample language to provide notice to its customers:

> **Important Information About Procedures For Opening a New Account**
> To help the government fight the funding of terrorism and money laundering activities, Federal law requires all financial institutions to obtain, verify and record information that identifies each person who opens an account.
>
> What this means for you: When you open an account, we will ask you for your name, address, date of birth and other information that will allow us to identify you. We may also ask to see your driver's license or other identifying documents.

[16] Currently, these financial institutions include banks, broker-dealers, FCMs and IBs. Regulations have been proposed that would require CTAs and IAs to adopt an AML compliance program. FCMs and IBs may rely upon these financial institutions to carry out the CIP pending the issuance of final CTA and IA AML program rules provided that the other reliance requirements noted above are satisfied. (*See* CFTC No Action Letter 05-50 (March 14, 2005)).

[17] *See supra* note 12.

[18] Each firm should determine whether it needs to develop additional "red flags" based on the nature of its customers and its business.

[19] Although alternative means of funding an account, such as credit cards and non-bank online remittance systems, e.g. PayPal, are not common in the futures industry, firms that accept such forms of payment should determine if their use by a customer, like suspicious wire activity, raises a "red flag" that should cause further inquiry.

[20] FinCEN has added FCMs and IBs to the "financial institution" definition in the rules under the BSA, thereby making them subject to the requirement to file currency transaction reports in lieu of Form 8300, *See* 68 FR 65392 (November 20, 2003). FCMs and IBs are also required to comply with BSA recordkeeping and reporting requirements set forth in 31 CFR 103.33, including the requirements regarding requests by customers for transfers and transmittals of funds in the amount of $3,000 or more.

[21] FCMs and IBs that comply with 31 CFR 103.110, which includes an annual notice filing and verification requirement, are immune from civil liability for sharing information for the purpose of detecting, identifying, or reporting activities involving possible money laundering or terrorist activities. This notice can be accessed at http://www.fincen.gov/fi_infoappb.html.

[22] Broker dealers that are notice registered for purposes of offering security futures products are required to comply with the broker-dealer reporting requirements in the securities industry. Dually registered broker-dealers may comply with the SAR requirements in the futures industry or the securities industry's requirements. *See* 68 FR 65392 (November 20, 2003).

[23] Firms are encouraged to file form SAR-SF for suspicious activity that is not required to be reported (e.g. a transaction falling below the $5,000 threshold).

[24] A copy of form SAR-SF and the filing instructions are available at http://www.fincen.gov/.

[25] See 31 CFR 103.17 for a copy of the final regulation.

[26] Firms jointly filing a single SAR-SF are immune from liability with respect to such filing as provided at 31 CFR 103.17(f).

[27] FCMs and IBs are not prohibited from sharing or disclosing the existence of a SAR to appropriate law enforcement agencies or regulatory agencies, including the CFTC, NFA and other self-regulatory organizations of which they are members, as provided by the suspicious activity reporting rules. In addition, when requested by one of these agencies, FCMs and IBs are required to provide these agencies with any supporting documentation to a SAR. (*See* FIN-2007-G003, *Suspicious Activity Report Supporting Documentation*, June 13, 2007.)

[28] FCMs and IBs may not share SARs with non-parent entity affiliates. FinCEN and the CFTC, however, are expected to issue additional guidance on this matter in the future.

[29] Although Section 314(a) applies to IBs, FinCEN currently does not routinely require IBs to conduct 314(a) searches. FinCEN has the authority to require IBs to comply with Section 314(a) in whole or with respect to a particular request. If FinCEN requests IBs to begin conducting 314(a) searches or to comply with a

particular request, IBs would be required to conduct the search or searches.

[30] If a firm does not have electronic access to FinCEN's secure web-site, FinCEN faxes the subject lists to the firm on a bi-weekly basis. This firm is required to conduct the same searches and report any matches to FinCEN via fax.

[31] FCMs are directed to follow the detailed instructions and frequently asked questions concerning these information requests that have been issued directly to them by FinCEN.

[32] See 71 Fed. Reg. 496 (January 4, 2006). *See also* FIN-2006-G009 - *Application of the Regulations Requiring Special Due Diligence Programs for Certain Foreign Accounts to Securities and Futures Industries.* May 10, 2006.

[33] Correspondent accounts include accounts for foreign financial institutions to engage in futures or commodity options transactions, funds transfers, or other financial transactions, whether for the financial institution or principal or for its customers. An account includes any formal relationship established by an FCM to provide regular services, including but not limited to, those established to effect transactions in contracts of sale of a commodity for future delivery, options on a commodity or options on futures. 31 CFR 103.175(d)(2)(iii).

[34] See FIN-2206-G011, *Application of the Regulations Requiring Special Due Diligence Programs for Certain Foreign Accounts to Certain Introduced Accounts and Give-Up Arrangements in the Futures Industries*, June 7, 2006.

[35] See 31 CFR 103.176(a)(2).

[36] As previously noted, as a general rule, the FCM establishing and maintaining the account is subject to the enhanced due diligence requirements of Section 312. An IB that only solicits or accepts orders for the purchase or sale of commodity futures contracts is not subject to the enhanced due diligence requirements of Section 312.

[37] The final rule refers to being designated by an intergovernmental group or organization of which the United States is a member. Currently, FATF is the only such group.

[38] A private banking account is an account (or any combination of accounts) that (1) requires a minimum aggregate deposit of funds or other assets of not less than $1,000,000; (2) is established on behalf of one or more individuals who have a direct or beneficial ownership interest in the account; and (3) is assigned to, or is administered or managed by, in whole or in part, an officer, employee, or agent of a financial institution acting as a liaison between the financial institution and the direct or beneficial owner of the account.

[39] See 31 CFR 103.178(b).

[40] OFAC administers sanction programs against a number of foreign countries. A list of these countries and the sanctioning documents can be found at http://www.ustreas.gov/offices/enforcement/ofac

[41] OFAC's SDN list identifies individuals and entities owned or controlled by, or acting for or on behalf of targeted countries, or known or suspected terrorists or terrorist organizations. This list and information on how to handle matches can be found at http://www.ustreas.gov/offices/enforcement/ofac.

[42] In addition, if a customer attempts to wire transfer money to or receive money from a country under a sanction program or an entity or individual on the SDN list, the firm should contact OFAC immediately.

[43] Although guarantor FCMs may conduct this audit for any of their guaranteed IBs, the IB's senior management must review the scope of the audit and its findings and take corrective action where necessary.

[44] For small firms with limited staff, the audit function can be accomplished by a staff person who is not involved in the anti-money laundering program.

[45] This discussion does not apply to reliance arrangements that meet the requirements discussed under the customer identification program section of this interpretive notice.

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Compliance Rules

RULE 2-9. SUPERVISION.
[Effective date of amendments: October 29, 1991; January 19, 1993; March 15, 1994; April 23, 2002; and November 1, 2007.]

(a) Each Member shall diligently supervise its employees and agents in the conduct of their commodity futures activities for or on behalf of the Member. Each Associate who has supervisory duties shall diligently exercise such duties in the conduct of that Associate's commodity futures activities on behalf of the Member.

(b) NFA's Board of Directors may require Members which meet specific criteria established by the Board relating to the employment history of its APs or principals or to the total commissions, fees and other charges paid by their customers to adopt supervisory procedures specified by the Board for the supervision of telemarketing. This requirement may, in NFA's discretion, be waived upon a showing by the Member that the Member's current supervisory procedures provide effective supervision over its employees and agents. Any Member seeking such a waiver may submit a written request to a three-member panel consisting of three members of the Business Conduct Committee and/or the Hearing Committee, said members to be appointed by the Board from time to time. Within 30 days after a Member submits a waiver request, the Compliance Director will submit a written response to the panel. The decision of the panel shall be final and shall be based upon the written submissions of the Member and of the Compliance Director.

(c) Each FCM and IB Member shall develop and implement a written anti-money laundering program approved in writing by senior management reasonably designed to achieve and monitor the Member's compliance with the applicable requirements of the Bank Secrecy Act (31 U.S.C. 5311, et. seq.), and the implementing regulations promulgated thereunder by the Department of the Treasury and, as applicable, the Commodity Futures Trading Commission. That anti-money laundering program shall, at a minimum,

(1) Establish and implement policies, procedures, and internal controls reasonably designed to assure compliance with the applicable provisions of the Bank Secrecy Act and the implementing regulations thereunder;

(2) Provide for independent testing for compliance to be conducted by Member personnel or by a qualified outside party;

(3) Designate an individual or individuals responsible for implementing and monitoring the day-to-day operations and internal controls of the program; and

(4) Provide ongoing training for appropriate personnel./p>

[See Interpretive Notice NFA Compliance Rule 2-9: FCM And IB Anti-Money Laundering Program and Interpretive Notice NFA Compliance Rule 2-29: Review of Promotional Material Prior to its First Use and Interpretive Notice Compliance Rule 2-9: Self-Audit Questionnaires and Interpretive Notice Compliance Rule 2-9: Supervision of Telemarketing Activity and Interpretive Notice Compliance Rule 2-9: Supervisory Procedures for E-Mail and the Use of Web Sites and Interpretive Notice Compliance Rule 2-29 and 2-9: NFA's Review and Approval of Certain Radio and Television Advertisements]

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Interpretive Notices

9046 - COMPLIANCE RULE 2-9: SUPERVISION OF THE USE OF AUTOMATED ORDER-ROUTING SYSTEMS
(Revised December 12, 2006)

INTERPRETIVE NOTICE

NFA Compliance Rule 2-9 places a continuing responsibility on every Member to diligently supervise its employees and agents in all aspects of their futures activities. The rule is broadly written to provide Members with flexibility in developing procedures tailored to meet their particular needs. On certain issues, however, NFA has issued Interpretive Notices to provide more specific guidance on acceptable standards for supervisory procedures.

Currently, information technology is changing nearly every aspect of how Members conduct business, including how customer orders are transmitted. The Board of Directors firmly believes that supervisory standards do not change with the medium used. How those standards are applied, however, may be affected by technology. Therefore, in order to fulfill their supervisory responsibilities, Members must adopt and enforce written procedures to examine the security, capacity, and credit and risk-management controls provided by the firm's automated order-routing systems (AORSs).[1]

NFA recognizes that, given the differences in the size, complexity of operations, and make-up of the customers serviced by NFA Members, there must be some degree of flexibility in determining what constitutes "diligent supervision" for each firm. It is NFA's policy to leave the exact form of supervision up to the Member, thereby providing the member with flexibility to design procedures that are tailored to the Member's own situation. It is also NFA's policy to set general standards rather than to require specific technology. Therefore, other procedures besides the ones described in this Interpretive Notice may comply with the general standards for supervisory responsibilities imposed by Compliance Rule 2-9.

The procedures discussed in this Interpretive Notice assume that customers have access to the AORS without human intervention. Systems used by Members to transmit customer orders from the firm to the exchange vary significantly, and certain of the procedures discussed in this Notice may not be needed when only firm personnel can enter orders into the system.

This Interpretive Notice applies to AORSs that are within a Member's control, including AORSs that are provided to the Member by an application service provider or an independent software vendor. While a Member is not, of course, responsible for an AORS chosen by the customer and outside of the Member's control - such as direct access systems provided by exchanges - the Member is nevertheless responsible for adopting procedures reasonably expected to address the trading, clearing, and other risks attendant to its customer relationship.[2]

Security
General Standard. Members who accept orders must adopt and enforce written procedures reasonably designed to protect the reliability and confidentiality of customer orders and account information at all points during the order-routing process. The procedures must also assign responsibility for overseeing the process to one or more individuals who understand how it works and who are capable of evaluating whether the process complies with the firm's procedures.

Authentication. The AORS, or other systems the customer must go through to access the AORS, should authenticate the user. Authentication can be accomplished through a number of methods, including, but not limited to, the following:

- Passwords;
- Authentication tokens, such as SecurID cards; or
- Digital certificates.

Encryption. The system should use encryption or equivalent protections for all authentication and for any order or account information that is transmitted over a public network, a semi-private network, or a virtual private network.[3] Encryption is less important for a private network that uses dedicated lines and is controlled by the Member (although it can still be a valuable protection). If more appropriate and effective security procedures are developed or identified, the use of those procedures would comply with this standard.

Firewalls. Firewalls or equivalent protections should be used with public networks, semi-private networks, and virtual private networks. The system should log the activities that pass through a firewall, and the log should be reviewed regularly for abnormal activity. If

more appropriate and effective security procedures are developed or identified, the use of those procedures would comply with this standard.

Authorization. Although it is the customer's responsibility to ensure that only authorized individuals access the AORS using the customer's facilities and authentication devices (e.g., passwords), the Member's procedures should, as appropriate, provide customers with a means to notify the Member that particular individuals are no longer authorized or to request that authentication devices be disabled. Customers should be informed about the notification process.[4]

Periodic Testing. The Member should conduct and evidence periodic,reasonable reviews designed to assess the security of the AORS using an independent internal audit department, a qualified outside party, or other appropriate means.

Administration. The Member should adopt and enforce written procedures assigning the responsibility for overseeing the security of the AORS to appropriate supervisory personnel. The procedures should also provide that appropriate personnel keep up with new developments, monitor the effectiveness of the system's security, and respond to any breaches, and that the firm update the system as needed so that the AORS maintains the appropriate level of security.

Capacity
General Standard. Members who accept orders must adopt and enforce written procedures reasonably designed to maintain adequate personnel and facilities for the timely and efficient delivery of customer orders and reporting of executions. The procedures must also be reasonably designed to handle customer complaints about order delivery and reporting in a timely manner.

Members may not misrepresent the services they provide or the quality of those services. If a Member represents that it maintains a particular capacity or performance level, it must take the measures necessary to achieve that level.[5]

Capacity Reviews.

The Member should adopt and enforce written procedures to regularly evaluate the capacity of the AORS and to increase capacity when needed. The procedures should also provide that the system will be subjected to an initial stress test. Such test may be conducted through simulation or other available means. Thereafter, the system should be subject to periodic reviews by using an independent internal audit department, or a qualified outside party, or using other appropriate means.

The Member should monitor both capacity (how much volume the system can handle before it is adversely impacted or shuts down) and performance (how much volume the system can handle before response time materially increases), and should assess the AORS's capacity and performance levels based on the major strains imposed on the system. The Member should establish acceptable capacity and performance levels for its AORS. The Member's procedures should be reasonably designed to provide adequate capacity to meet estimated peak volume needs based on past experience, present demands, and projected demands.

The procedures should also provide for the Member to follow-up on customer complaints about access problems, system slowdowns, or system outages. This follow-up should include identifying the cause of the problem, if any, and taking action to correct it, and/or evaluating ways to prevent it from re-occurring.

Disaster Recovery and Redundancies. The Member should have contingency plans reasonably designed to service customers if either the system goes down or activity exceeds reasonably expected peak volume needs. The Member should use redundant systems or be able to quickly convert to other systems if the need arises. These backup systems can include facilities for accepting orders by telephone or reliance on third-party brokers or clearing firms.

When operational difficulties occur, the Member should provide prompt and effective notification to customers affected by the operational difficulties. Notification can be made by a number of methods, including, but not limited to, the following:

- a message on the Member's web site;
- e-mails or instant messages;
- a recorded telephone message for customers on hold; and/or
- a recorded telephone message on a line dedicated to providing information to AORS customers.

Advance Disclosure. The Member should disclose, in advance, the factors that could reasonably be expected to affect materially the system's performance (e.g., periods of stress). The Member should also educate customers on alternative ways to enter orders when the system goes down or reaches an unacceptable performance level. This disclosure may be made in the account agreement, on the Member's web site, or in any other manner designed to provide this information to current customers before problems occur.

Credit and Risk-Management Controls
General Standard. Members who accept orders must adopt and enforce written procedures reasonably designed to prevent customers from entering into trades that create undue financial risks for the Member or the Member's other customers.[6]

Pre-Execution Controls.[7] An AORS should allow the Member to set limits for each customer based on commodity, quantity, and type of order or based on margin requirements. It should allow the Member to impose limits pre-execution and to automatically block any orders that exceed those limits.[8]

The Member does not have to impose pre-execution controls on all customers, however. The Member should review the customer's sophistication, credit-worthiness, objectives, and trading practices and strategies when determining whether to impose controls pre-execution or post-execution and deciding what levels to use when setting limits.

Post-Execution Controls. For customers subject to post-execution controls, the Member should have the ability to monitor trading

promptly.[9] This ability can be provided by the AORS or through other risk-management systems. The AORS should generate alerts when limits are exceeded through that system. The system should also allow the Member to block subsequent orders, either in their entirety or by kind (e.g., to block orders that create a new position or increase an existing position but not orders that liquidate some or all of an existing position).

Direct Access Systems. When authorizing (qualifying a customer for) use of a direct access system that does not allow the Member to monitor trading promptly, the Member should utilize pre-execution controls, if available, to set pre-execution limits for each customer, regardless of the nature of the customer.[10] Where the limits are set should be based on the customer's sophistication, credit-worthiness, objectives, and trading practices. Members should also consider any other relevant information when deciding whether to authorize a customer to use a direct access system.

Review. Members should use AORSs in conjunction with their credit-review/risk-management systems and should evaluate the controls imposed on each customer as part of their regular credit and risk-control procedures.

* * *

NFA Compliance Rule 2-9 requires NFA Members to meet the standards for security, capacity, and credit and risk-management controls that are set out in this Interpretive Notice. It is NFA's policy to leave the exact form of supervision up to the Member, thereby providing the Member with flexibility to design procedures that are tailored to the Member's own situation.

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[1]The written procedures do not, however, have to contain technical specifications or duplicate procedures that are documented elsewhere.

[2]An AORS may also be outside an IB Member's control if it is provided by the FCM.

[3] This notice only applies to AORSs. It does not, for example, require Members to encrypt account information provided to customers electronically under CFTC Rule 1.33(g).

[4]For purposes of this notice, the term "customer" includes CTAs except when referring to credit-worthiness and ability to accept risk. In those instances, the term "customer" is limited to the owner of the account.

[5]Misrepresenting capacity or performance levels or other material information regarding a Member's order-routing system is a violation of NFA Compliance Rule 2-29.

[6]NFA Compliance Rule 2-30 also requires Members to consider an individual customer's ability to accept risk.

[7]Pre-execution controls include both credit and "fat-finger" protections.

[8]The ability to impose pre-execution controls does not, however, have to be built into a system that will only be used by customers subject to post-execution controls.

[9]"Promptly" means as soon as practical under the circumstances. Obviously, Members can review trades of customers who engage in simple strategies on only one market much more quickly than they can review trades of customers who execute complex strategies on multiple markets. In the latter case, a Member may not have all of the relevant information until the end of the day.

[10] Customers may have a choice of direct access systems, some of which are better suited to their trading needs than others. While this interpretation does not dictate which system the customer uses, the Member should have the ability to either set pre-execution controls or monitor trading promptly.

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Bylaws

BYLAW 1101. PROHIBITION.
[Effective dates of amendments: July 27, 1983; January 1, 1990; and August 21, 2001.]

No Member may carry an account, accept an order or handle a transaction in commodity futures contracts for or on behalf of any non-Member of NFA, or suspended Member, that is required to be registered with the Commission as an FCM, IB, CPO, CTA or LTM, and that is acting in respect to the account, order or transaction for a customer, a commodity pool or participant therein, a client of a commodity trading advisor, or any other person, unless:

(a) such non-Member of NFA is a member of another futures association registered with the Commission under Section 17 of the Act, or is exempted from this prohibition by Board resolution;

(b) such non-Member of NFA is registered with the Commission as an FCM or IB under Section 4f(a)(2) of the Act and the account, order, or transaction involves only security futures products; or

(c) such suspended Member is exempted from this prohibition by the Appeals Committee.

No Member may accept orders in commodity futures contracts to cover leverage transactions, for or on behalf of any non-Member of NFA, or suspended Member, that is required to be registered with the Commission as an LTM, unless:

(a) such non-Member is a member of another futures association registered under Section 17 of the Act, or is exempted from this prohibition by Board resolution; or

(b) such suspended Member is exempted from this prohibition by the Appeals Committee.

(See Interpretive Notice Compliance with NFA Bylaw 1101.)

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Interpretive Notices

9007 - COMPLIANCE WITH NFA BYLAW 1101
(Staff, March 19, 1987; revised July 1, 2000)

INTERPRETIVE NOTICE

Mandatory membership in NFA is the cornerstone of NFA's regulatory structure. From the earliest stages of its formation, NFA's founders recognized that the creation of a meaningful and effective industrywide self-regulatory organization would be completely impossible unless all persons required to be registered as FCMs, IBs, CPOs or CTAs were required to be Members. The founders of NFA considered the issue to be of such critical importance that they not only prohibited the conduct of customer business with non-Members through NFA Bylaw 1101, but included that prohibition as one of NFA's fundamental purposes in Article III, Section 1(f) of NFA's Articles of Incorporation.

Given the importance of the mandatory membership concept, NFA Bylaw 1101, which tracks the language of Article III, Section 1(f), states the prohibition in the strongest possible terms. [See Bylaw 1101.]

The rule by its terms imposes strict liability on any Member conducting customer business with a non-Member that is required to be registered. The rule does not require proof that the Member firm was at fault or failed to exercise due diligence, simply that it transacted customer business with a non-Member that is required to be registered. NFA Bylaw 1101 requires Members to make two determinations: whether it is doing business with an entity which is required to be registered, and if so, whether that person is a Member of NFA. The second of these determinations is relatively simple. Any Member can check the BASIC system on NFA's web site at www.nfa.futures.org, send a request to NFA through the "contact" feature of the web site, or call NFA's Information Center at a toll-free number (800) 621-3570 to receive current and accurate information concerning the membership status of any person. The determination of whether a particular person is required to be registered can obviously be much more difficult. Any Member could, despite its best efforts, be transacting customer business with a person who is actually required to be registered as an FCM, IB, CPO or CTA. In such a case, the Member is in technical violation of the strict liability terms of NFA Bylaw 1101.

A review of NFA policy, procedures and past disciplinary actions, however, clearly indicates that NFA Bylaw 1101 has not been enforced unreasonably. In making its recommendations in cases involving apparent Bylaw 1101 violations, staff has consistently not relied on the strict liability standard set by the rule itself. Staff has recommended the issuance of complaints in Bylaw 1101 cases in which the evidence indicates that the Member knew or should have known of the violation. Of course, under NFA Compliance Rules, the ultimate decision of whether a particular violation of NFA Rules warrants prosecution rests with the Members of NFA's Business Conduct Committee ("BCC"). BCC Members exercise their informed business judgment in making these decisions, and are certainly aware that some violations of Bylaw 1101 may occur in spite of reasonably diligent efforts to comply with the rule.

The question of whether a Member should have known of a violation of NFA Bylaw 1101 depends in large part on the adequacy of its procedures to prevent such violations. Though it would be impossible to describe all of the situations which should put a Member on notice that a particular person is required to be a Member or NFA, there are certain minimal steps which should be taken to reduce the possibility of a violation of NFA Bylaw 1101:

1. FCM Members should ensure that all omnibus accounts they carry are held by FCM Members of NFA;

2. Each Member should review the list of CFTC registrants with which it does business to determine if they are NFA Members. A Member can determine whether a particular entity is a CFTC registrant by checking the BASIC system on NFA's web site located at www.nfa.futures.org, sending a request to NFA through the "contact" feature on the web site, or calling NFA's Information Center toll-free at (800) 621-3570.

3. Each Member should review its list of customers. If a customer's name indicates that it may be engaged in the futures business, the Member should inquire as to its registration and membership status;

4. When a FCM or IB Member carries an account controlled by a third party (other than an AP of the FCM or IB or a member of the same family as the account owner), the FCM or IB Member should check to see if the account controller is registered as a CTA and, if not registered, should inquire as to the basis of any exemption and, if applicable, should verify that account

controller has made the required filings with the CFTC and NFA;

5. If any customer is operating a commodity pool but claims to be exempt from registration as a CPO, the Member should verify that the customer has made the required filings with the CFTC and NFA;

6. Members should ensure that their branch offices are not separately incorporated entities. The CFTC Division of Trading and Markets has issued an interpretive letter stating that branch offices which are separately incorporated entities are required to be registered as introducing brokers; and

7. FCM Members should determine whether non-Member foreign brokers for whom the Member carries accounts solicit U.S. customers for transactions on U.S. exchanges.

As mentioned above, these suggested steps do not purport to be a dispositive list of internal procedures required to prevent violation of NFA Bylaw 1101. Though under some circumstances a Member following these suggestions could still be found liable for a violation of NFA Bylaw 1101, the suggested procedures should help foster compliance with NFA Bylaw 1101 and greater protection to the investing public.

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Interpretive Notices

9055 - NFA BYLAW 1101, COMPLIANCE RULES 2-9 AND 2-29: GUIDELINES RELATING TO THE REGISTRATION OF THIRD-PARTY TRADING SYSTEM DEVELOPERS AND THE RESPONSIBILITY OF NFA MEMBERS FOR PROMOTIONAL MATERIAL THAT PROMOTES THIRD-PARTY TRADING SYSTEM DEVELOPERS AND THEIR TRADING SYSTEMS
(Board of Directors, August 19, 2004; effective January 10, 2005)

INTERPRETIVE NOTICE

In recent years, there has been a significant increase in the number of futures trading systems being marketed to the public. These trading systems typically are computerized programs that generate signals as to when to buy and sell commodity futures and options contracts.

A number of NFA Member firms offer trade execution services to customers who use these computerized trading systems, many of which are developed by third-party trading system developers ("third-party system developers"), who are neither NFA members nor registered with the CFTC. Typically, in these situations, the customer will execute a Letter of Direction that directs the Member to place trades for the customer in strict accordance with the signals generated by the trading system. In some cases, the Letter of Direction is more limited and includes instructions to follow only certain signals (e.g., signals in given contracts or signals that meet particular parameters). In almost all cases in which a Letter of Direction is used, the Member is not permitted to use any judgment when placing orders for the customer.

This notice is designed to provide guidance as to the circumstances which may give rise to liability on the part of the Member, under NFA Bylaw 1101, for providing execution services to users of computerized trading systems developed by non-Member third-party system developers. This notice will also discuss the factors that may cause a Member to be responsible, under NFA Compliance Rule 2-29, for promotional material which promotes these trading systems and the Member's supervisory obligations under NFA Compliance Rule 2-9.

REGISTRATION REQUIREMENTS FOR
THIRD-PARTY SYSTEM DEVELOPERS

Section 1a (6) of the Commodity Exchange Act ("CEA") defines a CTA as any person who for compensation or profit, engages in the business of advising others, directly or through publications, writings, or electronic media, as to the value of or the advisability of trading commodity futures. Generally, Section 4m of the CEA requires individuals who fall within this definition to register with the CFTC. In March 2000, the CFTC adopted CFTC Rule 4.14(a)(9) to create an exemption from the CEA's registration requirements for CTAs that provide standardized advice by means of media such as newsletters, pre-recorded telephone hotlines, Internet web sites, and non-customized computer software.

To qualify for the exemption, under Rule 4.14(a)(9)(i) a CTA may not direct client accounts. As defined by Commission Rule 4.10(f), `` [d]irect, as used in the context of trading commodity interest accounts, refers to agreements whereby a person is authorized to cause transactions to be effected for a client's commodity interest account without the client's specific authorization." In a Commission Staff letter issued in May 2003, Commission Staff indicated that an agreement authorizing a person to direct a client's account - and, thus, requiring the person to be registered as a CTA - may be an informal agreement. The fact pattern addressed by the Commission's Staff letter involved a developer of a computerized trading system who was registered as an associated person ("AP") of an introducing broker ("IB"). The AP's activities on behalf of the IB consisted solely of soliciting clients to use his trading program. Such clients executed a "letter of direction" providing that the IB should execute trades for the clients' accounts and "follow [the trading program] signals as close as reasonably possible."

In analyzing the above fact pattern, Commission Staff concluded that, since the clients' contact with the AP/trading system developer included not only the trading program, but also the opening of a trading account that would be traded pursuant to a "letter of direction," there was an "informal arrangement", for which the exemption provided under Rule 4.14(a)(9) was not intended. After specifically noting that the "whole of [the AP/trading system developer's] activities as an AP of the IB consisted of the solicitation of clients for the trading program, CFTC staff determined that registration as a CTA was required of either the IB or the AP. (See CFTC staff letter, No. 03-26, May 30, 2003, re Section 4m - Interpretation with regard to Commodity Trading Advisor Registration.)

Rule 4.14(a)(9)(ii) also provides that, to qualify for the exemption, a CTA may not provide "commodity trading advice based on, or

tailored to, the commodity interest or cash market positions or other circumstances or characteristics of particular clients." So long as the CTA's advice is based on or tailored to such information, the CTA is required to register even if it gives the same advice to groups of similarly situated clients.

In determining whether advice is "based on or tailored to" within the meaning of 4.14 (a)(9)(ii), the context of the advice will be taken into account. For example, if the advice is provided in a book or a periodical, that factor may weigh against a finding that the CTA is providing advice "based on or tailored to" the characteristics of particular clients. On the other hand, if the advice is provided to a particular client in a face-to-face communication or over the telephone, that factor may weigh in favor of a finding that the CTA's advice is "based on or tailored to" that particular customer's characteristics, since such a context suggests that the CTA is being responsive to the client's individual needs.[1]

Whether a third-party system developer is required to be registered as a CTA still depends on the particular facts of each case. In some cases, the third-party system developer - or any third-party, for that matter - may be required to register as an IB, if it refers customers to an NFA Member and receives compensation for the referrals. Members who have questions concerning the application of Rule 4.14 are urged to seek advice from the CFTC.

Regardless of whether a third-party system developer is required to register as a CTA, the question sometimes arises whether the IBs involved must also register as CTAs. If the IB and the third-party system developer are operated as wholly independent entities and the IB has no authority to deviate from the third-party system developer's recommendations, generally the IB need not also register as a CTA. This is clearly the case where a customer independently selects a trading system and the IB does not solicit discretionary trading authority. However, if any of these factors change (e.g., the IB has authority to deviate from the trading system by selecting only some of the trades generated by the system), the IB may be required to register as a CTA, unless the IB is otherwise exempt because its activities related to placing trades based on the recommendations of the trading system are "solely in connection with its business as an IB."

NFA Bylaw 1101 provides, in pertinent part, that no Member may carry an account, accept an order or handle a transaction in commodity futures on behalf of any non-Member that is required to be registered as a CTA or in some other capacity. Therefore, if it appears that a third-party system developer, with whom an NFA Member does business, is required to be registered as a CTA or in some other capacity, the Member should request that the third-party system developer provide a letter from counsel stating the reasons why registration is not required.[2] In the absence of such a letter, the Member should request that the third-party system developer apply for registration and NFA membership. If the third-party system developer fails or refuses to register and become an NFA Member, the Member should terminate its relationship with the third-party system developer to avoid liability under NFA Bylaw 1101.

A MEMBER'S RESPONSIBILITY FOR MISLEADING PROMOTIONAL MATERIAL WHICH PROMOTES A THIRD-PARTY SYSTEM DEVELOPER'S TRADING PROGRAM

NFA has encountered, with increasing frequency in recent years, misleading promotional material promoting trading systems developed by third-party system developers, who are not NFA Members, and for which an NFA Member provides trade execution services. Often this promotional material uses hypothetical or simulated results - which are trading results not achieved by an actual account - that are not clearly identified as hypothetical and show impressive gains, when customers actually using the trading system have suffered substantial losses. In this and other contexts, both NFA and the Commission have brought numerous enforcement actions charging fraud in the use of such promotional material.

Following are several examples of situations where Members may be held accountable under Compliance Rules 2-29 and 2-9 for misleading promotional material that promotes third-party trading system developers and their trading systems.

Direct Responsibility

If an NFA Member or its Associates prepare or distribute the promotional material, the Member will be responsible for its misleading content under NFA Compliance Rule 2-29, which prohibits a Member from using misleading or deceptive promotional material.

Agency Responsibility

NFA's Business Conduct Committee has always recognized that each Member is responsible for the acts of its agents. This certainly applies to the preparation of advertising material. Thus, an NFA Member may be responsible, under NFA Compliance Rule 2-29, for misleading promotional material prepared and disseminated by a third-party trading system developer, whether or not the third-party trading system developer is an NFA Member or not, if there is an agency relationship between the NFA Member and the third-party trading system developer. (Of course, if the third-party trading system developer is also an NFA Member, it too would be responsible under NFA Compliance Rule 2-29 for the misleading promotional material that it prepared and distributed.)

In determining whether there is an agency relationship between the Member and the third-party system developer, which would trigger liability under NFA Compliance Rule 2-29, the central inquiry focuses on the nature of the business relationship between the parties and whether the parties have expressly or implicitly agreed that one may act for the other. As the CFTC has held, whether an agency relationship exists turns "on an overall assessment of the totality of the circumstances in each case." The more limited the contacts are between the third-party system developer and the NFA Member, the more likely it is that an agency relationship will not be found to exist between the parties.

If there is an agency relationship between the Member and the third-party system developer, then the Member has an affirmative duty, under NFA Compliance Rule 2-9, to supervise the activities of the third-party system developer/agent.

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Supervisory Responsibility Under NFA Compliance Rule 2-9

Even where no agency relationship exists, a Member whose web site links to or otherwise refers customers to a third-party system developer or has a referral agreement with a third-party trading system developer should conduct a due diligence inquiry into the system developer's advertising practices with a view towards identifying and avoiding the misleading advertising practices described earlier, i.e., the use of exaggerated profit claims, and hypothetical or simulated results which are not clearly identified as hypothetical, or which show highly profitable performance when actual customers trading the system have sustained significant losses.[3]

The fact that a Member creates a hyperlink from its web site or otherwise refers customers to a third-party system developer or has a referral agreement with a third-party system developer does not, in and of itself, make the Member firm accountable for the third-party system developer's web site or promotional material. Member firms should bear in mind, though, that their supervisory obligations under Rule 2-9 and Rule 2-29 require them to diligently supervise their employees and agents who are responsible for creating and maintaining hyperlinks to web sites of third-party system developers; or establishing referral agreements with third-party system developers. Members should consider whether appropriate supervisory procedures include periodic inquiries as to whether their employees and agents are conducting due diligence with respect to the third-party system developer's web site or advertising, and taking appropriate steps if deficiencies are found in such web site or advertising. A Member's failure to supervise its employees and agents in this regard will constitute a violation of NFA Compliance Rule 2-9 on the part of the Member. Moreover, in these situations, Member firms should not seek to circumvent NFA's promotional material requirements by relying upon the unregistered status of the third-party trading system developer.

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[1] The Commission gives a number of examples, which illustrate the application of Rule 4.14(a)(9) in specific situations, in the Rule's publication in the Federal Register. (Federal Register: March 10, 2000 (Volume 65, Number 48, pages 12938-12943.)

[2] Member firms may rely in good faith upon a copy of a letter from counsel. However, in some cases, a Member may have to perform additional due diligence to ascertain whether a third-party system developer is required to be registered.

[3] *See* also NFA's interpretive notice entitled "NFA Compliance Rule 2-9: Supervisory Procedures for E-Mail and the Use of Web Sites" (paragraph 9037).

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Financial Requirements

SECTION 8. ADDITIONAL INFORMATION REQUESTS.
[Effective dates of amendments: December 17, 1999.]

If requested by NFA, a Member FCM or IB must promptly submit such additional reports and supplemental financial information which NFA deems necessary.

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Financial Requirements

SECTION 4. FINANCIAL REQUIREMENTS AND TREATMENT OF CUSTOMER PROPERTY.
[Effective dates of amendments: December 17, 1999; and June 2, 2008.]

Any Member FCM or IB who violates any of CFTC Regulations 1.10, 1.12, 1.16, 1.17 or 1.20 through 1.30 (as applicable) shall be deemed to have violated an NFA requirement.

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Compliance Rules

RULE 2-10. RECORDKEEPING.
[Effective date of amendments: April 11, 1983; April 1, 2006 and July 1, 2007.]

(a) Each Member shall maintain adequate books and records necessary and appropriate to conduct its business including, without limitation, the records required to be kept under CFTC Regulations 1.18 and 1.32 through 1.37 for the period required under CFTC Regulation 1.31.

(b) Each FCM Member must either:

(1) Maintain an office in the continental United States, Alaska, Hawaii, or Puerto Rico responsible for preparing and maintaining financial and other records and reports required by CFTC and/or NFA rules under the supervision of a listed principal and registered associated person of the FCM who is resident in that office; or

(2) Maintain an office in a jurisdiction that the CFTC has found to have a comparable regulatory scheme for purposes of Part 30 of the CFTC's rules and be subject to that regulatory scheme. This foreign office must be responsible for preparing and maintaining financial and other records and reports required by CFTC and/or NFA rules under the supervision of a listed principal and registered associated person of the FCM who is resident in that office, and the Member must agree to reimburse NFA for any travel, translation, telephone, and similar expenses incurred in connection with inquiries, examinations and investigations of the Member that exceed the normal expenses incurred by NFA in examining an FCM Member located at the closest point in the continental United States, Alaska, Hawaii, or Puerto Rico.

(c) Each Member subject to minimum capital requirements must:

(1) prepare financial reports required to be filed with the CFTC and/or NFA in English, using U.S. dollars, and according to U.S. accounting standards; and

(2) maintain a general ledger in English using U.S. dollars.

(d) Each Member must:

(1) file reports, requests for extensions, and other documents required to be filed with the CFTC and/or NFA in English;

(2) maintain English translations of all foreign-language promotional material, including disclosure documents and Web sites, distributed to or intended for viewing by customers located in the United States, its territories, or possessions;

(3) maintain written procedures required by CFTC or NFA rules in English (as well as in any other language if necessary for them to be understood by the Member's employees and agents);

(4) provide English translations of other foreign-language documents and records and file financial information in U.S. dollars when requested by NFA; and

(5) make available to NFA (during an examination or to respond to other inquiries) an individual who is authorized to act on the Member's behalf, is fluent in English, and is knowledgeable about the Member's business and about financial matters.

[See Interpretive Notice NFA Compliance Rule 2-10: The Allocation of Block Orders for Multiple Accounts.]

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Compliance Rules

RULE 2-13. CPO/CTA REGULATIONS.
[Adopted effective September 29, 1982. Effective date of Amendments: April 11, 1983; July 5, 1984; April 4, 1988; August 24, 1995; October 10, 1996; July 24, 2000 and December 14, 2003.]

(a) Any Member who violates any of CFTC Regulations 4.1, 4.7, 4.12 and 4.16 through 4.41 shall be deemed to have violated an NFA requirement.

(b) Each Member CPO which delivers or causes to be delivered a Disclosure Document under CFTC Regulation 4.21 must include in the Disclosure Document a break-even analysis which includes a tabular presentation of fees and expenses. The break-even analysis must be presented in the manner prescribed by NFA's Board of Directors and must be accurate as of the date of the Disclosure Document.

(c) Each Member required to file any document with or give notice to the CFTC under CFTC Regulations 4.7, 4.12, 4.22, 4.26 or 4.36 shall also file one copy of such document with or give such notice to NFA at its Chicago office no later than the date such document or notice is due to be filed with or given to the CFTC. Any CPO Member may file with NFA a request for an extension of time in which to file the annual report required by CFTC Regulation 4.22(c) or a request for approval of a change to its fiscal-year election.

[See Interpretive Notice Interpretation of NFA Compliance Rule 2-13: Guideline for the Disclosure by CPOs and CTAs of "Up Front" Fees and Organizational and Offering Expenses and Interpretive Notice Compliance Rule 2-13: Break-Even Analysis (Board of Directors).]

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Compliance Rules

RULE 2-5. COOPERATION IN NFA INVESTIGATIONS AND PROCEEDINGS.
[Effective date of amendments: July 24, 2000.]

Each Member and Associate shall cooperate promptly and fully with NFA in any NFA investigation, inquiry, audit, examination or proceeding regarding compliance with NFA requirements or any NFA disciplinary or arbitration proceeding. Each Member and Associate shall comply with any order issued by the Executive Committee, the Membership Committee, the Business Conduct Committee, the Appeals Committee or any NFA hearing or arbitration panel.

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Compliance Rules

RULE 2-6. EXPELLED OR SUSPENDED MEMBER OR ASSOCIATE.
[Effective date of amendments: July 20, 2005; and June 5, 2007.]

No person who has been expelled or suspended or is subject to a similar sanction by NFA in a proceeding brought pursuant to Part 3 of NFA's Compliance Rules that temporarily or permanently prohibits the person from NFA membership or affiliation in any capacity with an NFA Member shall hold himself out as a Member in good standing of NFA, or as affiliated with a Member, as the case may be, during the period during which the sanction is in effect. No Member or Associate shall conduct commodity futures or forex business with such a person during the period the sanction is in effect unless authorized by the Business Conduct Committee, Hearing Committee or the Appeals Committee.

[See Interpretive Notice NFA Compliance Rule 2-6: Conducting Commodity Futures Business With an Expelled or Suspended Member or Associate

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Interpretive Notices

9056 - NFA COMPLIANCE RULE 2-6: CONDUCTING COMMODITY FUTURES BUSINESS WITH AN EXPELLED OR SUSPENDED MEMBER OR ASSOCIATE

(Board of Directors, May 19, 2005; effective July 20, 2005)

INTERPRETIVE NOTICE

In the last several years, NFA has encountered several instances where brokers, who have been barred from NFA membership as a result of an NFA disciplinary action, have continued to work at a Member firm. NFA Compliance Rule 2-6 provides that no Member or Associate shall conduct commodity futures business with a person who has been expelled or suspended or is subject to a similar sanction by NFA in a proceeding brought pursuant to Part 3 of NFA's Compliance Rules that temporarily or permanently prohibits the person from NFA membership or affiliation in any capacity with an NFA Member during the period the sanction is in effect unless authorized by the Business Conduct Committee, Hearing Committee or the Appeals Committee.

The purpose of this Rule is to address the problem described above. The phrase "commodity futures business", as used in Compliance Rule 2-6, means any and all activities performed by such persons on behalf of, and in connection with, an NFA Member's futures business. Therefore, a Member firm is prohibited from allowing a person who has been expelled or suspended or is subject to a similar sanction by NFA that temporarily or permanently prohibits the person from NFA membership or affiliation in any capacity with an NFA Member to perform any activities for or on its behalf regardless of whether such activities require registration or NFA membership. Member firms are also prohibited from having such persons acting for or on behalf of the firm in connection with its futures business, including as employees, consultants, independent contractors, agents or unpaid volunteers. Moreover, absent extraordinary circumstances, Member firms should not have such persons physically present in their offices.

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Compliance Rules

RULE 2-38. BUSINESS CONTINUITY AND DISASTER RECOVERY PLAN.
[Adopted effective April 7, 2003.]

(a) Each Member must establish and maintain a written business continuity and disaster recovery plan that outlines procedures to be followed in the event of an emergency or significant business disruption. The plan shall be reasonably designed to enable the Member to continue operating, to reestablish operations, or to transfer its business to another Member with minimal disruption to its customers, other Members, and the commodity futures markets.

(b) Each Member must provide NFA with the name of and contact information for an individual who NFA can contact in the event of an emergency, and the Member must update that information upon request. Each IB, CPO, and CTA Member that has more than one principal and each FCM Member must also provide NFA with the name of and contact information for a second individual who can be contacted if NFA cannot reach the primary contact, and the Member must update that information upon request. These individuals must be authorized to make key decisions in the event of an emergency.

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Interpretive Notices

9052 - NFA COMPLIANCE RULE 2-38: BUSINESS CONTINUITY AND DISASTER RECOVERY PLAN

INTERPRETIVE NOTICE

Since the events of September 11, 2001, the financial services industry has devoted increased attention to issues relating to disaster recovery plans. NFA's Board of Directors (Board) believes that disaster recovery and business continuity issues are of utmost importance and that NFA should be proactive in ensuring that its Members have adequate disaster recovery plans in place. As a result, NFA's Board recently adopted NFA Compliance Rule 2-38 to require all Members to adopt a business continuity and disaster recovery plan (Plan).

Compliance Rule 2-38 is broadly written to provide Members with the flexibility to adopt a Plan tailored to their individual needs. NFA recognizes that the exact form of the Plan adopted by a Member will vary based on a number of factors, including the size and complexity of the Member's business and the firm's resources. Nevertheless, the Board believes Members need additional guidance on the essential components of a Plan and what is required to maintain a Plan. This interpretive notice provides that guidance.

Essential Components
Compliance Rule 2-38 requires Members to have a Plan reasonably designed to enable them to continue operating, to reestablish operations, or to transfer their business to other Members with minimal disruption to their customers, other Members, and the commodity futures markets. A Plan should address the following, as applicable:

- Establishing back-up facilities, systems, and personnel that are located in one or more reasonably separate geographic areas from the Member's primary facilities, systems, and personnel (e.g. primary and back-up facilities should be located in different power grids and different telecommunication vendors should be used), which may include arrangements for the temporary use of facilities, systems, and personnel provided by third parties;
- Backing up or copying essential documents and data (e.g. general ledger) on a periodic basis and storing the information off-site in either hard-copy or electronic format;
- Considering the impact of business interruptions encountered by third parties and identifying ways to minimize that impact; and
- Developing a communication plan to contact essential parties such as employees, customers, carrying brokers, vendors and disaster recovery specialists.

These components are minimum areas that should be addressed in Members' Plans. A Member's Plan should also address any other areas that are essential to its business operations. An effective Plan will be designed to meet the Member's individual situation and needs.

Maintaining the Plan
In order for a Member's Plan to remain effective, the Member must update its Plan as necessary to respond to material changes in the Member's operations. Each Member must also periodically conduct and evidence reasonable reviews designed to assess the Plan's effectiveness.

Even the best Plan is useless if it is not available when needed. Therefore, each Member should distribute and explain the Plan to its key employees and communicate the essential components of the Plan to all employees. Each Member should also maintain copies of the Plan at one or more off-site locations that are readily accessible to key employees.

NFA Compliance Rule 2-38 requires NFA Members to establish and maintain business continuity and disaster recovery plans that are consistent with this interpretive notice. The Rule provides Members with flexibility in developing those Plans, and each Member should adopt a Plan that meets its individual situation and needs.

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Compliance Rules

RULE 2-45. PROHIBITION OF LOANS BY COMMODITY POOLS TO CPOS AND AFFILIATED ENTITIES
[Adopted effective September 11, 2009.]

No Member CPO may permit a commodity pool to use any means to make a direct or indirect loan or advance of pool assets to the CPO or any other affiliated person or entity.

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Interpretive Notices

9062 - COMPLIANCE RULE 2-45: PROHIBITION OF LOANS BY COMMODITY POOLS TO CPOS AND RELATED ENTITIES

(Board of Directors, August 20, 2009; effective September 11, 2009)

INTERPRETIVE NOTICE

NFA has recently taken a number of Member Responsibility Actions (MRAs) against commodity pool operators (CPOs) and CPO principals who directly or indirectly loaned or advanced pool assets to themselves or an affiliated person or entity. Many of these arrangements were used by these principals to purchase luxury items, while others went to related entities that did not have sufficient assets to repay the loans. In each case, the transaction resulted in significant losses to participants' funds.

The Board of Directors has determined that direct or indirect loans or advances from pools to their CPOs, the CPO's principals, or related entities should be prohibited. Therefore, NFA Compliance Rule 2-45 prohibits CPOs from permitting a commodity pool to use any means to make a direct or indirect loan or advance of pool assets to the CPO or any other affiliated person or entity.

NFA understands that a few pools may have made these types of loan or advance arrangements prior to Compliance Rule 2-45's effective date. These CPOs are required to notify NFA of these existing arrangements within thirty (30) days of Compliance Rule 2-45's effective date.

These arrangements violate NFA's existing compliance rules if the arrangements are not consistent with the pool's current disclosure document or offering materials and both the loan(s) or advance(s) and the conflict of interest are not fully disclosed to participants. Existing arrangements also violate NFA's rules if the loan or advance is not secured by marketable, liquid assets (e.g. a CPO participant's pro-rata interest in the pool's liquid assets) and, therefore, the arrangement could have a material effect upon the pool's ability to meet its obligations to participants.

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II. Off-Exchange Traded Futures Contracts

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Compliance Rules

RULE 2-36. REQUIREMENTS FOR FOREX TRANSACTIONS
[Adopted effective June 28, 2002. Effective dates of amendments: December 1, 2003; November 30, 2005; February 13, 2007; October 25, 2007; and April 1, 2009.]

(a) General Prohibition

No Forex Dealer Member shall engage in any forex transaction that is prohibited under the Commodity Exchange Act.

(b) Fraud and Related Matters

No Forex Dealer Member or Associate of a Forex Dealer Member engaging in any forex transaction shall:

(1) Cheat, defraud or deceive, or attempt to cheat, defraud or deceive any other person;

(2) Willfully make or cause to be made a false report, or willfully to enter or cause to be entered a false record in or in connection with any forex transaction;

(3) Disseminate, or cause to be disseminated, false or misleading information, or a knowingly inaccurate report, that affects or tends to affect the price of any foreign currency;

(4) Engage in manipulative acts or practices regarding the price of any foreign currency or a forex transaction;

(5) Willfully submit materially false or misleading information to NFA or its agents with respect to forex transactions;

(6) Embezzle, steal or purloin or knowingly convert any money, securities or other property received or accruing to any person in or in connection with a forex transaction.

(c) Just and Equitable Principles of Trade

Forex Dealer Members and their Associates shall observe high standards of commercial honor and just and equitable principles of trade in the conduct of their forex business.

(d) Doing Business with Non-Members

A Forex Dealer Member that is the counterparty, or offers to be the counterparty, to forex transactions for customers shall be subject to discipline for the activities of any person that solicits or introduces a customer to the Member or that manages such customer's accounts, unless such person is a Member or Associate of NFA, meets the criteria in Bylaw 306(b), or would be exempt from Commission registration if it were acting in the same capacity in connection with exchange-traded futures contracts.

(e) Supervision

Each Forex Dealer Member shall diligently supervise its employees and agents in the conduct of their forex activities for or on behalf of the Forex Dealer Member. Each Associate of a Forex Dealer Member who has supervisory duties shall diligently exercise such duties in the conduct of that Associate's forex activities for or on behalf of the Forex Dealer Member.

(f) Affiliates

Each Forex Dealer Member that has an affiliate that is authorized to engage in forex transactions solely by virtue of its affiliation with the Forex Dealer Member shall supervise its affiliate's forex activities for compliance with the same requirements that apply to the Forex Dealer Member, including section (a) of this rule. The Forex Dealer Member shall make the affiliate's books and records available to NFA staff upon request and shall be subject to discipline for acts and omissions of the affiliate that violate the standards imposed by NFA requirements.

(g) BASIC Disclosure

When a customer first opens an account and at least once a year thereafter, each Forex Dealer Member shall provide each customer with written information regarding NFA's Background Affiliation Status Information Center (BASIC), including the web site address.

(h) Filing Promotional Materials with NFA.

The Compliance Director may require any Forex Dealer Member for any specified period to file copies of all promotional material with NFA for its review and approval at least 10 days prior to its first use or such shorter period as NFA may allow. The Compliance Director may also require a

Forex Dealer Member to file for review and approval copies of promotional material prepared or used by some or all of the non-Members it is responsible for under Section (d).

(i) Hypothetical Results

Any Member who uses promotional material that includes a measurement or description or makes any reference to hypothetical forex transaction performance results that could have been achieved had a particular trading system of the Member or Associate been employed in the past must comply with Compliance Rule 2-29(c) and the related Interpretive Notice as if the performance results were for transactions in on-exchange futures contracts.

(j) Scope

This rule governs forex transactions as defined in Bylaw 1507(b).

(k) Definition of Customer

For purposes of this rule, the term "customer" means a counterparty that is not an eligible contract participant as defined in Section 1a(12) of the Act.

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9053 - FOREX TRANSACTIONS

(Revised November 9, 2004; June 13, 2005; September 15, 2005; November 30, 2005; April 30, 2006; July 31, 2006; October 1, 2006; February 13, 2007; March 7, 2007; March 9, 2007; March 31, 2007; May 7, 2007; June 5, 2007; July 1, 2007; September 21, 2007; October 1, 2007; October 25, 2007; December 17, 2007; December 21, 2007; June 1, 2008; July 1, 2008; October 31, 2008; April 1, 2009; June 1, 2009; November 30, 2009; and December 17, 2009.)

INTERPRETIVE NOTICE

The Commodity Exchange Act (CEA or Act) gives the Commodity Futures Trading Commission (CFTC or Commission) limited jurisdiction over off-exchange foreign currency transactions offered to or entered into with retail customers. As a result of those provisions, certain firms primarily engaged in the retail forex business have registered with the CFTC and become Members of NFA. NFA has adopted several requirements to govern the conduct of these firms and their associated persons.

As described below, NFA Bylaw 306 creates a Forex Dealer Member category for certain NFA Members who act as counterparties to forex transactions with retail customers. This category allows NFA to exercise appropriate regulatory jurisdiction over the retail forex activities of these Members without imposing unnecessary, and potentially duplicative, regulatory burdens on Members that are otherwise subject to regulatory oversight for their activities.

NFA Bylaw 1507(b) defines forex as foreign currency futures and options and any other agreement, contract, or transaction in foreign currency that is offered or entered into on a leveraged or margined basis, or financed by the offeror, the counterparty, or a person acting in concert with the offeror or counterparty on a similar basis that are:

- offered to or entered into with persons that are not eligible contract participants as defined in Section 1a(12) of the Act (retail customers); and
- not executed on or subject to the rules of a contract market, a derivatives transaction execution facility, a national securities exchange registered pursuant to Section 6(a) of the Securities Exchange Act of 1934, or a foreign board of trade.[1]

Bylaw 1507(b) also excludes the following from the forex definition if the transaction is not a futures or options contract:

- securities (other than security futures products);
- any contract of sale that results in actual delivery within two days; and
- any contract of sale that creates an enforceable obligation to deliver between a seller and buyer that have the ability to deliver and accept delivery, respectively, in connection with their line of business.

Given the differences between off-exchange transactions and traditional exchange-traded futures and options, the Board of Directors does not believe that it is appropriate to apply the full array of NFA's futures rules to forex transactions. Therefore, rather than simply incorporating forex transactions into the definition of "futures," NFA adopted NFA Compliance Rule 2-36 to govern these transactions.

In developing its forex requirements, NFA's primary concern was to ensure that they provide adequate protection for retail customers without imposing undue burdens on NFA Members. NFA also believes that its requirements should, where consistent with customer protection, promote innovation and competition. In order to provide Members with as much flexibility as possible, NFA has chosen to deal with a number of issues by providing guidance under NFA Compliance Rule 2-36 instead of by adopting additional rules.

NFA Compliance Rule 2-36 sets out the general standards that apply to Forex Dealer Members and their Associates in connection with forex transactions. Subsection (b) prohibits Forex Dealer Members and their Associates from engaging in fraudulent activities, subsection (c) requires Forex Dealer Members and their Associates to observe high standards of commercial honor and just and equitable principles of trade in connection with their forex business, and subsection (e) requires Forex Dealer Members and their Associates with supervisory duties to supervise their employees and agents. Other subsections address a Forex Dealer Member's responsibility for its unregulated affiliates and third-party solicitors and make Forex Dealer Members subject to discipline for the conduct of certain non-Members with which they do business.

This notice has three sections. The first section explains who qualifies as a Forex Dealer Member under NFA Bylaw 306, the second section provides additional guidance about the requirements in Compliance Rule 2-36, and the third section covers other miscellaneous requirements.

A. BYLAW 306

In general, Forex Dealer Members are NFA Members who act as counterparties to forex transactions. This is a self-executing requirement, which means that any Member who qualifies is automatically a Forex Dealer Member. There is no application form and no approval requirement.

Members who do not act as counterparties are not Forex Dealer Members, even if they introduce or manage forex accounts. Under NFA Compliance Rule 2-39, however, most Members who introduce or manage forex accounts are required to comply with subsections (a), (b), (c), and (e) of NFA Compliance Rule 2-36.

Bylaw 306(b) excludes Members that are otherwise subject to regulatory oversight for their forex activities, which means that these Members are not Forex Dealer Members and do not have to comply with Compliance Rule 2-36. [2] The exclusions mostly follow Section 2(c)(2)(B)(ii) of the CEA, although the exclusions for broker-dealers and their affiliates are conditioned on the Financial Industry Regulatory Authority ("FINRA") membership. In particular, the following entities are not Forex Dealer Members:

- financial institutions (e.g., banks and savings associations);
- certain insurance companies and their regulated subsidiaries or affiliates;
- financial holding companies;
- investment bank holding companies;
- registered broker-dealers that are members of FINRA;[3] and
- Material Associated Persons of registered broker-dealers that are members of FINRA.[4]

B. COMPLIANCE RULE 2-36

As noted above, this section provides additional guidance on what Compliance Rule 2-36 requires. Certain sections specifically refer to Forex Dealer Members. Except for Members that meet the criteria in Bylaw 306(b), all other provisions of this notice also apply to Members and their Associates who solicit, introduce or manage forex accounts.

1. *Disclosure* - Members must provide forex customers with understandable and timely disclosure on essential features of forex trading.

At or before the time a customer first engages in a forex transaction, a Forex Dealer Member and its Associates should provide the customer sufficient information concerning the characteristics and particular risks of entering into forex transactions. Members and Associates introducing or managing accounts should know what information has been provided and should supplement it when necessary.

This information must include the following statement prominently displayed:

> The transactions you are entering into with [Member] are not traded on an exchange. Therefore, under the U.S. Bankruptcy Code, your funds may not receive the same protections as funds used to margin or guarantee exchange-traded futures and options contracts, which receive a priority in bankruptcy. Since that same priority has not been given to funds used for off-exchange forex trading, if [Member] becomes insolvent and you have a claim for amounts deposited or profits earned on transactions with [Member], your claim may not receive a priority. Without a priority, you are a general creditor and your claim will be paid, along with the claims of other general creditors, from any monies still available after priority claims are paid. Even customer funds that [Member] keeps separate from its own operating funds may not be safe from the claims of other general and priority creditors.

At or before the time a customer first engages in a forex transaction, a Member and its Associates should disclose how the Member will be compensated for the services it will provide to the customer.

Additionally, a Forex Dealer Member must describe to the customer the nature of these foreign currency transactions. Therefore, a Forex Dealer Member must provide, and the customer must separately acknowledge receipt of, either the following disclosure language or other appropriate language (based upon the Forex Dealer Member's business model) approved by NFA staff, which must be prominently displayed in all uppercase letters and in 10 point size type or larger but in any event no smaller than any surrounding type:

> THE FOREIGN CURRENCY TRADING YOU ARE ENTERING INTO IS NOT CONDUCTED ON AN EXCHANGE. [MEMBER] IS ACTING AS A COUNTERPARTY IN THESE TRANSACTIONS AND, THEREFORE, ACTS AS THE BUYER WHEN YOU SELL AND THE SELLER WHEN YOU BUY. AS A RESULT, [MEMBER]'S INTERESTS MAY BE IN CONFLICT WITH YOURS. UNLESS OTHERWISE SPECIFIED IN YOUR WRITTEN AGREEMENT OR OTHER WRITTEN DOCUMENTS [MEMBER] ESTABLISHES THE PRICES AT WHICH IT OFFERS TO TRADE WITH YOU. THE PRICES [MEMBER] OFFERS MIGHT NOT BE THE BEST PRICES AVAILABLE AND [MEMBER] MAY OFFER DIFFERENT PRICES TO DIFFERENT CUSTOMERS.
>
> IF [MEMBER] ELECTS NOT TO COVER ITS OWN TRADING EXPOSURE, THEN YOU SHOULD BE AWARE THAT [MEMBER] MAY MAKE MORE MONEY IF THE MARKET GOES AGAINST YOU. ADDITIONALLY, SINCE [MEMBER] ACTS AS THE BUYER OR SELLER IN THE TRANSACTION, YOU SHOULD CAREFULLY EVALUATE ANY TRADE RECOMMENDATIONS YOU RECEIVE FROM [MEMBER] OR ANY OF ITS SOLICITORS.

Forex Dealer Members should provide both the bid and the offer when the customer enters an order.

Members should update any material information that has changed prior to entering into new transactions with current customers if failing to update the information would make it misleading.

2. *Reporting* - Forex Dealer Members must provide forex customers with timely and accurate notice of the status of their accounts.

Forex Dealer Members should provide written confirmations within one business day after any activity in the customer's account, including offsetting transactions, rollovers, deliveries, option exercises, option expirations, trades that have been reversed or adjusted, and monetary adjustments. The confirmation should include the information required by Compliance Rule 2-44.

Forex Dealer Members should provide regular monthly statements showing all forex transactions and other account activity to customers for all accounts that have open positions at the end of the month or changes in the account balance or equity since the prior statement. Forex Dealer

Members should provide statements at least quarterly for all other open accounts. The monthly or quarterly statements should include the information required by Compliance Rule 2-44.

Confirmations and monthly/quarterly statements may be provided on-line or transmitted by other electronic means if the customer consents to the specific method used.

3. *Supervision* - Members and their Associates having supervisory responsibilities must diligently supervise the Member's forex business, including the activities of the Member's Associates and agents. Members must establish, maintain, and enforce written supervisory procedures.

NFA has provided Members with guidance on minimum standards of supervision through interpretive notices issued under NFA Compliance Rule 2-9.[5] In these interpretive notices NFA recognized that, given the differences in the size of and complexity of the operations of NFA Members, there must be some degree of flexibility in determining what constitutes "diligent supervision" for each firm. This principle also applies to the supervision of a Member's forex business.

Although Members have the flexibility to design procedures that are tailored to their own situation, an adequate program for supervision would include procedures for performing day-to-day monitoring. These procedures would include:

- screening employees who will solicit transactions from or provide advice to customers or manage customer accounts to see if they are subject to any of the statutory disqualifications in Section 8a of the CEA and, if so, to determine the extent of supervision they will require;
- monitoring communications with the public, including sales solicitations and web sites, and approving promotional material;
- reviewing the information obtained from and the information provided to customers solicited by the firm and its employees to ensure that the necessary account information has been obtained and the appropriate information provided; and
- handling and resolving customer complaints.

For Forex Dealer Members, these procedures would also include:

- screening prospective Associates to ensure that they are registered with the Commodity Futures Trading Commission as associated persons;[6]
- screening persons who introduce customer business or manage customer accounts to see if the firm or any of its principals is subject to a statutory disqualification under Section 8a of the CEA and, if so, determining if the Forex Dealer Member should perform additional due diligence on that person;[7]
- reviewing disclosures given to customers to ensure they are understandable, timely, and provide sufficient information;
- reviewing and analyzing the forex activity in customer accounts, including discretionary customer accounts; and
- handling customer funds, including accepting security deposits.

A Forex Dealer Member and a listed principal that is also a registered associated person (see Financial Requirements 15(c)) must supervise the preparation of a Forex Dealer Member's financial books and records. Diligent supervision includes hiring and retaining qualified staff. In determining whether an individual responsible for preparing the Member's financial books and records is qualified, the firm and its financial principal should consider the following:

- Is the individual qualified for the position by experience or training?
- Does the individual exercise independent judgment?
- Has the individual ever been sanctioned or refused membership or licensing by NFA, the CFTC, the SEC, NASD or FINRA, the Public Company Accounting Oversight Board, or any other financial regulator?
- Has the individual ever been sanctioned or refused membership by the American Institute of Certified Public Accountants or any other accounting organization?
- Has any firm for which the individual performed auditing, accounting, or bookkeeping been subject to an emergency action or sanctioned by NFA, the CFTC, the SEC, NASD or FINRA, the Public Company Accounting Oversight Board, or any other financial regulator for failure to comply with financial requirements or for having inadequate books and records while the individual was engaged in those activities?
- Are there any pending actions against the individual or a firm for which the individual performed auditing, accounting, or bookkeeping?

This is not an exclusive list. If the individual or a firm for which the individual worked (either as an independent contractor or an employee) was subject to an emergency action, sanctioned by a financial regulator, or is subject to a pending action, the FDM and the listed principal/registered AP responsible for the FDM's financial books and records should consider the nature and seriousness of the conduct (or alleged conduct) and the individual's role in it. An NFA Member Responsibility Action or an emergency action by another financial regulator is always an extremely serious matter.

The Forex Dealer Member and its financial principal must also conduct due diligence and consider analogous information when selecting an independent public accountant to certify the firm's annual financial statements.

An adequate supervisory program should also include periodic on-site visits to branch offices, guaranteed introducing brokers, and otherwise unregulated affiliates that conduct forex business on behalf of the Member. The Member needs to determine the frequency and nature of these visits. The number of visits will depend on the amount of business generated, the number of customer complaints received, the training and experience of the office personnel, and the frequency and nature of problems that arise from the office.

Finally, a Member's supervisory responsibilities include the obligation to ensure that its employees are properly trained to perform their duties. The formality of a training program will depend on the size of the firm and the nature of its business. Procedures should be in place to ensure that supervisory personnel know and understand the firm's supervisory procedures and that employees receive adequate training to abide by NFA requirements and to properly handle customer accounts.

4. *Recordkeeping* - Members must keep books and records relating to their forex operations for a period of five years from the date thereof and shall keep them readily accessible during the first 2 years of the 5-year period. All such books and records shall be open to inspection by NFA.

Members should adopt and enforce reasonable procedures to create current and accurate books and records and to keep them from being

altered or destroyed. Such records must include, among other things, financial records substantiating a Members assets and liabilities, including liabilities owed to customers and receivables from other persons. The Member should be able to promptly produce its records in a format that NFA can read and reproduce.

Forex Dealer Members should adopt and enforce a written policy detailing the procedures it follows to calculate rollover or interest charges and payments. The policy must include the factors that are considered as well as the names of any sources for these factors. The Member should document the underlying factors reviewed in completing the calculation, including any related transactions entered into by the Forex Dealer Member, so it can be replicated.

5. *Communications with the Public and Promotional Material* - No Member or Associate shall make any communication with potential or current customers that operates as a fraud or deceit; uses a high-pressure approach; or implies that forex transactions are appropriate for all persons.

Promotional material used by the Member or Associate shall not:

- Deceive the public or contain any material misstatement of fact or omit a fact that makes the promotional material misleading;[8]
- Include any statements of opinion unless they are clearly identified as such and have a reasonable basis in fact;
- Mention the possibility of profit unless accompanied by an equally prominent statement of the risk of loss;
- Include any reference to actual past trading profits without mentioning that past results are not necessarily indicative of future results;
- Include any statistical or numerical information about past performance of actual accounts unless the Member can demonstrate that the performance is representative of actual performance of all reasonably comparable accounts for the same period (calculated in accordance with the formula in CFTC Regulation 4.35(a)(6) and NFA Compliance Rule 2-34); or
- Include testimonials unless they are representative of all reasonably comparable accounts, the material prominently states that the testimonial is not indicative of future performance or success, and the material prominently states that they are paid testimonials (if applicable).

No Member or Associate may represent that forex funds deposited with a Forex Dealer Member are given special protection under the bankruptcy laws. No Member or Associate may represent or imply that any assets necessary to satisfy its obligations to customers are more secure because the Member keeps some or all of those assets at a regulated entity in the United States or a money center country.

No Member or Associate may represent that its services are commission free without prominently disclosing how it is compensated in near proximity to that representation.

No Member or Associate may represent that it offers trading with "no-slippage" or that it guarantees the price at which a transaction will be executed or filled, unless:

- It can demonstrate that all orders for all customers have been executed and fulfilled at the price initially quoted on the trading platform when the order was placed;[9] and
- No authority exists, pursuant to a contract, agreement, or otherwise, to adjust customer accounts in a manner that would have the direct or indirect effect of changing the price at which an order was executed.[10]

Members and Associates may not solicit customers based on the leverage available unless they balance any discussion regarding the advantages of leverage with an equally prominent contemporaneous disclosure that increasing leverage increases risk.

No Member shall use or directly benefit from any radio or television advertisement that recommends specific forex transactions or describes the extent of any profit obtained in the past or that can be obtained in the future unless the member submits the advertisement to NFA's Promotional Material Review Team for its review and approval at least 10 days prior to its first use or such shorter period as NFA may allow.[11]

Every Member should adopt and enforce written procedures to supervise communications with potential and current customers and promotional material. A supervisory employee that is, or is under the ultimate supervision of, a listed principal who is also an NFA Associate should review and approve all promotional material and make a written record of such review and approval.[12]

All promotional material should be maintained by each Member and be available for examination for the periods specified in the recordkeeping section of this notice, measured from the date of last use.

6. *Know Your Customer* - Members and Associates have a duty to acquaint themselves sufficiently with the personal and financial circumstances of each forex customer to determine what further facts, explanations and disclosures are needed in order for the customer to make an informed decision on whether to enter into forex transactions.

Every Member should determine what information it will obtain from a prospective forex customer. At a minimum, the Member soliciting the customer to engage in forex transactions should obtain the customer's name, address, principal occupation or business, current estimated annual income and net worth, approximate age, and an indication of the customer's previous investment and trading experience. Members and their Associates need to ensure that each customer they solicit has received adequate information concerning the risks of forex transactions so that the customer can make an informed decision as to whether forex transactions are appropriate for the customer. These obligations fall on the Forex Dealer Member when a non-Member solicits the customer.

7. *Doing Business with Non-Members* - Forex Dealer Members are subject to discipline for the activities of most non-Members who solicit or introduce forex customers to the Forex Dealer Member or manage accounts for those customers.

If a customer is solicited or introduced by a non-Member of NFA, or if the customer's account is managed by a non-Member, the Forex Dealer Member is subject to discipline for the non-Member's conduct if that conduct would violate NFA requirements when engaged in by an NFA Member. In other words, a Forex Dealer Member is subject to an NFA disciplinary action for the non-Member's activities when soliciting,

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introducing, or managing accounts for the Forex Dealer Member's customers even if the non-Member was not the Forex Dealer Member's agent.

The rule allows NFA to bring a disciplinary action even if the Forex Dealer Member acts diligently and has no knowledge of the third-party's conduct. As a practical matter, however, NFA will not take disciplinary action unless the Forex Dealer Member knew or should have known of the third-party's conduct or failed to exercise due diligence when establishing and maintaining the relationship with the third party.

A Forex Dealer Member should adopt and enforce written procedures to review the activities of non-Member third parties. The procedures should include, among other things, a regular review of the trading being conducted in the accounts solicited, introduced, or managed by these non-Members. The Member should also have procedures for following up on any customer complaints received by the firm, including a written description of the investigation made by the Member and any resolution of the complaint. Further, supervisory procedures should include a regular review of all promotional material used by any non-Member third-party. The member should maintain copies of all promotional materials reviewed, along with a written record of the review conducted and any deficiencies corrected, and make them available for examination for the periods specified in the recordkeeping section of this notice. A supervisory employee that is, or is under the ultimate supervision of, a listed principal who is also an NFA Associate should conduct the review of the non-Member's activities.

The Forex Dealer Member is not subject to discipline for the actions of non-Members who are described in NFA Bylaw 306(b). It is also not subject to discipline for the actions of non-Members who would be exempt from Commission registration if they were acting in the same capacity in connection with exchange-traded futures contracts, such as foreign persons that solicit, introduce, or manage accounts for foreign customers only.[13] The Forex Dealer Member does, of course, have certain basic duties to its customers, including a duty to supervise its own activities in a way designed to ensure that it treats its customers fairly. Specifically, the Forex Dealer Member would violate this duty if it has actual or constructive notice that one of these entities engaged in fraudulent conduct and fails to take appropriate action.

8. *Affiliates* - Forex Dealer Members must supervise and are subject to discipline for the activities of affiliates that are authorized to engage in forex transactions solely by virtue of their affiliation with a Forex Dealer Member.

The CEA authorizes affiliates of FCMs to act as counterparties to forex transactions if the affiliate directly or indirectly controls, is controlled by, or is under common control with the FCM and the FCM makes and keeps records regarding the financial activities of the affiliate for purposes of the Commission's risk assessment requirements.[14] If a Forex Dealer Member has one or more affiliates that act as counterparty to forex customers solely on the basis of that affiliation, the Forex Dealer Member must supervise the affiliate's forex activities and is subject to discipline for that affiliate's activities.[15] The Forex Dealer Member must also make these affiliates' books and records available to NFA upon request. Additionally, the Forex Dealer Member must assure that its affiliates do not act as counterparties to forex transactions unless they are authorized to do so under the Act.

9. *BASIC Disclosure* - Members must provide forex customers with information on NFA's BASIC system.

NFA Compliance Rule 2-36(g) requires Forex Dealer Members to provide customers with written information regarding NFA's Background Affiliation Status Information Center (BASIC), including the web site address [16]. This information must be provided when the customer first opens an account and at least once a year thereafter.

Forex Dealer Members may provide the information electronically but must do it in a way that ensures each customer is aware of it. For example, merely having the information on the Member's web site is not adequate, but sending customers an e-mail including a link to that information and explaining what the link is would be sufficient in most circumstances.

10. *Discretion* - No Forex Dealer Member, or Associate of a Forex Dealer Member acting in such capacity, may exercise discretionary trading authority over a customer account for which the Forex Dealer Member is, or is offering to be, the counterparty to the transactions in the customer account.

C. OTHER REQUIREMENTS

This section of the notice provides guidance on dues, capital requirements, and security deposits. These requirements apply only to Forex Dealer Members.

1. Bylaw 1301

NFA Bylaw 1301(e) requires Forex Dealer Members to pay annual dues that are graduated according to the firm's gross annual revenue from customers (e.g., commissions, mark-ups, mark-downs) for its forex activities. Profits and losses from proprietary trades are *not* to be included. To calculate dues:

- Start with the FCM dues imposed by NFA Bylaw 1301(b)(ii);
- Add $44,375 if the Forex Dealer Member's gross annual revenue from forex transactions is $500,000 or less;
- Add $69,375 if the Forex Dealer Member's gross annual revenue from forex transactions is more than $500,000, but not more than $2,000,000;
- Add $94,375 if the Forex Dealer Member's gross annual revenue from forex transactions is more than $2,000,000, but not more than $5,000,000; or
- Add $119,375 if the Forex Dealer Member's gross annual revenue from these activities is more than $5,000,000.

The following table shows the dues to be assessed for Forex Dealer Members:

Amount of annual Gross Revenue From Forex Transactions	Dues if NFA is the DSRO	Dues if NFA is not the DSRO
$500,000 or less	$50,000	$45,875
More than $500,000, but not more than $2 million	$75,000	$70,875

More than $2 million, but not more than $5 million	$100,000	$95,875
More than $5 million	$125,000	$120,875

These dues apply when the Forex Dealer Member offers to be a counterparty to a forex transaction or accepts a forex trade (whichever is earlier), and NFA will send the Member an invoice for the minimum dues ($50,000 or $45,875) minus any amount already paid for that membership year. Thereafter, the dues will be assessed on the firm's membership renewal date and will be based on the Forex Dealer Member's latest certified financial statement.

The only exception to the dues set forth above is a situation in which NFA does not serve as the DSRO for a Forex Dealer Member and the DSRO has agreed to examine the Forex Dealer Member's forex activities. In this case, the surcharge paid by the Forex Dealer Member, regardless of gross annual revenue, is $12,000. Accordingly, for such a Forex Dealer Member the dues to be assessed at the time it offers to be a counterparty to a forex transaction or accepts a forex trade (whichever is earlier), and on its membership renewal date thereafter, will be $13,500.

Under NFA Compliance Rule 2-36(d), a Forex Dealer Member is subject to discipline for the activities of any person that solicits or introduces a customer to the Member or manages a customer's account unless that person is a Member or Associate of NFA, is otherwise regulated based on the criteria in Bylaw 306(b), or would be exempt from CFTC registration if it were acting in the same capacity in connection with exchange-traded futures contracts. Any Forex Dealer Member that is responsible under Compliance Rule 2-36(d) for solicitors and account managers is required to pay a separate annual fee on the firm's annual renewal date based on the number of unregulated solicitors and account managers. In determining whether this fee applies, the Forex Dealer Member should take the highest number of separate legal entities, including individuals acting as sole proprietors, that it was responsible for at any one time during the year. The following table shows this graduated fee.

Number of Unregulated Entities	Annual Fee
0	$ 0
1-4	$ 5,000
5-19	$10,000
20-99	$25,000
100 or more	$50,000

Each Forex Dealer Member is also required to pay an assessment of .0001% on the notional value of each forex transaction (as forex is defined in Bylaw 1507(b)). This equates to $.01 for each $10,000. For transactions with a notional value less than $10,000, the firm may aggregate separate transactions and pay $.01 on each multiple of $10,000. For transactions of $10,000 or above, the firm should round to the nearest cent.

This assessment is due only on initiating transactions. There is no assessment on rollovers, offsetting transactions, option expirations, or option exercises that do not result in new positions. The Member must remit the assessment to NFA within 30 days after the end of the month in which the transaction was initiated.

2. Financial Requirements Section 11(a)

Forex Dealer Members must maintain adjusted net capital equal to or in excess of the greatest amount specified in subsections (a)(i), (a)(ii), and (a)(iii) (if applicable). Subsection (a)(ii) applies to Forex Dealer Members that execute any customer transactions other than by using straight-through-processing and that also have liabilities to customers of more than $10 million. Where it applies, the Member's capital requirement is the minimum capital required by subsection (a)(i) plus 5% of the liabilities over $10 million. The formula is:

Amount required by (a)(i) + .05(customer liabilities - $10,000,000)

For example, if the minimum capital requirement is $20 million, a Forex Dealer Member that operates a dealing desk and has $208 million in liabilities to customers would be required to maintain adjusted net capital equal to or in excess of $29.9 million.

Forex Dealer Members with over $10 million in customer liabilities are subject to this alternative requirement unless they execute all customer transactions using straight-through-processing. Straight-through-processing refers to platforms that automatically (without human intervention and without exception) enter into an identical but opposite transaction with another counterparty, creating an offsetting position in the Forex Dealer Member's own name. A Forex Dealer Member that offers several platforms will be exempt from this requirement only if each platform executes all customer orders using straight-through-processing.

This requirement that all customer trades be executed by straight-through-processing is not, however, meant to limit a firm's ability to provide for other methods in its disaster recovery procedures. As long as those other methods are used only when dictated by those procedures and both the procedures and the firm's trading platform are designed to ensure that the need will rarely arise, the FDM will not lose its exemption by implementing other execution methods in disaster recovery situations.

3. Financial Requirements Section 11(b)

Section 11(b) prohibits a Forex Dealer Member from including assets held by an affiliate (unless approved) or an unregulated person in the firm's current assets for purposes of determining its adjusted net capital under CFTC Rule 1.17. This means an FDM may not count any part of those assets for capital purposes.[17]

An unregulated person is any person that is **not**:

(i) a financial institution regulated by a U.S. banking regulator;

(ii) a broker-dealer registered with the U.S. Securities and Exchange Commission and a member of FINRA;

(iii) a futures commission merchant registered with the U.S. Commodity Futures Trading Commission and a Member of NFA;

(iv) an insurance company regulated by any U.S. state;

(v) an entity regulated as a foreign equivalent of any of the above if regulated in a money center country as defined in CFTC Regulation 1.49; or

(vi) any other entity approved by NFA.

Effective October 1, 2010, the above paragraph will read as follows:

An unregulated person is any person that is **not**:

(i) a financial institution regulated by a U.S. banking regulator;

(ii) a broker-dealer registered with the U.S. Securities and Exchange Commission and a member of FINRA;

(iii) a futures commission merchant registered with the U.S. Commodity Futures Trading Commission and a Member of NFA;

(iv) a retail foreign exchange dealer registered with the U.S. Commodity Futures Trading Commission and a Member of NFA;

(v) an insurance company regulated by any U.S. state; or

(vi) any other entity approved by NFA.

Any Forex Dealer Member may ask NFA to approve an otherwise unregulated person for purposes of Financial Requirements Sections 11(b) and (c). In determining whether to approve an unregulated person that is not an affiliate, NFA will consider a number of factors, including:

- Whether the person is regulated in another jurisdiction and, if so, the type and extent of regulation;
- The person's capital; and
- The person's credit rating.

NFA's approval of a particular person means that all unaffiliated Forex Dealer Members may treat that person as regulated under Sections 11(b) and (c). NFA may also approve categories of counterparties (e.g., banks regulated in a particular jurisdiction or with a particular credit rating).

A Forex Dealer Member may not engage in Section 11(b) or (c) transactions with a regulated affiliate without NFA's approval. The Member may, however, ask NFA to authorize it to cover its positions with specified affiliates (including unregulated affiliates). An affiliate is any entity that controls, is controlled by, or is under common control with the Forex Dealer Member. The standards for approving affiliated persons are significantly higher than those for unaffiliated persons. For example, NFA will also consider:

- The parent company's and affiliated person's capital;
- Whether the parent company and the affiliated person are regulated entities;
- Whether the parent company will guarantee the obligations of the affiliated person (unless the parent company and the affiliated person are the same entity);
- The parent company's credit rating;
- Whether the affiliated person has strong risk-management policies to limit its value-at-risk; and
- For purposes of Section 11(c), whether the affiliated person limits the amount of offsetting transactions it enters into with unregulated counterparties.

4. Financial Requirements Section 11(c)

Section 11(c) prohibits Forex Dealer Members from using affiliates (unless approved) and unregulated persons to cover their foreign currency positions for purposes of CFTC Rule 1.17(c)(5).

The rule does not prohibit Forex Dealer Members from entering into positions with unregulated or unapproved counterparties. They may not, however, count positions with those counterparties when calculating their covered positions for purposes of CFTC Rule 1.17(c)(5).

For purposes of Section 11(c), Forex Dealer Members have four different types of counterparties. In particular:

- Account holders are those counterparties for whom it carries accounts and includes both retail customers and eligible contract participants.
- Trading partners are counterparties with whom the Member trades but who do not have accounts with the Member. For purposes of the calculations under Section 11(c), this category does not include affiliates (approved or unapproved) or regulated counterparties.
- Affiliates are entities that control, are controlled by, or are under common control with the Forex Dealer Member. For purposes of Section 11(c) only, this category does not include affiliates who have been approved by NFA under Section 11(b).
- Regulated entities are those counterparties that meet the definition in Section 11(b) and include entities-including affiliates-approved by NFA under that Section.

A Forex Dealer Member may net its exposure across account holders, across trading partners, and across affiliates, but it may not net its exposure between these categories. The Member may, however, net its exposure in any of these categories against regulated counterparties. Here is the information in chart form.

Type of Counterparty	Account Holders	Trading Partners	Affiliates	Regulated Entities
Account Holders	Yes	No	No	Yes
Trading Partners	No	Yes	No	Yes
Affiliates	No	No	Yes	Yes
Regulated Entities	Yes	Yes	Yes	Yes

A Forex Dealer Member is required to take a charge on the larger of its unnetted long or short position but not on both.

Example

Assume a Forex Dealer Member has the following Euro positions:

Type	Long	Short	Net Long	Net Short
Account Holders	11,154,912	6,011,794	5,143,118	
Trading Partners	4,987,345	7,299,886		2,312,541
Affiliates	3,790,754	2,640,553	1,150,201	
Regulated Entities	1,280,555	4,125,018		2,844,463

In determining the uncovered amount for purposes of the 6% haircut, the Forex Dealer Member can offset its net long position with account holders against the net short position with regulated entities but cannot offset its position with its trading partners or its position with unapproved affiliates against any category except regulated entities.

The math works this way (using only absolute numbers):

Net long position with account holders	5,143,118
Minus net short position with regulated entities	-2,844,463
	2,298,655
Uncovered long position with account holders	2,298,655
Plus net long position with affiliates	+1,150,201
Total uncovered long position	3,448,856
Net short position with trading partners	2,312,541
Larger of net long or short position	3,448,856
Haircut on Euros (3,448,856 X .06)	$206,931

5. Financial Requirements Section 12

Forex Dealer Members must collect security deposits from forex customers equal to 1% of the notional value of transactions in specified foreign currencies and 4% of the notional value of all other transactions. Where the two currencies are in different categories, the Forex Dealer Member must collect the higher amount. If the transaction pairs a foreign currency with the U.S. dollar, the security deposit is based on the foreign currency. If the transaction pairs a currency that qualifies for a 1% deposit with a currency that does not, the Forex Dealer Member must collect a 4% security deposit for the entire transaction. For example:

Currency Pair	Security Deposit
EUR/USD	1%
CND/JPY	1%
CND/BRL	4%
USD/MXN	4%
BRL/MXN	4%

For short options, the Forex Dealer Member must collect this amount plus the premium the customer received. For long options, the Forex Dealer Member must simply collect the entire premium from the customer.

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[1] The Board of Directors has declared that these transactions are a proper subject of NFA regulation and oversight under Article XVIII, paragraph (k).

[2] Compliance Rule 2-39 excludes these same entities when they introduce or manage forex accounts.

[3] Bylaw 306(b)(ii) excludes broker-dealers that are members of any fully-registered national securities association and FCMs that are members of another registered futures association. At this time, however, FINRA is the only fully-registered national securities association and NFA is the only registered futures association.

[4] These are affiliates of broker-dealers for which the broker-dealer makes and keeps records under the Securities and Exchange Commission's risk assessment requirements. See Section 17(h) of the Securities Exchange Act of 1934 and SEC Rule 17h-1T.

[5] See, for example, Compliance Rule 2-9: Supervision of Branch Offices and Guaranteed IBs, NFA Manual paragraph 9019; Compliance Rule 2-9: Supervisory Procedures for E-Mail and the Use of Web Sites, NFA Manual paragraph 9037; Compliance Rule 2-9: Supervision of the Use of Automated Order-Routing Systems, NFA Manual paragraph 9046. These interpretive notices do not directly apply to forex activities, but the principles included in these notices are equally applicable to those activities.

[6] The Commodity Futures Trading Commission has stated that all employees of an FCM who solicit or accept orders for forex transactions from retail customers must be registered with the Commission as an associated person of the FCM. See Division of Trading and Markets Advisory Concerning Foreign Currency Trading by Retail Customers (March 2002).

[7] The screening process should include 1) checking BASIC and any other readily available sources and 2) asking the third-party to represent that neither it nor any of its principals is subject to a statutory disqualification or to identify and explain any statutory disqualifications.

[8] Through interpretive notices issued under NFA Compliance Rule 2-29, NFA has provided Members with guidance on what activities are deceptive and misleading. See, for example, NFA Compliance Rule 2-29: Deceptive Advertising, NFA Manual paragraph 9033; NFA Compliance Rule 2-29: Deceptive Advertising, NFA Manual paragraph 9034; Compliance Rule 2-29: High Pressure Sales Tactics, NFA Manual paragraph 9038; and NFA Compliance Rules 2-29 and 2-9: NFA's Review and Approval of Certain Radio and television Advertisements, NFA Manual paragraph 9039. Although these interpretive notices do not directly apply to forex activities, the principles included in them with regard to what is deceptive or misleading are equally applicable to those activities.

[9] The Forex Dealer Member is not required to give the customer a price that is no longer reflected on the platform at the time the order reaches it. The Forex Dealer Member is not responsible for

transmission delays outside its control. If an Forex Dealer Member, however, advertises "no-slippage" or that it guarantees fill prices, it must prominently disclose that transmission delays might result in customer orders being executed at a price other than that seen by the customer.

[10] This includes *force majeure* provisions.

[11] Submission of promotional materials for NFA review is not a substitute for a Member's own responsibility to review promotional material. NFA staff will not independently verify the accuracy of statements made in an advertisement; that responsibility remains with the Member. Submitting promotional material to NFA will not provide a "safe harbor" from NFA actions for Members if misstatements or omissions of material fact are discovered subsequently or NFA otherwise later determines that the material is in violation of any applicable standards.

[12] Under traditional legal principles, Members can also be liable for promotional material promoting forex trading systems developed by third-parties. For example, a Member has direct responsibility for misleading promotional material if the Member prepares or distributes it; has agency responsibility if the system developer is an agent of the Member under established principles of agency law; and has supervisory responsibility if the Member fails to supervise its own employees when linking to a third-party trading system developer's web site, recommending a third-party's trading system, or entering into a referral agreement with a third-party system developer. See Interpretive Notice titled "NFA Bylaw 1101, Compliance Rules 2-9 and 2-29: Guidelines Relating to the Registration of Third-Party Trading System Developers and the Responsibility of NFA Members for Promotional Material That Promotes Third-Party Trading System Developers and their Trading Systems," NFA Manual, paragraph 9055.

[13] For this purpose, foreign persons and foreign customers are 1) natural persons who are not residents of the United States or 2) legal entities (other than passive investment vehicles) that are organized under the laws of a country other than the United States, do not have their principal place of business in the United States, and do not conduct their retail forex activities from a location in the United States. Those terms do not include a passive investment vehicle that is more than 10% owned by United States persons or that solicits United States persons who are not eligible contract participants as defined in Section 1a(12) of the Act. "United States" includes U.S. territories and possessions.

[14] See Sections 2(c)(2)(B)(ii)(III) and 4f(c)(2)(B) of the CEA and CFTC Regulations 1.14 and 1.15.

[15] Obviously, the Forex Dealer Member must also ensure that no entity with common ownership engages in the forex business unless it is authorized to do so.

[16] Forex Dealer Members can comply with this requirement by providing customers with a copy of NFA's brochure entitled "Background Affiliation Status Information Center (BASIC): An Information Resource for the Investing Public," which is available in print and on NFA's website at http://www.nfa.futures.org/.

[17] Where the CFTC's requirements for holding current assets are more stringent, those requirements apply.

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NFA Manual / Rules

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Compliance Rules

RULE 2-36. REQUIREMENTS FOR FOREX TRANSACTIONS
[Adopted effective June 28, 2002. Effective dates of amendments: December 1, 2003; November 30, 2005; February 13, 2007; October 25, 2007; and April 1, 2009.]

(a) General Prohibition

No Forex Dealer Member shall engage in any forex transaction that is prohibited under the Commodity Exchange Act.

(b) Fraud and Related Matters

No Forex Dealer Member or Associate of a Forex Dealer Member engaging in any forex transaction shall:

(1) Cheat, defraud or deceive, or attempt to cheat, defraud or deceive any other person;

(2) Willfully make or cause to be made a false report, or willfully to enter or cause to be entered a false record in or in connection with any forex transaction;

(3) Disseminate, or cause to be disseminated, false or misleading information, or a knowingly inaccurate report, that affects or tends to affect the price of any foreign currency;

(4) Engage in manipulative acts or practices regarding the price of any foreign currency or a forex transaction;

(5) Willfully submit materially false or misleading information to NFA or its agents with respect to forex transactions;

(6) Embezzle, steal or purloin or knowingly convert any money, securities or other property received or accruing to any person in or in connection with a forex transaction.

(c) Just and Equitable Principles of Trade

Forex Dealer Members and their Associates shall observe high standards of commercial honor and just and equitable principles of trade in the conduct of their forex business.

(d) Doing Business with Non-Members

A Forex Dealer Member that is the counterparty, or offers to be the counterparty, to forex transactions for customers shall be subject to discipline for the activities of any person that solicits or introduces a customer to the Member or that manages such customer's accounts, unless such person is a Member or Associate of NFA, meets the criteria in Bylaw 306(b), or would be exempt from Commission registration if it were acting in the same capacity in connection with exchange-traded futures contracts.

(e) Supervision

Each Forex Dealer Member shall diligently supervise its employees and agents in the conduct of their forex activities for or on behalf of the Forex Dealer Member. Each Associate of a Forex Dealer Member who has supervisory duties shall diligently exercise such duties in the conduct of that Associate's forex activities for or on behalf of the Forex Dealer Member.

(f) Affiliates

Each Forex Dealer Member that has an affiliate that is authorized to engage in forex transactions solely by virtue of its affiliation with the Forex Dealer Member shall supervise its affiliate's forex activities for compliance with the same requirements that apply to the Forex Dealer Member, including section (a) of this rule. The Forex Dealer Member shall make the affiliate's books and records available to NFA staff upon request and shall be subject to discipline for acts and omissions of the affiliate that violate the standards imposed by NFA requirements.

(g) BASIC Disclosure

When a customer first opens an account and at least once a year thereafter, each Forex Dealer Member shall provide each customer with written information regarding NFA's Background Affiliation Status Information Center (BASIC), including the web site address.

(h) Filing Promotional Materials with NFA.

The Compliance Director may require any Forex Dealer Member for any specified period to file copies of all promotional material with NFA for its review and approval at least 10 days prior to its first use or such shorter period as NFA may allow. The Compliance Director may also require a

Forex Dealer Member to file for review and approval copies of promotional material prepared or used by some or all of the non-Members it is responsible for under Section (d).

(i) Hypothetical Results

Any Member who uses promotional material that includes a measurement or description or makes any reference to hypothetical forex transaction performance results that could have been achieved had a particular trading system of the Member or Associate been employed in the past must comply with Compliance Rule 2-29(c) and the related Interpretive Notice as if the performance results were for transactions in on-exchange futures contracts.

(j) Scope

This rule governs forex transactions as defined in Bylaw 1507(b).

(k) Definition of Customer

For purposes of this rule, the term "customer" means a counterparty that is not an eligible contract participant as defined in Section 1a(12) of the Act.

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NFA Manual / Rules

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Interpretive Notices

9053 - FOREX TRANSACTIONS

(Revised November 9, 2004; June 13, 2005; September 15, 2005; November 30, 2005; April 30, 2006; July 31, 2006; October 1, 2006; February 13, 2007; March 7, 2007; March 9, 2007; March 31, 2007; May 7, 2007; June 5, 2007; July 1, 2007; September 21, 2007; October 1, 2007; October 25, 2007; December 17, 2007; December 21, 2007; June 1, 2008; July 1, 2008; October 31, 2008; April 1, 2009; June 1, 2009; November 30, 2009; and December 17, 2009.)

INTERPRETIVE NOTICE

The Commodity Exchange Act (CEA or Act) gives the Commodity Futures Trading Commission (CFTC or Commission) limited jurisdiction over off-exchange foreign currency transactions offered to or entered into with retail customers. As a result of those provisions, certain firms primarily engaged in the retail forex business have registered with the CFTC and become Members of NFA. NFA has adopted several requirements to govern the conduct of these firms and their associated persons.

As described below, NFA Bylaw 306 creates a Forex Dealer Member category for certain NFA Members who act as counterparties to forex transactions with retail customers. This category allows NFA to exercise appropriate regulatory jurisdiction over the retail forex activities of these Members without imposing unnecessary, and potentially duplicative, regulatory burdens on Members that are otherwise subject to regulatory oversight for their activities.

NFA Bylaw 1507(b) defines forex as foreign currency futures and options and any other agreement, contract, or transaction in foreign currency that is offered or entered into on a leveraged or margined basis, or financed by the offeror, the counterparty, or a person acting in concert with the offeror or counterparty on a similar basis that are:

- offered to or entered into with persons that are not eligible contract participants as defined in Section 1a(12) of the Act (retail customers); and
- not executed on or subject to the rules of a contract market, a derivatives transaction execution facility, a national securities exchange registered pursuant to Section 6(a) of the Securities Exchange Act of 1934, or a foreign board of trade.[1]

Bylaw 1507(b) also excludes the following from the forex definition if the transaction is not a futures or options contract:

- securities (other than security futures products);
- any contract of sale that results in actual delivery within two days; and
- any contract of sale that creates an enforceable obligation to deliver between a seller and buyer that have the ability to deliver and accept delivery, respectively, in connection with their line of business.

Given the differences between off-exchange transactions and traditional exchange-traded futures and options, the Board of Directors does not believe that it is appropriate to apply the full array of NFA's futures rules to forex transactions. Therefore, rather than simply incorporating forex transactions into the definition of "futures," NFA adopted NFA Compliance Rule 2-36 to govern these transactions.

In developing its forex requirements, NFA's primary concern was to ensure that they provide adequate protection for retail customers without imposing undue burdens on NFA Members. NFA also believes that its requirements should, where consistent with customer protection, promote innovation and competition. In order to provide Members with as much flexibility as possible, NFA has chosen to deal with a number of issues by providing guidance under NFA Compliance Rule 2-36 instead of by adopting additional rules.

NFA Compliance Rule 2-36 sets out the general standards that apply to Forex Dealer Members and their Associates in connection with forex transactions. Subsection (b) prohibits Forex Dealer Members and their Associates from engaging in fraudulent activities, subsection (c) requires Forex Dealer Members and their Associates to observe high standards of commercial honor and just and equitable principles of trade in connection with their forex business, and subsection (e) requires Forex Dealer Members and their Associates with supervisory duties to supervise their employees and agents. Other subsections address a Forex Dealer Member's responsibility for its unregulated affiliates and third-party solicitors and make Forex Dealer Members subject to discipline for the conduct of certain non-Members with which they do business.

This notice has three sections. The first section explains who qualifies as a Forex Dealer Member under NFA Bylaw 306, the second section provides additional guidance about the requirements in Compliance Rule 2-36, and the third section covers other miscellaneous requirements.

A. BYLAW 306

In general, Forex Dealer Members are NFA Members who act as counterparties to forex transactions. This is a self-executing requirement, which means that any Member who qualifies is automatically a Forex Dealer Member. There is no application form and no approval requirement.

Members who do not act as counterparties are not Forex Dealer Members, even if they introduce or manage forex accounts. Under NFA Compliance Rule 2-39, however, most Members who introduce or manage forex accounts are required to comply with subsections (a), (b), (c), and (e) of NFA Compliance Rule 2-36.

Bylaw 306(b) excludes Members that are otherwise subject to regulatory oversight for their forex activities, which means that these Members are not Forex Dealer Members and do not have to comply with Compliance Rule 2-36. [2] The exclusions mostly follow Section 2(c)(2)(B)(ii) of the CEA, although the exclusions for broker-dealers and their affiliates are conditioned on the Financial Industry Regulatory Authority ("FINRA") membership. In particular, the following entities are not Forex Dealer Members:

- financial institutions (e.g., banks and savings associations);
- certain insurance companies and their regulated subsidiaries or affiliates;
- financial holding companies;
- investment bank holding companies;
- registered broker-dealers that are members of FINRA;[3] and
- Material Associated Persons of registered broker-dealers that are members of FINRA.[4]

B. COMPLIANCE RULE 2-36

As noted above, this section provides additional guidance on what Compliance Rule 2-36 requires. Certain sections specifically refer to Forex Dealer Members. Except for Members that meet the criteria in Bylaw 306(b), all other provisions of this notice also apply to Members and their Associates who solicit, introduce or manage forex accounts.

1. *Disclosure* - Members must provide forex customers with understandable and timely disclosure on essential features of forex trading.

At or before the time a customer first engages in a forex transaction, a Forex Dealer Member and its Associates should provide the customer sufficient information concerning the characteristics and particular risks of entering into forex transactions. Members and Associates introducing or managing accounts should know what information has been provided and should supplement it when necessary.

This information must include the following statement prominently displayed:

> The transactions you are entering into with [Member] are not traded on an exchange. Therefore, under the U.S. Bankruptcy Code, your funds may not receive the same protections as funds used to margin or guarantee exchange-traded futures and options contracts, which receive a priority in bankruptcy. Since that same priority has not been given to funds used for off-exchange forex trading, if [Member] becomes insolvent and you have a claim for amounts deposited or profits earned on transactions with [Member], your claim may not receive a priority. Without a priority, you are a general creditor and your claim will be paid, along with the claims of other general creditors, from any monies still available after priority claims are paid. Even customer funds that [Member] keeps separate from its own operating funds may not be safe from the claims of other general and priority creditors.

At or before the time a customer first engages in a forex transaction, a Member and its Associates should disclose how the Member will be compensated for the services it will provide to the customer.

Additionally, a Forex Dealer Member must describe to the customer the nature of these foreign currency transactions. Therefore, a Forex Dealer Member must provide, and the customer must separately acknowledge receipt of, either the following disclosure language or other appropriate language (based upon the Forex Dealer Member's business model) approved by NFA staff, which must be prominently displayed in all uppercase letters and in 10 point size type or larger but in any event no smaller than any surrounding type:

> THE FOREIGN CURRENCY TRADING YOU ARE ENTERING INTO IS NOT CONDUCTED ON AN EXCHANGE. [MEMBER] IS ACTING AS A COUNTERPARTY IN THESE TRANSACTIONS AND, THEREFORE, ACTS AS THE BUYER WHEN YOU SELL AND THE SELLER WHEN YOU BUY. AS A RESULT, [MEMBER]'S INTERESTS MAY BE IN CONFLICT WITH YOURS. UNLESS OTHERWISE SPECIFIED IN YOUR WRITTEN AGREEMENT OR OTHER WRITTEN DOCUMENTS [MEMBER] ESTABLISHES THE PRICES AT WHICH IT OFFERS TO TRADE WITH YOU. THE PRICES [MEMBER] OFFERS MIGHT NOT BE THE BEST PRICES AVAILABLE AND [MEMBER] MAY OFFER DIFFERENT PRICES TO DIFFERENT CUSTOMERS.
>
> IF [MEMBER] ELECTS NOT TO COVER ITS OWN TRADING EXPOSURE, THEN YOU SHOULD BE AWARE THAT [MEMBER] MAY MAKE MORE MONEY IF THE MARKET GOES AGAINST YOU. ADDITIONALLY, SINCE [MEMBER] ACTS AS THE BUYER OR SELLER IN THE TRANSACTION, YOU SHOULD CAREFULLY EVALUATE ANY TRADE RECOMMENDATIONS YOU RECEIVE FROM [MEMBER] OR ANY OF ITS SOLICITORS.

Forex Dealer Members should provide both the bid and the offer when the customer enters an order.

Members should update any material information that has changed prior to entering into new transactions with current customers if failing to update the information would make it misleading.

2. *Reporting* - Forex Dealer Members must provide forex customers with timely and accurate notice of the status of their accounts.

Forex Dealer Members should provide written confirmations within one business day after any activity in the customer's account, including offsetting transactions, rollovers, deliveries, option exercises, option expirations, trades that have been reversed or adjusted, and monetary adjustments. The confirmation should include the information required by Compliance Rule 2-44.

Forex Dealer Members should provide regular monthly statements showing all forex transactions and other account activity to customers for all accounts that have open positions at the end of the month or changes in the account balance or equity since the prior statement. Forex Dealer

Members should provide statements at least quarterly for all other open accounts. The monthly or quarterly statements should include the information required by Compliance Rule 2-44.

Confirmations and monthly/quarterly statements may be provided on-line or transmitted by other electronic means if the customer consents to the specific method used.

3. *Supervision* - Members and their Associates having supervisory responsibilities must diligently supervise the Member's forex business, including the activities of the Member's Associates and agents. Members must establish, maintain, and enforce written supervisory procedures.

NFA has provided Members with guidance on minimum standards of supervision through interpretive notices issued under NFA Compliance Rule 2-9.[5] In these interpretive notices NFA recognized that, given the differences in the size of and complexity of the operations of NFA Members, there must be some degree of flexibility in determining what constitutes "diligent supervision" for each firm. This principle also applies to the supervision of a Member's forex business.

Although Members have the flexibility to design procedures that are tailored to their own situation, an adequate program for supervision would include procedures for performing day-to-day monitoring. These procedures would include:

- screening employees who will solicit transactions from or provide advice to customers or manage customer accounts to see if they are subject to any of the statutory disqualifications in Section 8a of the CEA and, if so, to determine the extent of supervision they will require;
- monitoring communications with the public, including sales solicitations and web sites, and approving promotional material;
- reviewing the information obtained from and the information provided to customers solicited by the firm and its employees to ensure that the necessary account information has been obtained and the appropriate information provided; and
- handling and resolving customer complaints.

For Forex Dealer Members, these procedures would also include:

- screening prospective Associates to ensure that they are registered with the Commodity Futures Trading Commission as associated persons;[6]
- screening persons who introduce customer business or manage customer accounts to see if the firm or any of its principals is subject to a statutory disqualification under Section 8a of the CEA and, if so, determining if the Forex Dealer Member should perform additional due diligence on that person;[7]
- reviewing disclosures given to customers to ensure they are understandable, timely, and provide sufficient information;
- reviewing and analyzing the forex activity in customer accounts, including discretionary customer accounts; and
- handling customer funds, including accepting security deposits.

A Forex Dealer Member and a listed principal that is also a registered associated person (see Financial Requirements 15(c)) must supervise the preparation of a Forex Dealer Member's financial books and records. Diligent supervision includes hiring and retaining qualified staff. In determining whether an individual responsible for preparing the Member's financial books and records is qualified, the firm and its financial principal should consider the following:

- Is the individual qualified for the position by experience or training?
- Does the individual exercise independent judgment?
- Has the individual ever been sanctioned or refused membership or licensing by NFA, the CFTC, the SEC, NASD or FINRA, the Public Company Accounting Oversight Board, or any other financial regulator?
- Has the individual ever been sanctioned or refused membership by the American Institute of Certified Public Accountants or any other accounting organization?
- Has any firm for which the individual performed auditing, accounting, or bookkeeping been subject to an emergency action or sanctioned by NFA, the CFTC, the SEC, NASD or FINRA, the Public Company Accounting Oversight Board, or any other financial regulator for failure to comply with financial requirements or for having inadequate books and records while the individual was engaged in those activities?
- Are there any pending actions against the individual or a firm for which the individual performed auditing, accounting, or bookkeeping?

This is not an exclusive list. If the individual or a firm for which the individual worked (either as an independent contractor or an employee) was subject to an emergency action, sanctioned by a financial regulator, or is subject to a pending action, the FDM and the listed principal/registered AP responsible for the FDM's financial books and records should consider the nature and seriousness of the conduct (or alleged conduct) and the individual's role in it. An NFA Member Responsibility Action or an emergency action by another financial regulator is always an extremely serious matter.

The Forex Dealer Member and its financial principal must also conduct due diligence and consider analogous information when selecting an independent public accountant to certify the firm's annual financial statements.

An adequate supervisory program should also include periodic on-site visits to branch offices, guaranteed introducing brokers, and otherwise unregulated affiliates that conduct forex business on behalf of the Member. The Member needs to determine the frequency and nature of these visits. The number of visits will depend on the amount of business generated, the number of customer complaints received, the training and experience of the office personnel, and the frequency and nature of problems that arise from the office.

Finally, a Member's supervisory responsibilities include the obligation to ensure that its employees are properly trained to perform their duties. The formality of a training program will depend on the size of the firm and the nature of its business. Procedures should be in place to ensure that supervisory personnel know and understand the firm's supervisory procedures and that employees receive adequate training to abide by NFA requirements and to properly handle customer accounts.

4. *Recordkeeping* - Members must keep books and records relating to their forex operations for a period of five years from the date thereof and shall keep them readily accessible during the first 2 years of the 5-year period. All such books and records shall be open to inspection by NFA.

Members should adopt and enforce reasonable procedures to create current and accurate books and records and to keep them from being

altered or destroyed. Such records must include, among other things, financial records substantiating a Members assets and liabilities, including liabilities owed to customers and receivables from other persons. The Member should be able to promptly produce its records in a format that NFA can read and reproduce.

Forex Dealer Members should adopt and enforce a written policy detailing the procedures it follows to calculate rollover or interest charges and payments. The policy must include the factors that are considered as well as the names of any sources for these factors. The Member should document the underlying factors reviewed in completing the calculation, including any related transactions entered into by the Forex Dealer Member, so it can be replicated.

5. *Communications with the Public and Promotional Material* - No Member or Associate shall make any communication with potential or current customers that operates as a fraud or deceit; uses a high-pressure approach; or implies that forex transactions are appropriate for all persons.

Promotional material used by the Member or Associate shall not:

- Deceive the public or contain any material misstatement of fact or omit a fact that makes the promotional material misleading;[8]
- Include any statements of opinion unless they are clearly identified as such and have a reasonable basis in fact;
- Mention the possibility of profit unless accompanied by an equally prominent statement of the risk of loss;
- Include any reference to actual past trading profits without mentioning that past results are not necessarily indicative of future results;
- Include any statistical or numerical information about past performance of actual accounts unless the Member can demonstrate that the performance is representative of actual performance of all reasonably comparable accounts for the same period (calculated in accordance with the formula in CFTC Regulation 4.35(a)(6) and NFA Compliance Rule 2-34); or
- Include testimonials unless they are representative of all reasonably comparable accounts, the material prominently states that the testimonial is not indicative of future performance or success, and the material prominently states that they are paid testimonials (if applicable).

No Member or Associate may represent that forex funds deposited with a Forex Dealer Member are given special protection under the bankruptcy laws. No Member or Associate may represent or imply that any assets necessary to satisfy its obligations to customers are more secure because the Member keeps some or all of those assets at a regulated entity in the United States or a money center country.

No Member or Associate may represent that its services are commission free without prominently disclosing how it is compensated in near proximity to that representation.

No Member or Associate may represent that it offers trading with "no-slippage" or that it guarantees the price at which a transaction will be executed or filled, unless:

- It can demonstrate that all orders for all customers have been executed and fulfilled at the price initially quoted on the trading platform when the order was placed;[9] and
- No authority exists, pursuant to a contract, agreement, or otherwise, to adjust customer accounts in a manner that would have the direct or indirect effect of changing the price at which an order was executed.[10]

Members and Associates may not solicit customers based on the leverage available unless they balance any discussion regarding the advantages of leverage with an equally prominent contemporaneous disclosure that increasing leverage increases risk.

No Member shall use or directly benefit from any radio or television advertisement that recommends specific forex transactions or describes the extent of any profit obtained in the past or that can be obtained in the future unless the member submits the advertisement to NFA's Promotional Material Review Team for its review and approval at least 10 days prior to its first use or such shorter period as NFA may allow.[11]

Every Member should adopt and enforce written procedures to supervise communications with potential and current customers and promotional material. A supervisory employee that is, or is under the ultimate supervision of, a listed principal who is also an NFA Associate should review and approve all promotional material and make a written record of such review and approval.[12]

All promotional material should be maintained by each Member and be available for examination for the periods specified in the recordkeeping section of this notice, measured from the date of last use.

6. *Know Your Customer* - Members and Associates have a duty to acquaint themselves sufficiently with the personal and financial circumstances of each forex customer to determine what further facts, explanations and disclosures are needed in order for the customer to make an informed decision on whether to enter into forex transactions.

Every Member should determine what information it will obtain from a prospective forex customer. At a minimum, the Member soliciting the customer to engage in forex transactions should obtain the customer's name, address, principal occupation or business, current estimated annual income and net worth, approximate age, and an indication of the customer's previous investment and trading experience. Members and their Associates need to ensure that each customer they solicit has received adequate information concerning the risks of forex transactions so that the customer can make an informed decision as to whether forex transactions are appropriate for the customer. These obligations fall on the Forex Dealer Member when a non-Member solicits the customer.

7. *Doing Business with Non-Members* - Forex Dealer Members are subject to discipline for the activities of most non-Members who solicit or introduce forex customers to the Forex Dealer Member or manage accounts for those customers.

If a customer is solicited or introduced by a non-Member of NFA, or if the customer's account is managed by a non-Member, the Forex Dealer Member is subject to discipline for the non-Member's conduct if that conduct would violate NFA requirements when engaged in by an NFA Member. In other words, a Forex Dealer Member is subject to an NFA disciplinary action for the non-Member's activities when soliciting,

introducing, or managing accounts for the Forex Dealer Member's customers even if the non-Member was not the Forex Dealer Member's agent.

The rule allows NFA to bring a disciplinary action even if the Forex Dealer Member acts diligently and has no knowledge of the third-party's conduct. As a practical matter, however, NFA will not take disciplinary action unless the Forex Dealer Member knew or should have known of the third-party's conduct or failed to exercise due diligence when establishing and maintaining the relationship with the third party.

A Forex Dealer Member should adopt and enforce written procedures to review the activities of non-Member third parties. The procedures should include, among other things, a regular review of the trading being conducted in the accounts solicited, introduced, or managed by these non-Members. The Member should also have procedures for following up on any customer complaints received by the firm, including a written description of the investigation made by the Member and any resolution of the complaint. Further, supervisory procedures should include a regular review of all promotional material used by any non-Member third-party. The member should maintain copies of all promotional materials reviewed, along with a written record of the review conducted and any deficiencies corrected, and make them available for examination for the periods specified in the recordkeeping section of this notice. A supervisory employee that is, or is under the ultimate supervision of, a listed principal who is also an NFA Associate should conduct the review of the non-Member's activities.

The Forex Dealer Member is not subject to discipline for the actions of non-Members who are described in NFA Bylaw 306(b). It is also not subject to discipline for the actions of non-Members who would be exempt from Commission registration if they were acting in the same capacity in connection with exchange-traded futures contracts, such as foreign persons that solicit, introduce, or manage accounts for foreign customers only.[13] The Forex Dealer Member does, of course, have certain basic duties to its customers, including a duty to supervise its own activities in a way designed to ensure that it treats its customers fairly. Specifically, the Forex Dealer Member would violate this duty if it has actual or constructive notice that one of these entities engaged in fraudulent conduct and fails to take appropriate action.

8. *Affiliates* - Forex Dealer Members must supervise and are subject to discipline for the activities of affiliates that are authorized to engage in forex transactions solely by virtue of their affiliation with a Forex Dealer Member.

The CEA authorizes affiliates of FCMs to act as counterparties to forex transactions if the affiliate directly or indirectly controls, is controlled by, or is under common control with the FCM and the FCM makes and keeps records regarding the financial activities of the affiliate for purposes of the Commission's risk assessment requirements.[14] If a Forex Dealer Member has one or more affiliates that act as counterparty to forex customers solely on the basis of that affiliation, the Forex Dealer Member must supervise the affiliate's forex activities and is subject to discipline for that affiliate's activities.[15] The Forex Dealer Member must also make these affiliates' books and records available to NFA upon request. Additionally, the Forex Dealer Member must assure that its affiliates do not act as counterparties to forex transactions unless they are authorized to do so under the Act.

9. *BASIC Disclosure* - Members must provide forex customers with information on NFA's BASIC system.

NFA Compliance Rule 2-36(g) requires Forex Dealer Members to provide customers with written information regarding NFA's Background Affiliation Status Information Center (BASIC), including the web site address [16]. This information must be provided when the customer first opens an account and at least once a year thereafter.

Forex Dealer Members may provide the information electronically but must do it in a way that ensures each customer is aware of it. For example, merely having the information on the Member's web site is not adequate, but sending customers an e-mail including a link to that information and explaining what the link is would be sufficient in most circumstances.

10. *Discretion* - No Forex Dealer Member, or Associate of a Forex Dealer Member acting in such capacity, may exercise discretionary trading authority over a customer account for which the Forex Dealer Member is, or is offering to be, the counterparty to the transactions in the customer account.

C. OTHER REQUIREMENTS

This section of the notice provides guidance on dues, capital requirements, and security deposits. These requirements apply only to Forex Dealer Members.

1. Bylaw 1301

NFA Bylaw 1301(e) requires Forex Dealer Members to pay annual dues that are graduated according to the firm's gross annual revenue from customers (e.g., commissions, mark-ups, mark-downs) for its forex activities. Profits and losses from proprietary trades are *not* to be included. To calculate dues:

- Start with the FCM dues imposed by NFA Bylaw 1301(b)(ii);
- Add $44,375 if the Forex Dealer Member's gross annual revenue from forex transactions is $500,000 or less;
- Add $69,375 if the Forex Dealer Member's gross annual revenue from forex transactions is more than $500,000, but not more than $2,000,000;
- Add $94,375 if the Forex Dealer Member's gross annual revenue from forex transactions is more than $2,000,000, but not more than $5,000,000; or
- Add $119,375 if the Forex Dealer Member's gross annual revenue from these activities is more than $5,000,000.

The following table shows the dues to be assessed for Forex Dealer Members:

Amount of annual Gross Revenue From Forex Transactions	Dues if NFA is the DSRO	Dues if NFA is not the DSRO
$500,000 or less	$50,000	$45,875
More than $500,000, but not more than $2 million	$75,000	$70,875

More than $2 million, but not more than $5 million	$100,000	$95,875
More than $5 million	$125,000	$120,875

These dues apply when the Forex Dealer Member offers to be a counterparty to a forex transaction or accepts a forex trade (whichever is earlier), and NFA will send the Member an invoice for the minimum dues ($50,000 or $45,875) minus any amount already paid for that membership year. Thereafter, the dues will be assessed on the firm's membership renewal date and will be based on the Forex Dealer Member's latest certified financial statement.

The only exception to the dues set forth above is a situation in which NFA does not serve as the DSRO for a Forex Dealer Member and the DSRO has agreed to examine the Forex Dealer Member's forex activities. In this case, the surcharge paid by the Forex Dealer Member, regardless of gross annual revenue, is $12,000. Accordingly, for such a Forex Dealer Member the dues to be assessed at the time it offers to be a counterparty to a forex transaction or accepts a forex trade (whichever is earlier), and on its membership renewal date thereafter, will be $13,500.

Under NFA Compliance Rule 2-36(d), a Forex Dealer Member is subject to discipline for the activities of any person that solicits or introduces a customer to the Member or manages a customer's account unless that person is a Member or Associate of NFA, is otherwise regulated based on the criteria in Bylaw 306(b), or would be exempt from CFTC registration if it were acting in the same capacity in connection with exchange-traded futures contracts. Any Forex Dealer Member that is responsible under Compliance Rule 2-36(d) for solicitors and account managers is required to pay a separate annual fee on the firm's annual renewal date based on the number of unregulated solicitors and account managers. In determining whether this fee applies, the Forex Dealer Member should take the highest number of separate legal entities, including individuals acting as sole proprietors, that it was responsible for at any one time during the year. The following table shows this graduated fee.

Number of Unregulated Entities	Annual Fee
0	$ 0
1-4	$ 5,000
5-19	$10,000
20-99	$25,000
100 or more	$50,000

Each Forex Dealer Member is also required to pay an assessment of .0001% on the notional value of each forex transaction (as forex is defined in Bylaw 1507(b)). This equates to $.01 for each $10,000. For transactions with a notional value less than $10,000, the firm may aggregate separate transactions and pay $.01 on each multiple of $10,000. For transactions of $10,000 or above, the firm should round to the nearest cent.

This assessment is due only on initiating transactions. There is no assessment on rollovers, offsetting transactions, option expirations, or option exercises that do not result in new positions. The Member must remit the assessment to NFA within 30 days after the end of the month in which the transaction was initiated.

2. Financial Requirements Section 11(a)

Forex Dealer Members must maintain adjusted net capital equal to or in excess of the greatest amount specified in subsections (a)(i), (a)(ii), and (a)(iii) (if applicable). Subsection (a)(ii) applies to Forex Dealer Members that execute any customer transactions other than by using straight-through-processing and that also have liabilities to customers of more than $10 million. Where it applies, the Member's capital requirement is the minimum capital required by subsection (a)(i) plus 5% of the liabilities over $10 million. The formula is:

Amount required by (a)(i) + .05(customer liabilities - $10,000,000)

For example, if the minimum capital requirement is $20 million, a Forex Dealer Member that operates a dealing desk and has $208 million in liabilities to customers would be required to maintain adjusted net capital equal to or in excess of $29.9 million.

Forex Dealer Members with over $10 million in customer liabilities are subject to this alternative requirement unless they execute all customer transactions using straight-through-processing. Straight-through-processing refers to platforms that automatically (without human intervention and without exception) enter into an identical but opposite transaction with another counterparty, creating an offsetting position in the Forex Dealer Member's own name. A Forex Dealer Member that offers several platforms will be exempt from this requirement only if each platform executes all customer orders using straight-through-processing.

This requirement that all customer trades be executed by straight-through-processing is not, however, meant to limit a firm's ability to provide for other methods in its disaster recovery procedures. As long as those other methods are used only when dictated by those procedures and both the procedures and the firm's trading platform are designed to ensure that the need will rarely arise, the FDM will not lose its exemption by implementing other execution methods in disaster recovery situations.

3. Financial Requirements Section 11(b)

Section 11(b) prohibits a Forex Dealer Member from including assets held by an affiliate (unless approved) or an unregulated person in the firm's current assets for purposes of determining its adjusted net capital under CFTC Rule 1.17. This means an FDM may not count any part of those assets for capital purposes.[17]

An unregulated person is any person that is **not**:

(i) a financial institution regulated by a U.S. banking regulator;

(ii) a broker-dealer registered with the U.S. Securities and Exchange Commission and a member of FINRA;

(iii) a futures commission merchant registered with the U.S. Commodity Futures Trading Commission and a Member of NFA;

(iv) an insurance company regulated by any U.S. state;

(v) an entity regulated as a foreign equivalent of any of the above if regulated in a money center country as defined in CFTC Regulation 1.49; or

(vi) any other entity approved by NFA.

Effective October 1, 2010, the above paragraph will read as follows:

An unregulated person is any person that is **not**:

(i) a financial institution regulated by a U.S. banking regulator;

(ii) a broker-dealer registered with the U.S. Securities and Exchange Commission and a member of FINRA;

(iii) a futures commission merchant registered with the U.S. Commodity Futures Trading Commission and a Member of NFA;

(iv) a retail foreign exchange dealer registered with the U.S. Commodity Futures Trading Commission and a Member of NFA;

(v) an insurance company regulated by any U.S. state; or

(vi) any other entity approved by NFA.

Any Forex Dealer Member may ask NFA to approve an otherwise unregulated person for purposes of Financial Requirements Sections 11(b) and (c). In determining whether to approve an unregulated person that is not an affiliate, NFA will consider a number of factors, including:

- Whether the person is regulated in another jurisdiction and, if so, the type and extent of regulation;
- The person's capital; and
- The person's credit rating.

NFA's approval of a particular person means that all unaffiliated Forex Dealer Members may treat that person as regulated under Sections 11(b) and (c). NFA may also approve categories of counterparties (e.g., banks regulated in a particular jurisdiction or with a particular credit rating).

A Forex Dealer Member may not engage in Section 11(b) or (c) transactions with a regulated affiliate without NFA's approval. The Member may, however, ask NFA to authorize it to cover its positions with specified affiliates (including unregulated affiliates). An affiliate is any entity that controls, is controlled by, or is under common control with the Forex Dealer Member. The standards for approving affiliated persons are significantly higher than those for unaffiliated persons. For example, NFA will also consider:

- The parent company's and affiliated person's capital;
- Whether the parent company and the affiliated person are regulated entities;
- Whether the parent company will guarantee the obligations of the affiliated person (unless the parent company and the affiliated person are the same entity);
- The parent company's credit rating;
- Whether the affiliated person has strong risk-management policies to limit its value-at-risk; and
- For purposes of Section 11(c), whether the affiliated person limits the amount of offsetting transactions it enters into with unregulated counterparties.

4. Financial Requirements Section 11(c)

Section 11(c) prohibits Forex Dealer Members from using affiliates (unless approved) and unregulated persons to cover their foreign currency positions for purposes of CFTC Rule 1.17(c)(5).

The rule does not prohibit Forex Dealer Members from entering into positions with unregulated or unapproved counterparties. They may not, however, count positions with those counterparties when calculating their covered positions for purposes of CFTC Rule 1.17(c)(5).

For purposes of Section 11(c), Forex Dealer Members have four different types of counterparties. In particular:

- Account holders are those counterparties for whom it carries accounts and includes both retail customers and eligible contract participants.
- Trading partners are counterparties with whom the Member trades but who do not have accounts with the Member. For purposes of the calculations under Section 11(c), this category does not include affiliates (approved or unapproved) or regulated counterparties.
- Affiliates are entities that control, are controlled by, or are under common control with the Forex Dealer Member. For purposes of Section 11(c) only, this category does not include affiliates who have been approved by NFA under Section 11(b).
- Regulated entities are those counterparties that meet the definition in Section 11(b) and include entities-including affiliates-approved by NFA under that Section.

A Forex Dealer Member may net its exposure across account holders, across trading partners, and across affiliates, but it may not net its exposure between these categories. The Member may, however, net its exposure in any of these categories against regulated counterparties. Here is the information in chart form.

Type of Counterparty	Account Holders	Trading Partners	Affiliates	Regulated Entities
Account Holders	Yes	No	No	Yes
Trading Partners	No	Yes	No	Yes
Affiliates	No	No	Yes	Yes
Regulated Entities	Yes	Yes	Yes	Yes

A Forex Dealer Member is required to take a charge on the larger of its unnetted long or short position but not on both.

Example

Assume a Forex Dealer Member has the following Euro positions:

Type	Long	Short	Net Long	Net Short
Account Holders	11,154,912	6,011,794	5,143,118	
Trading Partners	4,987,345	7,299,886		2,312,541
Affiliates	3,790,754	2,640,553	1,150,201	
Regulated Entities	1,280,555	4,125,018		2,844,463

In determining the uncovered amount for purposes of the 6% haircut, the Forex Dealer Member can offset its net long position with account holders against the net short position with regulated entities but cannot offset its position with its trading partners or its position with unapproved affiliates against any category except regulated entities.

The math works this way (using only absolute numbers):

Net long position with account holders	5,143,118
Minus net short position with regulated entities	-2,844,463
	2,298,655
Uncovered long position with account holders	2,298,655
Plus net long position with affiliates	+1,150,201
Total uncovered long position	3,448,856
Net short position with trading partners	2,312,541
Larger of net long or short position	3,448,856
Haircut on Euros (3,448,856 X .06)	$206,931

5. Financial Requirements Section 12

Forex Dealer Members must collect security deposits from forex customers equal to 1% of the notional value of transactions in specified foreign currencies and 4% of the notional value of all other transactions. Where the two currencies are in different categories, the Forex Dealer Member must collect the higher amount. If the transaction pairs a foreign currency with the U.S. dollar, the security deposit is based on the foreign currency. If the transaction pairs a currency that qualifies for a 1% deposit with a currency that does not, the Forex Dealer Member must collect a 4% security deposit for the entire transaction. For example:

Currency Pair	Security Deposit
EUR/USD	1%
CND/JPY	1%
CND/BRL	4%
USD/MXN	4%
BRL/MXN	4%

For short options, the Forex Dealer Member must collect this amount plus the premium the customer received. For long options, the Forex Dealer Member must simply collect the entire premium from the customer.

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[1] The Board of Directors has declared that these transactions are a proper subject of NFA regulation and oversight under Article XVIII, paragraph (k).

[2] Compliance Rule 2-39 excludes these same entities when they introduce or manage forex accounts.

[3] Bylaw 306(b)(ii) excludes broker-dealers that are members of any fully-registered national securities association and FCMs that are members of another registered futures association. At this time, however, FINRA is the only fully-registered national securities association and NFA is the only registered futures association.

[4] These are affiliates of broker-dealers for which the broker-dealer makes and keeps records under the Securities and Exchange Commission's risk assessment requirements. See Section 17(h) of the Securities Exchange Act of 1934 and SEC Rule 17h-1T.

[5] See, for example, Compliance Rule 2-9: Supervision of Branch Offices and Guaranteed IBs, NFA Manual paragraph 9019; Compliance Rule 2-9: Supervisory Procedures for E-Mail and the Use of Web Sites, NFA Manual paragraph 9037; Compliance Rule 2-9: Supervision of the Use of Automated Order-Routing Systems, NFA Manual paragraph 9046. These interpretive notices do not directly apply to forex activities, but the principles included in these notices are equally applicable to those activities.

[6] The Commodity Futures Trading Commission has stated that all employees of an FCM who solicit or accept orders for forex transactions from retail customers must be registered with the Commission as an associated person of the FCM. See Division of Trading and Markets Advisory Concerning Foreign Currency Trading by Retail Customers (March 2002).

[7] The screening process should include 1) checking BASIC and any other readily available sources and 2) asking the third-party to represent that neither it nor any of its principals is subject to a statutory disqualification or to identify and explain any statutory disqualifications.

[8] Through interpretive notices issued under NFA Compliance Rule 2-29, NFA has provided Members with guidance on what activities are deceptive and misleading. See, for example, NFA Compliance Rule 2-29: Deceptive Advertising, NFA Manual paragraph 9033; NFA Compliance Rule 2-29: Deceptive Advertising, NFA Manual paragraph 9034; Compliance Rule 2-29: High Pressure Sales Tactics, NFA Manual paragraph 9038; and NFA Compliance Rules 2-29 and 2-9: NFA's Review and Approval of Certain Radio and television Advertisements, NFA Manual paragraph 9039. Although these interpretive notices do not directly apply to forex activities, the principles included in them with regard to what is deceptive or misleading are equally applicable to those activities.

[9] The Forex Dealer Member is not required to give the customer a price that is no longer reflected on the platform at the time the order reaches it. The Forex Dealer Member is not responsible for

transmission delays outside its control. If an Forex Dealer Member, however, advertises "no-slippage" or that it guarantees fill prices, it must prominently disclose that transmission delays might result in customer orders being executed at a price other than that seen by the customer.

[10] This includes *force majeure* provisions.

[11] Submission of promotional materials for NFA review is not a substitute for a Member's own responsibility to review promotional material. NFA staff will not independently verify the accuracy of statements made in an advertisement; that responsibility remains with the Member. Submitting promotional material to NFA will not provide a "safe harbor" from NFA actions for Members if misstatements or omissions of material fact are discovered subsequently or NFA otherwise later determines that the material is in violation of any applicable standards.

[12] Under traditional legal principles, Members can also be liable for promotional material promoting forex trading systems developed by third-parties. For example, a Member has direct responsibility for misleading promotional material if the Member prepares or distributes it; has agency responsibility if the system developer is an agent of the Member under established principles of agency law; and has supervisory responsibility if the Member fails to supervise its own employees when linking to a third-party trading system developer's web site, recommending a third-party's trading system, or entering into a referral agreement with a third-party system developer. See Interpretive Notice titled "NFA Bylaw 1101, Compliance Rules 2-9 and 2-29: Guidelines Relating to the Registration of Third-Party Trading System Developers and the Responsibility of NFA Members for Promotional Material That Promotes Third-Party Trading System Developers and their Trading Systems," NFA Manual, paragraph 9055.

[13] For this purpose, foreign persons and foreign customers are 1) natural persons who are not residents of the United States or 2) legal entities (other than passive investment vehicles) that are organized under the laws of a country other than the United States, do not have their principal place of business in the United States, and do not conduct their retail forex activities from a location in the United States. Those terms do not include a passive investment vehicle that is more than 10% owned by United States persons or that solicits United States persons who are not eligible contract participants as defined in Section 1a(12) of the Act. "United States" includes U.S. territories and possessions.

[14] See Sections 2(c)(2)(B)(ii)(III) and 4f(c)(2)(B) of the CEA and CFTC Regulations 1.14 and 1.15.

[15] Obviously, the Forex Dealer Member must also ensure that no entity with common ownership engages in the forex business unless it is authorized to do so.

[16] Forex Dealer Members can comply with this requirement by providing customers with a copy of NFA's brochure entitled "Background Affiliation Status Information Center (BASIC): An Information Resource for the Investing Public," which is available in print and on NFA's website at http://www.nfa.futures.org/.

[17] Where the CFTC's requirements for holding current assets are more stringent, those requirements apply.

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Compliance Rules

RULE 2-41. FOREX POOL OPERATORS AND TRADING ADVISORS
[Adopted effective November 30, 2008. Effective date of amendments: December 8, 2008.]

(a) **Pool Operators.** Except for Members who meet the criteria in Bylaw 306(b) and Associates acting on their behalf, any Member or Associate operating or soliciting funds, securities, or property for a pooled investment vehicle that is not an eligible contract participant as defined in Section 1a(12) of the Act must comply with this section (a) if it enters into or intends to enter into any transaction described in NFA Bylaw 1507(b)(1) except as described in NFA Bylaw 1507(b)(3). For purposes of this section, a pooled investment vehicle may not claim to be an eligible contract participant by virtue of Section 1a(12)(A)(v)(II) or (III) of the Act.

(1) For each such pooled investment vehicle, the Member or Associate must prepare a Disclosure Document and must file it with NFA at least 21 days before soliciting the first potential pool participant that is not an eligible contract participant.

(2) The Member or Associate must deliver the Disclosure Document to a prospective pool participant who is not an eligible contract participant no later than the time it delivers the subscription agreement for the pool. Any information delivered before the Disclosure Document must be consistent with the information in the Disclosure Document.

(3) The Disclosure Document must comply with the requirements in CFTC Regulations 4.24, 4.25, and 4.26 as if operating a pool trading on-exchange futures contracts. The term "commodity interest" in those regulations should be read to include forex transactions, and the Risk Disclosure Statement required by CFTC Regulation 4.24(b)(1) must be replaced by the following if the pool does not trade on-exchange contracts and must be added as a separate statement if the pool trades both on-exchange contracts and forex.

RISK DISCLOSURE STATEMENT

YOU SHOULD CAREFULLY CONSIDER WHETHER YOUR FINANCIAL CONDITION PERMITS YOU TO PARTICIPATE IN A POOLED INVESTMENT VEHICLE. IN SO DOING, YOU SHOULD BE AWARE THAT THIS POOL ENTERS INTO TRANSACTIONS THAT ARE NOT TRADED ON AN EXCHANGE, AND THE FUNDS THE POOL INVESTS IN THOSE TRANSACTIONS MAY NOT RECEIVE THE SAME PROTECTIONS AS FUNDS USED TO MARGIN OR GUARANTEE EXCHANGE-TRADED FUTURES AND OPTIONS CONTRACTS. IF THE COUNTERPARTY BECOMES INSOLVENT AND THE POOL HAS A CLAIM FOR AMOUNTS DEPOSITED OR PROFITS EARNED ON TRANSACTIONS WITH THE COUNTERPARTY, THE POOL'S CLAIM MAY NOT RECEIVE A PRIORITY. WITHOUT A PRIORITY, THE POOL IS A GENERAL CREDITOR AND ITS CLAIM WILL BE PAID, ALONG WITH THE CLAIMS OF OTHER GENERAL CREDITORS, FROM ANY MONIES STILL AVAILABLE AFTER PRIORITY CLAIMS ARE PAID. EVEN POOL FUNDS THAT THE COUNTERPARTY KEEPS SEPARATE FROM ITS OWN OPERATING FUNDS MAY NOT BE SAFE FROM THE CLAIMS OF OTHER GENERAL AND PRIORITY CREDITORS.

FOREX TRADING CAN QUICKLY LEAD TO LARGE LOSSES AS WELL AS GAINS. SUCH TRADING LOSSES CAN SHARPLY REDUCE THE NET ASSET VALUE OF THE POOL AND CONSEQUENTLY THE VALUE OF YOUR INTEREST IN THE POOL. IN ADDITION, RESTRICTIONS ON REDEMPTIONS MAY AFFECT YOUR ABILITY TO WITHDRAW YOUR PARTICIPATION IN THE POOL.

INVESTMENTS IN THE POOL MAY BE SUBJECT TO SUBSTANTIAL CHARGES FOR MANAGEMENT, ADVISORY, AND BROKERAGE FEES, AND THE POOL MAY NEED TO MAKE SUBSTANTIAL TRADING PROFITS TO AVOID DEPLETING OR EXHAUSTING ITS ASSETS. THIS DISCLOSURE DOCUMENT CONTAINS A COMPLETE DESCRIPTION OF EACH EXPENSE (SEE PAGE [insert page number]) AND A STATEMENT OF THE PERCENTAGE RETURN NECESSARY TO BREAK EVEN, THAT IS, TO RECOVER THE AMOUNT OF YOUR INITIAL INVESTMENT (SEE PAGE [insert page number]).

THIS BRIEF STATEMENT CANNOT DISCLOSE ALL THE RISKS AND OTHER FACTORS NECESSARY TO EVALUATE YOUR PARTICIPATION IN THIS POOL. THEREFORE, BEFORE YOU DECIDE TO PARTICIPATE YOU SHOULD CAREFULLY REVIEW THIS DISCLOSURE DOCUMENT, INCLUDING A DESCRIPTION OF THE PRINCIPAL RISK FACTORS OF THIS INVESTMENT (SEE PAGE [insert page number]).

NATIONAL FUTURES ASSOCIATION HAS NEITHER PASSED UPON THE MERITS OF PARTICIPATING IN THIS POOL NOR THE ADEQUACY OR ACCURACY OF THIS DISCLOSURE DOCUMENT.

(b) **Trading Advisors.** Except for Members who meet the criteria in Bylaw 306(b) and Associates acting on their behalf, any Member or Associate managing, directing or guiding, or soliciting to manage, direct, or guide, accounts or trading on behalf of a client that is not an eligible contract participant as defined in Section 1a(12) of the Act by means of a systematic program must comply with this section (b) if it intends to manage, direct, or guide the client's account or trade in transactions described in NFA Bylaw 1507(b).

(1) The Member or Associate must prepare a Disclosure Document and must file it with NFA at least 21 days before soliciting the first potential client that is not an eligible contract participant.

(2) The Member or Associate must deliver the Disclosure Document to a prospective client who is not an eligible contract participant no later than the time it delivers the agreement to manage, direct, or guide the client's account or trading. Any information delivered before the Disclosure Document must be consistent with the information in the Disclosure Document.

(3) The Disclosure Document must comply with the requirements in CFTC Regulations 4.34, 4.35, and 4.36 as if managing, directing, or guiding accounts or trading in on-exchange futures contracts. The term "commodity interest" in those regulations should be read to include forex transactions, and the Risk Disclosure Statement required by CFTC Regulation 4.34(b)(1) must be replaced by the following if the managed, directed, or guided account or trading will not include transactions in on-exchange contracts and must be added as a separate statement if it will include transactions in both on-exchange contracts and forex.

RISK DISCLOSURE STATEMENT

THE RISK OF LOSS IN FOREX TRADING CAN BE SUBSTANTIAL. YOU SHOULD THEREFORE CAREFULLY CONSIDER WHETHER SUCH TRADING IS SUITABLE FOR YOU IN LIGHT OF YOUR FINANCIAL CONDITION. IN CONSIDERING WHETHER TO TRADE OR TO AUTHORIZE SOMEONE ELSE TO TRADE FOR YOU, YOU SHOULD ALSO BE AWARE OF THE FOLLOWING:

FOREX TRANSACTIONS ARE NOT TRADED ON AN EXCHANGE, AND THOSE FUNDS DEPOSITED WITH THE COUNTERPARTY FOR FOREX TRANSACTIONS MAY NOT RECEIVE THE SAME PROTECTIONS AS FUNDS USED TO MARGIN OR GUARANTEE EXCHANGE-TRADED FUTURES AND OPTIONS CONTRACTS. IF THE COUNTERPARTY BECOMES INSOLVENT AND YOU HAVE A CLAIM FOR AMOUNTS DEPOSITED OR PROFITS EARNED ON TRANSACTIONS WITH THE COUNTERPARTY, YOUR CLAIM MAY NOT RECEIVE A PRIORITY. WITHOUT A PRIORITY, YOU ARE A GENERAL CREDITOR AND YOUR CLAIM WILL BE PAID, ALONG WITH THE CLAIMS OF OTHER GENERAL CREDITORS, FROM ANY MONIES STILL AVAILABLE AFTER PRIORITY CLAIMS ARE PAID. EVEN CUSTOMER FUNDS THAT THE COUNTERPARTY KEEPS SEPARATE FROM ITS OWN OPERATING FUNDS MAY NOT BE SAFE FROM THE CLAIMS OF OTHER GENERAL AND PRIORITY CREDITORS.

THE HIGH DEGREE OF LEVERAGE THAT IS OFTEN OBTAINABLE IN FOREX TRADING CAN WORK AGAINST YOU AS WELL AS FOR YOU. THE USE OF LEVERAGE CAN LEAD TO LARGE LOSSES AS WELL AS GAINS.

MANAGED ACCOUNTS MAY BE SUBJECT TO SUBSTANTIAL CHARGES FOR MANAGEMENT AND ADVISORY FEES AND THE ACCOUNT MAY NEED TO MAKE SUBSTANTIAL TRADING PROFITS TO AVOID DEPLETING OR EXHAUSTING ITS ASSETS. THIS DISCLOSURE DOCUMENT CONTAINS A COMPLETE DESCRIPTION OF EACH FEE TO BE CHARGED TO YOUR ACCOUNT BY THE ACCOUNT MANAGER. (SEE PAGE [insert page number]).

THIS BRIEF STATEMENT CANNOT DISCLOSE ALL THE RISKS AND SIGNIFICANT ASPECTS OF THE FOREX MARKETS. THEREFORE, YOU SHOULD CAREFULLY REVIEW THIS DISCLOSURE DOCUMENT BEFORE YOU TRADE, INCLUDING THE DESCRIPTION OF THE PRINCIPAL RISK FACTORS OF THIS INVESTMENT (SEE PAGE [insert page number]).

NATIONAL FUTURES ASSOCIATION HAS NEITHER PASSED UPON THE MERITS OF PARTICIPATING IN THIS TRADING PROGRAM NOR THE ADEQUACY OR ACCURACY OF THIS DISCLOSURE DOCUMENT.

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Interpretive Notices

9053 - FOREX TRANSACTIONS

(Revised November 9, 2004; June 13, 2005; September 15, 2005; November 30, 2005; April 30, 2006; July 31, 2006; October 1, 2006; February 13, 2007; March 7, 2007; March 9, 2007; March 31, 2007; May 7, 2007; June 5, 2007; July 1, 2007; September 21, 2007; October 1, 2007; October 25, 2007; December 17, 2007; December 21, 2007; June 1, 2008; July 1, 2008; October 31, 2008; April 1, 2009; June 1, 2009; November 30, 2009; and December 17, 2009.)

INTERPRETIVE NOTICE

The Commodity Exchange Act (CEA or Act) gives the Commodity Futures Trading Commission (CFTC or Commission) limited jurisdiction over off-exchange foreign currency transactions offered to or entered into with retail customers. As a result of those provisions, certain firms primarily engaged in the retail forex business have registered with the CFTC and become Members of NFA. NFA has adopted several requirements to govern the conduct of these firms and their associated persons.

As described below, NFA Bylaw 306 creates a Forex Dealer Member category for certain NFA Members who act as counterparties to forex transactions with retail customers. This category allows NFA to exercise appropriate regulatory jurisdiction over the retail forex activities of these Members without imposing unnecessary, and potentially duplicative, regulatory burdens on Members that are otherwise subject to regulatory oversight for their activities.

NFA Bylaw 1507(b) defines forex as foreign currency futures and options and any other agreement, contract, or transaction in foreign currency that is offered or entered into on a leveraged or margined basis, or financed by the offeror, the counterparty, or a person acting in concert with the offeror or counterparty on a similar basis that are:

- offered to or entered into with persons that are not eligible contract participants as defined in Section 1a(12) of the Act (retail customers); and
- not executed on or subject to the rules of a contract market, a derivatives transaction execution facility, a national securities exchange registered pursuant to Section 6(a) of the Securities Exchange Act of 1934, or a foreign board of trade.[1]

Bylaw 1507(b) also excludes the following from the forex definition if the transaction is not a futures or options contract:

- securities (other than security futures products);
- any contract of sale that results in actual delivery within two days; and
- any contract of sale that creates an enforceable obligation to deliver between a seller and buyer that have the ability to deliver and accept delivery, respectively, in connection with their line of business.

Given the differences between off-exchange transactions and traditional exchange-traded futures and options, the Board of Directors does not believe that it is appropriate to apply the full array of NFA's futures rules to forex transactions. Therefore, rather than simply incorporating forex transactions into the definition of "futures," NFA adopted NFA Compliance Rule 2-36 to govern these transactions.

In developing its forex requirements, NFA's primary concern was to ensure that they provide adequate protection for retail customers without imposing undue burdens on NFA Members. NFA also believes that its requirements should, where consistent with customer protection, promote innovation and competition. In order to provide Members with as much flexibility as possible, NFA has chosen to deal with a number of issues by providing guidance under NFA Compliance Rule 2-36 instead of by adopting additional rules.

NFA Compliance Rule 2-36 sets out the general standards that apply to Forex Dealer Members and their Associates in connection with forex transactions. Subsection (b) prohibits Forex Dealer Members and their Associates from engaging in fraudulent activities, subsection (c) requires Forex Dealer Members and their Associates to observe high standards of commercial honor and just and equitable principles of trade in connection with their forex business, and subsection (e) requires Forex Dealer Members and their Associates with supervisory duties to supervise their employees and agents. Other subsections address a Forex Dealer Member's responsibility for its unregulated affiliates and third-party solicitors and make Forex Dealer Members subject to discipline for the conduct of certain non-Members with which they do business.

This notice has three sections. The first section explains who qualifies as a Forex Dealer Member under NFA Bylaw 306, the second section provides additional guidance about the requirements in Compliance Rule 2-36, and the third section covers other miscellaneous requirements.

A. BYLAW 306

In general, Forex Dealer Members are NFA Members who act as counterparties to forex transactions. This is a self-executing requirement, which means that any Member who qualifies is automatically a Forex Dealer Member. There is no application form and no approval requirement.

Members who do not act as counterparties are not Forex Dealer Members, even if they introduce or manage forex accounts. Under NFA Compliance Rule 2-39, however, most Members who introduce or manage forex accounts are required to comply with subsections (a), (b), (c), and (e) of NFA Compliance Rule 2-36.

Bylaw 306(b) excludes Members that are otherwise subject to regulatory oversight for their forex activities, which means that these Members are not Forex Dealer Members and do not have to comply with Compliance Rule 2-36. [2] The exclusions mostly follow Section 2(c)(2)(B)(ii) of the CEA, although the exclusions for broker-dealers and their affiliates are conditioned on the Financial Industry Regulatory Authority ("FINRA") membership. In particular, the following entities are not Forex Dealer Members:

- financial institutions (e.g., banks and savings associations);
- certain insurance companies and their regulated subsidiaries or affiliates;
- financial holding companies;
- investment bank holding companies;
- registered broker-dealers that are members of FINRA;[3] and
- Material Associated Persons of registered broker-dealers that are members of FINRA.[4]

B. COMPLIANCE RULE 2-36

As noted above, this section provides additional guidance on what Compliance Rule 2-36 requires. Certain sections specifically refer to Forex Dealer Members. Except for Members that meet the criteria in Bylaw 306(b), all other provisions of this notice also apply to Members and their Associates who solicit, introduce or manage forex accounts.

1. *Disclosure* - Members must provide forex customers with understandable and timely disclosure on essential features of forex trading.

At or before the time a customer first engages in a forex transaction, a Forex Dealer Member and its Associates should provide the customer sufficient information concerning the characteristics and particular risks of entering into forex transactions. Members and Associates introducing or managing accounts should know what information has been provided and should supplement it when necessary.

This information must include the following statement prominently displayed:

> The transactions you are entering into with [Member] are not traded on an exchange. Therefore, under the U.S. Bankruptcy Code, your funds may not receive the same protections as funds used to margin or guarantee exchange-traded futures and options contracts, which receive a priority in bankruptcy. Since that same priority has not been given to funds used for off-exchange forex trading, if [Member] becomes insolvent and you have a claim for amounts deposited or profits earned on transactions with [Member], your claim may not receive a priority. Without a priority, you are a general creditor and your claim will be paid, along with the claims of other general creditors, from any monies still available after priority claims are paid. Even customer funds that [Member] keeps separate from its own operating funds may not be safe from the claims of other general and priority creditors.

At or before the time a customer first engages in a forex transaction, a Member and its Associates should disclose how the Member will be compensated for the services it will provide to the customer.

Additionally, a Forex Dealer Member must describe to the customer the nature of these foreign currency transactions. Therefore, a Forex Dealer Member must provide, and the customer must separately acknowledge receipt of, either the following disclosure language or other appropriate language (based upon the Forex Dealer Member's business model) approved by NFA staff, which must be prominently displayed in all uppercase letters and in 10 point size type or larger but in any event no smaller than any surrounding type:

> THE FOREIGN CURRENCY TRADING YOU ARE ENTERING INTO IS NOT CONDUCTED ON AN EXCHANGE. [MEMBER] IS ACTING AS A COUNTERPARTY IN THESE TRANSACTIONS AND, THEREFORE, ACTS AS THE BUYER WHEN YOU SELL AND THE SELLER WHEN YOU BUY. AS A RESULT, [MEMBER]'S INTERESTS MAY BE IN CONFLICT WITH YOURS. UNLESS OTHERWISE SPECIFIED IN YOUR WRITTEN AGREEMENT OR OTHER WRITTEN DOCUMENTS [MEMBER] ESTABLISHES THE PRICES AT WHICH IT OFFERS TO TRADE WITH YOU. THE PRICES [MEMBER] OFFERS MIGHT NOT BE THE BEST PRICES AVAILABLE AND [MEMBER] MAY OFFER DIFFERENT PRICES TO DIFFERENT CUSTOMERS.
>
> IF [MEMBER] ELECTS NOT TO COVER ITS OWN TRADING EXPOSURE, THEN YOU SHOULD BE AWARE THAT [MEMBER] MAY MAKE MORE MONEY IF THE MARKET GOES AGAINST YOU. ADDITIONALLY, SINCE [MEMBER] ACTS AS THE BUYER OR SELLER IN THE TRANSACTION, YOU SHOULD CAREFULLY EVALUATE ANY TRADE RECOMMENDATIONS YOU RECEIVE FROM [MEMBER] OR ANY OF ITS SOLICITORS.

Forex Dealer Members should provide both the bid and the offer when the customer enters an order.

Members should update any material information that has changed prior to entering into new transactions with current customers if failing to update the information would make it misleading.

2. *Reporting* - Forex Dealer Members must provide forex customers with timely and accurate notice of the status of their accounts.

Forex Dealer Members should provide written confirmations within one business day after any activity in the customer's account, including offsetting transactions, rollovers, deliveries, option exercises, option expirations, trades that have been reversed or adjusted, and monetary adjustments. The confirmation should include the information required by Compliance Rule 2-44.

Forex Dealer Members should provide regular monthly statements showing all forex transactions and other account activity to customers for all accounts that have open positions at the end of the month or changes in the account balance or equity since the prior statement. Forex Dealer

Members should provide statements at least quarterly for all other open accounts. The monthly or quarterly statements should include the information required by Compliance Rule 2-44.

Confirmations and monthly/quarterly statements may be provided on-line or transmitted by other electronic means if the customer consents to the specific method used.

3. *Supervision* - Members and their Associates having supervisory responsibilities must diligently supervise the Member's forex business, including the activities of the Member's Associates and agents. Members must establish, maintain, and enforce written supervisory procedures.

NFA has provided Members with guidance on minimum standards of supervision through interpretive notices issued under NFA Compliance Rule 2-9.[5] In these interpretive notices NFA recognized that, given the differences in the size of and complexity of the operations of NFA Members, there must be some degree of flexibility in determining what constitutes "diligent supervision" for each firm. This principle also applies to the supervision of a Member's forex business.

Although Members have the flexibility to design procedures that are tailored to their own situation, an adequate program for supervision would include procedures for performing day-to-day monitoring. These procedures would include:

- screening employees who will solicit transactions from or provide advice to customers or manage customer accounts to see if they are subject to any of the statutory disqualifications in Section 8a of the CEA and, if so, to determine the extent of supervision they will require;
- monitoring communications with the public, including sales solicitations and web sites, and approving promotional material;
- reviewing the information obtained from and the information provided to customers solicited by the firm and its employees to ensure that the necessary account information has been obtained and the appropriate information provided; and
- handling and resolving customer complaints.

For Forex Dealer Members, these procedures would also include:

- screening prospective Associates to ensure that they are registered with the Commodity Futures Trading Commission as associated persons;[6]
- screening persons who introduce customer business or manage customer accounts to see if the firm or any of its principals is subject to a statutory disqualification under Section 8a of the CEA and, if so, determining if the Forex Dealer Member should perform additional due diligence on that person;[7]
- reviewing disclosures given to customers to ensure they are understandable, timely, and provide sufficient information;
- reviewing and analyzing the forex activity in customer accounts, including discretionary customer accounts; and
- handling customer funds, including accepting security deposits.

A Forex Dealer Member and a listed principal that is also a registered associated person (see Financial Requirements 15(c)) must supervise the preparation of a Forex Dealer Member's financial books and records. Diligent supervision includes hiring and retaining qualified staff. In determining whether an individual responsible for preparing the Member's financial books and records is qualified, the firm and its financial principal should consider the following:

- Is the individual qualified for the position by experience or training?
- Does the individual exercise independent judgment?
- Has the individual ever been sanctioned or refused membership or licensing by NFA, the CFTC, the SEC, NASD or FINRA, the Public Company Accounting Oversight Board, or any other financial regulator?
- Has the individual ever been sanctioned or refused membership by the American Institute of Certified Public Accountants or any other accounting organization?
- Has any firm for which the individual performed auditing, accounting, or bookkeeping been subject to an emergency action or sanctioned by NFA, the CFTC, the SEC, NASD or FINRA, the Public Company Accounting Oversight Board, or any other financial regulator for failure to comply with financial requirements or for having inadequate books and records while the individual was engaged in those activities?
- Are there any pending actions against the individual or a firm for which the individual performed auditing, accounting, or bookkeeping?

This is not an exclusive list. If the individual or a firm for which the individual worked (either as an independent contractor or an employee) was subject to an emergency action, sanctioned by a financial regulator, or is subject to a pending action, the FDM and the listed principal/registered AP responsible for the FDM's financial books and records should consider the nature and seriousness of the conduct (or alleged conduct) and the individual's role in it. An NFA Member Responsibility Action or an emergency action by another financial regulator is always an extremely serious matter.

The Forex Dealer Member and its financial principal must also conduct due diligence and consider analogous information when selecting an independent public accountant to certify the firm's annual financial statements.

An adequate supervisory program should also include periodic on-site visits to branch offices, guaranteed introducing brokers, and otherwise unregulated affiliates that conduct forex business on behalf of the Member. The Member needs to determine the frequency and nature of these visits. The number of visits will depend on the amount of business generated, the number of customer complaints received, the training and experience of the office personnel, and the frequency and nature of problems that arise from the office.

Finally, a Member's supervisory responsibilities include the obligation to ensure that its employees are properly trained to perform their duties. The formality of a training program will depend on the size of the firm and the nature of its business. Procedures should be in place to ensure that supervisory personnel know and understand the firm's supervisory procedures and that employees receive adequate training to abide by NFA requirements and to properly handle customer accounts.

4. *Recordkeeping* - Members must keep books and records relating to their forex operations for a period of five years from the date thereof and shall keep them readily accessible during the first 2 years of the 5-year period. All such books and records shall be open to inspection by NFA.

Members should adopt and enforce reasonable procedures to create current and accurate books and records and to keep them from being

altered or destroyed. Such records must include, among other things, financial records substantiating a Members assets and liabilities, including liabilities owed to customers and receivables from other persons. The Member should be able to promptly produce its records in a format that NFA can read and reproduce.

Forex Dealer Members should adopt and enforce a written policy detailing the procedures it follows to calculate rollover or interest charges and payments. The policy must include the factors that are considered as well as the names of any sources for these factors. The Member should document the underlying factors reviewed in completing the calculation, including any related transactions entered into by the Forex Dealer Member, so it can be replicated.

5. *Communications with the Public and Promotional Material* - No Member or Associate shall make any communication with potential or current customers that operates as a fraud or deceit; uses a high-pressure approach; or implies that forex transactions are appropriate for all persons.

Promotional material used by the Member or Associate shall not:

- Deceive the public or contain any material misstatement of fact or omit a fact that makes the promotional material misleading;[8]
- Include any statements of opinion unless they are clearly identified as such and have a reasonable basis in fact;
- Mention the possibility of profit unless accompanied by an equally prominent statement of the risk of loss;
- Include any reference to actual past trading profits without mentioning that past results are not necessarily indicative of future results;
- Include any statistical or numerical information about past performance of actual accounts unless the Member can demonstrate that the performance is representative of actual performance of all reasonably comparable accounts for the same period (calculated in accordance with the formula in CFTC Regulation 4.35(a)(6) and NFA Compliance Rule 2-34); or
- Include testimonials unless they are representative of all reasonably comparable accounts, the material prominently states that the testimonial is not indicative of future performance or success, and the material prominently states that they are paid testimonials (if applicable).

No Member or Associate may represent that forex funds deposited with a Forex Dealer Member are given special protection under the bankruptcy laws. No Member or Associate may represent or imply that any assets necessary to satisfy its obligations to customers are more secure because the Member keeps some or all of those assets at a regulated entity in the United States or a money center country.

No Member or Associate may represent that its services are commission free without prominently disclosing how it is compensated in near proximity to that representation.

No Member or Associate may represent that it offers trading with "no-slippage" or that it guarantees the price at which a transaction will be executed or filled, unless:

- It can demonstrate that all orders for all customers have been executed and fulfilled at the price initially quoted on the trading platform when the order was placed;[9] and
- No authority exists, pursuant to a contract, agreement, or otherwise, to adjust customer accounts in a manner that would have the direct or indirect effect of changing the price at which an order was executed.[10]

Members and Associates may not solicit customers based on the leverage available unless they balance any discussion regarding the advantages of leverage with an equally prominent contemporaneous disclosure that increasing leverage increases risk.

No Member shall use or directly benefit from any radio or television advertisement that recommends specific forex transactions or describes the extent of any profit obtained in the past or that can be obtained in the future unless the member submits the advertisement to NFA's Promotional Material Review Team for its review and approval at least 10 days prior to its first use or such shorter period as NFA may allow.[11]

Every Member should adopt and enforce written procedures to supervise communications with potential and current customers and promotional material. A supervisory employee that is, or is under the ultimate supervision of, a listed principal who is also an NFA Associate should review and approve all promotional material and make a written record of such review and approval.[12]

All promotional material should be maintained by each Member and be available for examination for the periods specified in the recordkeeping section of this notice, measured from the date of last use.

6. *Know Your Customer* - Members and Associates have a duty to acquaint themselves sufficiently with the personal and financial circumstances of each forex customer to determine what further facts, explanations and disclosures are needed in order for the customer to make an informed decision on whether to enter into forex transactions.

Every Member should determine what information it will obtain from a prospective forex customer. At a minimum, the Member soliciting the customer to engage in forex transactions should obtain the customer's name, address, principal occupation or business, current estimated annual income and net worth, approximate age, and an indication of the customer's previous investment and trading experience. Members and their Associates need to ensure that each customer they solicit has received adequate information concerning the risks of forex transactions so that the customer can make an informed decision as to whether forex transactions are appropriate for the customer. These obligations fall on the Forex Dealer Member when a non-Member solicits the customer.

7. *Doing Business with Non-Members* - Forex Dealer Members are subject to discipline for the activities of most non-Members who solicit or introduce forex customers to the Forex Dealer Member or manage accounts for those customers.

If a customer is solicited or introduced by a non-Member of NFA, or if the customer's account is managed by a non-Member, the Forex Dealer Member is subject to discipline for the non-Member's conduct if that conduct would violate NFA requirements when engaged in by an NFA Member. In other words, a Forex Dealer Member is subject to an NFA disciplinary action for the non-Member's activities when soliciting,

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introducing, or managing accounts for the Forex Dealer Member's customers even if the non-Member was not the Forex Dealer Member's agent.

The rule allows NFA to bring a disciplinary action even if the Forex Dealer Member acts diligently and has no knowledge of the third-party's conduct. As a practical matter, however, NFA will not take disciplinary action unless the Forex Dealer Member knew or should have known of the third-party's conduct or failed to exercise due diligence when establishing and maintaining the relationship with the third party.

A Forex Dealer Member should adopt and enforce written procedures to review the activities of non-Member third parties. The procedures should include, among other things, a regular review of the trading being conducted in the accounts solicited, introduced, or managed by these non-Members. The Member should also have procedures for following up on any customer complaints received by the firm, including a written description of the investigation made by the Member and any resolution of the complaint. Further, supervisory procedures should include a regular review of all promotional material used by any non-Member third-party. The member should maintain copies of all promotional materials reviewed, along with a written record of the review conducted and any deficiencies corrected, and make them available for examination for the periods specified in the recordkeeping section of this notice. A supervisory employee that is, or is under the ultimate supervision of, a listed principal who is also an NFA Associate should conduct the review of the non-Member's activities.

The Forex Dealer Member is not subject to discipline for the actions of non-Members who are described in NFA Bylaw 306(b). It is also not subject to discipline for the actions of non-Members who would be exempt from Commission registration if they were acting in the same capacity in connection with exchange-traded futures contracts, such as foreign persons that solicit, introduce, or manage accounts for foreign customers only.[13] The Forex Dealer Member does, of course, have certain basic duties to its customers, including a duty to supervise its own activities in a way designed to ensure that it treats its customers fairly. Specifically, the Forex Dealer Member would violate this duty if it has actual or constructive notice that one of these entities engaged in fraudulent conduct and fails to take appropriate action.

8. *Affiliates* - Forex Dealer Members must supervise and are subject to discipline for the activities of affiliates that are authorized to engage in forex transactions solely by virtue of their affiliation with a Forex Dealer Member.

The CEA authorizes affiliates of FCMs to act as counterparties to forex transactions if the affiliate directly or indirectly controls, is controlled by, or is under common control with the FCM and the FCM makes and keeps records regarding the financial activities of the affiliate for purposes of the Commission's risk assessment requirements.[14] If a Forex Dealer Member has one or more affiliates that act as counterparty to forex customers solely on the basis of that affiliation, the Forex Dealer Member must supervise the affiliate's forex activities and is subject to discipline for that affiliate's activities.[15] The Forex Dealer Member must also make these affiliates' books and records available to NFA upon request. Additionally, the Forex Dealer Member must assure that its affiliates do not act as counterparties to forex transactions unless they are authorized to do so under the Act.

9. *BASIC Disclosure* - Members must provide forex customers with information on NFA's BASIC system.

NFA Compliance Rule 2-36(g) requires Forex Dealer Members to provide customers with written information regarding NFA's Background Affiliation Status Information Center (BASIC), including the web site address [16]. This information must be provided when the customer first opens an account and at least once a year thereafter.

Forex Dealer Members may provide the information electronically but must do it in a way that ensures each customer is aware of it. For example, merely having the information on the Member's web site is not adequate, but sending customers an e-mail including a link to that information and explaining what the link is would be sufficient in most circumstances.

10. *Discretion* - No Forex Dealer Member, or Associate of a Forex Dealer Member acting in such capacity, may exercise discretionary trading authority over a customer account for which the Forex Dealer Member is, or is offering to be, the counterparty to the transactions in the customer account.

C. OTHER REQUIREMENTS

This section of the notice provides guidance on dues, capital requirements, and security deposits. These requirements apply only to Forex Dealer Members.

1. Bylaw 1301

NFA Bylaw 1301(e) requires Forex Dealer Members to pay annual dues that are graduated according to the firm's gross annual revenue from customers (e.g., commissions, mark-ups, mark-downs) for its forex activities. Profits and losses from proprietary trades are *not* to be included. To calculate dues:

- Start with the FCM dues imposed by NFA Bylaw 1301(b)(ii);
- Add $44,375 if the Forex Dealer Member's gross annual revenue from forex transactions is $500,000 or less;
- Add $69,375 if the Forex Dealer Member's gross annual revenue from forex transactions is more than $500,000, but not more than $2,000,000;
- Add $94,375 if the Forex Dealer Member's gross annual revenue from forex transactions is more than $2,000,000, but not more than $5,000,000; or
- Add $119,375 if the Forex Dealer Member's gross annual revenue from these activities is more than $5,000,000.

The following table shows the dues to be assessed for Forex Dealer Members:

Amount of annual Gross Revenue From Forex Transactions	Dues if NFA is the DSRO	Dues if NFA is not the DSRO
$500,000 or less	$50,000	$45,875
More than $500,000, but not more than $2 million	$75,000	$70,875

More than $2 million, but not more than $5 million	$100,000	$95,875
More than $5 million	$125,000	$120,875

These dues apply when the Forex Dealer Member offers to be a counterparty to a forex transaction or accepts a forex trade (whichever is earlier), and NFA will send the Member an invoice for the minimum dues ($50,000 or $45,875) minus any amount already paid for that membership year. Thereafter, the dues will be assessed on the firm's membership renewal date and will be based on the Forex Dealer Member's latest certified financial statement.

The only exception to the dues set forth above is a situation in which NFA does not serve as the DSRO for a Forex Dealer Member and the DSRO has agreed to examine the Forex Dealer Member's forex activities. In this case, the surcharge paid by the Forex Dealer Member, regardless of gross annual revenue, is $12,000. Accordingly, for such a Forex Dealer Member the dues to be assessed at the time it offers to be a counterparty to a forex transaction or accepts a forex trade (whichever is earlier), and on its membership renewal date thereafter, will be $13,500.

Under NFA Compliance Rule 2-36(d), a Forex Dealer Member is subject to discipline for the activities of any person that solicits or introduces a customer to the Member or manages a customer's account unless that person is a Member or Associate of NFA, is otherwise regulated based on the criteria in Bylaw 306(b), or would be exempt from CFTC registration if it were acting in the same capacity in connection with exchange-traded futures contracts. Any Forex Dealer Member that is responsible under Compliance Rule 2-36(d) for solicitors and account managers is required to pay a separate annual fee on the firm's annual renewal date based on the number of unregulated solicitors and account managers. In determining whether this fee applies, the Forex Dealer Member should take the highest number of separate legal entities, including individuals acting as sole proprietors, that it was responsible for at any one time during the year. The following table shows this graduated fee.

Number of Unregulated Entities	Annual Fee
0	$ 0
1-4	$ 5,000
5-19	$10,000
20-99	$25,000
100 or more	$50,000

Each Forex Dealer Member is also required to pay an assessment of .0001% on the notional value of each forex transaction (as forex is defined in Bylaw 1507(b)). This equates to $.01 for each $10,000. For transactions with a notional value less than $10,000, the firm may aggregate separate transactions and pay $.01 on each multiple of $10,000. For transactions of $10,000 or above, the firm should round to the nearest cent.

This assessment is due only on initiating transactions. There is no assessment on rollovers, offsetting transactions, option expirations, or option exercises that do not result in new positions. The Member must remit the assessment to NFA within 30 days after the end of the month in which the transaction was initiated.

2. Financial Requirements Section 11(a)

Forex Dealer Members must maintain adjusted net capital equal to or in excess of the greatest amount specified in subsections (a)(i), (a)(ii), and (a)(iii) (if applicable). Subsection (a)(ii) applies to Forex Dealer Members that execute any customer transactions other than by using straight-through-processing and that also have liabilities to customers of more than $10 million. Where it applies, the Member's capital requirement is the minimum capital required by subsection (a)(i) plus 5% of the liabilities over $10 million. The formula is:

Amount required by (a)(i) + .05(customer liabilities - $10,000,000)

For example, if the minimum capital requirement is $20 million, a Forex Dealer Member that operates a dealing desk and has $208 million in liabilities to customers would be required to maintain adjusted net capital equal to or in excess of $29.9 million.

Forex Dealer Members with over $10 million in customer liabilities are subject to this alternative requirement unless they execute all customer transactions using straight-through-processing. Straight-through-processing refers to platforms that automatically (without human intervention and without exception) enter into an identical but opposite transaction with another counterparty, creating an offsetting position in the Forex Dealer Member's own name. A Forex Dealer Member that offers several platforms will be exempt from this requirement only if each platform executes all customer orders using straight-through-processing.

This requirement that all customer trades be executed by straight-through-processing is not, however, meant to limit a firm's ability to provide for other methods in its disaster recovery procedures. As long as those other methods are used only when dictated by those procedures and both the procedures and the firm's trading platform are designed to ensure that the need will rarely arise, the FDM will not lose its exemption by implementing other execution methods in disaster recovery situations.

3. Financial Requirements Section 11(b)

Section 11(b) prohibits a Forex Dealer Member from including assets held by an affiliate (unless approved) or an unregulated person in the firm's current assets for purposes of determining its adjusted net capital under CFTC Rule 1.17. This means an FDM may not count any part of those assets for capital purposes.[17]

An unregulated person is any person that is **not**:

(i) a financial institution regulated by a U.S. banking regulator;

(ii) a broker-dealer registered with the U.S. Securities and Exchange Commission and a member of FINRA;

(iii) a futures commission merchant registered with the U.S. Commodity Futures Trading Commission and a Member of NFA;

(iv) an insurance company regulated by any U.S. state;

(v) an entity regulated as a foreign equivalent of any of the above if regulated in a money center country as defined in CFTC Regulation 1.49; or

(vi) any other entity approved by NFA.

Effective October 1, 2010, the above paragraph will read as follows:

An unregulated person is any person that is **not**:

(i) a financial institution regulated by a U.S. banking regulator;

(ii) a broker-dealer registered with the U.S. Securities and Exchange Commission and a member of FINRA;

(iii) a futures commission merchant registered with the U.S. Commodity Futures Trading Commission and a Member of NFA;

(iv) a retail foreign exchange dealer registered with the U.S. Commodity Futures Trading Commission and a Member of NFA;

(v) an insurance company regulated by any U.S. state; or

(vi) any other entity approved by NFA.

Any Forex Dealer Member may ask NFA to approve an otherwise unregulated person for purposes of Financial Requirements Sections 11(b) and (c). In determining whether to approve an unregulated person that is not an affiliate, NFA will consider a number of factors, including:

- Whether the person is regulated in another jurisdiction and, if so, the type and extent of regulation;
- The person's capital; and
- The person's credit rating.

NFA's approval of a particular person means that all unaffiliated Forex Dealer Members may treat that person as regulated under Sections 11(b) and (c). NFA may also approve categories of counterparties (e.g., banks regulated in a particular jurisdiction or with a particular credit rating).

A Forex Dealer Member may not engage in Section 11(b) or (c) transactions with a regulated affiliate without NFA's approval. The Member may, however, ask NFA to authorize it to cover its positions with specified affiliates (including unregulated affiliates). An affiliate is any entity that controls, is controlled by, or is under common control with the Forex Dealer Member. The standards for approving affiliated persons are significantly higher than those for unaffiliated persons. For example, NFA will also consider:

- The parent company's and affiliated person's capital;
- Whether the parent company and the affiliated person are regulated entities;
- Whether the parent company will guarantee the obligations of the affiliated person (unless the parent company and the affiliated person are the same entity);
- The parent company's credit rating;
- Whether the affiliated person has strong risk-management policies to limit its value-at-risk; and
- For purposes of Section 11(c), whether the affiliated person limits the amount of offsetting transactions it enters into with unregulated counterparties.

4. Financial Requirements Section 11(c)

Section 11(c) prohibits Forex Dealer Members from using affiliates (unless approved) and unregulated persons to cover their foreign currency positions for purposes of CFTC Rule 1.17(c)(5).

The rule does not prohibit Forex Dealer Members from entering into positions with unregulated or unapproved counterparties. They may not, however, count positions with those counterparties when calculating their covered positions for purposes of CFTC Rule 1.17(c)(5).

For purposes of Section 11(c), Forex Dealer Members have four different types of counterparties. In particular:

- Account holders are those counterparties for whom it carries accounts and includes both retail customers and eligible contract participants.
- Trading partners are counterparties with whom the Member trades but who do not have accounts with the Member. For purposes of the calculations under Section 11(c), this category does not include affiliates (approved or unapproved) or regulated counterparties.
- Affiliates are entities that control, are controlled by, or are under common control with the Forex Dealer Member. For purposes of Section 11(c) only, this category does not include affiliates who have been approved by NFA under Section 11(b).
- Regulated entities are those counterparties that meet the definition in Section 11(b) and include entities-including affiliates-approved by NFA under that Section.

A Forex Dealer Member may net its exposure across account holders, across trading partners, and across affiliates, but it may not net its exposure between these categories. The Member may, however, net its exposure in any of these categories against regulated counterparties. Here is the information in chart form.

Type of Counterparty	Account Holders	Trading Partners	Affiliates	Regulated Entities
Account Holders	Yes	No	No	Yes
Trading Partners	No	Yes	No	Yes
Affiliates	No	No	Yes	Yes
Regulated Entities	Yes	Yes	Yes	Yes

A Forex Dealer Member is required to take a charge on the larger of its unnetted long or short position but not on both.

Example

Assume a Forex Dealer Member has the following Euro positions:

Type	Long	Short	Net Long	Net Short
Account Holders	11,154,912	6,011,794	5,143,118	
Trading Partners	4,987,345	7,299,886		2,312,541
Affiliates	3,790,754	2,640,553	1,150,201	
Regulated Entities	1,280,555	4,125,018		2,844,463

In determining the uncovered amount for purposes of the 6% haircut, the Forex Dealer Member can offset its net long position with account holders against the net short position with regulated entities but cannot offset its position with its trading partners or its position with unapproved affiliates against any category except regulated entities.

The math works this way (using only absolute numbers):

Net long position with account holders	5,143,118
Minus net short position with regulated entities	-2,844,463
	2,298,655
Uncovered long position with account holders	2,298,655
Plus net long position with affiliates	+1,150,201
Total uncovered long position	3,448,856
Net short position with trading partners	2,312,541
Larger of net long or short position	3,448,856
Haircut on Euros (3,448,856 X .06)	$206,931

5. Financial Requirements Section 12

Forex Dealer Members must collect security deposits from forex customers equal to 1% of the notional value of transactions in specified foreign currencies and 4% of the notional value of all other transactions. Where the two currencies are in different categories, the Forex Dealer Member must collect the higher amount. If the transaction pairs a foreign currency with the U.S. dollar, the security deposit is based on the foreign currency. If the transaction pairs a currency that qualifies for a 1% deposit with a currency that does not, the Forex Dealer Member must collect a 4% security deposit for the entire transaction. For example:

Currency Pair	Security Deposit
EUR/USD	1%
CND/JPY	1%
CND/BRL	4%
USD/MXN	4%
BRL/MXN	4%

For short options, the Forex Dealer Member must collect this amount plus the premium the customer received. For long options, the Forex Dealer Member must simply collect the entire premium from the customer.

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[1] The Board of Directors has declared that these transactions are a proper subject of NFA regulation and oversight under Article XVIII, paragraph (k).

[2] Compliance Rule 2-39 excludes these same entities when they introduce or manage forex accounts.

[3] Bylaw 306(b)(ii) excludes broker-dealers that are members of any fully-registered national securities association and FCMs that are members of another registered futures association. At this time, however, FINRA is the only fully-registered national securities association and NFA is the only registered futures association.

[4] These are affiliates of broker-dealers for which the broker-dealer makes and keeps records under the Securities and Exchange Commission's risk assessment requirements. See Section 17(h) of the Securities Exchange Act of 1934 and SEC Rule 17h-1T.

[5] See, for example, Compliance Rule 2-9: Supervision of Branch Offices and Guaranteed IBs, NFA Manual paragraph 9019; Compliance Rule 2-9: Supervisory Procedures for E-Mail and the Use of Web Sites, NFA Manual paragraph 9037; Compliance Rule 2-9: Supervision of the Use of Automated Order-Routing Systems, NFA Manual paragraph 9046. These interpretive notices do not directly apply to forex activities, but the principles included in these notices are equally applicable to those activities.

[6] The Commodity Futures Trading Commission has stated that all employees of an FCM who solicit or accept orders for forex transactions from retail customers must be registered with the Commission as an associated person of the FCM. See Division of Trading and Markets Advisory Concerning Foreign Currency Trading by Retail Customers (March 2002).

[7] The screening process should include 1) checking BASIC and any other readily available sources and 2) asking the third-party to represent that neither it nor any of its principals is subject to a statutory disqualification or to identify and explain any statutory disqualifications.

[8] Through interpretive notices issued under NFA Compliance Rule 2-29, NFA has provided Members with guidance on what activities are deceptive and misleading. See, for example, NFA Compliance Rule 2-29: Deceptive Advertising, NFA Manual paragraph 9033; NFA Compliance Rule 2-29: Deceptive Advertising, NFA Manual paragraph 9034; Compliance Rule 2-29: High Pressure Sales Tactics, NFA Manual paragraph 9038; and NFA Compliance Rules 2-29 and 2-9: NFA's Review and Approval of Certain Radio and television Advertisements, NFA Manual paragraph 9039. Although these interpretive notices do not directly apply to forex activities, the principles included in them with regard to what is deceptive or misleading are equally applicable to those activities.

[9] The Forex Dealer Member is not required to give the customer a price that is no longer reflected on the platform at the time the order reaches it. The Forex Dealer Member is not responsible for

transmission delays outside its control. If an Forex Dealer Member, however, advertises "no-slippage" or that it guarantees fill prices, it must prominently disclose that transmission delays might result in customer orders being executed at a price other than that seen by the customer.

[10] This includes *force majeure* provisions.

[11] Submission of promotional materials for NFA review is not a substitute for a Member's own responsibility to review promotional material. NFA staff will not independently verify the accuracy of statements made in an advertisement; that responsibility remains with the Member. Submitting promotional material to NFA will not provide a "safe harbor" from NFA actions for Members if misstatements or omissions of material fact are discovered subsequently or NFA otherwise later determines that the material is in violation of any applicable standards.

[12] Under traditional legal principles, Members can also be liable for promotional material promoting forex trading systems developed by third-parties. For example, a Member has direct responsibility for misleading promotional material if the Member prepares or distributes it; has agency responsibility if the system developer is an agent of the Member under established principles of agency law; and has supervisory responsibility if the Member fails to supervise its own employees when linking to a third-party trading system developer's web site, recommending a third-party's trading system, or entering into a referral agreement with a third-party system developer. See Interpretive Notice titled "NFA Bylaw 1101, Compliance Rules 2-9 and 2-29: Guidelines Relating to the Registration of Third-Party Trading System Developers and the Responsibility of NFA Members for Promotional Material That Promotes Third-Party Trading System Developers and their Trading Systems," NFA Manual, paragraph 9055.

[13] For this purpose, foreign persons and foreign customers are 1) natural persons who are not residents of the United States or 2) legal entities (other than passive investment vehicles) that are organized under the laws of a country other than the United States, do not have their principal place of business in the United States, and do not conduct their retail forex activities from a location in the United States. Those terms do not include a passive investment vehicle that is more than 10% owned by United States persons or that solicits United States persons who are not eligible contract participants as defined in Section 1a(12) of the Act. "United States" includes U.S. territories and possessions.

[14] See Sections 2(c)(2)(B)(ii)(III) and 4f(c)(2)(B) of the CEA and CFTC Regulations 1.14 and 1.15.

[15] Obviously, the Forex Dealer Member must also ensure that no entity with common ownership engages in the forex business unless it is authorized to do so.

[16] Forex Dealer Members can comply with this requirement by providing customers with a copy of NFA's brochure entitled "Background Affiliation Status Information Center (BASIC): An Information Resource for the Investing Public," which is available in print and on NFA's website at http://www.nfa.futures.org/.

[17] Where the CFTC's requirements for holding current assets are more stringent, those requirements apply.

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Compliance Rules

RULE 2-36. REQUIREMENTS FOR FOREX TRANSACTIONS
[Adopted effective June 28, 2002. Effective dates of amendments: December 1, 2003; November 30, 2005; February 13, 2007; October 25, 2007; and April 1, 2009.]

(a) General Prohibition

No Forex Dealer Member shall engage in any forex transaction that is prohibited under the Commodity Exchange Act.

(b) Fraud and Related Matters

No Forex Dealer Member or Associate of a Forex Dealer Member engaging in any forex transaction shall:

(1) Cheat, defraud or deceive, or attempt to cheat, defraud or deceive any other person;

(2) Willfully make or cause to be made a false report, or willfully to enter or cause to be entered a false record in or in connection with any forex transaction;

(3) Disseminate, or cause to be disseminated, false or misleading information, or a knowingly inaccurate report, that affects or tends to affect the price of any foreign currency;

(4) Engage in manipulative acts or practices regarding the price of any foreign currency or a forex transaction;

(5) Willfully submit materially false or misleading information to NFA or its agents with respect to forex transactions;

(6) Embezzle, steal or purloin or knowingly convert any money, securities or other property received or accruing to any person in or in connection with a forex transaction.

(c) Just and Equitable Principles of Trade

Forex Dealer Members and their Associates shall observe high standards of commercial honor and just and equitable principles of trade in the conduct of their forex business.

(d) Doing Business with Non-Members

A Forex Dealer Member that is the counterparty, or offers to be the counterparty, to forex transactions for customers shall be subject to discipline for the activities of any person that solicits or introduces a customer to the Member or that manages such customer's accounts, unless such person is a Member or Associate of NFA, meets the criteria in Bylaw 306(b), or would be exempt from Commission registration if it were acting in the same capacity in connection with exchange-traded futures contracts.

(e) Supervision

Each Forex Dealer Member shall diligently supervise its employees and agents in the conduct of their forex activities for or on behalf of the Forex Dealer Member. Each Associate of a Forex Dealer Member who has supervisory duties shall diligently exercise such duties in the conduct of that Associate's forex activities for or on behalf of the Forex Dealer Member.

(f) Affiliates

Each Forex Dealer Member that has an affiliate that is authorized to engage in forex transactions solely by virtue of its affiliation with the Forex Dealer Member shall supervise its affiliate's forex activities for compliance with the same requirements that apply to the Forex Dealer Member, including section (a) of this rule. The Forex Dealer Member shall make the affiliate's books and records available to NFA staff upon request and shall be subject to discipline for acts and omissions of the affiliate that violate the standards imposed by NFA requirements.

(g) BASIC Disclosure

When a customer first opens an account and at least once a year thereafter, each Forex Dealer Member shall provide each customer with written information regarding NFA's Background Affiliation Status Information Center (BASIC), including the web site address.

(h) Filing Promotional Materials with NFA.

The Compliance Director may require any Forex Dealer Member for any specified period to file copies of all promotional material with NFA for its review and approval at least 10 days prior to its first use or such shorter period as NFA may allow. The Compliance Director may also require a

Forex Dealer Member to file for review and approval copies of promotional material prepared or used by some or all of the non-Members it is responsible for under Section (d).

(i) Hypothetical Results

Any Member who uses promotional material that includes a measurement or description or makes any reference to hypothetical forex transaction performance results that could have been achieved had a particular trading system of the Member or Associate been employed in the past must comply with Compliance Rule 2-29(c) and the related Interpretive Notice as if the performance results were for transactions in on-exchange futures contracts.

(j) Scope

This rule governs forex transactions as defined in Bylaw 1507(b).

(k) Definition of Customer

For purposes of this rule, the term "customer" means a counterparty that is not an eligible contract participant as defined in Section 1a(12) of the Act.

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NFA Manual / Rules

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Interpretive Notices

9053 - FOREX TRANSACTIONS

(Revised November 9, 2004; June 13, 2005; September 15, 2005; November 30, 2005; April 30, 2006; July 31, 2006; October 1, 2006; February 13, 2007; March 7, 2007; March 9, 2007; March 31, 2007; May 7, 2007; June 5, 2007; July 1, 2007; September 21, 2007; October 1, 2007; October 25, 2007; December 17, 2007; December 21, 2007; June 1, 2008; July 1, 2008; October 31, 2008; April 1, 2009; June 1, 2009; November 30, 2009; and December 17, 2009.)

INTERPRETIVE NOTICE

The Commodity Exchange Act (CEA or Act) gives the Commodity Futures Trading Commission (CFTC or Commission) limited jurisdiction over off-exchange foreign currency transactions offered to or entered into with retail customers. As a result of those provisions, certain firms primarily engaged in the retail forex business have registered with the CFTC and become Members of NFA. NFA has adopted several requirements to govern the conduct of these firms and their associated persons.

As described below, NFA Bylaw 306 creates a Forex Dealer Member category for certain NFA Members who act as counterparties to forex transactions with retail customers. This category allows NFA to exercise appropriate regulatory jurisdiction over the retail forex activities of these Members without imposing unnecessary, and potentially duplicative, regulatory burdens on Members that are otherwise subject to regulatory oversight for their activities.

NFA Bylaw 1507(b) defines forex as foreign currency futures and options and any other agreement, contract, or transaction in foreign currency that is offered or entered into on a leveraged or margined basis, or financed by the offeror, the counterparty, or a person acting in concert with the offeror or counterparty on a similar basis that are:

- offered to or entered into with persons that are not eligible contract participants as defined in Section 1a(12) of the Act (retail customers); and
- not executed on or subject to the rules of a contract market, a derivatives transaction execution facility, a national securities exchange registered pursuant to Section 6(a) of the Securities Exchange Act of 1934, or a foreign board of trade.[1]

Bylaw 1507(b) also excludes the following from the forex definition if the transaction is not a futures or options contract:

- securities (other than security futures products);
- any contract of sale that results in actual delivery within two days; and
- any contract of sale that creates an enforceable obligation to deliver between a seller and buyer that have the ability to deliver and accept delivery, respectively, in connection with their line of business.

Given the differences between off-exchange transactions and traditional exchange-traded futures and options, the Board of Directors does not believe that it is appropriate to apply the full array of NFA's futures rules to forex transactions. Therefore, rather than simply incorporating forex transactions into the definition of "futures," NFA adopted NFA Compliance Rule 2-36 to govern these transactions.

In developing its forex requirements, NFA's primary concern was to ensure that they provide adequate protection for retail customers without imposing undue burdens on NFA Members. NFA also believes that its requirements should, where consistent with customer protection, promote innovation and competition. In order to provide Members with as much flexibility as possible, NFA has chosen to deal with a number of issues by providing guidance under NFA Compliance Rule 2-36 instead of by adopting additional rules.

NFA Compliance Rule 2-36 sets out the general standards that apply to Forex Dealer Members and their Associates in connection with forex transactions. Subsection (b) prohibits Forex Dealer Members and their Associates from engaging in fraudulent activities, subsection (c) requires Forex Dealer Members and their Associates to observe high standards of commercial honor and just and equitable principles of trade in connection with their forex business, and subsection (e) requires Forex Dealer Members and their Associates with supervisory duties to supervise their employees and agents. Other subsections address a Forex Dealer Member's responsibility for its unregulated affiliates and third-party solicitors and make Forex Dealer Members subject to discipline for the conduct of certain non-Members with which they do business.

This notice has three sections. The first section explains who qualifies as a Forex Dealer Member under NFA Bylaw 306, the second section provides additional guidance about the requirements in Compliance Rule 2-36, and the third section covers other miscellaneous requirements.

A. BYLAW 306

In general, Forex Dealer Members are NFA Members who act as counterparties to forex transactions. This is a self-executing requirement, which means that any Member who qualifies is automatically a Forex Dealer Member. There is no application form and no approval requirement.

Members who do not act as counterparties are not Forex Dealer Members, even if they introduce or manage forex accounts. Under NFA Compliance Rule 2-39, however, most Members who introduce or manage forex accounts are required to comply with subsections (a), (b), (c), and (e) of NFA Compliance Rule 2-36.

Bylaw 306(b) excludes Members that are otherwise subject to regulatory oversight for their forex activities, which means that these Members are not Forex Dealer Members and do not have to comply with Compliance Rule 2-36. [2] The exclusions mostly follow Section 2(c)(2)(B)(ii) of the CEA, although the exclusions for broker-dealers and their affiliates are conditioned on the Financial Industry Regulatory Authority ("FINRA") membership. In particular, the following entities are not Forex Dealer Members:

- financial institutions (e.g., banks and savings associations);
- certain insurance companies and their regulated subsidiaries or affiliates;
- financial holding companies;
- investment bank holding companies;
- registered broker-dealers that are members of FINRA;[3] and
- Material Associated Persons of registered broker-dealers that are members of FINRA.[4]

B. COMPLIANCE RULE 2-36

As noted above, this section provides additional guidance on what Compliance Rule 2-36 requires. Certain sections specifically refer to Forex Dealer Members. Except for Members that meet the criteria in Bylaw 306(b), all other provisions of this notice also apply to Members and their Associates who solicit, introduce or manage forex accounts.

1. *Disclosure* - Members must provide forex customers with understandable and timely disclosure on essential features of forex trading.

At or before the time a customer first engages in a forex transaction, a Forex Dealer Member and its Associates should provide the customer sufficient information concerning the characteristics and particular risks of entering into forex transactions. Members and Associates introducing or managing accounts should know what information has been provided and should supplement it when necessary.

This information must include the following statement prominently displayed:

> The transactions you are entering into with [Member] are not traded on an exchange. Therefore, under the U.S. Bankruptcy Code, your funds may not receive the same protections as funds used to margin or guarantee exchange-traded futures and options contracts, which receive a priority in bankruptcy. Since that same priority has not been given to funds used for off-exchange forex trading, if [Member] becomes insolvent and you have a claim for amounts deposited or profits earned on transactions with [Member], your claim may not receive a priority. Without a priority, you are a general creditor and your claim will be paid, along with the claims of other general creditors, from any monies still available after priority claims are paid. Even customer funds that [Member] keeps separate from its own operating funds may not be safe from the claims of other general and priority creditors.

At or before the time a customer first engages in a forex transaction, a Member and its Associates should disclose how the Member will be compensated for the services it will provide to the customer.

Additionally, a Forex Dealer Member must describe to the customer the nature of these foreign currency transactions. Therefore, a Forex Dealer Member must provide, and the customer must separately acknowledge receipt of, either the following disclosure language or other appropriate language (based upon the Forex Dealer Member's business model) approved by NFA staff, which must be prominently displayed in all uppercase letters and in 10 point size type or larger but in any event no smaller than any surrounding type:

> THE FOREIGN CURRENCY TRADING YOU ARE ENTERING INTO IS NOT CONDUCTED ON AN EXCHANGE. [MEMBER] IS ACTING AS A COUNTERPARTY IN THESE TRANSACTIONS AND, THEREFORE, ACTS AS THE BUYER WHEN YOU SELL AND THE SELLER WHEN YOU BUY. AS A RESULT, [MEMBER]'S INTERESTS MAY BE IN CONFLICT WITH YOURS. UNLESS OTHERWISE SPECIFIED IN YOUR WRITTEN AGREEMENT OR OTHER WRITTEN DOCUMENTS [MEMBER] ESTABLISHES THE PRICES AT WHICH IT OFFERS TO TRADE WITH YOU. THE PRICES [MEMBER] OFFERS MIGHT NOT BE THE BEST PRICES AVAILABLE AND [MEMBER] MAY OFFER DIFFERENT PRICES TO DIFFERENT CUSTOMERS.
>
> IF [MEMBER] ELECTS NOT TO COVER ITS OWN TRADING EXPOSURE, THEN YOU SHOULD BE AWARE THAT [MEMBER] MAY MAKE MORE MONEY IF THE MARKET GOES AGAINST YOU. ADDITIONALLY, SINCE [MEMBER] ACTS AS THE BUYER OR SELLER IN THE TRANSACTION, YOU SHOULD CAREFULLY EVALUATE ANY TRADE RECOMMENDATIONS YOU RECEIVE FROM [MEMBER] OR ANY OF ITS SOLICITORS.

Forex Dealer Members should provide both the bid and the offer when the customer enters an order.

Members should update any material information that has changed prior to entering into new transactions with current customers if failing to update the information would make it misleading.

2. *Reporting* - Forex Dealer Members must provide forex customers with timely and accurate notice of the status of their accounts.

Forex Dealer Members should provide written confirmations within one business day after any activity in the customer's account, including offsetting transactions, rollovers, deliveries, option exercises, option expirations, trades that have been reversed or adjusted, and monetary adjustments. The confirmation should include the information required by Compliance Rule 2-44.

Forex Dealer Members should provide regular monthly statements showing all forex transactions and other account activity to customers for all accounts that have open positions at the end of the month or changes in the account balance or equity since the prior statement. Forex Dealer

Members should provide statements at least quarterly for all other open accounts. The monthly or quarterly statements should include the information required by Compliance Rule 2-44.

Confirmations and monthly/quarterly statements may be provided on-line or transmitted by other electronic means if the customer consents to the specific method used.

3. *Supervision* - Members and their Associates having supervisory responsibilities must diligently supervise the Member's forex business, including the activities of the Member's Associates and agents. Members must establish, maintain, and enforce written supervisory procedures.

NFA has provided Members with guidance on minimum standards of supervision through interpretive notices issued under NFA Compliance Rule 2-9.[5] In these interpretive notices NFA recognized that, given the differences in the size of and complexity of the operations of NFA Members, there must be some degree of flexibility in determining what constitutes "diligent supervision" for each firm. This principle also applies to the supervision of a Member's forex business.

Although Members have the flexibility to design procedures that are tailored to their own situation, an adequate program for supervision would include procedures for performing day-to-day monitoring. These procedures would include:

- screening employees who will solicit transactions from or provide advice to customers or manage customer accounts to see if they are subject to any of the statutory disqualifications in Section 8a of the CEA and, if so, to determine the extent of supervision they will require;
- monitoring communications with the public, including sales solicitations and web sites, and approving promotional material;
- reviewing the information obtained from and the information provided to customers solicited by the firm and its employees to ensure that the necessary account information has been obtained and the appropriate information provided; and
- handling and resolving customer complaints.

For Forex Dealer Members, these procedures would also include:

- screening prospective Associates to ensure that they are registered with the Commodity Futures Trading Commission as associated persons;[6]
- screening persons who introduce customer business or manage customer accounts to see if the firm or any of its principals is subject to a statutory disqualification under Section 8a of the CEA and, if so, determining if the Forex Dealer Member should perform additional due diligence on that person;[7]
- reviewing disclosures given to customers to ensure they are understandable, timely, and provide sufficient information;
- reviewing and analyzing the forex activity in customer accounts, including discretionary customer accounts; and
- handling customer funds, including accepting security deposits.

A Forex Dealer Member and a listed principal that is also a registered associated person (see Financial Requirements 15(c)) must supervise the preparation of a Forex Dealer Member's financial books and records. Diligent supervision includes hiring and retaining qualified staff. In determining whether an individual responsible for preparing the Member's financial books and records is qualified, the firm and its financial principal should consider the following:

- Is the individual qualified for the position by experience or training?
- Does the individual exercise independent judgment?
- Has the individual ever been sanctioned or refused membership or licensing by NFA, the CFTC, the SEC, NASD or FINRA, the Public Company Accounting Oversight Board, or any other financial regulator?
- Has the individual ever been sanctioned or refused membership by the American Institute of Certified Public Accountants or any other accounting organization?
- Has any firm for which the individual performed auditing, accounting, or bookkeeping been subject to an emergency action or sanctioned by NFA, the CFTC, the SEC, NASD or FINRA, the Public Company Accounting Oversight Board, or any other financial regulator for failure to comply with financial requirements or for having inadequate books and records while the individual was engaged in those activities?
- Are there any pending actions against the individual or a firm for which the individual performed auditing, accounting, or bookkeeping?

This is not an exclusive list. If the individual or a firm for which the individual worked (either as an independent contractor or an employee) was subject to an emergency action, sanctioned by a financial regulator, or is subject to a pending action, the FDM and the listed principal/registered AP responsible for the FDM's financial books and records should consider the nature and seriousness of the conduct (or alleged conduct) and the individual's role in it. An NFA Member Responsibility Action or an emergency action by another financial regulator is always an extremely serious matter.

The Forex Dealer Member and its financial principal must also conduct due diligence and consider analogous information when selecting an independent public accountant to certify the firm's annual financial statements.

An adequate supervisory program should also include periodic on-site visits to branch offices, guaranteed introducing brokers, and otherwise unregulated affiliates that conduct forex business on behalf of the Member. The Member needs to determine the frequency and nature of these visits. The number of visits will depend on the amount of business generated, the number of customer complaints received, the training and experience of the office personnel, and the frequency and nature of problems that arise from the office.

Finally, a Member's supervisory responsibilities include the obligation to ensure that its employees are properly trained to perform their duties. The formality of a training program will depend on the size of the firm and the nature of its business. Procedures should be in place to ensure that supervisory personnel know and understand the firm's supervisory procedures and that employees receive adequate training to abide by NFA requirements and to properly handle customer accounts.

4. *Recordkeeping* - Members must keep books and records relating to their forex operations for a period of five years from the date thereof and shall keep them readily accessible during the first 2 years of the 5-year period. All such books and records shall be open to inspection by NFA.

Members should adopt and enforce reasonable procedures to create current and accurate books and records and to keep them from being

altered or destroyed. Such records must include, among other things, financial records substantiating a Members assets and liabilities, including liabilities owed to customers and receivables from other persons. The Member should be able to promptly produce its records in a format that NFA can read and reproduce.

Forex Dealer Members should adopt and enforce a written policy detailing the procedures it follows to calculate rollover or interest charges and payments. The policy must include the factors that are considered as well as the names of any sources for these factors. The Member should document the underlying factors reviewed in completing the calculation, including any related transactions entered into by the Forex Dealer Member, so it can be replicated.

5. *Communications with the Public and Promotional Material* - No Member or Associate shall make any communication with potential or current customers that operates as a fraud or deceit; uses a high-pressure approach; or implies that forex transactions are appropriate for all persons.

Promotional material used by the Member or Associate shall not:

- Deceive the public or contain any material misstatement of fact or omit a fact that makes the promotional material misleading;[8]
- Include any statements of opinion unless they are clearly identified as such and have a reasonable basis in fact;
- Mention the possibility of profit unless accompanied by an equally prominent statement of the risk of loss;
- Include any reference to actual past trading profits without mentioning that past results are not necessarily indicative of future results;
- Include any statistical or numerical information about past performance of actual accounts unless the Member can demonstrate that the performance is representative of actual performance of all reasonably comparable accounts for the same period (calculated in accordance with the formula in CFTC Regulation 4.35(a)(6) and NFA Compliance Rule 2-34); or
- Include testimonials unless they are representative of all reasonably comparable accounts, the material prominently states that the testimonial is not indicative of future performance or success, and the material prominently states that they are paid testimonials (if applicable).

No Member or Associate may represent that forex funds deposited with a Forex Dealer Member are given special protection under the bankruptcy laws. No Member or Associate may represent or imply that any assets necessary to satisfy its obligations to customers are more secure because the Member keeps some or all of those assets at a regulated entity in the United States or a money center country.

No Member or Associate may represent that its services are commission free without prominently disclosing how it is compensated in near proximity to that representation.

No Member or Associate may represent that it offers trading with "no-slippage" or that it guarantees the price at which a transaction will be executed or filled, unless:

- It can demonstrate that all orders for all customers have been executed and fulfilled at the price initially quoted on the trading platform when the order was placed;[9] and
- No authority exists, pursuant to a contract, agreement, or otherwise, to adjust customer accounts in a manner that would have the direct or indirect effect of changing the price at which an order was executed.[10]

Members and Associates may not solicit customers based on the leverage available unless they balance any discussion regarding the advantages of leverage with an equally prominent contemporaneous disclosure that increasing leverage increases risk.

No Member shall use or directly benefit from any radio or television advertisement that recommends specific forex transactions or describes the extent of any profit obtained in the past or that can be obtained in the future unless the member submits the advertisement to NFA's Promotional Material Review Team for its review and approval at least 10 days prior to its first use or such shorter period as NFA may allow.[11]

Every Member should adopt and enforce written procedures to supervise communications with potential and current customers and promotional material. A supervisory employee that is, or is under the ultimate supervision of, a listed principal who is also an NFA Associate should review and approve all promotional material and make a written record of such review and approval.[12]

All promotional material should be maintained by each Member and be available for examination for the periods specified in the recordkeeping section of this notice, measured from the date of last use.

6. *Know Your Customer* - Members and Associates have a duty to acquaint themselves sufficiently with the personal and financial circumstances of each forex customer to determine what further facts, explanations and disclosures are needed in order for the customer to make an informed decision on whether to enter into forex transactions.

Every Member should determine what information it will obtain from a prospective forex customer. At a minimum, the Member soliciting the customer to engage in forex transactions should obtain the customer's name, address, principal occupation or business, current estimated annual income and net worth, approximate age, and an indication of the customer's previous investment and trading experience. Members and their Associates need to ensure that each customer they solicit has received adequate information concerning the risks of forex transactions so that the customer can make an informed decision as to whether forex transactions are appropriate for the customer. These obligations fall on the Forex Dealer Member when a non-Member solicits the customer.

7. *Doing Business with Non-Members* - Forex Dealer Members are subject to discipline for the activities of most non-Members who solicit or introduce forex customers to the Forex Dealer Member or manage accounts for those customers.

If a customer is solicited or introduced by a non-Member of NFA, or if the customer's account is managed by a non-Member, the Forex Dealer Member is subject to discipline for the non-Member's conduct if that conduct would violate NFA requirements when engaged in by an NFA Member. In other words, a Forex Dealer Member is subject to an NFA disciplinary action for the non-Member's activities when soliciting,

introducing, or managing accounts for the Forex Dealer Member's customers even if the non-Member was not the Forex Dealer Member's agent.

The rule allows NFA to bring a disciplinary action even if the Forex Dealer Member acts diligently and has no knowledge of the third-party's conduct. As a practical matter, however, NFA will not take disciplinary action unless the Forex Dealer Member knew or should have known of the third-party's conduct or failed to exercise due diligence when establishing and maintaining the relationship with the third party.

A Forex Dealer Member should adopt and enforce written procedures to review the activities of non-Member third parties. The procedures should include, among other things, a regular review of the trading being conducted in the accounts solicited, introduced, or managed by these non-Members. The Member should also have procedures for following up on any customer complaints received by the firm, including a written description of the investigation made by the Member and any resolution of the complaint. Further, supervisory procedures should include a regular review of all promotional material used by any non-Member third-party. The member should maintain copies of all promotional materials reviewed, along with a written record of the review conducted and any deficiencies corrected, and make them available for examination for the periods specified in the recordkeeping section of this notice. A supervisory employee that is, or is under the ultimate supervision of, a listed principal who is also an NFA Associate should conduct the review of the non-Member's activities.

The Forex Dealer Member is not subject to discipline for the actions of non-Members who are described in NFA Bylaw 306(b). It is also not subject to discipline for the actions of non-Members who would be exempt from Commission registration if they were acting in the same capacity in connection with exchange-traded futures contracts, such as foreign persons that solicit, introduce, or manage accounts for foreign customers only.[13] The Forex Dealer Member does, of course, have certain basic duties to its customers, including a duty to supervise its own activities in a way designed to ensure that it treats its customers fairly. Specifically, the Forex Dealer Member would violate this duty if it has actual or constructive notice that one of these entities engaged in fraudulent conduct and fails to take appropriate action.

8. *Affiliates* - Forex Dealer Members must supervise and are subject to discipline for the activities of affiliates that are authorized to engage in forex transactions solely by virtue of their affiliation with a Forex Dealer Member.

The CEA authorizes affiliates of FCMs to act as counterparties to forex transactions if the affiliate directly or indirectly controls, is controlled by, or is under common control with the FCM and the FCM makes and keeps records regarding the financial activities of the affiliate for purposes of the Commission's risk assessment requirements.[14] If a Forex Dealer Member has one or more affiliates that act as counterparty to forex customers solely on the basis of that affiliation, the Forex Dealer Member must supervise the affiliate's forex activities and is subject to discipline for that affiliate's activities.[15] The Forex Dealer Member must also make these affiliates' books and records available to NFA upon request. Additionally, the Forex Dealer Member must assure that its affiliates do not act as counterparties to forex transactions unless they are authorized to do so under the Act.

9. *BASIC Disclosure* - Members must provide forex customers with information on NFA's BASIC system.

NFA Compliance Rule 2-36(g) requires Forex Dealer Members to provide customers with written information regarding NFA's Background Affiliation Status Information Center (BASIC), including the web site address [16]. This information must be provided when the customer first opens an account and at least once a year thereafter.

Forex Dealer Members may provide the information electronically but must do it in a way that ensures each customer is aware of it. For example, merely having the information on the Member's web site is not adequate, but sending customers an e-mail including a link to that information and explaining what the link is would be sufficient in most circumstances.

10. *Discretion* - No Forex Dealer Member, or Associate of a Forex Dealer Member acting in such capacity, may exercise discretionary trading authority over a customer account for which the Forex Dealer Member is, or is offering to be, the counterparty to the transactions in the customer account.

C. OTHER REQUIREMENTS

This section of the notice provides guidance on dues, capital requirements, and security deposits. These requirements apply only to Forex Dealer Members.

1. Bylaw 1301

NFA Bylaw 1301(e) requires Forex Dealer Members to pay annual dues that are graduated according to the firm's gross annual revenue from customers (e.g., commissions, mark-ups, mark-downs) for its forex activities. Profits and losses from proprietary trades are *not* to be included. To calculate dues:

- Start with the FCM dues imposed by NFA Bylaw 1301(b)(ii);
- Add $44,375 if the Forex Dealer Member's gross annual revenue from forex transactions is $500,000 or less;
- Add $69,375 if the Forex Dealer Member's gross annual revenue from forex transactions is more than $500,000, but not more than $2,000,000;
- Add $94,375 if the Forex Dealer Member's gross annual revenue from forex transactions is more than $2,000,000, but not more than $5,000,000; or
- Add $119,375 if the Forex Dealer Member's gross annual revenue from these activities is more than $5,000,000.

The following table shows the dues to be assessed for Forex Dealer Members:

Amount of annual Gross Revenue From Forex Transactions	Dues if NFA is the DSRO	Dues if NFA is not the DSRO
$500,000 or less	$50,000	$45,875
More than $500,000, but not more than $2 million	$75,000	$70,875

More than $2 million, but not more than $5 million	$100,000	$95,875
More than $5 million	$125,000	$120,875

These dues apply when the Forex Dealer Member offers to be a counterparty to a forex transaction or accepts a forex trade (whichever is earlier), and NFA will send the Member an invoice for the minimum dues ($50,000 or $45,875) minus any amount already paid for that membership year. Thereafter, the dues will be assessed on the firm's membership renewal date and will be based on the Forex Dealer Member's latest certified financial statement.

The only exception to the dues set forth above is a situation in which NFA does not serve as the DSRO for a Forex Dealer Member and the DSRO has agreed to examine the Forex Dealer Member's forex activities. In this case, the surcharge paid by the Forex Dealer Member, regardless of gross annual revenue, is $12,000. Accordingly, for such a Forex Dealer Member the dues to be assessed at the time it offers to be a counterparty to a forex transaction or accepts a forex trade (whichever is earlier), and on its membership renewal date thereafter, will be $13,500.

Under NFA Compliance Rule 2-36(d), a Forex Dealer Member is subject to discipline for the activities of any person that solicits or introduces a customer to the Member or manages a customer's account unless that person is a Member or Associate of NFA, is otherwise regulated based on the criteria in Bylaw 306(b), or would be exempt from CFTC registration if it were acting in the same capacity in connection with exchange-traded futures contracts. Any Forex Dealer Member that is responsible under Compliance Rule 2-36(d) for solicitors and account managers is required to pay a separate annual fee on the firm's annual renewal date based on the number of unregulated solicitors and account managers. In determining whether this fee applies, the Forex Dealer Member should take the highest number of separate legal entities, including individuals acting as sole proprietors, that it was responsible for at any one time during the year. The following table shows this graduated fee.

Number of Unregulated Entities	Annual Fee
0	$ 0
1-4	$ 5,000
5-19	$10,000
20-99	$25,000
100 or more	$50,000

Each Forex Dealer Member is also required to pay an assessment of .0001% on the notional value of each forex transaction (as forex is defined in Bylaw 1507(b)). This equates to $.01 for each $10,000. For transactions with a notional value less than $10,000, the firm may aggregate separate transactions and pay $.01 on each multiple of $10,000. For transactions of $10,000 or above, the firm should round to the nearest cent.

This assessment is due only on initiating transactions. There is no assessment on rollovers, offsetting transactions, option expirations, or option exercises that do not result in new positions. The Member must remit the assessment to NFA within 30 days after the end of the month in which the transaction was initiated.

2. Financial Requirements Section 11(a)

Forex Dealer Members must maintain adjusted net capital equal to or in excess of the greatest amount specified in subsections (a)(i), (a)(ii), and (a)(iii) (if applicable). Subsection (a)(ii) applies to Forex Dealer Members that execute any customer transactions other than by using straight-through-processing and that also have liabilities to customers of more than $10 million. Where it applies, the Member's capital requirement is the minimum capital required by subsection (a)(i) plus 5% of the liabilities over $10 million. The formula is:

Amount required by (a)(i) + .05(customer liabilities - $10,000,000)

For example, if the minimum capital requirement is $20 million, a Forex Dealer Member that operates a dealing desk and has $208 million in liabilities to customers would be required to maintain adjusted net capital equal to or in excess of $29.9 million.

Forex Dealer Members with over $10 million in customer liabilities are subject to this alternative requirement unless they execute all customer transactions using straight-through-processing. Straight-through-processing refers to platforms that automatically (without human intervention and without exception) enter into an identical but opposite transaction with another counterparty, creating an offsetting position in the Forex Dealer Member's own name. A Forex Dealer Member that offers several platforms will be exempt from this requirement only if each platform executes all customer orders using straight-through-processing.

This requirement that all customer trades be executed by straight-through-processing is not, however, meant to limit a firm's ability to provide for other methods in its disaster recovery procedures. As long as those other methods are used only when dictated by those procedures and both the procedures and the firm's trading platform are designed to ensure that the need will rarely arise, the FDM will not lose its exemption by implementing other execution methods in disaster recovery situations.

3. Financial Requirements Section 11(b)

Section 11(b) prohibits a Forex Dealer Member from including assets held by an affiliate (unless approved) or an unregulated person in the firm's current assets for purposes of determining its adjusted net capital under CFTC Rule 1.17. This means an FDM may not count any part of those assets for capital purposes.[17]

An unregulated person is any person that is **not**:

(i) a financial institution regulated by a U.S. banking regulator;

(ii) a broker-dealer registered with the U.S. Securities and Exchange Commission and a member of FINRA;

(iii) a futures commission merchant registered with the U.S. Commodity Futures Trading Commission and a Member of NFA;

(iv) an insurance company regulated by any U.S. state;

(v) an entity regulated as a foreign equivalent of any of the above if regulated in a money center country as defined in CFTC Regulation 1.49; or

(vi) any other entity approved by NFA.

Effective October 1, 2010, the above paragraph will read as follows:

An unregulated person is any person that is **not**:

(i) a financial institution regulated by a U.S. banking regulator;

(ii) a broker-dealer registered with the U.S. Securities and Exchange Commission and a member of FINRA;

(iii) a futures commission merchant registered with the U.S. Commodity Futures Trading Commission and a Member of NFA;

(iv) a retail foreign exchange dealer registered with the U.S. Commodity Futures Trading Commission and a Member of NFA;

(v) an insurance company regulated by any U.S. state; or

(vi) any other entity approved by NFA.

Any Forex Dealer Member may ask NFA to approve an otherwise unregulated person for purposes of Financial Requirements Sections 11(b) and (c). In determining whether to approve an unregulated person that is not an affiliate, NFA will consider a number of factors, including:

- Whether the person is regulated in another jurisdiction and, if so, the type and extent of regulation;
- The person's capital; and
- The person's credit rating.

NFA's approval of a particular person means that all unaffiliated Forex Dealer Members may treat that person as regulated under Sections 11(b) and (c). NFA may also approve categories of counterparties (e.g., banks regulated in a particular jurisdiction or with a particular credit rating).

A Forex Dealer Member may not engage in Section 11(b) or (c) transactions with a regulated affiliate without NFA's approval. The Member may, however, ask NFA to authorize it to cover its positions with specified affiliates (including unregulated affiliates). An affiliate is any entity that controls, is controlled by, or is under common control with the Forex Dealer Member. The standards for approving affiliated persons are significantly higher than those for unaffiliated persons. For example, NFA will also consider:

- The parent company's and affiliated person's capital;
- Whether the parent company and the affiliated person are regulated entities;
- Whether the parent company will guarantee the obligations of the affiliated person (unless the parent company and the affiliated person are the same entity);
- The parent company's credit rating;
- Whether the affiliated person has strong risk-management policies to limit its value-at-risk; and
- For purposes of Section 11(c), whether the affiliated person limits the amount of offsetting transactions it enters into with unregulated counterparties.

4. Financial Requirements Section 11(c)

Section 11(c) prohibits Forex Dealer Members from using affiliates (unless approved) and unregulated persons to cover their foreign currency positions for purposes of CFTC Rule 1.17(c)(5).

The rule does not prohibit Forex Dealer Members from entering into positions with unregulated or unapproved counterparties. They may not, however, count positions with those counterparties when calculating their covered positions for purposes of CFTC Rule 1.17(c)(5).

For purposes of Section 11(c), Forex Dealer Members have four different types of counterparties. In particular:

- Account holders are those counterparties for whom it carries accounts and includes both retail customers and eligible contract participants.
- Trading partners are counterparties with whom the Member trades but who do not have accounts with the Member. For purposes of the calculations under Section 11(c), this category does not include affiliates (approved or unapproved) or regulated counterparties.
- Affiliates are entities that control, are controlled by, or are under common control with the Forex Dealer Member. For purposes of Section 11(c) only, this category does not include affiliates who have been approved by NFA under Section 11(b).
- Regulated entities are those counterparties that meet the definition in Section 11(b) and include entities-including affiliates-approved by NFA under that Section.

A Forex Dealer Member may net its exposure across account holders, across trading partners, and across affiliates, but it may not net its exposure between these categories. The Member may, however, net its exposure in any of these categories against regulated counterparties. Here is the information in chart form.

Type of Counterparty	Account Holders	Trading Partners	Affiliates	Regulated Entities
Account Holders	Yes	No	No	Yes
Trading Partners	No	Yes	No	Yes
Affiliates	No	No	Yes	Yes
Regulated Entities	Yes	Yes	Yes	Yes

A Forex Dealer Member is required to take a charge on the larger of its unnetted long or short position but not on both.

Example

Assume a Forex Dealer Member has the following Euro positions:

Type	Long	Short	Net Long	Net Short
Account Holders	11,154,912	6,011,794	5,143,118	
Trading Partners	4,987,345	7,299,886		2,312,541
Affiliates	3,790,754	2,640,553	1,150,201	
Regulated Entities	1,280,555	4,125,018		2,844,463

In determining the uncovered amount for purposes of the 6% haircut, the Forex Dealer Member can offset its net long position with account holders against the net short position with regulated entities but cannot offset its position with its trading partners or its position with unapproved affiliates against any category except regulated entities.

The math works this way (using only absolute numbers):

Net long position with account holders	5,143,118
Minus net short position with regulated entities	-2,844,463
	2,298,655
Uncovered long position with account holders	2,298,655
Plus net long position with affiliates	+1,150,201
Total uncovered long position	3,448,856
Net short position with trading partners	2,312,541
Larger of net long or short position	3,448,856
Haircut on Euros (3,448,856 X .06)	$206,931

5. Financial Requirements Section 12

Forex Dealer Members must collect security deposits from forex customers equal to 1% of the notional value of transactions in specified foreign currencies and 4% of the notional value of all other transactions. Where the two currencies are in different categories, the Forex Dealer Member must collect the higher amount. If the transaction pairs a foreign currency with the U.S. dollar, the security deposit is based on the foreign currency. If the transaction pairs a currency that qualifies for a 1% deposit with a currency that does not, the Forex Dealer Member must collect a 4% security deposit for the entire transaction. For example:

Currency Pair	Security Deposit
EUR/USD	1%
CND/JPY	1%
CND/BRL	4%
USD/MXN	4%
BRL/MXN	4%

For short options, the Forex Dealer Member must collect this amount plus the premium the customer received. For long options, the Forex Dealer Member must simply collect the entire premium from the customer.

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[1] The Board of Directors has declared that these transactions are a proper subject of NFA regulation and oversight under Article XVIII, paragraph (k).

[2] Compliance Rule 2-39 excludes these same entities when they introduce or manage forex accounts.

[3] Bylaw 306(b)(ii) excludes broker-dealers that are members of any fully-registered national securities association and FCMs that are members of another registered futures association. At this time, however, FINRA is the only fully-registered national securities association and NFA is the only registered futures association.

[4] These are affiliates of broker-dealers for which the broker-dealer makes and keeps records under the Securities and Exchange Commission's risk assessment requirements. See Section 17(h) of the Securities Exchange Act of 1934 and SEC Rule 17h-1T.

[5] See, for example, Compliance Rule 2-9: Supervision of Branch Offices and Guaranteed IBs, NFA Manual paragraph 9019; Compliance Rule 2-9: Supervisory Procedures for E-Mail and the Use of Web Sites, NFA Manual paragraph 9037; Compliance Rule 2-9: Supervision of the Use of Automated Order-Routing Systems, NFA Manual paragraph 9046. These interpretive notices do not directly apply to forex activities, but the principles included in these notices are equally applicable to those activities.

[6] The Commodity Futures Trading Commission has stated that all employees of an FCM who solicit or accept orders for forex transactions from retail customers must be registered with the Commission as an associated person of the FCM. See Division of Trading and Markets Advisory Concerning Foreign Currency Trading by Retail Customers (March 2002).

[7] The screening process should include 1) checking BASIC and any other readily available sources and 2) asking the third-party to represent that neither it nor any of its principals is subject to a statutory disqualification or to identify and explain any statutory disqualifications.

[8] Through interpretive notices issued under NFA Compliance Rule 2-29, NFA has provided Members with guidance on what activities are deceptive and misleading. See, for example, NFA Compliance Rule 2-29: Deceptive Advertising, NFA Manual paragraph 9033; NFA Compliance Rule 2-29: Deceptive Advertising, NFA Manual paragraph 9034; Compliance Rule 2-29: High Pressure Sales Tactics, NFA Manual paragraph 9038; and NFA Compliance Rules 2-29 and 2-9: NFA's Review and Approval of Certain Radio and television Advertisements, NFA Manual paragraph 9039. Although these interpretive notices do not directly apply to forex activities, the principles included in them with regard to what is deceptive or misleading are equally applicable to those activities.

[9] The Forex Dealer Member is not required to give the customer a price that is no longer reflected on the platform at the time the order reaches it. The Forex Dealer Member is not responsible for

transmission delays outside its control. If an Forex Dealer Member, however, advertises "no-slippage" or that it guarantees fill prices, it must prominently disclose that transmission delays might result in customer orders being executed at a price other than that seen by the customer.

[10] This includes *force majeure* provisions.

[11] Submission of promotional materials for NFA review is not a substitute for a Member's own responsibility to review promotional material. NFA staff will not independently verify the accuracy of statements made in an advertisement; that responsibility remains with the Member. Submitting promotional material to NFA will not provide a "safe harbor" from NFA actions for Members if misstatements or omissions of material fact are discovered subsequently or NFA otherwise later determines that the material is in violation of any applicable standards.

[12] Under traditional legal principles, Members can also be liable for promotional material promoting forex trading systems developed by third-parties. For example, a Member has direct responsibility for misleading promotional material if the Member prepares or distributes it; has agency responsibility if the system developer is an agent of the Member under established principles of agency law; and has supervisory responsibility if the Member fails to supervise its own employees when linking to a third-party trading system developer's web site, recommending a third-party's trading system, or entering into a referral agreement with a third-party system developer. See Interpretive Notice titled "NFA Bylaw 1101, Compliance Rules 2-9 and 2-29: Guidelines Relating to the Registration of Third-Party Trading System Developers and the Responsibility of NFA Members for Promotional Material That Promotes Third-Party Trading System Developers and their Trading Systems," NFA Manual, paragraph 9055.

[13] For this purpose, foreign persons and foreign customers are 1) natural persons who are not residents of the United States or 2) legal entities (other than passive investment vehicles) that are organized under the laws of a country other than the United States, do not have their principal place of business in the United States, and do not conduct their retail forex activities from a location in the United States. Those terms do not include a passive investment vehicle that is more than 10% owned by United States persons or that solicits United States persons who are not eligible contract participants as defined in Section 1a(12) of the Act. "United States" includes U.S. territories and possessions.

[14] See Sections 2(c)(2)(B)(ii)(III) and 4f(c)(2)(B) of the CEA and CFTC Regulations 1.14 and 1.15.

[15] Obviously, the Forex Dealer Member must also ensure that no entity with common ownership engages in the forex business unless it is authorized to do so.

[16] Forex Dealer Members can comply with this requirement by providing customers with a copy of NFA's brochure entitled "Background Affiliation Status Information Center (BASIC): An Information Resource for the Investing Public," which is available in print and on NFA's website at http://www.nfa.futures.org/.

[17] Where the CFTC's requirements for holding current assets are more stringent, those requirements apply.

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Compliance Rules

RULE 2-36. REQUIREMENTS FOR FOREX TRANSACTIONS
[Adopted effective June 28, 2002. Effective dates of amendments: December 1, 2003; November 30, 2005; February 13, 2007; October 25, 2007; and April 1, 2009.]

(a) General Prohibition

No Forex Dealer Member shall engage in any forex transaction that is prohibited under the Commodity Exchange Act.

(b) Fraud and Related Matters

No Forex Dealer Member or Associate of a Forex Dealer Member engaging in any forex transaction shall:

(1) Cheat, defraud or deceive, or attempt to cheat, defraud or deceive any other person;

(2) Willfully make or cause to be made a false report, or willfully to enter or cause to be entered a false record in or in connection with any forex transaction;

(3) Disseminate, or cause to be disseminated, false or misleading information, or a knowingly inaccurate report, that affects or tends to affect the price of any foreign currency;

(4) Engage in manipulative acts or practices regarding the price of any foreign currency or a forex transaction;

(5) Willfully submit materially false or misleading information to NFA or its agents with respect to forex transactions;

(6) Embezzle, steal or purloin or knowingly convert any money, securities or other property received or accruing to any person in or in connection with a forex transaction.

(c) Just and Equitable Principles of Trade

Forex Dealer Members and their Associates shall observe high standards of commercial honor and just and equitable principles of trade in the conduct of their forex business.

(d) Doing Business with Non-Members

A Forex Dealer Member that is the counterparty, or offers to be the counterparty, to forex transactions for customers shall be subject to discipline for the activities of any person that solicits or introduces a customer to the Member or that manages such customer's accounts, unless such person is a Member or Associate of NFA, meets the criteria in Bylaw 306(b), or would be exempt from Commission registration if it were acting in the same capacity in connection with exchange-traded futures contracts.

(e) Supervision

Each Forex Dealer Member shall diligently supervise its employees and agents in the conduct of their forex activities for or on behalf of the Forex Dealer Member. Each Associate of a Forex Dealer Member who has supervisory duties shall diligently exercise such duties in the conduct of that Associate's forex activities for or on behalf of the Forex Dealer Member.

(f) Affiliates

Each Forex Dealer Member that has an affiliate that is authorized to engage in forex transactions solely by virtue of its affiliation with the Forex Dealer Member shall supervise its affiliate's forex activities for compliance with the same requirements that apply to the Forex Dealer Member, including section (a) of this rule. The Forex Dealer Member shall make the affiliate's books and records available to NFA staff upon request and shall be subject to discipline for acts and omissions of the affiliate that violate the standards imposed by NFA requirements.

(g) BASIC Disclosure

When a customer first opens an account and at least once a year thereafter, each Forex Dealer Member shall provide each customer with written information regarding NFA's Background Affiliation Status Information Center (BASIC), including the web site address.

(h) Filing Promotional Materials with NFA.

The Compliance Director may require any Forex Dealer Member for any specified period to file copies of all promotional material with NFA for its review and approval at least 10 days prior to its first use or such shorter period as NFA may allow. The Compliance Director may also require a

Forex Dealer Member to file for review and approval copies of promotional material prepared or used by some or all of the non-Members it is responsible for under Section (d).

(i) Hypothetical Results

Any Member who uses promotional material that includes a measurement or description or makes any reference to hypothetical forex transaction performance results that could have been achieved had a particular trading system of the Member or Associate been employed in the past must comply with Compliance Rule 2-29(c) and the related Interpretive Notice as if the performance results were for transactions in on-exchange futures contracts.

(j) Scope

This rule governs forex transactions as defined in Bylaw 1507(b).

(k) Definition of Customer

For purposes of this rule, the term "customer" means a counterparty that is not an eligible contract participant as defined in Section 1a(12) of the Act.

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Interpretive Notices

9053 - FOREX TRANSACTIONS

(Revised November 9, 2004; June 13, 2005; September 15, 2005; November 30, 2005; April 30, 2006; July 31, 2006; October 1, 2006; February 13, 2007; March 7, 2007; March 9, 2007; March 31, 2007; May 7, 2007; June 5, 2007; July 1, 2007; September 21, 2007; October 1, 2007; October 25, 2007; December 17, 2007; December 21, 2007; June 1, 2008; July 1, 2008; October 31, 2008; April 1, 2009; June 1, 2009; November 30, 2009; and December 17, 2009.)

INTERPRETIVE NOTICE

The Commodity Exchange Act (CEA or Act) gives the Commodity Futures Trading Commission (CFTC or Commission) limited jurisdiction over off-exchange foreign currency transactions offered to or entered into with retail customers. As a result of those provisions, certain firms primarily engaged in the retail forex business have registered with the CFTC and become Members of NFA. NFA has adopted several requirements to govern the conduct of these firms and their associated persons.

As described below, NFA Bylaw 306 creates a Forex Dealer Member category for certain NFA Members who act as counterparties to forex transactions with retail customers. This category allows NFA to exercise appropriate regulatory jurisdiction over the retail forex activities of these Members without imposing unnecessary, and potentially duplicative, regulatory burdens on Members that are otherwise subject to regulatory oversight for their activities.

NFA Bylaw 1507(b) defines forex as foreign currency futures and options and any other agreement, contract, or transaction in foreign currency that is offered or entered into on a leveraged or margined basis, or financed by the offeror, the counterparty, or a person acting in concert with the offeror or counterparty on a similar basis that are:

- offered to or entered into with persons that are not eligible contract participants as defined in Section 1a(12) of the Act (retail customers); and
- not executed on or subject to the rules of a contract market, a derivatives transaction execution facility, a national securities exchange registered pursuant to Section 6(a) of the Securities Exchange Act of 1934, or a foreign board of trade.[1]

Bylaw 1507(b) also excludes the following from the forex definition if the transaction is not a futures or options contract:

- securities (other than security futures products);
- any contract of sale that results in actual delivery within two days; and
- any contract of sale that creates an enforceable obligation to deliver between a seller and buyer that have the ability to deliver and accept delivery, respectively, in connection with their line of business.

Given the differences between off-exchange transactions and traditional exchange-traded futures and options, the Board of Directors does not believe that it is appropriate to apply the full array of NFA's futures rules to forex transactions. Therefore, rather than simply incorporating forex transactions into the definition of "futures," NFA adopted NFA Compliance Rule 2-36 to govern these transactions.

In developing its forex requirements, NFA's primary concern was to ensure that they provide adequate protection for retail customers without imposing undue burdens on NFA Members. NFA also believes that its requirements should, where consistent with customer protection, promote innovation and competition. In order to provide Members with as much flexibility as possible, NFA has chosen to deal with a number of issues by providing guidance under NFA Compliance Rule 2-36 instead of by adopting additional rules.

NFA Compliance Rule 2-36 sets out the general standards that apply to Forex Dealer Members and their Associates in connection with forex transactions. Subsection (b) prohibits Forex Dealer Members and their Associates from engaging in fraudulent activities, subsection (c) requires Forex Dealer Members and their Associates to observe high standards of commercial honor and just and equitable principles of trade in connection with their forex business, and subsection (e) requires Forex Dealer Members and their Associates with supervisory duties to supervise their employees and agents. Other subsections address a Forex Dealer Member's responsibility for its unregulated affiliates and third-party solicitors and make Forex Dealer Members subject to discipline for the conduct of certain non-Members with which they do business.

This notice has three sections. The first section explains who qualifies as a Forex Dealer Member under NFA Bylaw 306, the second section provides additional guidance about the requirements in Compliance Rule 2-36, and the third section covers other miscellaneous requirements.

A. BYLAW 306

In general, Forex Dealer Members are NFA Members who act as counterparties to forex transactions. This is a self-executing requirement, which means that any Member who qualifies is automatically a Forex Dealer Member. There is no application form and no approval requirement.

Members who do not act as counterparties are not Forex Dealer Members, even if they introduce or manage forex accounts. Under NFA Compliance Rule 2-39, however, most Members who introduce or manage forex accounts are required to comply with subsections (a), (b), (c), and (e) of NFA Compliance Rule 2-36.

Bylaw 306(b) excludes Members that are otherwise subject to regulatory oversight for their forex activities, which means that these Members are not Forex Dealer Members and do not have to comply with Compliance Rule 2-36. [2] The exclusions mostly follow Section 2(c)(2)(B)(ii) of the CEA, although the exclusions for broker-dealers and their affiliates are conditioned on the Financial Industry Regulatory Authority ("FINRA") membership. In particular, the following entities are not Forex Dealer Members:

- financial institutions (e.g., banks and savings associations);
- certain insurance companies and their regulated subsidiaries or affiliates;
- financial holding companies;
- investment bank holding companies;
- registered broker-dealers that are members of FINRA;[3] and
- Material Associated Persons of registered broker-dealers that are members of FINRA.[4]

B. COMPLIANCE RULE 2-36

As noted above, this section provides additional guidance on what Compliance Rule 2-36 requires. Certain sections specifically refer to Forex Dealer Members. Except for Members that meet the criteria in Bylaw 306(b), all other provisions of this notice also apply to Members and their Associates who solicit, introduce or manage forex accounts.

1. *Disclosure* - Members must provide forex customers with understandable and timely disclosure on essential features of forex trading.

At or before the time a customer first engages in a forex transaction, a Forex Dealer Member and its Associates should provide the customer sufficient information concerning the characteristics and particular risks of entering into forex transactions. Members and Associates introducing or managing accounts should know what information has been provided and should supplement it when necessary.

This information must include the following statement prominently displayed:

> The transactions you are entering into with [Member] are not traded on an exchange. Therefore, under the U.S. Bankruptcy Code, your funds may not receive the same protections as funds used to margin or guarantee exchange-traded futures and options contracts, which receive a priority in bankruptcy. Since that same priority has not been given to funds used for off-exchange forex trading, if [Member] becomes insolvent and you have a claim for amounts deposited or profits earned on transactions with [Member], your claim may not receive a priority. Without a priority, you are a general creditor and your claim will be paid, along with the claims of other general creditors, from any monies still available after priority claims are paid. Even customer funds that [Member] keeps separate from its own operating funds may not be safe from the claims of other general and priority creditors.

At or before the time a customer first engages in a forex transaction, a Member and its Associates should disclose how the Member will be compensated for the services it will provide to the customer.

Additionally, a Forex Dealer Member must describe to the customer the nature of these foreign currency transactions. Therefore, a Forex Dealer Member must provide, and the customer must separately acknowledge receipt of, either the following disclosure language or other appropriate language (based upon the Forex Dealer Member's business model) approved by NFA staff, which must be prominently displayed in all uppercase letters and in 10 point size type or larger but in any event no smaller than any surrounding type:

> THE FOREIGN CURRENCY TRADING YOU ARE ENTERING INTO IS NOT CONDUCTED ON AN EXCHANGE. [MEMBER] IS ACTING AS A COUNTERPARTY IN THESE TRANSACTIONS AND, THEREFORE, ACTS AS THE BUYER WHEN YOU SELL AND THE SELLER WHEN YOU BUY. AS A RESULT, [MEMBER]'S INTERESTS MAY BE IN CONFLICT WITH YOURS. UNLESS OTHERWISE SPECIFIED IN YOUR WRITTEN AGREEMENT OR OTHER WRITTEN DOCUMENTS [MEMBER] ESTABLISHES THE PRICES AT WHICH IT OFFERS TO TRADE WITH YOU. THE PRICES [MEMBER] OFFERS MIGHT NOT BE THE BEST PRICES AVAILABLE AND [MEMBER] MAY OFFER DIFFERENT PRICES TO DIFFERENT CUSTOMERS.
>
> IF [MEMBER] ELECTS NOT TO COVER ITS OWN TRADING EXPOSURE, THEN YOU SHOULD BE AWARE THAT [MEMBER] MAY MAKE MORE MONEY IF THE MARKET GOES AGAINST YOU. ADDITIONALLY, SINCE [MEMBER] ACTS AS THE BUYER OR SELLER IN THE TRANSACTION, YOU SHOULD CAREFULLY EVALUATE ANY TRADE RECOMMENDATIONS YOU RECEIVE FROM [MEMBER] OR ANY OF ITS SOLICITORS.

Forex Dealer Members should provide both the bid and the offer when the customer enters an order.

Members should update any material information that has changed prior to entering into new transactions with current customers if failing to update the information would make it misleading.

2. *Reporting* - Forex Dealer Members must provide forex customers with timely and accurate notice of the status of their accounts.

Forex Dealer Members should provide written confirmations within one business day after any activity in the customer's account, including offsetting transactions, rollovers, deliveries, option exercises, option expirations, trades that have been reversed or adjusted, and monetary adjustments. The confirmation should include the information required by Compliance Rule 2-44.

Forex Dealer Members should provide regular monthly statements showing all forex transactions and other account activity to customers for all accounts that have open positions at the end of the month or changes in the account balance or equity since the prior statement. Forex Dealer

Members should provide statements at least quarterly for all other open accounts. The monthly or quarterly statements should include the information required by Compliance Rule 2-44.

Confirmations and monthly/quarterly statements may be provided on-line or transmitted by other electronic means if the customer consents to the specific method used.

3. *Supervision* - Members and their Associates having supervisory responsibilities must diligently supervise the Member's forex business, including the activities of the Member's Associates and agents. Members must establish, maintain, and enforce written supervisory procedures.

NFA has provided Members with guidance on minimum standards of supervision through interpretive notices issued under NFA Compliance Rule 2-9.[5] In these interpretive notices NFA recognized that, given the differences in the size of and complexity of the operations of NFA Members, there must be some degree of flexibility in determining what constitutes "diligent supervision" for each firm. This principle also applies to the supervision of a Member's forex business.

Although Members have the flexibility to design procedures that are tailored to their own situation, an adequate program for supervision would include procedures for performing day-to-day monitoring. These procedures would include:

- screening employees who will solicit transactions from or provide advice to customers or manage customer accounts to see if they are subject to any of the statutory disqualifications in Section 8a of the CEA and, if so, to determine the extent of supervision they will require;
- monitoring communications with the public, including sales solicitations and web sites, and approving promotional material;
- reviewing the information obtained from and the information provided to customers solicited by the firm and its employees to ensure that the necessary account information has been obtained and the appropriate information provided; and
- handling and resolving customer complaints.

For Forex Dealer Members, these procedures would also include:

- screening prospective Associates to ensure that they are registered with the Commodity Futures Trading Commission as associated persons;[6]
- screening persons who introduce customer business or manage customer accounts to see if the firm or any of its principals is subject to a statutory disqualification under Section 8a of the CEA and, if so, determining if the Forex Dealer Member should perform additional due diligence on that person;[7]
- reviewing disclosures given to customers to ensure they are understandable, timely, and provide sufficient information;
- reviewing and analyzing the forex activity in customer accounts, including discretionary customer accounts; and
- handling customer funds, including accepting security deposits.

A Forex Dealer Member and a listed principal that is also a registered associated person (see Financial Requirements 15(c)) must supervise the preparation of a Forex Dealer Member's financial books and records. Diligent supervision includes hiring and retaining qualified staff. In determining whether an individual responsible for preparing the Member's financial books and records is qualified, the firm and its financial principal should consider the following:

- Is the individual qualified for the position by experience or training?
- Does the individual exercise independent judgment?
- Has the individual ever been sanctioned or refused membership or licensing by NFA, the CFTC, the SEC, NASD or FINRA, the Public Company Accounting Oversight Board, or any other financial regulator?
- Has the individual ever been sanctioned or refused membership by the American Institute of Certified Public Accountants or any other accounting organization?
- Has any firm for which the individual performed auditing, accounting, or bookkeeping been subject to an emergency action or sanctioned by NFA, the CFTC, the SEC, NASD or FINRA, the Public Company Accounting Oversight Board, or any other financial regulator for failure to comply with financial requirements or for having inadequate books and records while the individual was engaged in those activities?
- Are there any pending actions against the individual or a firm for which the individual performed auditing, accounting, or bookkeeping?

This is not an exclusive list. If the individual or a firm for which the individual worked (either as an independent contractor or an employee) was subject to an emergency action, sanctioned by a financial regulator, or is subject to a pending action, the FDM and the listed principal/registered AP responsible for the FDM's financial books and records should consider the nature and seriousness of the conduct (or alleged conduct) and the individual's role in it. An NFA Member Responsibility Action or an emergency action by another financial regulator is always an extremely serious matter.

The Forex Dealer Member and its financial principal must also conduct due diligence and consider analogous information when selecting an independent public accountant to certify the firm's annual financial statements.

An adequate supervisory program should also include periodic on-site visits to branch offices, guaranteed introducing brokers, and otherwise unregulated affiliates that conduct forex business on behalf of the Member. The Member needs to determine the frequency and nature of these visits. The number of visits will depend on the amount of business generated, the number of customer complaints received, the training and experience of the office personnel, and the frequency and nature of problems that arise from the office.

Finally, a Member's supervisory responsibilities include the obligation to ensure that its employees are properly trained to perform their duties. The formality of a training program will depend on the size of the firm and the nature of its business. Procedures should be in place to ensure that supervisory personnel know and understand the firm's supervisory procedures and that employees receive adequate training to abide by NFA requirements and to properly handle customer accounts.

4. *Recordkeeping* - Members must keep books and records relating to their forex operations for a period of five years from the date thereof and shall keep them readily accessible during the first 2 years of the 5-year period. All such books and records shall be open to inspection by NFA.

Members should adopt and enforce reasonable procedures to create current and accurate books and records and to keep them from being

altered or destroyed. Such records must include, among other things, financial records substantiating a Members assets and liabilities, including liabilities owed to customers and receivables from other persons. The Member should be able to promptly produce its records in a format that NFA can read and reproduce.

Forex Dealer Members should adopt and enforce a written policy detailing the procedures it follows to calculate rollover or interest charges and payments. The policy must include the factors that are considered as well as the names of any sources for these factors. The Member should document the underlying factors reviewed in completing the calculation, including any related transactions entered into by the Forex Dealer Member, so it can be replicated.

5. *Communications with the Public and Promotional Material* - No Member or Associate shall make any communication with potential or current customers that operates as a fraud or deceit; uses a high-pressure approach; or implies that forex transactions are appropriate for all persons.

Promotional material used by the Member or Associate shall not:

- Deceive the public or contain any material misstatement of fact or omit a fact that makes the promotional material misleading;[8]
- Include any statements of opinion unless they are clearly identified as such and have a reasonable basis in fact;
- Mention the possibility of profit unless accompanied by an equally prominent statement of the risk of loss;
- Include any reference to actual past trading profits without mentioning that past results are not necessarily indicative of future results;
- Include any statistical or numerical information about past performance of actual accounts unless the Member can demonstrate that the performance is representative of actual performance of all reasonably comparable accounts for the same period (calculated in accordance with the formula in CFTC Regulation 4.35(a)(6) and NFA Compliance Rule 2-34); or
- Include testimonials unless they are representative of all reasonably comparable accounts, the material prominently states that the testimonial is not indicative of future performance or success, and the material prominently states that they are paid testimonials (if applicable).

No Member or Associate may represent that forex funds deposited with a Forex Dealer Member are given special protection under the bankruptcy laws. No Member or Associate may represent or imply that any assets necessary to satisfy its obligations to customers are more secure because the Member keeps some or all of those assets at a regulated entity in the United States or a money center country.

No Member or Associate may represent that its services are commission free without prominently disclosing how it is compensated in near proximity to that representation.

No Member or Associate may represent that it offers trading with "no-slippage" or that it guarantees the price at which a transaction will be executed or filled, unless:

- It can demonstrate that all orders for all customers have been executed and fulfilled at the price initially quoted on the trading platform when the order was placed;[9] and
- No authority exists, pursuant to a contract, agreement, or otherwise, to adjust customer accounts in a manner that would have the direct or indirect effect of changing the price at which an order was executed.[10]

Members and Associates may not solicit customers based on the leverage available unless they balance any discussion regarding the advantages of leverage with an equally prominent contemporaneous disclosure that increasing leverage increases risk.

No Member shall use or directly benefit from any radio or television advertisement that recommends specific forex transactions or describes the extent of any profit obtained in the past or that can be obtained in the future unless the member submits the advertisement to NFA's Promotional Material Review Team for its review and approval at least 10 days prior to its first use or such shorter period as NFA may allow.[11]

Every Member should adopt and enforce written procedures to supervise communications with potential and current customers and promotional material. A supervisory employee that is, or is under the ultimate supervision of, a listed principal who is also an NFA Associate should review and approve all promotional material and make a written record of such review and approval.[12]

All promotional material should be maintained by each Member and be available for examination for the periods specified in the recordkeeping section of this notice, measured from the date of last use.

6. *Know Your Customer* - Members and Associates have a duty to acquaint themselves sufficiently with the personal and financial circumstances of each forex customer to determine what further facts, explanations and disclosures are needed in order for the customer to make an informed decision on whether to enter into forex transactions.

Every Member should determine what information it will obtain from a prospective forex customer. At a minimum, the Member soliciting the customer to engage in forex transactions should obtain the customer's name, address, principal occupation or business, current estimated annual income and net worth, approximate age, and an indication of the customer's previous investment and trading experience. Members and their Associates need to ensure that each customer they solicit has received adequate information concerning the risks of forex transactions so that the customer can make an informed decision as to whether forex transactions are appropriate for the customer. These obligations fall on the Forex Dealer Member when a non-Member solicits the customer.

7. *Doing Business with Non-Members* - Forex Dealer Members are subject to discipline for the activities of most non-Members who solicit or introduce forex customers to the Forex Dealer Member or manage accounts for those customers.

If a customer is solicited or introduced by a non-Member of NFA, or if the customer's account is managed by a non-Member, the Forex Dealer Member is subject to discipline for the non-Member's conduct if that conduct would violate NFA requirements when engaged in by an NFA Member. In other words, a Forex Dealer Member is subject to an NFA disciplinary action for the non-Member's activities when soliciting,

introducing, or managing accounts for the Forex Dealer Member's customers even if the non-Member was not the Forex Dealer Member's agent.

The rule allows NFA to bring a disciplinary action even if the Forex Dealer Member acts diligently and has no knowledge of the third-party's conduct. As a practical matter, however, NFA will not take disciplinary action unless the Forex Dealer Member knew or should have known of the third-party's conduct or failed to exercise due diligence when establishing and maintaining the relationship with the third party.

A Forex Dealer Member should adopt and enforce written procedures to review the activities of non-Member third parties. The procedures should include, among other things, a regular review of the trading being conducted in the accounts solicited, introduced, or managed by these non-Members. The Member should also have procedures for following up on any customer complaints received by the firm, including a written description of the investigation made by the Member and any resolution of the complaint. Further, supervisory procedures should include a regular review of all promotional material used by any non-Member third-party. The member should maintain copies of all promotional materials reviewed, along with a written record of the review conducted and any deficiencies corrected, and make them available for examination for the periods specified in the recordkeeping section of this notice. A supervisory employee that is, or is under the ultimate supervision of, a listed principal who is also an NFA Associate should conduct the review of the non-Member's activities.

The Forex Dealer Member is not subject to discipline for the actions of non-Members who are described in NFA Bylaw 306(b). It is also not subject to discipline for the actions of non-Members who would be exempt from Commission registration if they were acting in the same capacity in connection with exchange-traded futures contracts, such as foreign persons that solicit, introduce, or manage accounts for foreign customers only.[13] The Forex Dealer Member does, of course, have certain basic duties to its customers, including a duty to supervise its own activities in a way designed to ensure that it treats its customers fairly. Specifically, the Forex Dealer Member would violate this duty if it has actual or constructive notice that one of these entities engaged in fraudulent conduct and fails to take appropriate action.

8. *Affiliates* - Forex Dealer Members must supervise and are subject to discipline for the activities of affiliates that are authorized to engage in forex transactions solely by virtue of their affiliation with a Forex Dealer Member.

The CEA authorizes affiliates of FCMs to act as counterparties to forex transactions if the affiliate directly or indirectly controls, is controlled by, or is under common control with the FCM and the FCM makes and keeps records regarding the financial activities of the affiliate for purposes of the Commission's risk assessment requirements.[14] If a Forex Dealer Member has one or more affiliates that act as counterparty to forex customers solely on the basis of that affiliation, the Forex Dealer Member must supervise the affiliate's forex activities and is subject to discipline for that affiliate's activities.[15] The Forex Dealer Member must also make these affiliates' books and records available to NFA upon request. Additionally, the Forex Dealer Member must assure that its affiliates do not act as counterparties to forex transactions unless they are authorized to do so under the Act.

9. *BASIC Disclosure* - Members must provide forex customers with information on NFA's BASIC system.

NFA Compliance Rule 2-36(g) requires Forex Dealer Members to provide customers with written information regarding NFA's Background Affiliation Status Information Center (BASIC), including the web site address [16]. This information must be provided when the customer first opens an account and at least once a year thereafter.

Forex Dealer Members may provide the information electronically but must do it in a way that ensures each customer is aware of it. For example, merely having the information on the Member's web site is not adequate, but sending customers an e-mail including a link to that information and explaining what the link is would be sufficient in most circumstances.

10. *Discretion* - No Forex Dealer Member, or Associate of a Forex Dealer Member acting in such capacity, may exercise discretionary trading authority over a customer account for which the Forex Dealer Member is, or is offering to be, the counterparty to the transactions in the customer account.

C. OTHER REQUIREMENTS

This section of the notice provides guidance on dues, capital requirements, and security deposits. These requirements apply only to Forex Dealer Members.

1. Bylaw 1301

NFA Bylaw 1301(e) requires Forex Dealer Members to pay annual dues that are graduated according to the firm's gross annual revenue from customers (e.g., commissions, mark-ups, mark-downs) for its forex activities. Profits and losses from proprietary trades are *not* to be included. To calculate dues:

- Start with the FCM dues imposed by NFA Bylaw 1301(b)(ii);
- Add $44,375 if the Forex Dealer Member's gross annual revenue from forex transactions is $500,000 or less;
- Add $69,375 if the Forex Dealer Member's gross annual revenue from forex transactions is more than $500,000, but not more than $2,000,000;
- Add $94,375 if the Forex Dealer Member's gross annual revenue from forex transactions is more than $2,000,000, but not more than $5,000,000; or
- Add $119,375 if the Forex Dealer Member's gross annual revenue from these activities is more than $5,000,000.

The following table shows the dues to be assessed for Forex Dealer Members:

Amount of annual Gross Revenue From Forex Transactions	Dues if NFA is the DSRO	Dues if NFA is not the DSRO
$500,000 or less	$50,000	$45,875
More than $500,000, but not more than $2 million	$75,000	$70,875

More than $2 million, but not more than $5 million	$100,000	$95,875
More than $5 million	$125,000	$120,875

These dues apply when the Forex Dealer Member offers to be a counterparty to a forex transaction or accepts a forex trade (whichever is earlier), and NFA will send the Member an invoice for the minimum dues ($50,000 or $45,875) minus any amount already paid for that membership year. Thereafter, the dues will be assessed on the firm's membership renewal date and will be based on the Forex Dealer Member's latest certified financial statement.

The only exception to the dues set forth above is a situation in which NFA does not serve as the DSRO for a Forex Dealer Member and the DSRO has agreed to examine the Forex Dealer Member's forex activities. In this case, the surcharge paid by the Forex Dealer Member, regardless of gross annual revenue, is $12,000. Accordingly, for such a Forex Dealer Member the dues to be assessed at the time it offers to be a counterparty to a forex transaction or accepts a forex trade (whichever is earlier), and on its membership renewal date thereafter, will be $13,500.

Under NFA Compliance Rule 2-36(d), a Forex Dealer Member is subject to discipline for the activities of any person that solicits or introduces a customer to the Member or manages a customer's account unless that person is a Member or Associate of NFA, is otherwise regulated based on the criteria in Bylaw 306(b), or would be exempt from CFTC registration if it were acting in the same capacity in connection with exchange-traded futures contracts. Any Forex Dealer Member that is responsible under Compliance Rule 2-36(d) for solicitors and account managers is required to pay a separate annual fee on the firm's annual renewal date based on the number of unregulated solicitors and account managers. In determining whether this fee applies, the Forex Dealer Member should take the highest number of separate legal entities, including individuals acting as sole proprietors, that it was responsible for at any one time during the year. The following table shows this graduated fee.

Number of Unregulated Entities	Annual Fee
0	$ 0
1-4	$ 5,000
5-19	$10,000
20-99	$25,000
100 or more	$50,000

Each Forex Dealer Member is also required to pay an assessment of .0001% on the notional value of each forex transaction (as forex is defined in Bylaw 1507(b)). This equates to $.01 for each $10,000. For transactions with a notional value less than $10,000, the firm may aggregate separate transactions and pay $.01 on each multiple of $10,000. For transactions of $10,000 or above, the firm should round to the nearest cent.

This assessment is due only on initiating transactions. There is no assessment on rollovers, offsetting transactions, option expirations, or option exercises that do not result in new positions. The Member must remit the assessment to NFA within 30 days after the end of the month in which the transaction was initiated.

2. Financial Requirements Section 11(a)

Forex Dealer Members must maintain adjusted net capital equal to or in excess of the greatest amount specified in subsections (a)(i), (a)(ii), and (a)(iii) (if applicable). Subsection (a)(ii) applies to Forex Dealer Members that execute any customer transactions other than by using straight-through-processing and that also have liabilities to customers of more than $10 million. Where it applies, the Member's capital requirement is the minimum capital required by subsection (a)(i) plus 5% of the liabilities over $10 million. The formula is:

Amount required by (a)(i) + .05(customer liabilities - $10,000,000)

For example, if the minimum capital requirement is $20 million, a Forex Dealer Member that operates a dealing desk and has $208 million in liabilities to customers would be required to maintain adjusted net capital equal to or in excess of $29.9 million.

Forex Dealer Members with over $10 million in customer liabilities are subject to this alternative requirement unless they execute all customer transactions using straight-through-processing. Straight-through-processing refers to platforms that automatically (without human intervention and without exception) enter into an identical but opposite transaction with another counterparty, creating an offsetting position in the Forex Dealer Member's own name. A Forex Dealer Member that offers several platforms will be exempt from this requirement only if each platform executes all customer orders using straight-through-processing.

This requirement that all customer trades be executed by straight-through-processing is not, however, meant to limit a firm's ability to provide for other methods in its disaster recovery procedures. As long as those other methods are used only when dictated by those procedures and both the procedures and the firm's trading platform are designed to ensure that the need will rarely arise, the FDM will not lose its exemption by implementing other execution methods in disaster recovery situations.

3. Financial Requirements Section 11(b)

Section 11(b) prohibits a Forex Dealer Member from including assets held by an affiliate (unless approved) or an unregulated person in the firm's current assets for purposes of determining its adjusted net capital under CFTC Rule 1.17. This means an FDM may not count any part of those assets for capital purposes.[17]

An unregulated person is any person that is **not**:

(i) a financial institution regulated by a U.S. banking regulator;

(ii) a broker-dealer registered with the U.S. Securities and Exchange Commission and a member of FINRA;

(iii) a futures commission merchant registered with the U.S. Commodity Futures Trading Commission and a Member of NFA;

(iv) an insurance company regulated by any U.S. state;

(v) an entity regulated as a foreign equivalent of any of the above if regulated in a money center country as defined in CFTC Regulation 1.49; or

(vi) any other entity approved by NFA.

Effective October 1, 2010, the above paragraph will read as follows:

An unregulated person is any person that is **not**:

(i) a financial institution regulated by a U.S. banking regulator;

(ii) a broker-dealer registered with the U.S. Securities and Exchange Commission and a member of FINRA;

(iii) a futures commission merchant registered with the U.S. Commodity Futures Trading Commission and a Member of NFA;

(iv) a retail foreign exchange dealer registered with the U.S. Commodity Futures Trading Commission and a Member of NFA;

(v) an insurance company regulated by any U.S. state; or

(vi) any other entity approved by NFA.

Any Forex Dealer Member may ask NFA to approve an otherwise unregulated person for purposes of Financial Requirements Sections 11(b) and (c). In determining whether to approve an unregulated person that is not an affiliate, NFA will consider a number of factors, including:

- Whether the person is regulated in another jurisdiction and, if so, the type and extent of regulation;
- The person's capital; and
- The person's credit rating.

NFA's approval of a particular person means that all unaffiliated Forex Dealer Members may treat that person as regulated under Sections 11(b) and (c). NFA may also approve categories of counterparties (e.g., banks regulated in a particular jurisdiction or with a particular credit rating).

A Forex Dealer Member may not engage in Section 11(b) or (c) transactions with a regulated affiliate without NFA's approval. The Member may, however, ask NFA to authorize it to cover its positions with specified affiliates (including unregulated affiliates). An affiliate is any entity that controls, is controlled by, or is under common control with the Forex Dealer Member. The standards for approving affiliated persons are significantly higher than those for unaffiliated persons. For example, NFA will also consider:

- The parent company's and affiliated person's capital;
- Whether the parent company and the affiliated person are regulated entities;
- Whether the parent company will guarantee the obligations of the affiliated person (unless the parent company and the affiliated person are the same entity);
- The parent company's credit rating;
- Whether the affiliated person has strong risk-management policies to limit its value-at-risk; and
- For purposes of Section 11(c), whether the affiliated person limits the amount of offsetting transactions it enters into with unregulated counterparties.

4. Financial Requirements Section 11(c)

Section 11(c) prohibits Forex Dealer Members from using affiliates (unless approved) and unregulated persons to cover their foreign currency positions for purposes of CFTC Rule 1.17(c)(5).

The rule does not prohibit Forex Dealer Members from entering into positions with unregulated or unapproved counterparties. They may not, however, count positions with those counterparties when calculating their covered positions for purposes of CFTC Rule 1.17(c)(5).

For purposes of Section 11(c), Forex Dealer Members have four different types of counterparties. In particular:

- Account holders are those counterparties for whom it carries accounts and includes both retail customers and eligible contract participants.
- Trading partners are counterparties with whom the Member trades but who do not have accounts with the Member. For purposes of the calculations under Section 11(c), this category does not include affiliates (approved or unapproved) or regulated counterparties.
- Affiliates are entities that control, are controlled by, or are under common control with the Forex Dealer Member. For purposes of Section 11(c) only, this category does not include affiliates who have been approved by NFA under Section 11(b).
- Regulated entities are those counterparties that meet the definition in Section 11(b) and include entities-including affiliates-approved by NFA under that Section.

A Forex Dealer Member may net its exposure across account holders, across trading partners, and across affiliates, but it may not net its exposure between these categories. The Member may, however, net its exposure in any of these categories against regulated counterparties. Here is the information in chart form.

Type of Counterparty	Account Holders	Trading Partners	Affiliates	Regulated Entities
Account Holders	Yes	No	No	Yes
Trading Partners	No	Yes	No	Yes
Affiliates	No	No	Yes	Yes
Regulated Entities	Yes	Yes	Yes	Yes

A Forex Dealer Member is required to take a charge on the larger of its unnetted long or short position but not on both.

Example

Assume a Forex Dealer Member has the following Euro positions:

Type	Long	Short	Net Long	Net Short
Account Holders	11,154,912	6,011,794	5,143,118	
Trading Partners	4,987,345	7,299,886		2,312,541
Affiliates	3,790,754	2,640,553	1,150,201	
Regulated Entities	1,280,555	4,125,018		2,844,463

In determining the uncovered amount for purposes of the 6% haircut, the Forex Dealer Member can offset its net long position with account holders against the net short position with regulated entities but cannot offset its position with its trading partners or its position with unapproved affiliates against any category except regulated entities.

The math works this way (using only absolute numbers):

Net long position with account holders	5,143,118
Minus net short position with regulated entities	-2,844,463
	2,298,655
Uncovered long position with account holders	2,298,655
Plus net long position with affiliates	+1,150,201
Total uncovered long position	3,448,856
Net short position with trading partners	2,312,541
Larger of net long or short position	3,448,856
Haircut on Euros (3,448,856 X .06)	$206,931

5. Financial Requirements Section 12

Forex Dealer Members must collect security deposits from forex customers equal to 1% of the notional value of transactions in specified foreign currencies and 4% of the notional value of all other transactions. Where the two currencies are in different categories, the Forex Dealer Member must collect the higher amount. If the transaction pairs a foreign currency with the U.S. dollar, the security deposit is based on the foreign currency. If the transaction pairs a currency that qualifies for a 1% deposit with a currency that does not, the Forex Dealer Member must collect a 4% security deposit for the entire transaction. For example:

Currency Pair	Security Deposit
EUR/USD	1%
CND/JPY	1%
CND/BRL	4%
USD/MXN	4%
BRL/MXN	4%

For short options, the Forex Dealer Member must collect this amount plus the premium the customer received. For long options, the Forex Dealer Member must simply collect the entire premium from the customer.

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[1] The Board of Directors has declared that these transactions are a proper subject of NFA regulation and oversight under Article XVIII, paragraph (k).

[2] Compliance Rule 2-39 excludes these same entities when they introduce or manage forex accounts.

[3] Bylaw 306(b)(ii) excludes broker-dealers that are members of any fully-registered national securities association and FCMs that are members of another registered futures association. At this time, however, FINRA is the only fully-registered national securities association and NFA is the only registered futures association.

[4] These are affiliates of broker-dealers for which the broker-dealer makes and keeps records under the Securities and Exchange Commission's risk assessment requirements. See Section 17(h) of the Securities Exchange Act of 1934 and SEC Rule 17h-1T.

[5] See, for example, Compliance Rule 2-9: Supervision of Branch Offices and Guaranteed IBs, NFA Manual paragraph 9019; Compliance Rule 2-9: Supervisory Procedures for E-Mail and the Use of Web Sites, NFA Manual paragraph 9037; Compliance Rule 2-9: Supervision of the Use of Automated Order-Routing Systems, NFA Manual paragraph 9046. These interpretive notices do not directly apply to forex activities, but the principles included in these notices are equally applicable to those activities.

[6] The Commodity Futures Trading Commission has stated that all employees of an FCM who solicit or accept orders for forex transactions from retail customers must be registered with the Commission as an associated person of the FCM. See Division of Trading and Markets Advisory Concerning Foreign Currency Trading by Retail Customers (March 2002).

[7] The screening process should include 1) checking BASIC and any other readily available sources and 2) asking the third-party to represent that neither it nor any of its principals is subject to a statutory disqualification or to identify and explain any statutory disqualifications.

[8] Through interpretive notices issued under NFA Compliance Rule 2-29, NFA has provided Members with guidance on what activities are deceptive and misleading. See, for example, NFA Compliance Rule 2-29: Deceptive Advertising, NFA Manual paragraph 9033; NFA Compliance Rule 2-29: Deceptive Advertising, NFA Manual paragraph 9034; Compliance Rule 2-29: High Pressure Sales Tactics, NFA Manual paragraph 9038; and NFA Compliance Rules 2-29 and 2-9: NFA's Review and Approval of Certain Radio and television Advertisements, NFA Manual paragraph 9039. Although these interpretive notices do not directly apply to forex activities, the principles included in them with regard to what is deceptive or misleading are equally applicable to those activities.

[9] The Forex Dealer Member is not required to give the customer a price that is no longer reflected on the platform at the time the order reaches it. The Forex Dealer Member is not responsible for

transmission delays outside its control. If an Forex Dealer Member, however, advertises "no-slippage" or that it guarantees fill prices, it must prominently disclose that transmission delays might result in customer orders being executed at a price other than that seen by the customer.

[10] This includes *force majeure* provisions.

[11] Submission of promotional materials for NFA review is not a substitute for a Member's own responsibility to review promotional material. NFA staff will not independently verify the accuracy of statements made in an advertisement; that responsibility remains with the Member. Submitting promotional material to NFA will not provide a "safe harbor" from NFA actions for Members if misstatements or omissions of material fact are discovered subsequently or NFA otherwise later determines that the material is in violation of any applicable standards.

[12] Under traditional legal principles, Members can also be liable for promotional material promoting forex trading systems developed by third-parties. For example, a Member has direct responsibility for misleading promotional material if the Member prepares or distributes it; has agency responsibility if the system developer is an agent of the Member under established principles of agency law; and has supervisory responsibility if the Member fails to supervise its own employees when linking to a third-party trading system developer's web site, recommending a third-party's trading system, or entering into a referral agreement with a third-party system developer. See Interpretive Notice titled "NFA Bylaw 1101, Compliance Rules 2-9 and 2-29: Guidelines Relating to the Registration of Third-Party Trading System Developers and the Responsibility of NFA Members for Promotional Material That Promotes Third-Party Trading System Developers and their Trading Systems," NFA Manual, paragraph 9055.

[13] For this purpose, foreign persons and foreign customers are 1) natural persons who are not residents of the United States or 2) legal entities (other than passive investment vehicles) that are organized under the laws of a country other than the United States, do not have their principal place of business in the United States, and do not conduct their retail forex activities from a location in the United States. Those terms do not include a passive investment vehicle that is more than 10% owned by United States persons or that solicits United States persons who are not eligible contract participants as defined in Section 1a(12) of the Act. "United States" includes U.S. territories and possessions.

[14] See Sections 2(c)(2)(B)(ii)(III) and 4f(c)(2)(B) of the CEA and CFTC Regulations 1.14 and 1.15.

[15] Obviously, the Forex Dealer Member must also ensure that no entity with common ownership engages in the forex business unless it is authorized to do so.

[16] Forex Dealer Members can comply with this requirement by providing customers with a copy of NFA's brochure entitled "Background Affiliation Status Information Center (BASIC): An Information Resource for the Investing Public," which is available in print and on NFA's website at http://www.nfa.futures.org/.

[17] Where the CFTC's requirements for holding current assets are more stringent, those requirements apply.

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Compliance Rules

RULE 2-40. BULK ASSIGNMENT OR LIQUIDATION OF FOREX POSITIONS; CESSATION OF CUSTOMER BUSINESS.
[Adopted effective February 16, 2007. Effective dates of amendments: June 5, 2007.]

(a) Bulk Assignment, Transfer, or Liquidation. A Forex Dealer Member may not enter into a bulk assignment, transfer, or liquidation of forex positions or accounts unless the assignment, liquidation, or transfer complies with procedures established by NFA.

(b) Obligation of Assignees. If forex positions or accounts are assigned or transferred to a Forex Dealer Member, the Member may not accept orders initiating new positions until it has either:

(1) obtained personal and financial information from the customer and provided the disclosures required under Compliance Rule 2-36; or

(2) if the assignor was a Forex Dealer Member, obtained the necessary personal and financial information pertaining to the customer from the assignor and obtained reliable written evidence (which may include electronic records) that the assignor provided the required disclosures.

(c) Ceasing Business. A Forex Dealer Member must notify NFA by e-mail or facsimile seven calendar days prior to ceasing its forex business.

(d) Definitions. For purposes of this rule, the term "forex" has the same meaning as in Bylaw 1507(b) and the term "customer" has the same meaning as in Compliance Rule 2-36(i).

[See Interpretive Notice of NFA Compliance Rule 2-40: Procedures for the Bulk Assignment or Liquidation of Forex Positions; Cessation of Customer Business.]

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NFA Manual / Rules

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Interpretive Notices

9058 - NFA COMPLIANCE RULE 2-40: PROCEDURES FOR THE BULK ASSIGNMENT OR LIQUIDATION OF FOREX POSITIONS; CESSATION OF CUSTOMER BUSINESS
(Board of Directors, November 16, 2006; effective February 16, 2007)

INTERPRETIVE NOTICE

A Forex Dealer Member ("FDM") must follow these procedures when seeking to employ a bulk assignment or liquidation of its customer's positions or a bulk transfer of customer accounts. NFA may waive or modify any of these procedures or impose additional requirements if doing so is in the FDM's customers' best interest or if the circumstances otherwise require.

BULK ASSIGNMENTS AND TRANSFERS

Permitted Assignees

An FDM must notify NFA's Compliance Department ("Compliance") prior to any bulk assignment of customer positions or bulk transfer of customer accounts. An FDM may only assign open positions to an entity that is an authorized counterparty enumerated in Section 2 (c)(2)(B)(ii) of the Act. Prior to the assignment or transfer, the FDM must conduct a reasonable investigation and determine that the assignee intends and is financially able to honor its commitments to the FDM's customers as a result of the assignment or transfer. The FDM must document this investigation and provide this information to NFA.

Written Consent or Prior Notice

An FDM may assign customer positions and transfer customer accounts to an authorized counterparty with the express written consent of its customers. Alternatively, an FDM may assign open positions and transfer accounts by providing its customers with prior notice. The FDM must send NFA's Compliance Department a copy of this notice before the notice is sent to customers.

Notice to Customers

The notice should be sent to the customer's independent e-mail address (not a dedicated address provided by the Forex Dealer Member) and by postal mail (at least first class delivery). Generally, the FDM must provide this notice at least seven calendar days before the assignment or transfer. In rare and unusual circumstances, NFA's Compliance Department might determine that a shorter notice period is appropriate. Additionally, there might be circumstances in which the Compliance Department determines that a longer notice period is required.
The notice should include any information that is material based upon the specific circumstances of the assignment or transfer. At a minimum, the notice must include:

1. The reason for the assignment/transfer;

2. A clear and concise statement that as of a particular date (the assignment/transfer date, which should not be less than seven calendar days after the date of the notice) the FDM will no longer be the counterparty to the customer's positions and will not service the customer's account;

3. The name, NFA ID (if applicable), postal and e-mail addresses, and telephone number of the proposed assignee/transferee as well as the name of an individual at the assignee/transferee the customer can contact about the proposed assignment/transfer;

4. A statement that the customer is not required to accept the proposed assignment/transfer but may direct the assignor/ transferor FDM to liquidate the customer's positions;

5. The name, postal and e-mail address, and telephone number of an individual at the assignor/transferor FDM the customer can contact with questions or to liquidate positions; and

6. A statement that failure to respond to the notice within a specified period of time, not less than seven days from the date of the notice, will result in a default action, which must be either (A) assigning the customer's positions and

transferring account balances to the assignee (if authorized by contract) or (B) liquidating the customer's positions and returning the remaining funds, whichever is the case.

Where the customer positions and accounts are being assigned/transferred to a firm that is not an NFA Member, the notice must include the following disclosure:

YOUR POSITIONS AND ACCOUNT WILL BE ASSIGNED TO A FIRM THAT IS NOT A MEMBER OF NATIONAL FUTURES ASSOCIATION (NFA), IS NOT REGULATED BY NFA, AND IS NOT REQUIRED TO COMPLY WITH NFA's RULES.

Where the customer positions and accounts are being assigned/transferred to a firm that is an NFA Member but is not an FDM, the notice must include the following disclosure:

YOUR POSITIONS AND ACCOUNT WILL BE ASSIGNED TO A FIRM WHOSE OFF-EXCHANGE FOREX ACTIVITIES ARE NOT REGULATED BY NATIONAL FUTURES ASSOCIATION.

BULK LIQUIDATIONS

An FDM must notify NFA's Compliance Department prior to any bulk liquidation of customer positions. An FDM may liquidate customer positions with the express written consent of its customers. Alternatively, an FDM may liquidate customer positions by providing its customers with prior notice of the liquidation. The FDM must send NFA's Compliance Department a copy of this notice before the notice is sent to customers.

Notice to Customers

The notice should be sent to the customer's independent e-mail address (not a dedicated address provided by the Forex Dealer Member) and by postal mail (at least first class delivery). Generally, the FDM must provide this notice at least seven calendar days before the liquidation. In rare and unusual circumstances, NFA's Compliance Department might determine that a shorter notice period is appropriate. Additionally, there might be circumstances in which the Compliance Department determines that a longer notice period is required.

The notice should include any information that is material based upon the specific circumstances of the liquidation. At a minimum, the notice must include:

1. The reason for the liquidation;

2. A clear and concise statement that as of a particular date (the liquidation date, which should not be less than seven calendar days after the date of the notice) the FDM will liquidate all open positions in the customer's account and close the account; and

3. The name, postal and e-mail address, and telephone number of an individual at the FDM the customer can contact with questions regarding the liquidation.

RECORDS

For a bulk assignment, liquidation, or transfer, the FDM should provide NFA's Compliance Department with all pertinent records pertaining to the transaction. At a minimum, the FDM should provide the following records.

At the time that the FDM first contacts NFA's Compliance Department, the FDM must provide:

1. representative copies of the customer agreements;
2. a list of the affected accounts, including:
   a. customer names;
   b. account numbers; and
   c. account values as of the end of the previous day;
3. if an assignment or transfer, documentation regarding the assignor FDM's investigation of the assignee's status as an authorized counterparty and its financial ability to honor its commitments to the customers.

Immediately after the bulk assignment, liquidation, or transfer, the FDM must provide a list of the affected accounts and the value of each account as of the date of the transaction.

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NFA Manual / Rules

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Compliance Rules

RULE 2-42. FOREX POOL REPORTING
[Adopted effective November 30, 2008. Effective date of amendments: December 8, 2008.]

(a) Except for Members who meet the criteria in Bylaw 306(b), any Member operating a pool that is not an eligible contract participant as defined in Section 1a(12) of the Act and that trades forex must comply with the requirements in CFTC Regulation 4.22 in the same manner as would be applicable to the operation of a pool trading on-exchange futures contracts. The term "commodity interest" in that regulation should be read to include forex transactions. For purposes of this section, a pool may not claim to be an eligible contract participant by virtue of Section 1a(12)(A)(v)(II) or (III) of the Act.

(b) A Member may file with NFA a request for an extension of time in which to file the annual report in the same form as provided for in CFTC Regulation 4.22(f).

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NFA Manual / Rules

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Interpretive Notices

9053 - FOREX TRANSACTIONS

(Revised November 9, 2004; June 13, 2005; September 15, 2005; November 30, 2005; April 30, 2006; July 31, 2006; October 1, 2006; February 13, 2007; March 7, 2007; March 9, 2007; March 31, 2007; May 7, 2007; June 5, 2007; July 1, 2007; September 21, 2007; October 1, 2007; October 25, 2007; December 17, 2007; December 21, 2007; June 1, 2008; July 1, 2008; October 31, 2008; April 1, 2009; June 1, 2009; November 30, 2009; and December 17, 2009.)

INTERPRETIVE NOTICE

The Commodity Exchange Act (CEA or Act) gives the Commodity Futures Trading Commission (CFTC or Commission) limited jurisdiction over off-exchange foreign currency transactions offered to or entered into with retail customers. As a result of those provisions, certain firms primarily engaged in the retail forex business have registered with the CFTC and become Members of NFA. NFA has adopted several requirements to govern the conduct of these firms and their associated persons.

As described below, NFA Bylaw 306 creates a Forex Dealer Member category for certain NFA Members who act as counterparties to forex transactions with retail customers. This category allows NFA to exercise appropriate regulatory jurisdiction over the retail forex activities of these Members without imposing unnecessary, and potentially duplicative, regulatory burdens on Members that are otherwise subject to regulatory oversight for their activities.

NFA Bylaw 1507(b) defines forex as foreign currency futures and options and any other agreement, contract, or transaction in foreign currency that is offered or entered into on a leveraged or margined basis, or financed by the offeror, the counterparty, or a person acting in concert with the offeror or counterparty on a similar basis that are:

- offered to or entered into with persons that are not eligible contract participants as defined in Section 1a(12) of the Act (retail customers); and
- not executed on or subject to the rules of a contract market, a derivatives transaction execution facility, a national securities exchange registered pursuant to Section 6(a) of the Securities Exchange Act of 1934, or a foreign board of trade.[1]

Bylaw 1507(b) also excludes the following from the forex definition if the transaction is not a futures or options contract:

- securities (other than security futures products);
- any contract of sale that results in actual delivery within two days; and
- any contract of sale that creates an enforceable obligation to deliver between a seller and buyer that have the ability to deliver and accept delivery, respectively, in connection with their line of business.

Given the differences between off-exchange transactions and traditional exchange-traded futures and options, the Board of Directors does not believe that it is appropriate to apply the full array of NFA's futures rules to forex transactions. Therefore, rather than simply incorporating forex transactions into the definition of "futures," NFA adopted NFA Compliance Rule 2-36 to govern these transactions.

In developing its forex requirements, NFA's primary concern was to ensure that they provide adequate protection for retail customers without imposing undue burdens on NFA Members. NFA also believes that its requirements should, where consistent with customer protection, promote innovation and competition. In order to provide Members with as much flexibility as possible, NFA has chosen to deal with a number of issues by providing guidance under NFA Compliance Rule 2-36 instead of by adopting additional rules.

NFA Compliance Rule 2-36 sets out the general standards that apply to Forex Dealer Members and their Associates in connection with forex transactions. Subsection (b) prohibits Forex Dealer Members and their Associates from engaging in fraudulent activities, subsection (c) requires Forex Dealer Members and their Associates to observe high standards of commercial honor and just and equitable principles of trade in connection with their forex business, and subsection (e) requires Forex Dealer Members and their Associates with supervisory duties to supervise their employees and agents. Other subsections address a Forex Dealer Member's responsibility for its unregulated affiliates and third-party solicitors and make Forex Dealer Members subject to discipline for the conduct of certain non-Members with which they do business.

This notice has three sections. The first section explains who qualifies as a Forex Dealer Member under NFA Bylaw 306, the second section provides additional guidance about the requirements in Compliance Rule 2-36, and the third section covers other miscellaneous requirements.

A. BYLAW 306

In general, Forex Dealer Members are NFA Members who act as counterparties to forex transactions. This is a self-executing requirement, which means that any Member who qualifies is automatically a Forex Dealer Member. There is no application form and no approval requirement.

Members who do not act as counterparties are not Forex Dealer Members, even if they introduce or manage forex accounts. Under NFA Compliance Rule 2-39, however, most Members who introduce or manage forex accounts are required to comply with subsections (a), (b), (c), and (e) of NFA Compliance Rule 2-36.

Bylaw 306(b) excludes Members that are otherwise subject to regulatory oversight for their forex activities, which means that these Members are not Forex Dealer Members and do not have to comply with Compliance Rule 2-36. [2] The exclusions mostly follow Section 2(c)(2)(B)(ii) of the CEA, although the exclusions for broker-dealers and their affiliates are conditioned on the Financial Industry Regulatory Authority ("FINRA") membership. In particular, the following entities are not Forex Dealer Members:

- financial institutions (e.g., banks and savings associations);
- certain insurance companies and their regulated subsidiaries or affiliates;
- financial holding companies;
- investment bank holding companies;
- registered broker-dealers that are members of FINRA;[3] and
- Material Associated Persons of registered broker-dealers that are members of FINRA.[4]

B. COMPLIANCE RULE 2-36

As noted above, this section provides additional guidance on what Compliance Rule 2-36 requires. Certain sections specifically refer to Forex Dealer Members. Except for Members that meet the criteria in Bylaw 306(b), all other provisions of this notice also apply to Members and their Associates who solicit, introduce or manage forex accounts.

1. *Disclosure* - Members must provide forex customers with understandable and timely disclosure on essential features of forex trading.

At or before the time a customer first engages in a forex transaction, a Forex Dealer Member and its Associates should provide the customer sufficient information concerning the characteristics and particular risks of entering into forex transactions. Members and Associates introducing or managing accounts should know what information has been provided and should supplement it when necessary.

This information must include the following statement prominently displayed:

> The transactions you are entering into with [Member] are not traded on an exchange. Therefore, under the U.S. Bankruptcy Code, your funds may not receive the same protections as funds used to margin or guarantee exchange-traded futures and options contracts, which receive a priority in bankruptcy. Since that same priority has not been given to funds used for off-exchange forex trading, if [Member] becomes insolvent and you have a claim for amounts deposited or profits earned on transactions with [Member], your claim may not receive a priority. Without a priority, you are a general creditor and your claim will be paid, along with the claims of other general creditors, from any monies still available after priority claims are paid. Even customer funds that [Member] keeps separate from its own operating funds may not be safe from the claims of other general and priority creditors.

At or before the time a customer first engages in a forex transaction, a Member and its Associates should disclose how the Member will be compensated for the services it will provide to the customer.

Additionally, a Forex Dealer Member must describe to the customer the nature of these foreign currency transactions. Therefore, a Forex Dealer Member must provide, and the customer must separately acknowledge receipt of, either the following disclosure language or other appropriate language (based upon the Forex Dealer Member's business model) approved by NFA staff, which must be prominently displayed in all uppercase letters and in 10 point size type or larger but in any event no smaller than any surrounding type:

> THE FOREIGN CURRENCY TRADING YOU ARE ENTERING INTO IS NOT CONDUCTED ON AN EXCHANGE. [MEMBER] IS ACTING AS A COUNTERPARTY IN THESE TRANSACTIONS AND, THEREFORE, ACTS AS THE BUYER WHEN YOU SELL AND THE SELLER WHEN YOU BUY. AS A RESULT, [MEMBER]'S INTERESTS MAY BE IN CONFLICT WITH YOURS. UNLESS OTHERWISE SPECIFIED IN YOUR WRITTEN AGREEMENT OR OTHER WRITTEN DOCUMENTS [MEMBER] ESTABLISHES THE PRICES AT WHICH IT OFFERS TO TRADE WITH YOU. THE PRICES [MEMBER] OFFERS MIGHT NOT BE THE BEST PRICES AVAILABLE AND [MEMBER] MAY OFFER DIFFERENT PRICES TO DIFFERENT CUSTOMERS.
>
> IF [MEMBER] ELECTS NOT TO COVER ITS OWN TRADING EXPOSURE, THEN YOU SHOULD BE AWARE THAT [MEMBER] MAY MAKE MORE MONEY IF THE MARKET GOES AGAINST YOU. ADDITIONALLY, SINCE [MEMBER] ACTS AS THE BUYER OR SELLER IN THE TRANSACTION, YOU SHOULD CAREFULLY EVALUATE ANY TRADE RECOMMENDATIONS YOU RECEIVE FROM [MEMBER] OR ANY OF ITS SOLICITORS.

Forex Dealer Members should provide both the bid and the offer when the customer enters an order.

Members should update any material information that has changed prior to entering into new transactions with current customers if failing to update the information would make it misleading.

2. *Reporting* - Forex Dealer Members must provide forex customers with timely and accurate notice of the status of their accounts.

Forex Dealer Members should provide written confirmations within one business day after any activity in the customer's account, including offsetting transactions, rollovers, deliveries, option exercises, option expirations, trades that have been reversed or adjusted, and monetary adjustments. The confirmation should include the information required by Compliance Rule 2-44.

Forex Dealer Members should provide regular monthly statements showing all forex transactions and other account activity to customers for all accounts that have open positions at the end of the month or changes in the account balance or equity since the prior statement. Forex Dealer

Members should provide statements at least quarterly for all other open accounts. The monthly or quarterly statements should include the information required by Compliance Rule 2-44.

Confirmations and monthly/quarterly statements may be provided on-line or transmitted by other electronic means if the customer consents to the specific method used.

3. *Supervision* - Members and their Associates having supervisory responsibilities must diligently supervise the Member's forex business, including the activities of the Member's Associates and agents. Members must establish, maintain, and enforce written supervisory procedures.

NFA has provided Members with guidance on minimum standards of supervision through interpretive notices issued under NFA Compliance Rule 2-9.[5] In these interpretive notices NFA recognized that, given the differences in the size of and complexity of the operations of NFA Members, there must be some degree of flexibility in determining what constitutes "diligent supervision" for each firm. This principle also applies to the supervision of a Member's forex business.

Although Members have the flexibility to design procedures that are tailored to their own situation, an adequate program for supervision would include procedures for performing day-to-day monitoring. These procedures would include:

- screening employees who will solicit transactions from or provide advice to customers or manage customer accounts to see if they are subject to any of the statutory disqualifications in Section 8a of the CEA and, if so, to determine the extent of supervision they will require;
- monitoring communications with the public, including sales solicitations and web sites, and approving promotional material;
- reviewing the information obtained from and the information provided to customers solicited by the firm and its employees to ensure that the necessary account information has been obtained and the appropriate information provided; and
- handling and resolving customer complaints.

For Forex Dealer Members, these procedures would also include:

- screening prospective Associates to ensure that they are registered with the Commodity Futures Trading Commission as associated persons;[6]
- screening persons who introduce customer business or manage customer accounts to see if the firm or any of its principals is subject to a statutory disqualification under Section 8a of the CEA and, if so, determining if the Forex Dealer Member should perform additional due diligence on that person;[7]
- reviewing disclosures given to customers to ensure they are understandable, timely, and provide sufficient information;
- reviewing and analyzing the forex activity in customer accounts, including discretionary customer accounts; and
- handling customer funds, including accepting security deposits.

A Forex Dealer Member and a listed principal that is also a registered associated person (see Financial Requirements 15(c)) must supervise the preparation of a Forex Dealer Member's financial books and records. Diligent supervision includes hiring and retaining qualified staff. In determining whether an individual responsible for preparing the Member's financial books and records is qualified, the firm and its financial principal should consider the following:

- Is the individual qualified for the position by experience or training?
- Does the individual exercise independent judgment?
- Has the individual ever been sanctioned or refused membership or licensing by NFA, the CFTC, the SEC, NASD or FINRA, the Public Company Accounting Oversight Board, or any other financial regulator?
- Has the individual ever been sanctioned or refused membership by the American Institute of Certified Public Accountants or any other accounting organization?
- Has any firm for which the individual performed auditing, accounting, or bookkeeping been subject to an emergency action or sanctioned by NFA, the CFTC, the SEC, NASD or FINRA, the Public Company Accounting Oversight Board, or any other financial regulator for failure to comply with financial requirements or for having inadequate books and records while the individual was engaged in those activities?
- Are there any pending actions against the individual or a firm for which the individual performed auditing, accounting, or bookkeeping?

This is not an exclusive list. If the individual or a firm for which the individual worked (either as an independent contractor or an employee) was subject to an emergency action, sanctioned by a financial regulator, or is subject to a pending action, the FDM and the listed principal/registered AP responsible for the FDM's financial books and records should consider the nature and seriousness of the conduct (or alleged conduct) and the individual's role in it. An NFA Member Responsibility Action or an emergency action by another financial regulator is always an extremely serious matter.

The Forex Dealer Member and its financial principal must also conduct due diligence and consider analogous information when selecting an independent public accountant to certify the firm's annual financial statements.

An adequate supervisory program should also include periodic on-site visits to branch offices, guaranteed introducing brokers, and otherwise unregulated affiliates that conduct forex business on behalf of the Member. The Member needs to determine the frequency and nature of these visits. The number of visits will depend on the amount of business generated, the number of customer complaints received, the training and experience of the office personnel, and the frequency and nature of problems that arise from the office.

Finally, a Member's supervisory responsibilities include the obligation to ensure that its employees are properly trained to perform their duties. The formality of a training program will depend on the size of the firm and the nature of its business. Procedures should be in place to ensure that supervisory personnel know and understand the firm's supervisory procedures and that employees receive adequate training to abide by NFA requirements and to properly handle customer accounts.

4. *Recordkeeping* - Members must keep books and records relating to their forex operations for a period of five years from the date thereof and shall keep them readily accessible during the first 2 years of the 5-year period. All such books and records shall be open to inspection by NFA.

Members should adopt and enforce reasonable procedures to create current and accurate books and records and to keep them from being

altered or destroyed. Such records must include, among other things, financial records substantiating a Members assets and liabilities, including liabilities owed to customers and receivables from other persons. The Member should be able to promptly produce its records in a format that NFA can read and reproduce.

Forex Dealer Members should adopt and enforce a written policy detailing the procedures it follows to calculate rollover or interest charges and payments. The policy must include the factors that are considered as well as the names of any sources for these factors. The Member should document the underlying factors reviewed in completing the calculation, including any related transactions entered into by the Forex Dealer Member, so it can be replicated.

5. *Communications with the Public and Promotional Material* - No Member or Associate shall make any communication with potential or current customers that operates as a fraud or deceit; uses a high-pressure approach; or implies that forex transactions are appropriate for all persons.

Promotional material used by the Member or Associate shall not:

- Deceive the public or contain any material misstatement of fact or omit a fact that makes the promotional material misleading;[8]
- Include any statements of opinion unless they are clearly identified as such and have a reasonable basis in fact;
- Mention the possibility of profit unless accompanied by an equally prominent statement of the risk of loss;
- Include any reference to actual past trading profits without mentioning that past results are not necessarily indicative of future results;
- Include any statistical or numerical information about past performance of actual accounts unless the Member can demonstrate that the performance is representative of actual performance of all reasonably comparable accounts for the same period (calculated in accordance with the formula in CFTC Regulation 4.35(a)(6) and NFA Compliance Rule 2-34); or
- Include testimonials unless they are representative of all reasonably comparable accounts, the material prominently states that the testimonial is not indicative of future performance or success, and the material prominently states that they are paid testimonials (if applicable).

No Member or Associate may represent that forex funds deposited with a Forex Dealer Member are given special protection under the bankruptcy laws. No Member or Associate may represent or imply that any assets necessary to satisfy its obligations to customers are more secure because the Member keeps some or all of those assets at a regulated entity in the United States or a money center country.

No Member or Associate may represent that its services are commission free without prominently disclosing how it is compensated in near proximity to that representation.

No Member or Associate may represent that it offers trading with "no-slippage" or that it guarantees the price at which a transaction will be executed or filled, unless:

- It can demonstrate that all orders for all customers have been executed and fulfilled at the price initially quoted on the trading platform when the order was placed;[9] and
- No authority exists, pursuant to a contract, agreement, or otherwise, to adjust customer accounts in a manner that would have the direct or indirect effect of changing the price at which an order was executed.[10]

Members and Associates may not solicit customers based on the leverage available unless they balance any discussion regarding the advantages of leverage with an equally prominent contemporaneous disclosure that increasing leverage increases risk.

No Member shall use or directly benefit from any radio or television advertisement that recommends specific forex transactions or describes the extent of any profit obtained in the past or that can be obtained in the future unless the member submits the advertisement to NFA's Promotional Material Review Team for its review and approval at least 10 days prior to its first use or such shorter period as NFA may allow.[11]

Every Member should adopt and enforce written procedures to supervise communications with potential and current customers and promotional material. A supervisory employee that is, or is under the ultimate supervision of, a listed principal who is also an NFA Associate should review and approve all promotional material and make a written record of such review and approval.[12]

All promotional material should be maintained by each Member and be available for examination for the periods specified in the recordkeeping section of this notice, measured from the date of last use.

6. *Know Your Customer* - Members and Associates have a duty to acquaint themselves sufficiently with the personal and financial circumstances of each forex customer to determine what further facts, explanations and disclosures are needed in order for the customer to make an informed decision on whether to enter into forex transactions.

Every Member should determine what information it will obtain from a prospective forex customer. At a minimum, the Member soliciting the customer to engage in forex transactions should obtain the customer's name, address, principal occupation or business, current estimated annual income and net worth, approximate age, and an indication of the customer's previous investment and trading experience. Members and their Associates need to ensure that each customer they solicit has received adequate information concerning the risks of forex transactions so that the customer can make an informed decision as to whether forex transactions are appropriate for the customer. These obligations fall on the Forex Dealer Member when a non-Member solicits the customer.

7. *Doing Business with Non-Members* - Forex Dealer Members are subject to discipline for the activities of most non-Members who solicit or introduce forex customers to the Forex Dealer Member or manage accounts for those customers.

If a customer is solicited or introduced by a non-Member of NFA, or if the customer's account is managed by a non-Member, the Forex Dealer Member is subject to discipline for the non-Member's conduct if that conduct would violate NFA requirements when engaged in by an NFA Member. In other words, a Forex Dealer Member is subject to an NFA disciplinary action for the non-Member's activities when soliciting,

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introducing, or managing accounts for the Forex Dealer Member's customers even if the non-Member was not the Forex Dealer Member's agent.

The rule allows NFA to bring a disciplinary action even if the Forex Dealer Member acts diligently and has no knowledge of the third-party's conduct. As a practical matter, however, NFA will not take disciplinary action unless the Forex Dealer Member knew or should have known of the third-party's conduct or failed to exercise due diligence when establishing and maintaining the relationship with the third party.

A Forex Dealer Member should adopt and enforce written procedures to review the activities of non-Member third parties. The procedures should include, among other things, a regular review of the trading being conducted in the accounts solicited, introduced, or managed by these non-Members. The Member should also have procedures for following up on any customer complaints received by the firm, including a written description of the investigation made by the Member and any resolution of the complaint. Further, supervisory procedures should include a regular review of all promotional material used by any non-Member third-party. The member should maintain copies of all promotional materials reviewed, along with a written record of the review conducted and any deficiencies corrected, and make them available for examination for the periods specified in the recordkeeping section of this notice. A supervisory employee that is, or is under the ultimate supervision of, a listed principal who is also an NFA Associate should conduct the review of the non-Member's activities.

The Forex Dealer Member is not subject to discipline for the actions of non-Members who are described in NFA Bylaw 306(b). It is also not subject to discipline for the actions of non-Members who would be exempt from Commission registration if they were acting in the same capacity in connection with exchange-traded futures contracts, such as foreign persons that solicit, introduce, or manage accounts for foreign customers only.[13] The Forex Dealer Member does, of course, have certain basic duties to its customers, including a duty to supervise its own activities in a way designed to ensure that it treats its customers fairly. Specifically, the Forex Dealer Member would violate this duty if it has actual or constructive notice that one of these entities engaged in fraudulent conduct and fails to take appropriate action.

8. *Affiliates* - Forex Dealer Members must supervise and are subject to discipline for the activities of affiliates that are authorized to engage in forex transactions solely by virtue of their affiliation with a Forex Dealer Member.

The CEA authorizes affiliates of FCMs to act as counterparties to forex transactions if the affiliate directly or indirectly controls, is controlled by, or is under common control with the FCM and the FCM makes and keeps records regarding the financial activities of the affiliate for purposes of the Commission's risk assessment requirements.[14] If a Forex Dealer Member has one or more affiliates that act as counterparty to forex customers solely on the basis of that affiliation, the Forex Dealer Member must supervise the affiliate's forex activities and is subject to discipline for that affiliate's activities.[15] The Forex Dealer Member must also make these affiliates' books and records available to NFA upon request. Additionally, the Forex Dealer Member must assure that its affiliates do not act as counterparties to forex transactions unless they are authorized to do so under the Act.

9. *BASIC Disclosure* - Members must provide forex customers with information on NFA's BASIC system.

NFA Compliance Rule 2-36(g) requires Forex Dealer Members to provide customers with written information regarding NFA's Background Affiliation Status Information Center (BASIC), including the web site address [16]. This information must be provided when the customer first opens an account and at least once a year thereafter.

Forex Dealer Members may provide the information electronically but must do it in a way that ensures each customer is aware of it. For example, merely having the information on the Member's web site is not adequate, but sending customers an e-mail including a link to that information and explaining what the link is would be sufficient in most circumstances.

10. *Discretion* - No Forex Dealer Member, or Associate of a Forex Dealer Member acting in such capacity, may exercise discretionary trading authority over a customer account for which the Forex Dealer Member is, or is offering to be, the counterparty to the transactions in the customer account.

C. OTHER REQUIREMENTS

This section of the notice provides guidance on dues, capital requirements, and security deposits. These requirements apply only to Forex Dealer Members.

1. Bylaw 1301

NFA Bylaw 1301(e) requires Forex Dealer Members to pay annual dues that are graduated according to the firm's gross annual revenue from customers (e.g., commissions, mark-ups, mark-downs) for its forex activities. Profits and losses from proprietary trades are *not* to be included. To calculate dues:

- Start with the FCM dues imposed by NFA Bylaw 1301(b)(ii);
- Add $44,375 if the Forex Dealer Member's gross annual revenue from forex transactions is $500,000 or less;
- Add $69,375 if the Forex Dealer Member's gross annual revenue from forex transactions is more than $500,000, but not more than $2,000,000;
- Add $94,375 if the Forex Dealer Member's gross annual revenue from forex transactions is more than $2,000,000, but not more than $5,000,000; or
- Add $119,375 if the Forex Dealer Member's gross annual revenue from these activities is more than $5,000,000.

The following table shows the dues to be assessed for Forex Dealer Members:

Amount of annual Gross Revenue From Forex Transactions	Dues if NFA is the DSRO	Dues if NFA is not the DSRO
$500,000 or less	$50,000	$45,875
More than $500,000, but not more than $2 million	$75,000	$70,875

More than $2 million, but not more than $5 million	$100,000	$95,875
More than $5 million	$125,000	$120,875

These dues apply when the Forex Dealer Member offers to be a counterparty to a forex transaction or accepts a forex trade (whichever is earlier), and NFA will send the Member an invoice for the minimum dues ($50,000 or $45,875) minus any amount already paid for that membership year. Thereafter, the dues will be assessed on the firm's membership renewal date and will be based on the Forex Dealer Member's latest certified financial statement.

The only exception to the dues set forth above is a situation in which NFA does not serve as the DSRO for a Forex Dealer Member and the DSRO has agreed to examine the Forex Dealer Member's forex activities. In this case, the surcharge paid by the Forex Dealer Member, regardless of gross annual revenue, is $12,000. Accordingly, for such a Forex Dealer Member the dues to be assessed at the time it offers to be a counterparty to a forex transaction or accepts a forex trade (whichever is earlier), and on its membership renewal date thereafter, will be $13,500.

Under NFA Compliance Rule 2-36(d), a Forex Dealer Member is subject to discipline for the activities of any person that solicits or introduces a customer to the Member or manages a customer's account unless that person is a Member or Associate of NFA, is otherwise regulated based on the criteria in Bylaw 306(b), or would be exempt from CFTC registration if it were acting in the same capacity in connection with exchange-traded futures contracts. Any Forex Dealer Member that is responsible under Compliance Rule 2-36(d) for solicitors and account managers is required to pay a separate annual fee on the firm's annual renewal date based on the number of unregulated solicitors and account managers. In determining whether this fee applies, the Forex Dealer Member should take the highest number of separate legal entities, including individuals acting as sole proprietors, that it was responsible for at any one time during the year. The following table shows this graduated fee.

Number of Unregulated Entities	Annual Fee
0	$ 0
1-4	$ 5,000
5-19	$10,000
20-99	$25,000
100 or more	$50,000

Each Forex Dealer Member is also required to pay an assessment of .0001% on the notional value of each forex transaction (as forex is defined in Bylaw 1507(b)). This equates to $.01 for each $10,000. For transactions with a notional value less than $10,000, the firm may aggregate separate transactions and pay $.01 on each multiple of $10,000. For transactions of $10,000 or above, the firm should round to the nearest cent.

This assessment is due only on initiating transactions. There is no assessment on rollovers, offsetting transactions, option expirations, or option exercises that do not result in new positions. The Member must remit the assessment to NFA within 30 days after the end of the month in which the transaction was initiated.

2. Financial Requirements Section 11(a)

Forex Dealer Members must maintain adjusted net capital equal to or in excess of the greatest amount specified in subsections (a)(i), (a)(ii), and (a)(iii) (if applicable). Subsection (a)(ii) applies to Forex Dealer Members that execute any customer transactions other than by using straight-through-processing and that also have liabilities to customers of more than $10 million. Where it applies, the Member's capital requirement is the minimum capital required by subsection (a)(i) plus 5% of the liabilities over $10 million. The formula is:

Amount required by (a)(i) + .05(customer liabilities - $10,000,000)

For example, if the minimum capital requirement is $20 million, a Forex Dealer Member that operates a dealing desk and has $208 million in liabilities to customers would be required to maintain adjusted net capital equal to or in excess of $29.9 million.

Forex Dealer Members with over $10 million in customer liabilities are subject to this alternative requirement unless they execute all customer transactions using straight-through-processing. Straight-through-processing refers to platforms that automatically (without human intervention and without exception) enter into an identical but opposite transaction with another counterparty, creating an offsetting position in the Forex Dealer Member's own name. A Forex Dealer Member that offers several platforms will be exempt from this requirement only if each platform executes all customer orders using straight-through-processing.

This requirement that all customer trades be executed by straight-through-processing is not, however, meant to limit a firm's ability to provide for other methods in its disaster recovery procedures. As long as those other methods are used only when dictated by those procedures and both the procedures and the firm's trading platform are designed to ensure that the need will rarely arise, the FDM will not lose its exemption by implementing other execution methods in disaster recovery situations.

3. Financial Requirements Section 11(b)

Section 11(b) prohibits a Forex Dealer Member from including assets held by an affiliate (unless approved) or an unregulated person in the firm's current assets for purposes of determining its adjusted net capital under CFTC Rule 1.17. This means an FDM may not count any part of those assets for capital purposes.[17]

An unregulated person is any person that is **not**:

(i) a financial institution regulated by a U.S. banking regulator;

(ii) a broker-dealer registered with the U.S. Securities and Exchange Commission and a member of FINRA;

(iii) a futures commission merchant registered with the U.S. Commodity Futures Trading Commission and a Member of NFA;

(iv) an insurance company regulated by any U.S. state;

(v) an entity regulated as a foreign equivalent of any of the above if regulated in a money center country as defined in CFTC Regulation 1.49; or

(vi) any other entity approved by NFA.

Effective October 1, 2010, the above paragraph will read as follows:

An unregulated person is any person that is **not**:

(i) a financial institution regulated by a U.S. banking regulator;

(ii) a broker-dealer registered with the U.S. Securities and Exchange Commission and a member of FINRA;

(iii) a futures commission merchant registered with the U.S. Commodity Futures Trading Commission and a Member of NFA;

(iv) a retail foreign exchange dealer registered with the U.S. Commodity Futures Trading Commission and a Member of NFA;

(v) an insurance company regulated by any U.S. state; or

(vi) any other entity approved by NFA.

Any Forex Dealer Member may ask NFA to approve an otherwise unregulated person for purposes of Financial Requirements Sections 11(b) and (c). In determining whether to approve an unregulated person that is not an affiliate, NFA will consider a number of factors, including:

- Whether the person is regulated in another jurisdiction and, if so, the type and extent of regulation;
- The person's capital; and
- The person's credit rating.

NFA's approval of a particular person means that all unaffiliated Forex Dealer Members may treat that person as regulated under Sections 11(b) and (c). NFA may also approve categories of counterparties (e.g., banks regulated in a particular jurisdiction or with a particular credit rating).

A Forex Dealer Member may not engage in Section 11(b) or (c) transactions with a regulated affiliate without NFA's approval. The Member may, however, ask NFA to authorize it to cover its positions with specified affiliates (including unregulated affiliates). An affiliate is any entity that controls, is controlled by, or is under common control with the Forex Dealer Member. The standards for approving affiliated persons are significantly higher than those for unaffiliated persons. For example, NFA will also consider:

- The parent company's and affiliated person's capital;
- Whether the parent company and the affiliated person are regulated entities;
- Whether the parent company will guarantee the obligations of the affiliated person (unless the parent company and the affiliated person are the same entity);
- The parent company's credit rating;
- Whether the affiliated person has strong risk-management policies to limit its value-at-risk; and
- For purposes of Section 11(c), whether the affiliated person limits the amount of offsetting transactions it enters into with unregulated counterparties.

4. Financial Requirements Section 11(c)

Section 11(c) prohibits Forex Dealer Members from using affiliates (unless approved) and unregulated persons to cover their foreign currency positions for purposes of CFTC Rule 1.17(c)(5).

The rule does not prohibit Forex Dealer Members from entering into positions with unregulated or unapproved counterparties. They may not, however, count positions with those counterparties when calculating their covered positions for purposes of CFTC Rule 1.17(c)(5).

For purposes of Section 11(c), Forex Dealer Members have four different types of counterparties. In particular:

- Account holders are those counterparties for whom it carries accounts and includes both retail customers and eligible contract participants.
- Trading partners are counterparties with whom the Member trades but who do not have accounts with the Member. For purposes of the calculations under Section 11(c), this category does not include affiliates (approved or unapproved) or regulated counterparties.
- Affiliates are entities that control, are controlled by, or are under common control with the Forex Dealer Member. For purposes of Section 11(c) only, this category does not include affiliates who have been approved by NFA under Section 11(b).
- Regulated entities are those counterparties that meet the definition in Section 11(b) and include entities-including affiliates-approved by NFA under that Section.

A Forex Dealer Member may net its exposure across account holders, across trading partners, and across affiliates, but it may not net its exposure between these categories. The Member may, however, net its exposure in any of these categories against regulated counterparties. Here is the information in chart form.

Type of Counterparty	Account Holders	Trading Partners	Affiliates	Regulated Entities
Account Holders	Yes	No	No	Yes
Trading Partners	No	Yes	No	Yes
Affiliates	No	No	Yes	Yes
Regulated Entities	Yes	Yes	Yes	Yes

A Forex Dealer Member is required to take a charge on the larger of its unnetted long or short position but not on both.

Example

Assume a Forex Dealer Member has the following Euro positions:

Type	Long	Short	Net Long	Net Short
Account Holders	11,154,912	6,011,794	5,143,118	
Trading Partners	4,987,345	7,299,886		2,312,541
Affiliates	3,790,754	2,640,553	1,150,201	
Regulated Entities	1,280,555	4,125,018		2,844,463

In determining the uncovered amount for purposes of the 6% haircut, the Forex Dealer Member can offset its net long position with account holders against the net short position with regulated entities but cannot offset its position with its trading partners or its position with unapproved affiliates against any category except regulated entities.

The math works this way (using only absolute numbers):

Net long position with account holders	5,143,118
Minus net short position with regulated entities	-2,844,463
	2,298,655
Uncovered long position with account holders	2,298,655
Plus net long position with affiliates	+1,150,201
Total uncovered long position	3,448,856
Net short position with trading partners	2,312,541
Larger of net long or short position	3,448,856
Haircut on Euros (3,448,856 X .06)	$206,931

5. Financial Requirements Section 12

Forex Dealer Members must collect security deposits from forex customers equal to 1% of the notional value of transactions in specified foreign currencies and 4% of the notional value of all other transactions. Where the two currencies are in different categories, the Forex Dealer Member must collect the higher amount. If the transaction pairs a foreign currency with the U.S. dollar, the security deposit is based on the foreign currency. If the transaction pairs a currency that qualifies for a 1% deposit with a currency that does not, the Forex Dealer Member must collect a 4% security deposit for the entire transaction. For example:

Currency Pair	Security Deposit
EUR/USD	1%
CND/JPY	1%
CND/BRL	4%
USD/MXN	4%
BRL/MXN	4%

For short options, the Forex Dealer Member must collect this amount plus the premium the customer received. For long options, the Forex Dealer Member must simply collect the entire premium from the customer.

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[1] The Board of Directors has declared that these transactions are a proper subject of NFA regulation and oversight under Article XVIII, paragraph (k).

[2] Compliance Rule 2-39 excludes these same entities when they introduce or manage forex accounts.

[3] Bylaw 306(b)(ii) excludes broker-dealers that are members of any fully-registered national securities association and FCMs that are members of another registered futures association. At this time, however, FINRA is the only fully-registered national securities association and NFA is the only registered futures association.

[4] These are affiliates of broker-dealers for which the broker-dealer makes and keeps records under the Securities and Exchange Commission's risk assessment requirements. See Section 17(h) of the Securities Exchange Act of 1934 and SEC Rule 17h-1T.

[5] See, for example, Compliance Rule 2-9: Supervision of Branch Offices and Guaranteed IBs, NFA Manual paragraph 9019; Compliance Rule 2-9: Supervisory Procedures for E-Mail and the Use of Web Sites, NFA Manual paragraph 9037; Compliance Rule 2-9: Supervision of the Use of Automated Order-Routing Systems, NFA Manual paragraph 9046. These interpretive notices do not directly apply to forex activities, but the principles included in these notices are equally applicable to those activities.

[6] The Commodity Futures Trading Commission has stated that all employees of an FCM who solicit or accept orders for forex transactions from retail customers must be registered with the Commission as an associated person of the FCM. See Division of Trading and Markets Advisory Concerning Foreign Currency Trading by Retail Customers (March 2002).

[7] The screening process should include 1) checking BASIC and any other readily available sources and 2) asking the third-party to represent that neither it nor any of its principals is subject to a statutory disqualification or to identify and explain any statutory disqualifications.

[8] Through interpretive notices issued under NFA Compliance Rule 2-29, NFA has provided Members with guidance on what activities are deceptive and misleading. See, for example, NFA Compliance Rule 2-29: Deceptive Advertising, NFA Manual paragraph 9033; NFA Compliance Rule 2-29: Deceptive Advertising, NFA Manual paragraph 9034; Compliance Rule 2-29: High Pressure Sales Tactics, NFA Manual paragraph 9038; and NFA Compliance Rules 2-29 and 2-9: NFA's Review and Approval of Certain Radio and television Advertisements, NFA Manual paragraph 9039. Although these interpretive notices do not directly apply to forex activities, the principles included in them with regard to what is deceptive or misleading are equally applicable to those activities.

[9] The Forex Dealer Member is not required to give the customer a price that is no longer reflected on the platform at the time the order reaches it. The Forex Dealer Member is not responsible for

transmission delays outside its control. If an Forex Dealer Member, however, advertises "no-slippage" or that it guarantees fill prices, it must prominently disclose that transmission delays might result in customer orders being executed at a price other than that seen by the customer.

[10] This includes *force majeure* provisions.

[11] Submission of promotional materials for NFA review is not a substitute for a Member's own responsibility to review promotional material. NFA staff will not independently verify the accuracy of statements made in an advertisement; that responsibility remains with the Member. Submitting promotional material to NFA will not provide a "safe harbor" from NFA actions for Members if misstatements or omissions of material fact are discovered subsequently or NFA otherwise later determines that the material is in violation of any applicable standards.

[12] Under traditional legal principles, Members can also be liable for promotional material promoting forex trading systems developed by third-parties. For example, a Member has direct responsibility for misleading promotional material if the Member prepares or distributes it; has agency responsibility if the system developer is an agent of the Member under established principles of agency law; and has supervisory responsibility if the Member fails to supervise its own employees when linking to a third-party trading system developer's web site, recommending a third-party's trading system, or entering into a referral agreement with a third-party system developer. See Interpretive Notice titled "NFA Bylaw 1101, Compliance Rules 2-9 and 2-29: Guidelines Relating to the Registration of Third-Party Trading System Developers and the Responsibility of NFA Members for Promotional Material That Promotes Third-Party Trading System Developers and their Trading Systems," NFA Manual, paragraph 9055.

[13] For this purpose, foreign persons and foreign customers are 1) natural persons who are not residents of the United States or 2) legal entities (other than passive investment vehicles) that are organized under the laws of a country other than the United States, do not have their principal place of business in the United States, and do not conduct their retail forex activities from a location in the United States. Those terms do not include a passive investment vehicle that is more than 10% owned by United States persons or that solicits United States persons who are not eligible contract participants as defined in Section 1a(12) of the Act. "United States" includes U.S. territories and possessions.

[14] See Sections 2(c)(2)(B)(ii)(III) and 4f(c)(2)(B) of the CEA and CFTC Regulations 1.14 and 1.15.

[15] Obviously, the Forex Dealer Member must also ensure that no entity with common ownership engages in the forex business unless it is authorized to do so.

[16] Forex Dealer Members can comply with this requirement by providing customers with a copy of NFA's brochure entitled "Background Affiliation Status Information Center (BASIC): An Information Resource for the Investing Public," which is available in print and on NFA's website at http://www.nfa.futures.org/.

[17] Where the CFTC's requirements for holding current assets are more stringent, those requirements apply.

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DRAFT

July 8, 2010

Memo To: Executive Committee

From: Lauren Brinati
Tim McHenry

Re: Proposed NFA Compliance Rule 2-48: FDM Trade Reporting System

Last year, this Committee authorized staff to develop an electronic trade practice surveillance system to monitor FDM forex trading activity in order to identify trade practice abuses. In approving the system's development, this Committee recognized that NFA's current methods for identifying trade practice abuses (through audits or investigations of customer complaints) are not very effective because they do not provide staff with a method of regularly monitoring trade information and identifying unusual or suspicious trends. Moreover, the process for reviewing the trading activity is very labor intensive because it is done manually. The Committee agreed that it would be beneficial for NFA to receive regular current trade information from FDMs in a format that allowed NFA to monitor the information electronically and produce exception reports and alerts for activity that might be indicative of a trade practice abuse.

Over the last 18 months, Compliance staff and Information Systems staff have worked closely to develop a system. The first step in this process was to identify the information that would be useful for monitoring for abuses and the frequency that FDMs should submit the information. Staff concluded that FDMs should submit the following information:

- All order transaction records on a daily basis;
- A list of executed trades on a daily basis;
- A list of all customers on the first day of reporting, with any changes being reported daily;
- A list of all money managers on the first day of reporting, with any changes being reported daily;

- A list identifying all customers being managed by a particular money manager on the first day of reporting, with any changes being reported daily;

- A list of all price adjustments made by the FDM on a daily basis; and

- A list of any unusual events, such as a system outage or "fast market" on a daily basis as applicable.

The system will analyze this information and create exceptions reports that identify, among other things:

- delays between when customer orders reach the platform and when they are executed;

- how frequently prices received by customers differ from the prices reflected on the platform at the time the orders reach it;

- whether the fills at a particular FDM are out-of-line with the market (as measured by a feed from Bloomberg or a similar source) or an FDM's spreads are out-of-line with those offered by other FDMs; and

- whether prices that touch off customer stop orders or induce margin calls are consistent with prices offered by other FDMs.

NFA staff dedicated to this area will review these reports and identify trends that may indicate a trading abuse.

NFA staff has made FDM Members fully aware of the system's development. Compliance staff contacted each FDM and provided significant information on the system and what the firm's obligations will be once the system commences operations. In addition, over the next several weeks, Compliance staff plan to hold a series of conference calls with FDMs to address their questions and concerns.

A pilot program to test the system began on July 1, 2010, with one FDM participating. Another FDM is scheduled to begin participating in the program within the next few days. Staff has invited all FDMs to participate in the pilot and we hope to have most, if not all, of the FDMs submitting daily reports in the next few weeks.

Staff anticipates that the system will be ready to be fully implemented by the end of this year or early next year. In order to formally implement the system, however, NFA must adopt a rule to impose the reporting requirement on FDM Members. The following resolution would recommend that the Board adopt Compliance Rule 2-48 to require FDM Members to submit the required daily report of trade data and to impose an automatic late fee for reports that are not filed in a timely manner.

RESOLVED, that the Executive Committee recommend to the Board of Directors that NFA Compliance Rule 2-48 be adopted to read as follows:

COMPLIANCE RULES

* * *

PART 2 – RULES GOVERNING THE BUSINESS CONDUCT OF MEMBERS REGISTERED WITH THE COMMISSION

* * *

RULE 2-48. FOREX DEALER MEMBER DAILY TRADE DATA REPORTS

(a) Each Forex Dealer Member must file a daily electronic report of trade data with NFA using the electronic filing method required by NFA. The report must contain the data and be in the format prescribed by NFA. Each Forex Dealer Member must prepare the report as of 5:00 P.M. Eastern time and file it with NFA by 11:59 P.M. Eastern time the same day.

(b) By submitting the report, the FDM certifies that the report is true and complete.

(c) Each daily report that is filed after it is due shall be accompanied by a late fee of $200 for each business day that it is late. Payment and acceptance of the fee does not preclude NFA from filing a disciplinary action for failure to comply with the deadlines imposed in this rule.

(caw\Executive Committee Fortran Rule)

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Compliance Rules

RULE 2-43. FOREX ORDERS
[Adopted effective May 15, 2009. Effective dates of amendments: June 12, 2009 and September 11, 2009.]

(a) Price Adjustments

(1) A Forex Dealer Member may not cancel an executed customer order or adjust a customer account in a manner that would have the direct or indirect effect of changing the price of an executed order except when:

(i) the cancellation or adjustment is favorable to the customer and is done as part of a settlement of a customer complaint, provided, however, that individual customer complaints are not required in order for a Forex Dealer Member to favorably adjust all customer orders that were adversely affected by technical problems with the trading platform or by similar factors beyond the customer's control and that are unrelated to market price movements (except that the Forex Dealer Member must adjust all customer orders adversely affected and may not, except as provided in section (a)(1)(ii), adjust any order that received a favorable price due to the problem); or

(ii) if a Forex Dealer Member exclusively uses straight-through processing such that the Forex Dealer Member automatically (without human intervention and without exception) enters into the identical but opposite transaction with another counterparty (creating an offsetting position in its own name) and that counterparty cancels or adjusts the price at which the position was executed.

(2) With regard to cancellations or adjustments made pursuant to section (a)(1)(ii), a Forex Dealer Member must:

(i) provide written notification to the customer within fifteen (15) minutes of the customer order having been executed that it is seeking to cancel the executed order or adjust the customer's account to reflect the adjusted price provided by the Forex Dealer Member's counterparty, as applicable, and the written notification must include documentation of the cancellation or adjustment from the Forex Dealer Member's counterparty; and

(ii) either cancel or adjust all executed customer orders executed during the same time period and in the same currency pair or option regardless of whether they were buy or sell orders.

(3) Notwithstanding section (a)(2)(ii), a Forex Dealer Member may choose to honor transactions in which customer orders resulted in profits for the customers but must do so with regard to all similarly situated customers.

(4) Cancellations and adjustments to executed customer orders must be reviewed and approved by a listed principal that is also an NFA Associate. Such review and approval must be documented by a written record, must include any supporting documentation, and must be provided to NFA in the manner requested by NFA.

(5) A customer order is considered executed upon the earlier of the customer receiving notification of the execution price from the Forex Dealer Member or when the position established by such order is identified in the customer's account, whether electronically or otherwise.

(6) If a Forex Dealer Member may cancel or adjust an executed order under the circumstances provided for in section (a)(1)(ii), the FDM must provide customers with written notice that the Forex Dealer Member may cancel or adjust executed customer orders based upon liquidity provider price changes prior to the time they first engage in forex transactions with the Forex Dealer Member. The notice may be included in a customer agreement.

(7) Any provision in a customer agreement or any contract between a Forex Dealer Member and a customer that reserves to the Forex Dealer Member the right to make price or equity adjustments to a customer account except as allowed by this Rule is prohibited.

(b) Offsetting Transactions

Forex Dealer Members may not carry offsetting positions in a customer account but must offset them on a first-in, first-out basis. At the customer's request, an FDM may offset same-size transactions even if there are older transactions of a different size but must offset the transaction against the oldest transaction of that size.

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Interpretive Notices

9053 - FOREX TRANSACTIONS

(Revised November 9, 2004; June 13, 2005; September 15, 2005; November 30, 2005; April 30, 2006; July 31, 2006; October 1, 2006; February 13, 2007; March 7, 2007; March 9, 2007; March 31, 2007; May 7, 2007; June 5, 2007; July 1, 2007; September 21, 2007; October 1, 2007; October 25, 2007; December 17, 2007; December 21, 2007; June 1, 2008; July 1, 2008; October 31, 2008; April 1, 2009; June 1, 2009; November 30, 2009; and December 17, 2009.)

INTERPRETIVE NOTICE

The Commodity Exchange Act (CEA or Act) gives the Commodity Futures Trading Commission (CFTC or Commission) limited jurisdiction over off-exchange foreign currency transactions offered to or entered into with retail customers. As a result of those provisions, certain firms primarily engaged in the retail forex business have registered with the CFTC and become Members of NFA. NFA has adopted several requirements to govern the conduct of these firms and their associated persons.

As described below, NFA Bylaw 306 creates a Forex Dealer Member category for certain NFA Members who act as counterparties to forex transactions with retail customers. This category allows NFA to exercise appropriate regulatory jurisdiction over the retail forex activities of these Members without imposing unnecessary, and potentially duplicative, regulatory burdens on Members that are otherwise subject to regulatory oversight for their activities.

NFA Bylaw 1507(b) defines forex as foreign currency futures and options and any other agreement, contract, or transaction in foreign currency that is offered or entered into on a leveraged or margined basis, or financed by the offeror, the counterparty, or a person acting in concert with the offeror or counterparty on a similar basis that are:

- offered to or entered into with persons that are not eligible contract participants as defined in Section 1a(12) of the Act (retail customers); and
- not executed on or subject to the rules of a contract market, a derivatives transaction execution facility, a national securities exchange registered pursuant to Section 6(a) of the Securities Exchange Act of 1934, or a foreign board of trade.[1]

Bylaw 1507(b) also excludes the following from the forex definition if the transaction is not a futures or options contract:

- securities (other than security futures products);
- any contract of sale that results in actual delivery within two days; and
- any contract of sale that creates an enforceable obligation to deliver between a seller and buyer that have the ability to deliver and accept delivery, respectively, in connection with their line of business.

Given the differences between off-exchange transactions and traditional exchange-traded futures and options, the Board of Directors does not believe that it is appropriate to apply the full array of NFA's futures rules to forex transactions. Therefore, rather than simply incorporating forex transactions into the definition of "futures," NFA adopted NFA Compliance Rule 2-36 to govern these transactions.

In developing its forex requirements, NFA's primary concern was to ensure that they provide adequate protection for retail customers without imposing undue burdens on NFA Members. NFA also believes that its requirements should, where consistent with customer protection, promote innovation and competition. In order to provide Members with as much flexibility as possible, NFA has chosen to deal with a number of issues by providing guidance under NFA Compliance Rule 2-36 instead of by adopting additional rules.

NFA Compliance Rule 2-36 sets out the general standards that apply to Forex Dealer Members and their Associates in connection with forex transactions. Subsection (b) prohibits Forex Dealer Members and their Associates from engaging in fraudulent activities, subsection (c) requires Forex Dealer Members and their Associates to observe high standards of commercial honor and just and equitable principles of trade in connection with their forex business, and subsection (e) requires Forex Dealer Members and their Associates with supervisory duties to supervise their employees and agents. Other subsections address a Forex Dealer Member's responsibility for its unregulated affiliates and third-party solicitors and make Forex Dealer Members subject to discipline for the conduct of certain non-Members with which they do business.

This notice has three sections. The first section explains who qualifies as a Forex Dealer Member under NFA Bylaw 306, the second section provides additional guidance about the requirements in Compliance Rule 2-36, and the third section covers other miscellaneous requirements.

A. BYLAW 306

In general, Forex Dealer Members are NFA Members who act as counterparties to forex transactions. This is a self-executing requirement, which means that any Member who qualifies is automatically a Forex Dealer Member. There is no application form and no approval requirement.

Members who do not act as counterparties are not Forex Dealer Members, even if they introduce or manage forex accounts. Under NFA Compliance Rule 2-39, however, most Members who introduce or manage forex accounts are required to comply with subsections (a), (b), (c), and (e) of NFA Compliance Rule 2-36.

Bylaw 306(b) excludes Members that are otherwise subject to regulatory oversight for their forex activities, which means that these Members are not Forex Dealer Members and do not have to comply with Compliance Rule 2-36. [2] The exclusions mostly follow Section 2(c)(2)(B)(ii) of the CEA, although the exclusions for broker-dealers and their affiliates are conditioned on the Financial Industry Regulatory Authority ("FINRA") membership. In particular, the following entities are not Forex Dealer Members:

- financial institutions (e.g., banks and savings associations);
- certain insurance companies and their regulated subsidiaries or affiliates;
- financial holding companies;
- investment bank holding companies;
- registered broker-dealers that are members of FINRA;[3] and
- Material Associated Persons of registered broker-dealers that are members of FINRA.[4]

B. COMPLIANCE RULE 2-36

As noted above, this section provides additional guidance on what Compliance Rule 2-36 requires. Certain sections specifically refer to Forex Dealer Members. Except for Members that meet the criteria in Bylaw 306(b), all other provisions of this notice also apply to Members and their Associates who solicit, introduce or manage forex accounts.

1. *Disclosure* - Members must provide forex customers with understandable and timely disclosure on essential features of forex trading.

At or before the time a customer first engages in a forex transaction, a Forex Dealer Member and its Associates should provide the customer sufficient information concerning the characteristics and particular risks of entering into forex transactions. Members and Associates introducing or managing accounts should know what information has been provided and should supplement it when necessary.

This information must include the following statement prominently displayed:

> The transactions you are entering into with [Member] are not traded on an exchange. Therefore, under the U.S. Bankruptcy Code, your funds may not receive the same protections as funds used to margin or guarantee exchange-traded futures and options contracts, which receive a priority in bankruptcy. Since that same priority has not been given to funds used for off-exchange forex trading, if [Member] becomes insolvent and you have a claim for amounts deposited or profits earned on transactions with [Member], your claim may not receive a priority. Without a priority, you are a general creditor and your claim will be paid, along with the claims of other general creditors, from any monies still available after priority claims are paid. Even customer funds that [Member] keeps separate from its own operating funds may not be safe from the claims of other general and priority creditors.

At or before the time a customer first engages in a forex transaction, a Member and its Associates should disclose how the Member will be compensated for the services it will provide to the customer.

Additionally, a Forex Dealer Member must describe to the customer the nature of these foreign currency transactions. Therefore, a Forex Dealer Member must provide, and the customer must separately acknowledge receipt of, either the following disclosure language or other appropriate language (based upon the Forex Dealer Member's business model) approved by NFA staff, which must be prominently displayed in all uppercase letters and in 10 point size type or larger but in any event no smaller than any surrounding type:

> THE FOREIGN CURRENCY TRADING YOU ARE ENTERING INTO IS NOT CONDUCTED ON AN EXCHANGE. [MEMBER] IS ACTING AS A COUNTERPARTY IN THESE TRANSACTIONS AND, THEREFORE, ACTS AS THE BUYER WHEN YOU SELL AND THE SELLER WHEN YOU BUY. AS A RESULT, [MEMBER]'S INTERESTS MAY BE IN CONFLICT WITH YOURS. UNLESS OTHERWISE SPECIFIED IN YOUR WRITTEN AGREEMENT OR OTHER WRITTEN DOCUMENTS [MEMBER] ESTABLISHES THE PRICES AT WHICH IT OFFERS TO TRADE WITH YOU. THE PRICES [MEMBER] OFFERS MIGHT NOT BE THE BEST PRICES AVAILABLE AND [MEMBER] MAY OFFER DIFFERENT PRICES TO DIFFERENT CUSTOMERS.
>
> IF [MEMBER] ELECTS NOT TO COVER ITS OWN TRADING EXPOSURE, THEN YOU SHOULD BE AWARE THAT [MEMBER] MAY MAKE MORE MONEY IF THE MARKET GOES AGAINST YOU. ADDITIONALLY, SINCE [MEMBER] ACTS AS THE BUYER OR SELLER IN THE TRANSACTION, YOU SHOULD CAREFULLY EVALUATE ANY TRADE RECOMMENDATIONS YOU RECEIVE FROM [MEMBER] OR ANY OF ITS SOLICITORS.

Forex Dealer Members should provide both the bid and the offer when the customer enters an order.

Members should update any material information that has changed prior to entering into new transactions with current customers if failing to update the information would make it misleading.

2. *Reporting* - Forex Dealer Members must provide forex customers with timely and accurate notice of the status of their accounts.

Forex Dealer Members should provide written confirmations within one business day after any activity in the customer's account, including offsetting transactions, rollovers, deliveries, option exercises, option expirations, trades that have been reversed or adjusted, and monetary adjustments. The confirmation should include the information required by Compliance Rule 2-44.

Forex Dealer Members should provide regular monthly statements showing all forex transactions and other account activity to customers for all accounts that have open positions at the end of the month or changes in the account balance or equity since the prior statement. Forex Dealer

Members should provide statements at least quarterly for all other open accounts. The monthly or quarterly statements should include the information required by Compliance Rule 2-44.

Confirmations and monthly/quarterly statements may be provided on-line or transmitted by other electronic means if the customer consents to the specific method used.

3. *Supervision* - Members and their Associates having supervisory responsibilities must diligently supervise the Member's forex business, including the activities of the Member's Associates and agents. Members must establish, maintain, and enforce written supervisory procedures.

NFA has provided Members with guidance on minimum standards of supervision through interpretive notices issued under NFA Compliance Rule 2-9.[5] In these interpretive notices NFA recognized that, given the differences in the size of and complexity of the operations of NFA Members, there must be some degree of flexibility in determining what constitutes "diligent supervision" for each firm. This principle also applies to the supervision of a Member's forex business.

Although Members have the flexibility to design procedures that are tailored to their own situation, an adequate program for supervision would include procedures for performing day-to-day monitoring. These procedures would include:

- screening employees who will solicit transactions from or provide advice to customers or manage customer accounts to see if they are subject to any of the statutory disqualifications in Section 8a of the CEA and, if so, to determine the extent of supervision they will require;
- monitoring communications with the public, including sales solicitations and web sites, and approving promotional material;
- reviewing the information obtained from and the information provided to customers solicited by the firm and its employees to ensure that the necessary account information has been obtained and the appropriate information provided; and
- handling and resolving customer complaints.

For Forex Dealer Members, these procedures would also include:

- screening prospective Associates to ensure that they are registered with the Commodity Futures Trading Commission as associated persons;[6]
- screening persons who introduce customer business or manage customer accounts to see if the firm or any of its principals is subject to a statutory disqualification under Section 8a of the CEA and, if so, determining if the Forex Dealer Member should perform additional due diligence on that person;[7]
- reviewing disclosures given to customers to ensure they are understandable, timely, and provide sufficient information;
- reviewing and analyzing the forex activity in customer accounts, including discretionary customer accounts; and
- handling customer funds, including accepting security deposits.

A Forex Dealer Member and a listed principal that is also a registered associated person (see Financial Requirements 15(c)) must supervise the preparation of a Forex Dealer Member's financial books and records. Diligent supervision includes hiring and retaining qualified staff. In determining whether an individual responsible for preparing the Member's financial books and records is qualified, the firm and its financial principal should consider the following:

- Is the individual qualified for the position by experience or training?
- Does the individual exercise independent judgment?
- Has the individual ever been sanctioned or refused membership or licensing by NFA, the CFTC, the SEC, NASD or FINRA, the Public Company Accounting Oversight Board, or any other financial regulator?
- Has the individual ever been sanctioned or refused membership by the American Institute of Certified Public Accountants or any other accounting organization?
- Has any firm for which the individual performed auditing, accounting, or bookkeeping been subject to an emergency action or sanctioned by NFA, the CFTC, the SEC, NASD or FINRA, the Public Company Accounting Oversight Board, or any other financial regulator for failure to comply with financial requirements or for having inadequate books and records while the individual was engaged in those activities?
- Are there any pending actions against the individual or a firm for which the individual performed auditing, accounting, or bookkeeping?

This is not an exclusive list. If the individual or a firm for which the individual worked (either as an independent contractor or an employee) was subject to an emergency action, sanctioned by a financial regulator, or is subject to a pending action, the FDM and the listed principal/registered AP responsible for the FDM's financial books and records should consider the nature and seriousness of the conduct (or alleged conduct) and the individual's role in it. An NFA Member Responsibility Action or an emergency action by another financial regulator is always an extremely serious matter.

The Forex Dealer Member and its financial principal must also conduct due diligence and consider analogous information when selecting an independent public accountant to certify the firm's annual financial statements.

An adequate supervisory program should also include periodic on-site visits to branch offices, guaranteed introducing brokers, and otherwise unregulated affiliates that conduct forex business on behalf of the Member. The Member needs to determine the frequency and nature of these visits. The number of visits will depend on the amount of business generated, the number of customer complaints received, the training and experience of the office personnel, and the frequency and nature of problems that arise from the office.

Finally, a Member's supervisory responsibilities include the obligation to ensure that its employees are properly trained to perform their duties. The formality of a training program will depend on the size of the firm and the nature of its business. Procedures should be in place to ensure that supervisory personnel know and understand the firm's supervisory procedures and that employees receive adequate training to abide by NFA requirements and to properly handle customer accounts.

4. *Recordkeeping* - Members must keep books and records relating to their forex operations for a period of five years from the date thereof and shall keep them readily accessible during the first 2 years of the 5-year period. All such books and records shall be open to inspection by NFA.

Members should adopt and enforce reasonable procedures to create current and accurate books and records and to keep them from being

altered or destroyed. Such records must include, among other things, financial records substantiating a Members assets and liabilities, including liabilities owed to customers and receivables from other persons. The Member should be able to promptly produce its records in a format that NFA can read and reproduce.

Forex Dealer Members should adopt and enforce a written policy detailing the procedures it follows to calculate rollover or interest charges and payments. The policy must include the factors that are considered as well as the names of any sources for these factors. The Member should document the underlying factors reviewed in completing the calculation, including any related transactions entered into by the Forex Dealer Member, so it can be replicated.

5. *Communications with the Public and Promotional Material* - No Member or Associate shall make any communication with potential or current customers that operates as a fraud or deceit; uses a high-pressure approach; or implies that forex transactions are appropriate for all persons.

Promotional material used by the Member or Associate shall not:

- Deceive the public or contain any material misstatement of fact or omit a fact that makes the promotional material misleading;[8]
- Include any statements of opinion unless they are clearly identified as such and have a reasonable basis in fact;
- Mention the possibility of profit unless accompanied by an equally prominent statement of the risk of loss;
- Include any reference to actual past trading profits without mentioning that past results are not necessarily indicative of future results;
- Include any statistical or numerical information about past performance of actual accounts unless the Member can demonstrate that the performance is representative of actual performance of all reasonably comparable accounts for the same period (calculated in accordance with the formula in CFTC Regulation 4.35(a)(6) and NFA Compliance Rule 2-34); or
- Include testimonials unless they are representative of all reasonably comparable accounts, the material prominently states that the testimonial is not indicative of future performance or success, and the material prominently states that they are paid testimonials (if applicable).

No Member or Associate may represent that forex funds deposited with a Forex Dealer Member are given special protection under the bankruptcy laws. No Member or Associate may represent or imply that any assets necessary to satisfy its obligations to customers are more secure because the Member keeps some or all of those assets at a regulated entity in the United States or a money center country.

No Member or Associate may represent that its services are commission free without prominently disclosing how it is compensated in near proximity to that representation.

No Member or Associate may represent that it offers trading with "no-slippage" or that it guarantees the price at which a transaction will be executed or filled, unless:

- It can demonstrate that all orders for all customers have been executed and fulfilled at the price initially quoted on the trading platform when the order was placed;[9] and
- No authority exists, pursuant to a contract, agreement, or otherwise, to adjust customer accounts in a manner that would have the direct or indirect effect of changing the price at which an order was executed.[10]

Members and Associates may not solicit customers based on the leverage available unless they balance any discussion regarding the advantages of leverage with an equally prominent contemporaneous disclosure that increasing leverage increases risk.

No Member shall use or directly benefit from any radio or television advertisement that recommends specific forex transactions or describes the extent of any profit obtained in the past or that can be obtained in the future unless the member submits the advertisement to NFA's Promotional Material Review Team for its review and approval at least 10 days prior to its first use or such shorter period as NFA may allow.[11]

Every Member should adopt and enforce written procedures to supervise communications with potential and current customers and promotional material. A supervisory employee that is, or is under the ultimate supervision of, a listed principal who is also an NFA Associate should review and approve all promotional material and make a written record of such review and approval.[12]

All promotional material should be maintained by each Member and be available for examination for the periods specified in the recordkeeping section of this notice, measured from the date of last use.

6. *Know Your Customer* - Members and Associates have a duty to acquaint themselves sufficiently with the personal and financial circumstances of each forex customer to determine what further facts, explanations and disclosures are needed in order for the customer to make an informed decision on whether to enter into forex transactions.

Every Member should determine what information it will obtain from a prospective forex customer. At a minimum, the Member soliciting the customer to engage in forex transactions should obtain the customer's name, address, principal occupation or business, current estimated annual income and net worth, approximate age, and an indication of the customer's previous investment and trading experience. Members and their Associates need to ensure that each customer they solicit has received adequate information concerning the risks of forex transactions so that the customer can make an informed decision as to whether forex transactions are appropriate for the customer. These obligations fall on the Forex Dealer Member when a non-Member solicits the customer.

7. *Doing Business with Non-Members* - Forex Dealer Members are subject to discipline for the activities of most non-Members who solicit or introduce forex customers to the Forex Dealer Member or manage accounts for those customers.

If a customer is solicited or introduced by a non-Member of NFA, or if the customer's account is managed by a non-Member, the Forex Dealer Member is subject to discipline for the non-Member's conduct if that conduct would violate NFA requirements when engaged in by an NFA Member. In other words, a Forex Dealer Member is subject to an NFA disciplinary action for the non-Member's activities when soliciting,

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introducing, or managing accounts for the Forex Dealer Member's customers even if the non-Member was not the Forex Dealer Member's agent.

The rule allows NFA to bring a disciplinary action even if the Forex Dealer Member acts diligently and has no knowledge of the third-party's conduct. As a practical matter, however, NFA will not take disciplinary action unless the Forex Dealer Member knew or should have known of the third-party's conduct or failed to exercise due diligence when establishing and maintaining the relationship with the third party.

A Forex Dealer Member should adopt and enforce written procedures to review the activities of non-Member third parties. The procedures should include, among other things, a regular review of the trading being conducted in the accounts solicited, introduced, or managed by these non-Members. The Member should also have procedures for following up on any customer complaints received by the firm, including a written description of the investigation made by the Member and any resolution of the complaint. Further, supervisory procedures should include a regular review of all promotional material used by any non-Member third-party. The member should maintain copies of all promotional materials reviewed, along with a written record of the review conducted and any deficiencies corrected, and make them available for examination for the periods specified in the recordkeeping section of this notice. A supervisory employee that is, or is under the ultimate supervision of, a listed principal who is also an NFA Associate should conduct the review of the non-Member's activities.

The Forex Dealer Member is not subject to discipline for the actions of non-Members who are described in NFA Bylaw 306(b). It is also not subject to discipline for the actions of non-Members who would be exempt from Commission registration if they were acting in the same capacity in connection with exchange-traded futures contracts, such as foreign persons that solicit, introduce, or manage accounts for foreign customers only.[13] The Forex Dealer Member does, of course, have certain basic duties to its customers, including a duty to supervise its own activities in a way designed to ensure that it treats its customers fairly. Specifically, the Forex Dealer Member would violate this duty if it has actual or constructive notice that one of these entities engaged in fraudulent conduct and fails to take appropriate action.

8. *Affiliates* - Forex Dealer Members must supervise and are subject to discipline for the activities of affiliates that are authorized to engage in forex transactions solely by virtue of their affiliation with a Forex Dealer Member.

The CEA authorizes affiliates of FCMs to act as counterparties to forex transactions if the affiliate directly or indirectly controls, is controlled by, or is under common control with the FCM and the FCM makes and keeps records regarding the financial activities of the affiliate for purposes of the Commission's risk assessment requirements.[14] If a Forex Dealer Member has one or more affiliates that act as counterparty to forex customers solely on the basis of that affiliation, the Forex Dealer Member must supervise the affiliate's forex activities and is subject to discipline for that affiliate's activities.[15] The Forex Dealer Member must also make these affiliates' books and records available to NFA upon request. Additionally, the Forex Dealer Member must assure that its affiliates do not act as counterparties to forex transactions unless they are authorized to do so under the Act.

9. *BASIC Disclosure* - Members must provide forex customers with information on NFA's BASIC system.

NFA Compliance Rule 2-36(g) requires Forex Dealer Members to provide customers with written information regarding NFA's Background Affiliation Status Information Center (BASIC), including the web site address [16]. This information must be provided when the customer first opens an account and at least once a year thereafter.

Forex Dealer Members may provide the information electronically but must do it in a way that ensures each customer is aware of it. For example, merely having the information on the Member's web site is not adequate, but sending customers an e-mail including a link to that information and explaining what the link is would be sufficient in most circumstances.

10. *Discretion* - No Forex Dealer Member, or Associate of a Forex Dealer Member acting in such capacity, may exercise discretionary trading authority over a customer account for which the Forex Dealer Member is, or is offering to be, the counterparty to the transactions in the customer account.

C. OTHER REQUIREMENTS

This section of the notice provides guidance on dues, capital requirements, and security deposits. These requirements apply only to Forex Dealer Members.

1. Bylaw 1301

NFA Bylaw 1301(e) requires Forex Dealer Members to pay annual dues that are graduated according to the firm's gross annual revenue from customers (e.g., commissions, mark-ups, mark-downs) for its forex activities. Profits and losses from proprietary trades are *not* to be included. To calculate dues:

- Start with the FCM dues imposed by NFA Bylaw 1301(b)(ii);
- Add $44,375 if the Forex Dealer Member's gross annual revenue from forex transactions is $500,000 or less;
- Add $69,375 if the Forex Dealer Member's gross annual revenue from forex transactions is more than $500,000, but not more than $2,000,000;
- Add $94,375 if the Forex Dealer Member's gross annual revenue from forex transactions is more than $2,000,000, but not more than $5,000,000; or
- Add $119,375 if the Forex Dealer Member's gross annual revenue from these activities is more than $5,000,000.

The following table shows the dues to be assessed for Forex Dealer Members:

Amount of annual Gross Revenue From Forex Transactions	Dues if NFA is the DSRO	Dues if NFA is not the DSRO
$500,000 or less	$50,000	$45,875
More than $500,000, but not more than $2 million	$75,000	$70,875

More than $2 million, but not more than $5 million	$100,000	$95,875
More than $5 million	$125,000	$120,875

These dues apply when the Forex Dealer Member offers to be a counterparty to a forex transaction or accepts a forex trade (whichever is earlier), and NFA will send the Member an invoice for the minimum dues ($50,000 or $45,875) minus any amount already paid for that membership year. Thereafter, the dues will be assessed on the firm's membership renewal date and will be based on the Forex Dealer Member's latest certified financial statement.

The only exception to the dues set forth above is a situation in which NFA does not serve as the DSRO for a Forex Dealer Member and the DSRO has agreed to examine the Forex Dealer Member's forex activities. In this case, the surcharge paid by the Forex Dealer Member, regardless of gross annual revenue, is $12,000. Accordingly, for such a Forex Dealer Member the dues to be assessed at the time it offers to be a counterparty to a forex transaction or accepts a forex trade (whichever is earlier), and on its membership renewal date thereafter, will be $13,500.

Under NFA Compliance Rule 2-36(d), a Forex Dealer Member is subject to discipline for the activities of any person that solicits or introduces a customer to the Member or manages a customer's account unless that person is a Member or Associate of NFA, is otherwise regulated based on the criteria in Bylaw 306(b), or would be exempt from CFTC registration if it were acting in the same capacity in connection with exchange-traded futures contracts. Any Forex Dealer Member that is responsible under Compliance Rule 2-36(d) for solicitors and account managers is required to pay a separate annual fee on the firm's annual renewal date based on the number of unregulated solicitors and account managers. In determining whether this fee applies, the Forex Dealer Member should take the highest number of separate legal entities, including individuals acting as sole proprietors, that it was responsible for at any one time during the year. The following table shows this graduated fee.

Number of Unregulated Entities	Annual Fee
0	$ 0
1-4	$ 5,000
5-19	$10,000
20-99	$25,000
100 or more	$50,000

Each Forex Dealer Member is also required to pay an assessment of .0001% on the notional value of each forex transaction (as forex is defined in Bylaw 1507(b)). This equates to $.01 for each $10,000. For transactions with a notional value less than $10,000, the firm may aggregate separate transactions and pay $.01 on each multiple of $10,000. For transactions of $10,000 or above, the firm should round to the nearest cent.

This assessment is due only on initiating transactions. There is no assessment on rollovers, offsetting transactions, option expirations, or option exercises that do not result in new positions. The Member must remit the assessment to NFA within 30 days after the end of the month in which the transaction was initiated.

2. Financial Requirements Section 11(a)

Forex Dealer Members must maintain adjusted net capital equal to or in excess of the greatest amount specified in subsections (a)(i), (a)(ii), and (a)(iii) (if applicable). Subsection (a)(ii) applies to Forex Dealer Members that execute any customer transactions other than by using straight-through-processing and that also have liabilities to customers of more than $10 million. Where it applies, the Member's capital requirement is the minimum capital required by subsection (a)(i) plus 5% of the liabilities over $10 million. The formula is:

Amount required by (a)(i) + .05(customer liabilities - $10,000,000)

For example, if the minimum capital requirement is $20 million, a Forex Dealer Member that operates a dealing desk and has $208 million in liabilities to customers would be required to maintain adjusted net capital equal to or in excess of $29.9 million.

Forex Dealer Members with over $10 million in customer liabilities are subject to this alternative requirement unless they execute all customer transactions using straight-through-processing. Straight-through-processing refers to platforms that automatically (without human intervention and without exception) enter into an identical but opposite transaction with another counterparty, creating an offsetting position in the Forex Dealer Member's own name. A Forex Dealer Member that offers several platforms will be exempt from this requirement only if each platform executes all customer orders using straight-through-processing.

This requirement that all customer trades be executed by straight-through-processing is not, however, meant to limit a firm's ability to provide for other methods in its disaster recovery procedures. As long as those other methods are used only when dictated by those procedures and both the procedures and the firm's trading platform are designed to ensure that the need will rarely arise, the FDM will not lose its exemption by implementing other execution methods in disaster recovery situations.

3. Financial Requirements Section 11(b)

Section 11(b) prohibits a Forex Dealer Member from including assets held by an affiliate (unless approved) or an unregulated person in the firm's current assets for purposes of determining its adjusted net capital under CFTC Rule 1.17. This means an FDM may not count any part of those assets for capital purposes.[17]

An unregulated person is any person that is **not**:

(i) a financial institution regulated by a U.S. banking regulator;

(ii) a broker-dealer registered with the U.S. Securities and Exchange Commission and a member of FINRA;

(iii) a futures commission merchant registered with the U.S. Commodity Futures Trading Commission and a Member of NFA;

(iv) an insurance company regulated by any U.S. state;

(v) an entity regulated as a foreign equivalent of any of the above if regulated in a money center country as defined in CFTC Regulation 1.49; or

(vi) any other entity approved by NFA.

Effective October 1, 2010, the above paragraph will read as follows:

An unregulated person is any person that is **not**:

(i) a financial institution regulated by a U.S. banking regulator;

(ii) a broker-dealer registered with the U.S. Securities and Exchange Commission and a member of FINRA;

(iii) a futures commission merchant registered with the U.S. Commodity Futures Trading Commission and a Member of NFA;

(iv) a retail foreign exchange dealer registered with the U.S. Commodity Futures Trading Commission and a Member of NFA;

(v) an insurance company regulated by any U.S. state; or

(vi) any other entity approved by NFA.

Any Forex Dealer Member may ask NFA to approve an otherwise unregulated person for purposes of Financial Requirements Sections 11(b) and (c). In determining whether to approve an unregulated person that is not an affiliate, NFA will consider a number of factors, including:

- Whether the person is regulated in another jurisdiction and, if so, the type and extent of regulation;
- The person's capital; and
- The person's credit rating.

NFA's approval of a particular person means that all unaffiliated Forex Dealer Members may treat that person as regulated under Sections 11(b) and (c). NFA may also approve categories of counterparties (e.g., banks regulated in a particular jurisdiction or with a particular credit rating).

A Forex Dealer Member may not engage in Section 11(b) or (c) transactions with a regulated affiliate without NFA's approval. The Member may, however, ask NFA to authorize it to cover its positions with specified affiliates (including unregulated affiliates). An affiliate is any entity that controls, is controlled by, or is under common control with the Forex Dealer Member. The standards for approving affiliated persons are significantly higher than those for unaffiliated persons. For example, NFA will also consider:

- The parent company's and affiliated person's capital;
- Whether the parent company and the affiliated person are regulated entities;
- Whether the parent company will guarantee the obligations of the affiliated person (unless the parent company and the affiliated person are the same entity);
- The parent company's credit rating;
- Whether the affiliated person has strong risk-management policies to limit its value-at-risk; and
- For purposes of Section 11(c), whether the affiliated person limits the amount of offsetting transactions it enters into with unregulated counterparties.

4. Financial Requirements Section 11(c)

Section 11(c) prohibits Forex Dealer Members from using affiliates (unless approved) and unregulated persons to cover their foreign currency positions for purposes of CFTC Rule 1.17(c)(5).

The rule does not prohibit Forex Dealer Members from entering into positions with unregulated or unapproved counterparties. They may not, however, count positions with those counterparties when calculating their covered positions for purposes of CFTC Rule 1.17(c)(5).

For purposes of Section 11(c), Forex Dealer Members have four different types of counterparties. In particular:

- Account holders are those counterparties for whom it carries accounts and includes both retail customers and eligible contract participants.
- Trading partners are counterparties with whom the Member trades but who do not have accounts with the Member. For purposes of the calculations under Section 11(c), this category does not include affiliates (approved or unapproved) or regulated counterparties.
- Affiliates are entities that control, are controlled by, or are under common control with the Forex Dealer Member. For purposes of Section 11(c) only, this category does not include affiliates who have been approved by NFA under Section 11(b).
- Regulated entities are those counterparties that meet the definition in Section 11(b) and include entities-including affiliates-approved by NFA under that Section.

A Forex Dealer Member may net its exposure across account holders, across trading partners, and across affiliates, but it may not net its exposure between these categories. The Member may, however, net its exposure in any of these categories against regulated counterparties. Here is the information in chart form.

Type of Counterparty	Account Holders	Trading Partners	Affiliates	Regulated Entities
Account Holders	Yes	No	No	Yes
Trading Partners	No	Yes	No	Yes
Affiliates	No	No	Yes	Yes
Regulated Entities	Yes	Yes	Yes	Yes

A Forex Dealer Member is required to take a charge on the larger of its unnetted long or short position but not on both.

Example

Assume a Forex Dealer Member has the following Euro positions:

Type	**Long**	**Short**	**Net Long**	**Net Short**
Account Holders	11,154,912	6,011,794	5,143,118	
Trading Partners	4,987,345	7,299,886		2,312,541
Affiliates	3,790,754	2,640,553	1,150,201	
Regulated Entities	1,280,555	4,125,018		2,844,463

In determining the uncovered amount for purposes of the 6% haircut, the Forex Dealer Member can offset its net long position with account holders against the net short position with regulated entities but cannot offset its position with its trading partners or its position with unapproved affiliates against any category except regulated entities.

The math works this way (using only absolute numbers):

Net long position with account holders	5,143,118
Minus net short position with regulated entities	-2,844,463
	2,298,655
Uncovered long position with account holders	2,298,655
Plus net long position with affiliates	+1,150,201
Total uncovered long position	3,448,856
Net short position with trading partners	2,312,541
Larger of net long or short position	3,448,856
Haircut on Euros (3,448,856 X .06)	$206,931

5. Financial Requirements Section 12

Forex Dealer Members must collect security deposits from forex customers equal to 1% of the notional value of transactions in specified foreign currencies and 4% of the notional value of all other transactions. Where the two currencies are in different categories, the Forex Dealer Member must collect the higher amount. If the transaction pairs a foreign currency with the U.S. dollar, the security deposit is based on the foreign currency. If the transaction pairs a currency that qualifies for a 1% deposit with a currency that does not, the Forex Dealer Member must collect a 4% security deposit for the entire transaction. For example:

Currency Pair	Security Deposit
EUR/USD	1%
CND/JPY	1%
CND/BRL	4%
USD/MXN	4%
BRL/MXN	4%

For short options, the Forex Dealer Member must collect this amount plus the premium the customer received. For long options, the Forex Dealer Member must simply collect the entire premium from the customer.

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[1] The Board of Directors has declared that these transactions are a proper subject of NFA regulation and oversight under Article XVIII, paragraph (k).

[2] Compliance Rule 2-39 excludes these same entities when they introduce or manage forex accounts.

[3] Bylaw 306(b)(ii) excludes broker-dealers that are members of any fully-registered national securities association and FCMs that are members of another registered futures association. At this time, however, FINRA is the only fully-registered national securities association and NFA is the only registered futures association.

[4] These are affiliates of broker-dealers for which the broker-dealer makes and keeps records under the Securities and Exchange Commission's risk assessment requirements. See Section 17(h) of the Securities Exchange Act of 1934 and SEC Rule 17h-1T.

[5] See, for example, Compliance Rule 2-9: Supervision of Branch Offices and Guaranteed IBs, NFA Manual paragraph 9019; Compliance Rule 2-9: Supervisory Procedures for E-Mail and the Use of Web Sites, NFA Manual paragraph 9037; Compliance Rule 2-9: Supervision of the Use of Automated Order-Routing Systems, NFA Manual paragraph 9046. These interpretive notices do not directly apply to forex activities, but the principles included in these notices are equally applicable to those activities.

[6] The Commodity Futures Trading Commission has stated that all employees of an FCM who solicit or accept orders for forex transactions from retail customers must be registered with the Commission as an associated person of the FCM. See Division of Trading and Markets Advisory Concerning Foreign Currency Trading by Retail Customers (March 2002).

[7] The screening process should include 1) checking BASIC and any other readily available sources and 2) asking the third-party to represent that neither it nor any of its principals is subject to a statutory disqualification or to identify and explain any statutory disqualifications.

[8] Through interpretive notices issued under NFA Compliance Rule 2-29, NFA has provided Members with guidance on what activities are deceptive and misleading. See, for example, NFA Compliance Rule 2-29: Deceptive Advertising, NFA Manual paragraph 9033; NFA Compliance Rule 2-29: Deceptive Advertising, NFA Manual paragraph 9034; Compliance Rule 2-29: High Pressure Sales Tactics, NFA Manual paragraph 9038; and NFA Compliance Rules 2-29 and 2-9: NFA's Review and Approval of Certain Radio and television Advertisements, NFA Manual paragraph 9039. Although these interpretive notices do not directly apply to forex activities, the principles included in them with regard to what is deceptive or misleading are equally applicable to those activities.

[9] The Forex Dealer Member is not required to give the customer a price that is no longer reflected on the platform at the time the order reaches it. The Forex Dealer Member is not responsible for

transmission delays outside its control. If an Forex Dealer Member, however, advertises "no-slippage" or that it guarantees fill prices, it must prominently disclose that transmission delays might result in customer orders being executed at a price other than that seen by the customer.

[10] This includes *force majeure* provisions.

[11] Submission of promotional materials for NFA review is not a substitute for a Member's own responsibility to review promotional material. NFA staff will not independently verify the accuracy of statements made in an advertisement; that responsibility remains with the Member. Submitting promotional material to NFA will not provide a "safe harbor" from NFA actions for Members if misstatements or omissions of material fact are discovered subsequently or NFA otherwise later determines that the material is in violation of any applicable standards.

[12] Under traditional legal principles, Members can also be liable for promotional material promoting forex trading systems developed by third-parties. For example, a Member has direct responsibility for misleading promotional material if the Member prepares or distributes it; has agency responsibility if the system developer is an agent of the Member under established principles of agency law; and has supervisory responsibility if the Member fails to supervise its own employees when linking to a third-party trading system developer's web site, recommending a third-party's trading system, or entering into a referral agreement with a third-party system developer. See Interpretive Notice titled "NFA Bylaw 1101, Compliance Rules 2-9 and 2-29: Guidelines Relating to the Registration of Third-Party Trading System Developers and the Responsibility of NFA Members for Promotional Material That Promotes Third-Party Trading System Developers and their Trading Systems," NFA Manual, paragraph 9055.

[13] For this purpose, foreign persons and foreign customers are 1) natural persons who are not residents of the United States or 2) legal entities (other than passive investment vehicles) that are organized under the laws of a country other than the United States, do not have their principal place of business in the United States, and do not conduct their retail forex activities from a location in the United States. Those terms do not include a passive investment vehicle that is more than 10% owned by United States persons or that solicits United States persons who are not eligible contract participants as defined in Section 1a(12) of the Act. "United States" includes U.S. territories and possessions.

[14] See Sections 2(c)(2)(B)(ii)(III) and 4f(c)(2)(B) of the CEA and CFTC Regulations 1.14 and 1.15.

[15] Obviously, the Forex Dealer Member must also ensure that no entity with common ownership engages in the forex business unless it is authorized to do so.

[16] Forex Dealer Members can comply with this requirement by providing customers with a copy of NFA's brochure entitled "Background Affiliation Status Information Center (BASIC): An Information Resource for the Investing Public," which is available in print and on NFA's website at http://www.nfa.futures.org/.

[17] Where the CFTC's requirements for holding current assets are more stringent, those requirements apply.

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Compliance Rules

RULE 2-44. FOREX CUSTOMER STATEMENTS
[Adopted effective June 1, 2009.]

Forex Dealer Members must provide customers with confirmations, daily statements, and monthly statements as provided in this rule.

(a) Confirmations

Written confirmations must be provided to customers within one business day after any activity in the customer's account, including offsetting transactions, rollovers, deliveries, option exercises, option expirations, trades that have been reversed or adjusted, and monetary adjustments. The confirmations must contain the following information regarding the transaction and the funds in the account:

(1) Transaction date;
(2) Transaction type (e.g., new position, offsetting position, rollover, adjustment);
(3) Currency pair
(4) Buy or sell (if a new or offsetting position);
(5) Size
(6) Price or premium (for new or offsetting positions or price adjustments);
(7) Price or premium change (for price adjustments);
(8) Monetary adjustments (debit or credit);
(9) Net profit or loss for offsetting positions; and
(10) Charges for each transaction (e.g., rollover interest and/or fees).

(b) Daily Statements

Daily statements must show the account equity as of the end of the previous day. The daily statements may be provided electronically as long as they are readily accessible to customers. The daily statements may be combined with the confirmations but, in that event, they may not be provided electronically without the customer's consent.

(c) Monthly or Quarterly Statements

Monthly statements are required for all accounts that have open positions at the end of the month or changes in the account balance or equity since the prior statement. Quarterly statements are required for all other open accounts. The monthly or quarterly statements must contain the following information regarding the transactions during the reporting period and the funds in the account:

(1) The account equity at the beginning of the reporting period;
(2) All initiating or offsetting transactions, deliveries, option exercises, or option expirations that occurred during the reporting period, with the following information for each: date, currency pair, buy or sell, size, and price or premium (with any price or premium adjustment noted);
(3) All open positions in the account, with the following information for each position: date initiated, currency pair, long or short, size, price or premium at which it was initiated (with any price or premium adjustment noted), and the unrealized profit or loss;
(4) All deposits and withdrawals during the reporting period;
(5) All other monetary adjustments (debits and credits) to the account;
(6) The amount of cash in the account (excluding non-cash collateral and unrealized profits and losses);
(7) A breakdown by type of all fees and charges during the period, including commissions and interest expense or rollover fees; and
(8) The account equity at the end of the reporting period.

(d) Options

For options transactions, Forex Dealer Members must provide the following additional information:

(1) On confirmations and monthly or quarterly statements, strike price and expiration date; and
(2) For open positions on monthly or quarterly statements, the value of the option marked to the market.

(e) Account Equity

Each daily, monthly, or quarterly statement must prominently display the account equity. The account equity is the sum of all realized profits and losses, all unrealized profits and losses, and any other cash and collateral in the account.

(f) Electronic Delivery

Daily statements may be provided on-line or by other electronic means as long as they are readily accessible to customers. Confirmations and monthly/quarterly statements may be provided on-line or transmitted by other electronic means if the customer consents to the specific method used.

(g) Adjustments

For purposes of this Rule, the term "adjustment" means any change to the price or premium of an initiating or offsetting transaction and any debit or credit to the account that has the same effect (monetary adjustment).

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NFA Manual / Rules

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Interpretive Notices

9053 - FOREX TRANSACTIONS

(Revised November 9, 2004; June 13, 2005; September 15, 2005; November 30, 2005; April 30, 2006; July 31, 2006; October 1, 2006; February 13, 2007; March 7, 2007; March 9, 2007; March 31, 2007; May 7, 2007; June 5, 2007; July 1, 2007; September 21, 2007; October 1, 2007; October 25, 2007; December 17, 2007; December 21, 2007; June 1, 2008; July 1, 2008; October 31, 2008; April 1, 2009; June 1, 2009; November 30, 2009; and December 17, 2009.)

INTERPRETIVE NOTICE

The Commodity Exchange Act (CEA or Act) gives the Commodity Futures Trading Commission (CFTC or Commission) limited jurisdiction over off-exchange foreign currency transactions offered to or entered into with retail customers. As a result of those provisions, certain firms primarily engaged in the retail forex business have registered with the CFTC and become Members of NFA. NFA has adopted several requirements to govern the conduct of these firms and their associated persons.

As described below, NFA Bylaw 306 creates a Forex Dealer Member category for certain NFA Members who act as counterparties to forex transactions with retail customers. This category allows NFA to exercise appropriate regulatory jurisdiction over the retail forex activities of these Members without imposing unnecessary, and potentially duplicative, regulatory burdens on Members that are otherwise subject to regulatory oversight for their activities.

NFA Bylaw 1507(b) defines forex as foreign currency futures and options and any other agreement, contract, or transaction in foreign currency that is offered or entered into on a leveraged or margined basis, or financed by the offeror, the counterparty, or a person acting in concert with the offeror or counterparty on a similar basis that are:

- offered to or entered into with persons that are not eligible contract participants as defined in Section 1a(12) of the Act (retail customers); and
- not executed on or subject to the rules of a contract market, a derivatives transaction execution facility, a national securities exchange registered pursuant to Section 6(a) of the Securities Exchange Act of 1934, or a foreign board of trade.[1]

Bylaw 1507(b) also excludes the following from the forex definition if the transaction is not a futures or options contract:

- securities (other than security futures products);
- any contract of sale that results in actual delivery within two days; and
- any contract of sale that creates an enforceable obligation to deliver between a seller and buyer that have the ability to deliver and accept delivery, respectively, in connection with their line of business.

Given the differences between off-exchange transactions and traditional exchange-traded futures and options, the Board of Directors does not believe that it is appropriate to apply the full array of NFA's futures rules to forex transactions. Therefore, rather than simply incorporating forex transactions into the definition of "futures," NFA adopted NFA Compliance Rule 2-36 to govern these transactions.

In developing its forex requirements, NFA's primary concern was to ensure that they provide adequate protection for retail customers without imposing undue burdens on NFA Members. NFA also believes that its requirements should, where consistent with customer protection, promote innovation and competition. In order to provide Members with as much flexibility as possible, NFA has chosen to deal with a number of issues by providing guidance under NFA Compliance Rule 2-36 instead of by adopting additional rules.

NFA Compliance Rule 2-36 sets out the general standards that apply to Forex Dealer Members and their Associates in connection with forex transactions. Subsection (b) prohibits Forex Dealer Members and their Associates from engaging in fraudulent activities, subsection (c) requires Forex Dealer Members and their Associates to observe high standards of commercial honor and just and equitable principles of trade in connection with their forex business, and subsection (e) requires Forex Dealer Members and their Associates with supervisory duties to supervise their employees and agents. Other subsections address a Forex Dealer Member's responsibility for its unregulated affiliates and third-party solicitors and make Forex Dealer Members subject to discipline for the conduct of certain non-Members with which they do business.

This notice has three sections. The first section explains who qualifies as a Forex Dealer Member under NFA Bylaw 306, the second section provides additional guidance about the requirements in Compliance Rule 2-36, and the third section covers other miscellaneous requirements.

A. BYLAW 306

In general, Forex Dealer Members are NFA Members who act as counterparties to forex transactions. This is a self-executing requirement, which means that any Member who qualifies is automatically a Forex Dealer Member. There is no application form and no approval requirement.

Members who do not act as counterparties are not Forex Dealer Members, even if they introduce or manage forex accounts. Under NFA Compliance Rule 2-39, however, most Members who introduce or manage forex accounts are required to comply with subsections (a), (b), (c), and (e) of NFA Compliance Rule 2-36.

Bylaw 306(b) excludes Members that are otherwise subject to regulatory oversight for their forex activities, which means that these Members are not Forex Dealer Members and do not have to comply with Compliance Rule 2-36. [2] The exclusions mostly follow Section 2(c)(2)(B)(ii) of the CEA, although the exclusions for broker-dealers and their affiliates are conditioned on the Financial Industry Regulatory Authority ("FINRA") membership. In particular, the following entities are not Forex Dealer Members:

- financial institutions (e.g., banks and savings associations);
- certain insurance companies and their regulated subsidiaries or affiliates;
- financial holding companies;
- investment bank holding companies;
- registered broker-dealers that are members of FINRA;[3] and
- Material Associated Persons of registered broker-dealers that are members of FINRA.[4]

B. COMPLIANCE RULE 2-36

As noted above, this section provides additional guidance on what Compliance Rule 2-36 requires. Certain sections specifically refer to Forex Dealer Members. Except for Members that meet the criteria in Bylaw 306(b), all other provisions of this notice also apply to Members and their Associates who solicit, introduce or manage forex accounts.

1. *Disclosure* - Members must provide forex customers with understandable and timely disclosure on essential features of forex trading.

At or before the time a customer first engages in a forex transaction, a Forex Dealer Member and its Associates should provide the customer sufficient information concerning the characteristics and particular risks of entering into forex transactions. Members and Associates introducing or managing accounts should know what information has been provided and should supplement it when necessary.

This information must include the following statement prominently displayed:

> The transactions you are entering into with [Member] are not traded on an exchange. Therefore, under the U.S. Bankruptcy Code, your funds may not receive the same protections as funds used to margin or guarantee exchange-traded futures and options contracts, which receive a priority in bankruptcy. Since that same priority has not been given to funds used for off-exchange forex trading, if [Member] becomes insolvent and you have a claim for amounts deposited or profits earned on transactions with [Member], your claim may not receive a priority. Without a priority, you are a general creditor and your claim will be paid, along with the claims of other general creditors, from any monies still available after priority claims are paid. Even customer funds that [Member] keeps separate from its own operating funds may not be safe from the claims of other general and priority creditors.

At or before the time a customer first engages in a forex transaction, a Member and its Associates should disclose how the Member will be compensated for the services it will provide to the customer.

Additionally, a Forex Dealer Member must describe to the customer the nature of these foreign currency transactions. Therefore, a Forex Dealer Member must provide, and the customer must separately acknowledge receipt of, either the following disclosure language or other appropriate language (based upon the Forex Dealer Member's business model) approved by NFA staff, which must be prominently displayed in all uppercase letters and in 10 point size type or larger but in any event no smaller than any surrounding type:

> THE FOREIGN CURRENCY TRADING YOU ARE ENTERING INTO IS NOT CONDUCTED ON AN EXCHANGE. [MEMBER] IS ACTING AS A COUNTERPARTY IN THESE TRANSACTIONS AND, THEREFORE, ACTS AS THE BUYER WHEN YOU SELL AND THE SELLER WHEN YOU BUY. AS A RESULT, [MEMBER]'S INTERESTS MAY BE IN CONFLICT WITH YOURS. UNLESS OTHERWISE SPECIFIED IN YOUR WRITTEN AGREEMENT OR OTHER WRITTEN DOCUMENTS [MEMBER] ESTABLISHES THE PRICES AT WHICH IT OFFERS TO TRADE WITH YOU. THE PRICES [MEMBER] OFFERS MIGHT NOT BE THE BEST PRICES AVAILABLE AND [MEMBER] MAY OFFER DIFFERENT PRICES TO DIFFERENT CUSTOMERS.
>
> IF [MEMBER] ELECTS NOT TO COVER ITS OWN TRADING EXPOSURE, THEN YOU SHOULD BE AWARE THAT [MEMBER] MAY MAKE MORE MONEY IF THE MARKET GOES AGAINST YOU. ADDITIONALLY, SINCE [MEMBER] ACTS AS THE BUYER OR SELLER IN THE TRANSACTION, YOU SHOULD CAREFULLY EVALUATE ANY TRADE RECOMMENDATIONS YOU RECEIVE FROM [MEMBER] OR ANY OF ITS SOLICITORS.

Forex Dealer Members should provide both the bid and the offer when the customer enters an order.

Members should update any material information that has changed prior to entering into new transactions with current customers if failing to update the information would make it misleading.

2. *Reporting* - Forex Dealer Members must provide forex customers with timely and accurate notice of the status of their accounts.

Forex Dealer Members should provide written confirmations within one business day after any activity in the customer's account, including offsetting transactions, rollovers, deliveries, option exercises, option expirations, trades that have been reversed or adjusted, and monetary adjustments. The confirmation should include the information required by Compliance Rule 2-44.

Forex Dealer Members should provide regular monthly statements showing all forex transactions and other account activity to customers for all accounts that have open positions at the end of the month or changes in the account balance or equity since the prior statement. Forex Dealer

Members should provide statements at least quarterly for all other open accounts. The monthly or quarterly statements should include the information required by Compliance Rule 2-44.

Confirmations and monthly/quarterly statements may be provided on-line or transmitted by other electronic means if the customer consents to the specific method used.

3. *Supervision* - Members and their Associates having supervisory responsibilities must diligently supervise the Member's forex business, including the activities of the Member's Associates and agents. Members must establish, maintain, and enforce written supervisory procedures.

NFA has provided Members with guidance on minimum standards of supervision through interpretive notices issued under NFA Compliance Rule 2-9.[5] In these interpretive notices NFA recognized that, given the differences in the size of and complexity of the operations of NFA Members, there must be some degree of flexibility in determining what constitutes "diligent supervision" for each firm. This principle also applies to the supervision of a Member's forex business.

Although Members have the flexibility to design procedures that are tailored to their own situation, an adequate program for supervision would include procedures for performing day-to-day monitoring. These procedures would include:

- screening employees who will solicit transactions from or provide advice to customers or manage customer accounts to see if they are subject to any of the statutory disqualifications in Section 8a of the CEA and, if so, to determine the extent of supervision they will require;
- monitoring communications with the public, including sales solicitations and web sites, and approving promotional material;
- reviewing the information obtained from and the information provided to customers solicited by the firm and its employees to ensure that the necessary account information has been obtained and the appropriate information provided; and
- handling and resolving customer complaints.

For Forex Dealer Members, these procedures would also include:

- screening prospective Associates to ensure that they are registered with the Commodity Futures Trading Commission as associated persons;[6]
- screening persons who introduce customer business or manage customer accounts to see if the firm or any of its principals is subject to a statutory disqualification under Section 8a of the CEA and, if so, determining if the Forex Dealer Member should perform additional due diligence on that person;[7]
- reviewing disclosures given to customers to ensure they are understandable, timely, and provide sufficient information;
- reviewing and analyzing the forex activity in customer accounts, including discretionary customer accounts; and
- handling customer funds, including accepting security deposits.

A Forex Dealer Member and a listed principal that is also a registered associated person (see Financial Requirements 15(c)) must supervise the preparation of a Forex Dealer Member's financial books and records. Diligent supervision includes hiring and retaining qualified staff. In determining whether an individual responsible for preparing the Member's financial books and records is qualified, the firm and its financial principal should consider the following:

- Is the individual qualified for the position by experience or training?
- Does the individual exercise independent judgment?
- Has the individual ever been sanctioned or refused membership or licensing by NFA, the CFTC, the SEC, NASD or FINRA, the Public Company Accounting Oversight Board, or any other financial regulator?
- Has the individual ever been sanctioned or refused membership by the American Institute of Certified Public Accountants or any other accounting organization?
- Has any firm for which the individual performed auditing, accounting, or bookkeeping been subject to an emergency action or sanctioned by NFA, the CFTC, the SEC, NASD or FINRA, the Public Company Accounting Oversight Board, or any other financial regulator for failure to comply with financial requirements or for having inadequate books and records while the individual was engaged in those activities?
- Are there any pending actions against the individual or a firm for which the individual performed auditing, accounting, or bookkeeping?

This is not an exclusive list. If the individual or a firm for which the individual worked (either as an independent contractor or an employee) was subject to an emergency action, sanctioned by a financial regulator, or is subject to a pending action, the FDM and the listed principal/registered AP responsible for the FDM's financial books and records should consider the nature and seriousness of the conduct (or alleged conduct) and the individual's role in it. An NFA Member Responsibility Action or an emergency action by another financial regulator is always an extremely serious matter.

The Forex Dealer Member and its financial principal must also conduct due diligence and consider analogous information when selecting an independent public accountant to certify the firm's annual financial statements.

An adequate supervisory program should also include periodic on-site visits to branch offices, guaranteed introducing brokers, and otherwise unregulated affiliates that conduct forex business on behalf of the Member. The Member needs to determine the frequency and nature of these visits. The number of visits will depend on the amount of business generated, the number of customer complaints received, the training and experience of the office personnel, and the frequency and nature of problems that arise from the office.

Finally, a Member's supervisory responsibilities include the obligation to ensure that its employees are properly trained to perform their duties. The formality of a training program will depend on the size of the firm and the nature of its business. Procedures should be in place to ensure that supervisory personnel know and understand the firm's supervisory procedures and that employees receive adequate training to abide by NFA requirements and to properly handle customer accounts.

4. *Recordkeeping* - Members must keep books and records relating to their forex operations for a period of five years from the date thereof and shall keep them readily accessible during the first 2 years of the 5-year period. All such books and records shall be open to inspection by NFA.

Members should adopt and enforce reasonable procedures to create current and accurate books and records and to keep them from being

altered or destroyed. Such records must include, among other things, financial records substantiating a Members assets and liabilities, including liabilities owed to customers and receivables from other persons. The Member should be able to promptly produce its records in a format that NFA can read and reproduce.

Forex Dealer Members should adopt and enforce a written policy detailing the procedures it follows to calculate rollover or interest charges and payments. The policy must include the factors that are considered as well as the names of any sources for these factors. The Member should document the underlying factors reviewed in completing the calculation, including any related transactions entered into by the Forex Dealer Member, so it can be replicated.

5. *Communications with the Public and Promotional Material* - No Member or Associate shall make any communication with potential or current customers that operates as a fraud or deceit; uses a high-pressure approach; or implies that forex transactions are appropriate for all persons.

Promotional material used by the Member or Associate shall not:

- Deceive the public or contain any material misstatement of fact or omit a fact that makes the promotional material misleading;[8]
- Include any statements of opinion unless they are clearly identified as such and have a reasonable basis in fact;
- Mention the possibility of profit unless accompanied by an equally prominent statement of the risk of loss;
- Include any reference to actual past trading profits without mentioning that past results are not necessarily indicative of future results;
- Include any statistical or numerical information about past performance of actual accounts unless the Member can demonstrate that the performance is representative of actual performance of all reasonably comparable accounts for the same period (calculated in accordance with the formula in CFTC Regulation 4.35(a)(6) and NFA Compliance Rule 2-34); or
- Include testimonials unless they are representative of all reasonably comparable accounts, the material prominently states that the testimonial is not indicative of future performance or success, and the material prominently states that they are paid testimonials (if applicable).

No Member or Associate may represent that forex funds deposited with a Forex Dealer Member are given special protection under the bankruptcy laws. No Member or Associate may represent or imply that any assets necessary to satisfy its obligations to customers are more secure because the Member keeps some or all of those assets at a regulated entity in the United States or a money center country.

No Member or Associate may represent that its services are commission free without prominently disclosing how it is compensated in near proximity to that representation.

No Member or Associate may represent that it offers trading with "no-slippage" or that it guarantees the price at which a transaction will be executed or filled, unless:

- It can demonstrate that all orders for all customers have been executed and fulfilled at the price initially quoted on the trading platform when the order was placed;[9] and
- No authority exists, pursuant to a contract, agreement, or otherwise, to adjust customer accounts in a manner that would have the direct or indirect effect of changing the price at which an order was executed.[10]

Members and Associates may not solicit customers based on the leverage available unless they balance any discussion regarding the advantages of leverage with an equally prominent contemporaneous disclosure that increasing leverage increases risk.

No Member shall use or directly benefit from any radio or television advertisement that recommends specific forex transactions or describes the extent of any profit obtained in the past or that can be obtained in the future unless the member submits the advertisement to NFA's Promotional Material Review Team for its review and approval at least 10 days prior to its first use or such shorter period as NFA may allow.[11]

Every Member should adopt and enforce written procedures to supervise communications with potential and current customers and promotional material. A supervisory employee that is, or is under the ultimate supervision of, a listed principal who is also an NFA Associate should review and approve all promotional material and make a written record of such review and approval.[12]

All promotional material should be maintained by each Member and be available for examination for the periods specified in the recordkeeping section of this notice, measured from the date of last use.

6. *Know Your Customer* - Members and Associates have a duty to acquaint themselves sufficiently with the personal and financial circumstances of each forex customer to determine what further facts, explanations and disclosures are needed in order for the customer to make an informed decision on whether to enter into forex transactions.

Every Member should determine what information it will obtain from a prospective forex customer. At a minimum, the Member soliciting the customer to engage in forex transactions should obtain the customer's name, address, principal occupation or business, current estimated annual income and net worth, approximate age, and an indication of the customer's previous investment and trading experience. Members and their Associates need to ensure that each customer they solicit has received adequate information concerning the risks of forex transactions so that the customer can make an informed decision as to whether forex transactions are appropriate for the customer. These obligations fall on the Forex Dealer Member when a non-Member solicits the customer.

7. *Doing Business with Non-Members* - Forex Dealer Members are subject to discipline for the activities of most non-Members who solicit or introduce forex customers to the Forex Dealer Member or manage accounts for those customers.

If a customer is solicited or introduced by a non-Member of NFA, or if the customer's account is managed by a non-Member, the Forex Dealer Member is subject to discipline for the non-Member's conduct if that conduct would violate NFA requirements when engaged in by an NFA Member. In other words, a Forex Dealer Member is subject to an NFA disciplinary action for the non-Member's activities when soliciting,

introducing, or managing accounts for the Forex Dealer Member's customers even if the non-Member was not the Forex Dealer Member's agent.

The rule allows NFA to bring a disciplinary action even if the Forex Dealer Member acts diligently and has no knowledge of the third-party's conduct. As a practical matter, however, NFA will not take disciplinary action unless the Forex Dealer Member knew or should have known of the third-party's conduct or failed to exercise due diligence when establishing and maintaining the relationship with the third party.

A Forex Dealer Member should adopt and enforce written procedures to review the activities of non-Member third parties. The procedures should include, among other things, a regular review of the trading being conducted in the accounts solicited, introduced, or managed by these non-Members. The Member should also have procedures for following up on any customer complaints received by the firm, including a written description of the investigation made by the Member and any resolution of the complaint. Further, supervisory procedures should include a regular review of all promotional material used by any non-Member third-party. The member should maintain copies of all promotional materials reviewed, along with a written record of the review conducted and any deficiencies corrected, and make them available for examination for the periods specified in the recordkeeping section of this notice. A supervisory employee that is, or is under the ultimate supervision of, a listed principal who is also an NFA Associate should conduct the review of the non-Member's activities.

The Forex Dealer Member is not subject to discipline for the actions of non-Members who are described in NFA Bylaw 306(b). It is also not subject to discipline for the actions of non-Members who would be exempt from Commission registration if they were acting in the same capacity in connection with exchange-traded futures contracts, such as foreign persons that solicit, introduce, or manage accounts for foreign customers only.[13] The Forex Dealer Member does, of course, have certain basic duties to its customers, including a duty to supervise its own activities in a way designed to ensure that it treats its customers fairly. Specifically, the Forex Dealer Member would violate this duty if it has actual or constructive notice that one of these entities engaged in fraudulent conduct and fails to take appropriate action.

8. *Affiliates* - Forex Dealer Members must supervise and are subject to discipline for the activities of affiliates that are authorized to engage in forex transactions solely by virtue of their affiliation with a Forex Dealer Member.

The CEA authorizes affiliates of FCMs to act as counterparties to forex transactions if the affiliate directly or indirectly controls, is controlled by, or is under common control with the FCM and the FCM makes and keeps records regarding the financial activities of the affiliate for purposes of the Commission's risk assessment requirements.[14] If a Forex Dealer Member has one or more affiliates that act as counterparty to forex customers solely on the basis of that affiliation, the Forex Dealer Member must supervise the affiliate's forex activities and is subject to discipline for that affiliate's activities.[15] The Forex Dealer Member must also make these affiliates' books and records available to NFA upon request. Additionally, the Forex Dealer Member must assure that its affiliates do not act as counterparties to forex transactions unless they are authorized to do so under the Act.

9. *BASIC Disclosure* - Members must provide forex customers with information on NFA's BASIC system.

NFA Compliance Rule 2-36(g) requires Forex Dealer Members to provide customers with written information regarding NFA's Background Affiliation Status Information Center (BASIC), including the web site address [16]. This information must be provided when the customer first opens an account and at least once a year thereafter.

Forex Dealer Members may provide the information electronically but must do it in a way that ensures each customer is aware of it. For example, merely having the information on the Member's web site is not adequate, but sending customers an e-mail including a link to that information and explaining what the link is would be sufficient in most circumstances.

10. *Discretion* - No Forex Dealer Member, or Associate of a Forex Dealer Member acting in such capacity, may exercise discretionary trading authority over a customer account for which the Forex Dealer Member is, or is offering to be, the counterparty to the transactions in the customer account.

C. OTHER REQUIREMENTS

This section of the notice provides guidance on dues, capital requirements, and security deposits. These requirements apply only to Forex Dealer Members.

1. Bylaw 1301

NFA Bylaw 1301(e) requires Forex Dealer Members to pay annual dues that are graduated according to the firm's gross annual revenue from customers (e.g., commissions, mark-ups, mark-downs) for its forex activities. Profits and losses from proprietary trades are *not* to be included. To calculate dues:

- Start with the FCM dues imposed by NFA Bylaw 1301(b)(ii);
- Add $44,375 if the Forex Dealer Member's gross annual revenue from forex transactions is $500,000 or less;
- Add $69,375 if the Forex Dealer Member's gross annual revenue from forex transactions is more than $500,000, but not more than $2,000,000;
- Add $94,375 if the Forex Dealer Member's gross annual revenue from forex transactions is more than $2,000,000, but not more than $5,000,000; or
- Add $119,375 if the Forex Dealer Member's gross annual revenue from these activities is more than $5,000,000.

The following table shows the dues to be assessed for Forex Dealer Members:

Amount of annual Gross Revenue From Forex Transactions	Dues if NFA is the DSRO	Dues if NFA is not the DSRO
$500,000 or less	$50,000	$45,875
More than $500,000, but not more than $2 million	$75,000	$70,875

More than $2 million, but not more than $5 million	$100,000	$95,875
More than $5 million	$125,000	$120,875

These dues apply when the Forex Dealer Member offers to be a counterparty to a forex transaction or accepts a forex trade (whichever is earlier), and NFA will send the Member an invoice for the minimum dues ($50,000 or $45,875) minus any amount already paid for that membership year. Thereafter, the dues will be assessed on the firm's membership renewal date and will be based on the Forex Dealer Member's latest certified financial statement.

The only exception to the dues set forth above is a situation in which NFA does not serve as the DSRO for a Forex Dealer Member and the DSRO has agreed to examine the Forex Dealer Member's forex activities. In this case, the surcharge paid by the Forex Dealer Member, regardless of gross annual revenue, is $12,000. Accordingly, for such a Forex Dealer Member the dues to be assessed at the time it offers to be a counterparty to a forex transaction or accepts a forex trade (whichever is earlier), and on its membership renewal date thereafter, will be $13,500.

Under NFA Compliance Rule 2-36(d), a Forex Dealer Member is subject to discipline for the activities of any person that solicits or introduces a customer to the Member or manages a customer's account unless that person is a Member or Associate of NFA, is otherwise regulated based on the criteria in Bylaw 306(b), or would be exempt from CFTC registration if it were acting in the same capacity in connection with exchange-traded futures contracts. Any Forex Dealer Member that is responsible under Compliance Rule 2-36(d) for solicitors and account managers is required to pay a separate annual fee on the firm's annual renewal date based on the number of unregulated solicitors and account managers. In determining whether this fee applies, the Forex Dealer Member should take the highest number of separate legal entities, including individuals acting as sole proprietors, that it was responsible for at any one time during the year. The following table shows this graduated fee.

Number of Unregulated Entities	Annual Fee
0	$ 0
1-4	$ 5,000
5-19	$10,000
20-99	$25,000
100 or more	$50,000

Each Forex Dealer Member is also required to pay an assessment of .0001% on the notional value of each forex transaction (as forex is defined in Bylaw 1507(b)). This equates to $.01 for each $10,000. For transactions with a notional value less than $10,000, the firm may aggregate separate transactions and pay $.01 on each multiple of $10,000. For transactions of $10,000 or above, the firm should round to the nearest cent.

This assessment is due only on initiating transactions. There is no assessment on rollovers, offsetting transactions, option expirations, or option exercises that do not result in new positions. The Member must remit the assessment to NFA within 30 days after the end of the month in which the transaction was initiated.

2. Financial Requirements Section 11(a)

Forex Dealer Members must maintain adjusted net capital equal to or in excess of the greatest amount specified in subsections (a)(i), (a)(ii), and (a)(iii) (if applicable). Subsection (a)(ii) applies to Forex Dealer Members that execute any customer transactions other than by using straight-through-processing and that also have liabilities to customers of more than $10 million. Where it applies, the Member's capital requirement is the minimum capital required by subsection (a)(i) plus 5% of the liabilities over $10 million. The formula is:

Amount required by (a)(i) + .05(customer liabilities - $10,000,000)

For example, if the minimum capital requirement is $20 million, a Forex Dealer Member that operates a dealing desk and has $208 million in liabilities to customers would be required to maintain adjusted net capital equal to or in excess of $29.9 million.

Forex Dealer Members with over $10 million in customer liabilities are subject to this alternative requirement unless they execute all customer transactions using straight-through-processing. Straight-through-processing refers to platforms that automatically (without human intervention and without exception) enter into an identical but opposite transaction with another counterparty, creating an offsetting position in the Forex Dealer Member's own name. A Forex Dealer Member that offers several platforms will be exempt from this requirement only if each platform executes all customer orders using straight-through-processing.

This requirement that all customer trades be executed by straight-through-processing is not, however, meant to limit a firm's ability to provide for other methods in its disaster recovery procedures. As long as those other methods are used only when dictated by those procedures and both the procedures and the firm's trading platform are designed to ensure that the need will rarely arise, the FDM will not lose its exemption by implementing other execution methods in disaster recovery situations.

3. Financial Requirements Section 11(b)

Section 11(b) prohibits a Forex Dealer Member from including assets held by an affiliate (unless approved) or an unregulated person in the firm's current assets for purposes of determining its adjusted net capital under CFTC Rule 1.17. This means an FDM may not count any part of those assets for capital purposes.[17]

An unregulated person is any person that is **not**:

(i) a financial institution regulated by a U.S. banking regulator;

(ii) a broker-dealer registered with the U.S. Securities and Exchange Commission and a member of FINRA;

(iii) a futures commission merchant registered with the U.S. Commodity Futures Trading Commission and a Member of NFA;

(iv) an insurance company regulated by any U.S. state;

(v) an entity regulated as a foreign equivalent of any of the above if regulated in a money center country as defined in CFTC Regulation 1.49; or

(vi) any other entity approved by NFA.

Effective October 1, 2010, the above paragraph will read as follows:

An unregulated person is any person that is **not**:

(i) a financial institution regulated by a U.S. banking regulator;

(ii) a broker-dealer registered with the U.S. Securities and Exchange Commission and a member of FINRA;

(iii) a futures commission merchant registered with the U.S. Commodity Futures Trading Commission and a Member of NFA;

(iv) a retail foreign exchange dealer registered with the U.S. Commodity Futures Trading Commission and a Member of NFA;

(v) an insurance company regulated by any U.S. state; or

(vi) any other entity approved by NFA.

Any Forex Dealer Member may ask NFA to approve an otherwise unregulated person for purposes of Financial Requirements Sections 11(b) and (c). In determining whether to approve an unregulated person that is not an affiliate, NFA will consider a number of factors, including:

- Whether the person is regulated in another jurisdiction and, if so, the type and extent of regulation;
- The person's capital; and
- The person's credit rating.

NFA's approval of a particular person means that all unaffiliated Forex Dealer Members may treat that person as regulated under Sections 11(b) and (c). NFA may also approve categories of counterparties (e.g., banks regulated in a particular jurisdiction or with a particular credit rating).

A Forex Dealer Member may not engage in Section 11(b) or (c) transactions with a regulated affiliate without NFA's approval. The Member may, however, ask NFA to authorize it to cover its positions with specified affiliates (including unregulated affiliates). An affiliate is any entity that controls, is controlled by, or is under common control with the Forex Dealer Member. The standards for approving affiliated persons are significantly higher than those for unaffiliated persons. For example, NFA will also consider:

- The parent company's and affiliated person's capital;
- Whether the parent company and the affiliated person are regulated entities;
- Whether the parent company will guarantee the obligations of the affiliated person (unless the parent company and the affiliated person are the same entity);
- The parent company's credit rating;
- Whether the affiliated person has strong risk-management policies to limit its value-at-risk; and
- For purposes of Section 11(c), whether the affiliated person limits the amount of offsetting transactions it enters into with unregulated counterparties.

4. Financial Requirements Section 11(c)

Section 11(c) prohibits Forex Dealer Members from using affiliates (unless approved) and unregulated persons to cover their foreign currency positions for purposes of CFTC Rule 1.17(c)(5).

The rule does not prohibit Forex Dealer Members from entering into positions with unregulated or unapproved counterparties. They may not, however, count positions with those counterparties when calculating their covered positions for purposes of CFTC Rule 1.17(c)(5).

For purposes of Section 11(c), Forex Dealer Members have four different types of counterparties. In particular:

- Account holders are those counterparties for whom it carries accounts and includes both retail customers and eligible contract participants.
- Trading partners are counterparties with whom the Member trades but who do not have accounts with the Member. For purposes of the calculations under Section 11(c), this category does not include affiliates (approved or unapproved) or regulated counterparties.
- Affiliates are entities that control, are controlled by, or are under common control with the Forex Dealer Member. For purposes of Section 11(c) only, this category does not include affiliates who have been approved by NFA under Section 11(b).
- Regulated entities are those counterparties that meet the definition in Section 11(b) and include entities-including affiliates-approved by NFA under that Section.

A Forex Dealer Member may net its exposure across account holders, across trading partners, and across affiliates, but it may not net its exposure between these categories. The Member may, however, net its exposure in any of these categories against regulated counterparties. Here is the information in chart form.

Type of Counterparty	Account Holders	Trading Partners	Affiliates	Regulated Entities
Account Holders	Yes	No	No	Yes
Trading Partners	No	Yes	No	Yes
Affiliates	No	No	Yes	Yes
Regulated Entities	Yes	Yes	Yes	Yes

A Forex Dealer Member is required to take a charge on the larger of its unnetted long or short position but not on both.

Example

Assume a Forex Dealer Member has the following Euro positions:

Type	Long	Short	Net Long	Net Short
Account Holders	11,154,912	6,011,794	5,143,118	
Trading Partners	4,987,345	7,299,886		2,312,541
Affiliates	3,790,754	2,640,553	1,150,201	
Regulated Entities	1,280,555	4,125,018		2,844,463

In determining the uncovered amount for purposes of the 6% haircut, the Forex Dealer Member can offset its net long position with account holders against the net short position with regulated entities but cannot offset its position with its trading partners or its position with unapproved affiliates against any category except regulated entities.

The math works this way (using only absolute numbers):

Net long position with account holders	5,143,118
Minus net short position with regulated entities	-2,844,463
	2,298,655
Uncovered long position with account holders	2,298,655
Plus net long position with affiliates	+1,150,201
Total uncovered long position	3,448,856
Net short position with trading partners	2,312,541
Larger of net long or short position	3,448,856
Haircut on Euros (3,448,856 X .06)	$206,931

5. Financial Requirements Section 12

Forex Dealer Members must collect security deposits from forex customers equal to 1% of the notional value of transactions in specified foreign currencies and 4% of the notional value of all other transactions. Where the two currencies are in different categories, the Forex Dealer Member must collect the higher amount. If the transaction pairs a foreign currency with the U.S. dollar, the security deposit is based on the foreign currency. If the transaction pairs a currency that qualifies for a 1% deposit with a currency that does not, the Forex Dealer Member must collect a 4% security deposit for the entire transaction. For example:

Currency Pair	Security Deposit
EUR/USD	1%
CND/JPY	1%
CND/BRL	4%
USD/MXN	4%
BRL/MXN	4%

For short options, the Forex Dealer Member must collect this amount plus the premium the customer received. For long options, the Forex Dealer Member must simply collect the entire premium from the customer.

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[1] The Board of Directors has declared that these transactions are a proper subject of NFA regulation and oversight under Article XVIII, paragraph (k).

[2] Compliance Rule 2-39 excludes these same entities when they introduce or manage forex accounts.

[3] Bylaw 306(b)(ii) excludes broker-dealers that are members of any fully-registered national securities association and FCMs that are members of another registered futures association. At this time, however, FINRA is the only fully-registered national securities association and NFA is the only registered futures association.

[4] These are affiliates of broker-dealers for which the broker-dealer makes and keeps records under the Securities and Exchange Commission's risk assessment requirements. See Section 17(h) of the Securities Exchange Act of 1934 and SEC Rule 17h-1T.

[5] See, for example, Compliance Rule 2-9: Supervision of Branch Offices and Guaranteed IBs, NFA Manual paragraph 9019; Compliance Rule 2-9: Supervisory Procedures for E-Mail and the Use of Web Sites, NFA Manual paragraph 9037; Compliance Rule 2-9: Supervision of the Use of Automated Order-Routing Systems, NFA Manual paragraph 9046. These interpretive notices do not directly apply to forex activities, but the principles included in these notices are equally applicable to those activities.

[6] The Commodity Futures Trading Commission has stated that all employees of an FCM who solicit or accept orders for forex transactions from retail customers must be registered with the Commission as an associated person of the FCM. See Division of Trading and Markets Advisory Concerning Foreign Currency Trading by Retail Customers (March 2002).

[7] The screening process should include 1) checking BASIC and any other readily available sources and 2) asking the third-party to represent that neither it nor any of its principals is subject to a statutory disqualification or to identify and explain any statutory disqualifications.

[8] Through interpretive notices issued under NFA Compliance Rule 2-29, NFA has provided Members with guidance on what activities are deceptive and misleading. See, for example, NFA Compliance Rule 2-29: Deceptive Advertising, NFA Manual paragraph 9033; NFA Compliance Rule 2-29: Deceptive Advertising, NFA Manual paragraph 9034; Compliance Rule 2-29: High Pressure Sales Tactics, NFA Manual paragraph 9038; and NFA Compliance Rules 2-29 and 2-9: NFA's Review and Approval of Certain Radio and television Advertisements, NFA Manual paragraph 9039. Although these interpretive notices do not directly apply to forex activities, the principles included in them with regard to what is deceptive or misleading are equally applicable to those activities.

[9] The Forex Dealer Member is not required to give the customer a price that is no longer reflected on the platform at the time the order reaches it. The Forex Dealer Member is not responsible for

transmission delays outside its control. If an Forex Dealer Member, however, advertises "no-slippage" or that it guarantees fill prices, it must prominently disclose that transmission delays might result in customer orders being executed at a price other than that seen by the customer.

[10] This includes *force majeure* provisions.

[11] Submission of promotional materials for NFA review is not a substitute for a Member's own responsibility to review promotional material. NFA staff will not independently verify the accuracy of statements made in an advertisement; that responsibility remains with the Member. Submitting promotional material to NFA will not provide a "safe harbor" from NFA actions for Members if misstatements or omissions of material fact are discovered subsequently or NFA otherwise later determines that the material is in violation of any applicable standards.

[12] Under traditional legal principles, Members can also be liable for promotional material promoting forex trading systems developed by third-parties. For example, a Member has direct responsibility for misleading promotional material if the Member prepares or distributes it; has agency responsibility if the system developer is an agent of the Member under established principles of agency law; and has supervisory responsibility if the Member fails to supervise its own employees when linking to a third-party trading system developer's web site, recommending a third-party's trading system, or entering into a referral agreement with a third-party system developer. See Interpretive Notice titled "NFA Bylaw 1101, Compliance Rules 2-9 and 2-29: Guidelines Relating to the Registration of Third-Party Trading System Developers and the Responsibility of NFA Members for Promotional Material That Promotes Third-Party Trading System Developers and their Trading Systems," NFA Manual, paragraph 9055.

[13] For this purpose, foreign persons and foreign customers are 1) natural persons who are not residents of the United States or 2) legal entities (other than passive investment vehicles) that are organized under the laws of a country other than the United States, do not have their principal place of business in the United States, and do not conduct their retail forex activities from a location in the United States. Those terms do not include a passive investment vehicle that is more than 10% owned by United States persons or that solicits United States persons who are not eligible contract participants as defined in Section 1a(12) of the Act. "United States" includes U.S. territories and possessions.

[14] See Sections 2(c)(2)(B)(ii)(III) and 4f(c)(2)(B) of the CEA and CFTC Regulations 1.14 and 1.15.

[15] Obviously, the Forex Dealer Member must also ensure that no entity with common ownership engages in the forex business unless it is authorized to do so.

[16] Forex Dealer Members can comply with this requirement by providing customers with a copy of NFA's brochure entitled "Background Affiliation Status Information Center (BASIC): An Information Resource for the Investing Public," which is available in print and on NFA's website at http://www.nfa.futures.org/.

[17] Where the CFTC's requirements for holding current assets are more stringent, those requirements apply.

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Compliance Rules

RULE 2-36. REQUIREMENTS FOR FOREX TRANSACTIONS
[Adopted effective June 28, 2002. Effective dates of amendments: December 1, 2003; November 30, 2005; February 13, 2007; October 25, 2007; and April 1, 2009.]

(a) General Prohibition

No Forex Dealer Member shall engage in any forex transaction that is prohibited under the Commodity Exchange Act.

(b) Fraud and Related Matters

No Forex Dealer Member or Associate of a Forex Dealer Member engaging in any forex transaction shall:

(1) Cheat, defraud or deceive, or attempt to cheat, defraud or deceive any other person;

(2) Willfully make or cause to be made a false report, or willfully to enter or cause to be entered a false record in or in connection with any forex transaction;

(3) Disseminate, or cause to be disseminated, false or misleading information, or a knowingly inaccurate report, that affects or tends to affect the price of any foreign currency;

(4) Engage in manipulative acts or practices regarding the price of any foreign currency or a forex transaction;

(5) Willfully submit materially false or misleading information to NFA or its agents with respect to forex transactions;

(6) Embezzle, steal or purloin or knowingly convert any money, securities or other property received or accruing to any person in or in connection with a forex transaction.

(c) Just and Equitable Principles of Trade

Forex Dealer Members and their Associates shall observe high standards of commercial honor and just and equitable principles of trade in the conduct of their forex business.

(d) Doing Business with Non-Members

A Forex Dealer Member that is the counterparty, or offers to be the counterparty, to forex transactions for customers shall be subject to discipline for the activities of any person that solicits or introduces a customer to the Member or that manages such customer's accounts, unless such person is a Member or Associate of NFA, meets the criteria in Bylaw 306(b), or would be exempt from Commission registration if it were acting in the same capacity in connection with exchange-traded futures contracts.

(e) Supervision

Each Forex Dealer Member shall diligently supervise its employees and agents in the conduct of their forex activities for or on behalf of the Forex Dealer Member. Each Associate of a Forex Dealer Member who has supervisory duties shall diligently exercise such duties in the conduct of that Associate's forex activities for or on behalf of the Forex Dealer Member.

(f) Affiliates

Each Forex Dealer Member that has an affiliate that is authorized to engage in forex transactions solely by virtue of its affiliation with the Forex Dealer Member shall supervise its affiliate's forex activities for compliance with the same requirements that apply to the Forex Dealer Member, including section (a) of this rule. The Forex Dealer Member shall make the affiliate's books and records available to NFA staff upon request and shall be subject to discipline for acts and omissions of the affiliate that violate the standards imposed by NFA requirements.

(g) BASIC Disclosure

When a customer first opens an account and at least once a year thereafter, each Forex Dealer Member shall provide each customer with written information regarding NFA's Background Affiliation Status Information Center (BASIC), including the web site address.

(h) Filing Promotional Materials with NFA.

The Compliance Director may require any Forex Dealer Member for any specified period to file copies of all promotional material with NFA for its review and approval at least 10 days prior to its first use or such shorter period as NFA may allow. The Compliance Director may also require a

Forex Dealer Member to file for review and approval copies of promotional material prepared or used by some or all of the non-Members it is responsible for under Section (d).

(i) Hypothetical Results

Any Member who uses promotional material that includes a measurement or description or makes any reference to hypothetical forex transaction performance results that could have been achieved had a particular trading system of the Member or Associate been employed in the past must comply with Compliance Rule 2-29(c) and the related Interpretive Notice as if the performance results were for transactions in on-exchange futures contracts.

(j) Scope

This rule governs forex transactions as defined in Bylaw 1507(b).

(k) Definition of Customer

For purposes of this rule, the term "customer" means a counterparty that is not an eligible contract participant as defined in Section 1a(12) of the Act.

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Interpretive Notices

9060 - COMPLIANCE RULE 2-36(e): SUPERVISION OF THE USE OF ELECTRONIC TRADING SYSTEMS
(Board of Directors, November 16, 2006; effective July 1, 2007; October 15, 2007; December 17, 2007; and June 1, 2009.)

INTERPRETIVE NOTICE

NFA Compliance Rule 2-36(e) places a continuing responsibility on every Forex Dealer Member (FDM) to diligently supervise its employees and agents in all aspects of its forex activities, and Compliance Rule 2-39 applies this same requirement to certain Members who solicit, introduce, or manage forex customer accounts.[1] These rules are broadly written to provide Members with flexibility in developing procedures tailored to meet their particular needs, so NFA uses interpretive notices to provide more specific guidance.[2]

Although the Board of Directors firmly believes that supervisory standards do not change with the medium used, technology may affect how those standards are applied. The forex markets are highly automated, with virtually all trading done on electronic platforms. Most orders are also placed electronically, usually entered directly with the platform via the Internet. Therefore, in order to fulfill their supervisory responsibilities, Members must adopt and enforce written procedures to address the security, capacity, credit and risk-management controls, and records provided by the firm's electronic trading systems.[3] This includes electronic trading platforms, order-routing systems incorporated into electronic trading platforms, and separate order-routing systems (AORSs).[4] For an electronic trading platform, the procedures must also address the integrity of the trades placed on it.

NFA recognizes that Members who solicit or manage accounts may not have control over the electronic platform where the customer places its trades. Nonetheless, if these Members are subject to NFA Compliance Rule 2-39 and are dealing with a counterparty that is not an FDM, they have a supervisory responsibility to conduct a reasonable investigation regarding security, capacity, credit and risk-management, records, and integrity of trades on the platform prior to entering into a relationship with that counterparty and periodically thereafter. Therefore, while they are not subject to the more specific requirements of this Notice, they should adopt written procedures addressing the steps they will take to investigate the platform and how they will respond if they have reason to believe that the platform does not meet the general standards set out after each major heading.[5]

The specific requirements of this Notice do, however, apply to any FDM that uses another entity's trading platform through a "white-labeling" arrangement.[6] If the entity providing the platform (the white labeler) is also an FDM, the FDM using the platform (the sponsor) may rely on the white labeler to comply with most of these requirements. The sponsor must, however, adopt and enforce written procedures to:

- Provide required notifications and disclosures to customers;
- Maintain records; and
- Respond to situations where it has reason to believe the white labeler is not complying with the Notice.

If the white labeler is not an FDM, the sponsor and the white labeler may agree by contract that the white labeler will comply with the Notice, but the sponsor FDM will still be liable if the requirements are not met.[7]

Each FDM must notify NFA of the trading platform it uses. The platform must identify the platform's owner and developer (if different than the owner) and must state whether the platform is proprietary, used under a white-labeling arrangement, or leased from a third-party under other terms. The FDM must also notify NFA when it changes its trading platform, adds a new trading platform, or drops a trading platform.

Each FDM must also provide NFA with a copy of the written procedures this Notice requires it to maintain. The procedures must assign the responsibility for complying with this Notice to individuals who are under the ultimate supervision of an Associated Person who is also a listed principal.

Given the differences in NFA Members' size, complexity of operations, and business activities, they must have some flexibility in determining what constitutes "diligent supervision" for their firms. NFA's policy is to leave the exact form of supervision up to each Member, thereby providing the Member with flexibility to design procedures tailored to its own situation. It is also NFA's policy to set general standards rather than to require specific technology. Therefore, other procedures besides the ones described in this

Interpretive Notice may comply with the general standards for supervisory responsibilities imposed by Compliance Rules 2-36 and 2-39.[8]

Security

General Standard. Members who handle customer orders must adopt and enforce written procedures reasonably designed to protect the reliability and confidentiality of customer orders and account information. The procedures must also assign responsibility for overseeing the process to one or more individuals who understand how it works and who are capable of evaluating whether the process complies with the firm's procedures.

Authentication. Electronic trading systems, or other systems the customer must go through to access electronic trading systems, should authenticate the user. Authentication can be accomplished through a number of methods, including:

- Passwords;
- Authentication tokens, such as SecurID cards; or
- Digital certificates.

Encryption. The system should use encryption or equivalent protections for all authentication and for any order or account information that is transmitted over a public network (including the Internet), a semi-private network, or a virtual private network. If more appropriate and effective security procedures are developed or identified, the use of those procedures would comply with this standard.

Firewalls. Firewalls or equivalent protections should be used with public networks, semi-private networks, and virtual private networks. The system should log the activities that pass through a firewall, and the log should be reviewed regularly for abnormal activity. If more appropriate and effective security procedures are developed or identified, the use of those procedures would comply with this standard.

Authorization. Although it is the customer's responsibility to ensure that only authorized individuals have access to the electronic trading system using the customer's facilities and authentication devices (e.g., passwords), the Member's procedures should, as appropriate, provide customers with a means to notify the Member that particular individuals are no longer authorized or to request that authentication devices be disabled. Customers should be informed about the notification process.[9]

Periodic Testing. The Member should conduct periodic reviews designed to assess the security of the electronic trading system.

Administration. The Member should adopt and enforce written procedures assigning the responsibility for overseeing the security of the electronic trading system to appropriate supervisory personnel. The procedures should also provide that appropriate personnel keep up with new developments, monitor the effectiveness of the system's security, and respond to any breaches. Additionally, the procedures should provide for updating the system as needed to maintain the appropriate level of security.

Capacity

General Standard. Members who handle customer orders must adopt and enforce written procedures reasonably designed to maintain adequate personnel and facilities for the timely and efficient delivery of customer orders and reporting of executions. Members who operate trading platforms must adopt and enforce written procedures reasonably designed to maintain adequate personnel and facilities for the timely and efficient execution of customer orders. The procedures must also be reasonably designed to handle customer complaints about order delivery, execution (if applicable), and reporting and to handle those complaints in a timely manner.

Members may not misrepresent the services they provide or the quality of those services. If a Member represents that it maintains a particular capacity or performance level, it must take the measures necessary to achieve that level.[10]

Capacity Reviews. The Member should adopt and enforce written procedures to regularly evaluate the capacity of each electronic trading system and to increase capacity when needed. The procedures should also provide that each system will be subjected to an initial stress test. Such test may be conducted through simulation or other available means. Capacity reviews should be conducted whenever major changes are made to the system or the Member projects a significant increase in volume and should occur at least annually.

The Member should monitor both capacity (how much volume the system can handle before it is adversely impacted or shuts down) and performance (how much volume the system can handle before response time materially increases), and should assess the electronic trading system's capacity and performance levels based on the major strains imposed on the system. The Member should establish acceptable capacity and performance levels for each of its electronic trading systems. The Member's procedures should be reasonably designed to provide adequate capacity to meet estimated peak volume needs based on past experience, present demands, and projected demands.

The procedures should also provide for the Member to follow up on customer complaints about access problems, system slowdowns, system outages, or other problems that may be related to capacity.[11] The Member should identify the cause of any problem and take action to prevent it from re-occurring.

Disaster Recovery and Redundancies. The Member should have contingency plans reasonably designed to service customers if either the system goes down or activity exceeds reasonably expected peak volume needs. The Member should use redundant systems or be able to quickly convert to other systems if the need arises. These backup systems can include facilities for accepting

orders by telephone.

When operational difficulties occur, the Member should provide prompt and effective notification to customers affected by the operational difficulties. Notification can be made by a number of methods, including:

- a message on the Member's web site;
- e-mails or instant messages;
- a recorded telephone message for customers on hold; and/or
- a recorded telephone message on a line dedicated to providing system bulletins to existing customers.

An FDM must notify NFA as soon as reasonably possible, but no more than 24 hours, after operational difficulties occur. The notice should include the date, time, length, and cause of the outage or disruption; what the FDM did to remedy the situation in the short term; what steps the FDM will take to guard against future occurrences; the number of customers affected; and any actions the FDM took to adjust customer trades or accounts.

Advance Disclosure. The Member should disclose, in advance, the factors that could reasonably be expected to materially affect the system's performance (e.g., periods of stress) and the means available for contacting the Member during a system outage or slow-down. This disclosure should be provided to each customer at the time the customer opens an account using a method reasonably calculated to ensure that the customer becomes aware of it.[12] The disclosure should also be prominently displayed on the Member's web site. The Member should also educate customers on alternative ways to enter orders when the system goes down or reaches an unacceptable performance level. This disclosure may be made in the account agreement, on the Member's web site, or in any other manner designed to provide this information to current customers before problems occur.

Credit and Risk-Management Controls

General Standard. Members who handle customer orders must adopt and enforce written procedures reasonably designed to prevent customers from entering into trades that create undue financial risks for the Member or the Member's other customers.[13]

Account Controls. An electronic trading system should be designed to allow the Member to set limits for each customer based on the amount of equity in the account or the currency, quantity, and type of order, and the Member should utilize these controls. The system should automatically block any orders that exceed the pre-set limits.[14]

If the trading platform automatically liquidates positions, the FDM should set the liquidation levels high enough so that the positions will be closed out at prices that will prevent the account from going into a deficit position under all but the most extraordinary market conditions.[15] The FDM's platform must automatically liquidate positions, and it must set its liquidation levels to comply with this requirement, if its customer agreement or promotional material states or implies that customers cannot lose more than they invest.

An electronic trading platform that does not automatically liquidate positions should generate an immediate alert when an account is in danger of going into a deficit position. Firm personnel should monitor those alerts throughout the day and take action when necessary.

Review. A Member should conduct periodic system reviews designed to assess the reliability of its credit and risk-management controls.

Recordkeeping

General Standard. Members who handle orders must adopt and enforce written procedures reasonably designed to record and maintain essential information regarding customer orders and account activity.

Transaction Records. Electronic trading systems should record the following information for each transaction:

- Date and time the order is received by the system;
- Price (or premium for an option) at which the order is placed;
- Price (or premium for an option) quoted on the trading platform when the order was placed (if the system is a trading platform);

- Account identification;
- Currency pair;
- Size;
- Buy or sell;
- Type of order (if not a straight market order);
- Date and time the order is transmitted to the trading platform (if the system is an AORS);
- Date and time of execution (if the system is a trading platform);
- Size and price (or premium) at which the order is executed;
- Date and time the execution information is received (if the system is an AORS); and
- Date and time the execution information is reported by the system.

For options, the system should record the following additional information:

- Put or call;
- Strike price; and
- Expiration date.

All times must be recorded to the nearest second. The system must also record any other necessary information (e.g., requotes, that the platform did not execute the order because the customer had insufficient equity in its account). If the transaction is not subject to daily rollovers, the system must also record the expiration date of the transaction, if any.
The system should record this same information for liquidating orders. If customers place them as liquidating orders, the system should identify them as liquidating orders. If they are generated by the system because there is insufficient equity in the account, the system should record that information. If customers enter them as new orders, however, they need not be identified as liquidating orders in the order information even if they result in offset.

Electronic trading platforms should record the following information for rollovers:

- Account identification;
- Currency pair;
- Size;
- Long or short;
- Date and time of the rollover;[16]
- Price of the position after the rollover;
- Bid and ask prices quoted on the platform when the rollover occurred;
- Amount of interest credited or debited to the account, if any;
- Any other fees charged for the rollover.

An electronic trading platform should be programmed to provide this information for each individual order and account. It should also be programmed to provide a report, upon request, showing the following information for all transactions other than rollovers executed on that day: time, price (or premium), quantity, long or short, currency pair, account identification, and, for options, strike price, put or call, and expiration date.

Account Records. Electronic trading platforms should create and maintain daily records containing the following information:

- Account identification;
- Funds in the account (net of any commissions and fees);
- Open trade equity (the net profits and losses on open trades); and
- Account balance (funds in the account plus or minus open trade equity).

For open option positions, the account balance should be adjusted for the net option value and the daily record should include the following additional information:

- Long option value;
- Short option value; and
- Net option value.

Time and Price Records. Electronic trading platforms should create daily logs showing each price change on the platform, the time of the change to the nearest second, and the trading volume at that time and price. Upon request by a customer, FDMs should provide time and price records covering all executed transactions for the same currency pair or option during the time period in which the customer's order was or could have been executed.

Profit and Loss Reports. Electronic trading platforms should be able to produce, upon request, a report showing monthly and yearly realized and unrealized profits and losses by customer. The report should be sortable by the person soliciting, introducing, or managing the account.

The system should generate year-end reports for each customer showing the realized profits and losses incurred during the calendar year and the unrealized profits and losses on open positions. The FDM must distribute these reports to customers by January 31st.[17]

Exception Reports. Electronic trading platforms should generate daily exception reports showing all price adjustments and all orders filled outside the price range displayed by the system when the order was placed.[18] Management should review these reports for suspicious or unjustifiable activity.

Assessment Fee Reports. Electronic trading platforms should generate month-end assessment fee reports for each FDM using the platform. The report should summarize the number of forex transactions executed during the month and the size of those transactions.[19]

Retention. Members must maintain this information for five years from the date created, and it must be readily accessible during the first two years. These records must be open to inspection by NFA, and copies must be provided to NFA upon request.

Reviews. The FDM should conduct periodic reviews designed to ensure that the electronic trading platform maintains the data and is capable of generating the reports required by this Notice.

Trade Integrity

General Standard. FDMs must adopt and enforce written procedures reasonably designed to ensure the integrity of trades placed on their trading platforms.

Pricing. Trading platforms must be designed to provide bids and offers that are reasonably related to current market prices and

conditions. For example, bids and offers should increase as prices increase, and spreads should remain relatively constant unless the market is volatile.[20] Furthermore, if an FDM advertises a particular spread (e.g., 1 pip) for certain currency pairs or provides for a particular spread in its customer agreement, the system should be designed to provide that spread.[21]

Slippage. An electronic trading platform should be designed to ensure that any slippage is based on real market conditions. For example, slippage should be less frequent in stable currencies than in volatile ones, and prices should move in customers' favor as often as they move against it.

If an FDM advertises "no slippage," the electronic trading platform should be designed to execute a market order at the price displayed when the order is entered and to execute a stop order at the stop price.[22] The FDM's procedures should also prohibit personnel from adjusting prices for any reason once the order reaches the platform.[23]

Settlement. An electronic trading platform should be designed to calculate uniform settlement prices. An FDM must have written procedures describing how settlement prices will be set using objective criteria.

Rollovers. If an electronic trading platform automatically rolls over open positions, the trading platform should be designed to ensure that the rollover complies with the terms disclosed in the customer agreement, including those provisions dictating how the rollover price is determined.

Periodic Testing. The FDM should conduct periodic reviews designed to ensure that an electronic trading platform complies with the requirements in this section and otherwise protects the integrity of trades placed on it.

Periodic Reviews and Annual Certification

For electronic trading platforms, a qualified outside party must conduct an independent annual review within twelve months after the FDM begins trading on that platform or within twelve months after the firm becomes an FDM, whichever is later.[24] Thereafter, an independent review must be conducted at least annually, and a qualified outside party must conduct the review every other year. The remaining annual reviews and any additional reviews (which should be performed when needed) may be conducted by either an independent internal audit department or a qualified outside party. For pure order-routing systems, the required reviews may be conducted by an independent internal audit department or a qualified outside party and must be done at least annually.

The reviews should audit the system for compliance with the requirements in this Notice. The results should be documented and reported to the firm's senior management or to an internal audit committee or department. The Member should follow up to ensure that any deficiencies are addressed and corrected and should document the corrective action taken.

Each FDM - including each FDM that provides a trading platform to its customers through a white-labeling arrangement - must certify annually that the requirements in this Notice have been met and that the written procedures required by this Notice are up-to-date. The certification must be signed by a principal who is also a registered AP and must be filed with NFA.

Members who solicit or introduce forex customers or manage forex customer accounts must provide annual certifications if they use an electronic trading platform offered by a counterparty that is not an FDM or if they provide or endorse a separate AORS. The certification must be signed by a principal who is also a registered AP and must be filed with NFA. The certification may, however, be limited to the applicable requirements.

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[1] Compliance Rule 2-39 and this Interpretive Notice apply to all Members except those who are described in Bylaw 306(b). It does not apply to Members who are registered as broker-dealers and members of the Financial Industry Regulatory Authority.

[2] For purposes of this Notice, the term "Forex Dealer Member" has the same meaning as in Bylaw 306, the term "forex" has the same meaning as in Bylaw 1507(b), and the term "customer" has the same meaning as in Compliance Rule 2-36(i).

[3] The written procedures do not, however, have to contain technical specifications or duplicate procedures that are documented elsewhere.

[4] A trading platform executes a customer's trade by assigning the other side of the trade to a counterparty. An order-routing system transmits orders to a trading platform (or to another system or individual). In most instances, the same trading system will perform both functions. NFA understands that separate systems are extremely rare in the forex markets. Nonetheless, since most of the same principles apply, these separate systems are included in this Notice.

[5] If the Member provides or endorses a separate AORS, however, the Member is responsible for meeting all of the applicable requirements in connection with that system.

[6] White labeling refers to the practice of leasing the right to place the lessee's name on and market another firm's trading platform as its own and then passing the trades through to the lessor. In the typical while labeling arrangement, the lessee's customers do not have a contractual relationship with, and in fact may be unaware of, the firm that owns and operates the platform. For regulatory purposes, the lessee is the counterparty to the customer's trades and the corresponding transactions with the lessor are separate transactions between the lessee and the lessor to hedge the lessee's customer obligations.

[7] As a practical matter, NFA will not take disciplinary action unless the sponsor knew or should have known that the white labeler was not meeting its contractual obligation to comply with this Notice or the sponsor failed to exercise due diligence when establishing and maintaining the relationship with the white labeler.

[8] For example, an FDM that negotiates prices with its customers may have different procedures to satisfy this Notice's record-keeping requirements outside of the platform.

[9] For purposes of this notice, the term "customer" includes CTAs entering orders for forex customers except when referring to credit-worthiness and ability to accept risk. In those instances, the term "customer" is limited to the owner of the account.

[10] Misrepresenting capacity or performance levels or other material information regarding a Member's electronic systems is a violation of NFA Compliance Rule 2-36(b) or 2-39(a).

[11] For example, lack of capacity might result in excessive slippage.

[12] A Member could, for example, provide the disclosure in a separate e-mail to an address provided by the customer. Burying the disclosure in the account opening documents is not sufficient.

[13] A Member should assess each individual customer's ability to accept risk as part of the Member's obligation to know its customers. (*See* NFA Interpretive Notice entitled "Forex Transactions," NFA Manual, paragraph 9053).

[14] An AORS used to access an electronic trading platform need not include pre-execution and post-execution controls if the Member providing or sponsoring the AORS has determined, after a reasonable investigation, that the trading platform complies with those requirements and that the Member who controls the trading platform effectively utilizes its controls.

[15] If the FDM unconditionally guarantees customers against deficits it should, of course, take any loss that occurs beyond the amount of equity in the account even when the deficit occurs because of those extraordinary market conditions. Misrepresenting the potential for customer losses is a violation of NFA Compliance Rule 2-36(b) or 2-39(a).

[16] If the system treats the rollover as two transactions, it should provide the date and time of each transaction.

[17] FDMs can use Form 1099-B to satisfy this requirement.

[18] Obviously, this requirement does not include limit orders that are not executable when placed. The FDM should, however, have procedures for reviewing limit orders that are executed at prices inconsistent with their terms.

[19] The report should exclude transactions by eligible contract participants as that term is defined in Section 1a(12) of the CEA.

[20] Management should approve each fill outside the price range displayed by the system when a market order was placed and should document the reason for the fill price.

[21] If the FDM's customer agreement provides for exceptions in volatile or illiquid markets and those exceptions are prominently disclosed, the system may be programmed to be consistent with the agreement's terms.

[22] The FDM is not required to give the customer a price that is no longer reflected on the platform at the time the order reaches it. The FDM is not responsible for order transmission delays outside its control.

[23] Members may not, of course, advertise "no slippage" if these conditions are not met. (See NFA Interpretive Notice entitled "Forex Transactions," *NFA Manual*, paragraph 9053, for a more detailed discussion of this requirement.)

[24] For purposes of this Notice, "qualified outside party" means an unaffiliated individual or entity that, through experience or training, understands complex IT systems and is able to test the firm's systems for compliance with the requirements in the Notice.

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Compliance Rules

RULE 2-39. SOLICITING, INTRODUCING, OR MANAGING FOREX TRANSACTIONS OR ACCOUNTS.
[Adopted effective September 15, 2005. Effective dates of amendments: February 13, 2007; June 5, 2007; September 21, 2007; October 25, 2007; and April 1, 2009.]

(a) Except for members who meet the criteria in Bylaw 306(b) and Associates acting on their behalf, Members and Associates who solicit customers, introduce customers to a counterparty, or manage accounts on behalf of customers in connection with forex transactions shall comply with Sections (a),(b),(c),(e),(h), and (i) of Compliance Rule 2-36.

(b) No Member except a Forex Dealer Member or a Member who meets the criteria in Bylaw 306(b) may accept forex orders or accounts or receive compensation-directly or indirectly-for forex transactions from any person unless that person is a Member or Associate of NFA, meets the criteria in NFA Bylaw 306(b), or would be exempt from Commission registration if it were acting in the same capacity in connection with exchange-traded futures products.

(c) For purposes of this rule, the term "customer" means a person that is not an eligible contract participant as defined in Section 1a (12) of the Act and includes persons who participate in pooled accounts.

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III. Security Futures Transactions

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Compliance Rules

RULE 2-9. SUPERVISION.
[Effective date of amendments: October 29, 1991; January 19, 1993; March 15, 1994; April 23, 2002; and November 1, 2007.]

(a) Each Member shall diligently supervise its employees and agents in the conduct of their commodity futures activities for or on behalf of the Member. Each Associate who has supervisory duties shall diligently exercise such duties in the conduct of that Associate's commodity futures activities on behalf of the Member.

(b) NFA's Board of Directors may require Members which meet specific criteria established by the Board relating to the employment history of its APs or principals or to the total commissions, fees and other charges paid by their customers to adopt supervisory procedures specified by the Board for the supervision of telemarketing. This requirement may, in NFA's discretion, be waived upon a showing by the Member that the Member's current supervisory procedures provide effective supervision over its employees and agents. Any Member seeking such a waiver may submit a written request to a three-member panel consisting of three members of the Business Conduct Committee and/or the Hearing Committee, said members to be appointed by the Board from time to time. Within 30 days after a Member submits a waiver request, the Compliance Director will submit a written response to the panel. The decision of the panel shall be final and shall be based upon the written submissions of the Member and of the Compliance Director.

(c) Each FCM and IB Member shall develop and implement a written anti-money laundering program approved in writing by senior management reasonably designed to achieve and monitor the Member's compliance with the applicable requirements of the Bank Secrecy Act (31 U.S.C. 5311, et. seq.), and the implementing regulations promulgated thereunder by the Department of the Treasury and, as applicable, the Commodity Futures Trading Commission. That anti-money laundering program shall, at a minimum,

(1) Establish and implement policies, procedures, and internal controls reasonably designed to assure compliance with the applicable provisions of the Bank Secrecy Act and the implementing regulations thereunder;

(2) Provide for independent testing for compliance to be conducted by Member personnel or by a qualified outside party;

(3) Designate an individual or individuals responsible for implementing and monitoring the day-to-day operations and internal controls of the program; and

(4) Provide ongoing training for appropriate personnel./p>

[See Interpretive Notice NFA Compliance Rule 2-9: FCM And IB Anti-Money Laundering Program and Interpretive Notice NFA Compliance Rule 2-29: Review of Promotional Material Prior to its First Use and Interpretive Notice Compliance Rule 2-9: Self-Audit Questionnaires and Interpretive Notice Compliance Rule 2-9: Supervision of Telemarketing Activity and Interpretive Notice Compliance Rule 2-9: Supervisory Procedures for E-Mail and the Use of Web Sites and Interpretive Notice Compliance Rule 2-29 and 2-9: NFA's Review and Approval of Certain Radio and Television Advertisements]

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Interpretive Notices

9042 - COMPLIANCE RULE 2-9: SPECIAL SUPERVISORY REQUIREMENTS FOR MEMBERS REGISTERED AS BROKER-DEALERS UNDER SECTION 15(b)(11) OF THE SECURITIES EXCHANGE ACT OF 1934
(Revised December 17, 2007)

INTERPRETIVE NOTICE

The Commodity Futures Modernization Act of 2000 (CFMA), which was signed into law on December 21, 2000, lifts the 18-year ban on single-stock futures and narrow-based security indices ("security futures products"). Unlike other futures contracts, however, the CFMA provides that security futures products are securities as well as futures. Therefore, under Section 15A(k) of the Securities Exchange Act of 1934 (Exchange Act), NFA is a national securities association (NSA) for the limited purpose of regulating the activities of Members who are registered as brokers or dealers in security futures products under Section 15(b)(11) of the Exchange Act (i.e., FCMs and IBs who "passport" in to broker-dealer registration because they limit their securities activities to security futures products).

NFA Compliance Rule 2-9 places a continuing responsibility on every Member to diligently supervise its employees and agents in all aspects of their futures business. Compliance Rule 2-9 and the interpretive notices issued under Compliance Rule 2-9 apply to activities involving security futures products just as they do to all other futures-related activities. When regulating the securities futures activities of Members registered as broker-dealers under Section 15(b)(11) of the Exchange Act, however, Section 15A(k)(2)(B) of the Exchange Act requires NFA to impose requirements reasonably comparable to those of national securities associations registered under Section 15A(a) of the Exchange Act. This notice describes special supervisory requirements for those Members.[1]

A Member's security futures activities must be supervised by a designated security futures principal who meets the requirements of NFA Compliance Rule 2-7. A Member must also have one or more designated security futures principals at each main or branch office that solicits or accepts accounts or orders for or recommends or engages in transactions in security futures products on behalf of customers. The Member must have clear lines of supervision that assign each registered individual engaged in security futures activities to a particular designated security futures principal.

Members must develop and implement specific written procedures concerning the manner of supervision of customer accounts that trade security futures products and specifically providing for frequent supervisory review of those accounts. Within a reasonable time, Members must amend their procedures to incorporate applicable changes in the futures and securities laws and regulations and NFA requirements as well as changes in their supervisory systems. Each designated security futures principal shall be responsible for reviewing and enforcing the procedures and taking or recommending to senior management appropriate action reasonably designed to achieve the Member's compliance with the applicable futures and securities laws and regulations and with NFA requirements.

Each main or branch office that solicits or accepts accounts or orders or recommends or engages in transactions in security futures products - and each office that supervises these activities - must keep and maintain a current copy of the Member's written supervisory procedures governing these activities. Members must communicate all changes in the procedures to the appropriate offices.

Discretionary Accounts

Under Compliance Rule 2-8(b), a security futures principal must regularly review discretionary security futures trading activity and must make a written record of that review. A security futures principal must also consider the discretionary nature of the account when approving the account to trade security futures and must comply with the requirements of the interpretive notice entitled "Compliance Rule 2-9: Supervision of Branch Offices and Guaranteed IBs" (9019) regarding account activity and discretionary accounts.

Promotional Material and Correspondence

Members must comply with the interpretive notice entitled "NFA Compliance Rule 2-9: Supervisory Procedures for E-Mail and the Use of Web Sites" (9037) for security futures products. E-mails are not the only type of security futures correspondence that must be reviewed, however. Both incoming and outgoing correspondence must be reviewed, and the designated security futures principal must make a record of the review, including noting who conducted the review. The review must include steps to ensure that all correspondence is retained and that the names of the persons who prepared outgoing correspondence are ascertainable from the retained record.

Members must adopt review procedures that are appropriate in light of their business activities, including the structure, size, and nature of their business operations. In establishing criteria for review of correspondence, the procedures must take into consideration the nature of the communication, the relative sophistication of the customer and the training and background of the Member's employees or the employees of its guaranteed IBs. In some instances, spot-checking or sampling correspondence may be appropriate and in others it may not. For example, a firm dealing with sophisticated or institutional customers might choose to sample a relatively small but representative amount of correspondence, while firms dealing with individual, relatively unsophisticated retail customers must use a larger sample or even review all outgoing correspondence. Similarly, if any employee or employee of a guaranteed IB has a disciplinary history involving problems with customers or was previously employed at a firm that has been disciplined for fraud, then the firm must have a heightened level of scrutiny regarding that employee's correspondence.

In many instances outgoing correspondence may constitute promotional material. Correspondence directed to the public soliciting business constitutes promotional material and is subject to the same rules as any other form of promotional material. For example, a letter or e-mail message sent to targeted individuals or groups is promotional material if its ultimate purpose is to solicit funds or orders. Therefore, a Member's correspondence review procedures must also be designed to ensure compliance with NFA's promotional material content and review requirements.

Where the firm's procedures for the review of correspondence do not require review of all outgoing correspondence prior to its use or distribution, Members must educate and train their employees on the firm's policies regarding correspondence with the public. Special attention should be given to those employees with previous compliance or disciplinary problems.

Account Approval

Under NFA Compliance Rule 2-30(j)(1), accounts that trade security futures products must be approved in writing for that activity by the designated security futures principal. The Member must adopt and enforce specific written procedures regarding the approval process that include at least the following:

- Specific criteria and standards to be used in evaluating the suitability of a customer to engage in security futures transactions;
- Specific procedures for approving accounts to engage in security futures transactions, including requiring written approval by a designated security futures principal;
- A requirement that the designated security futures principal explain, in writing, why he or she has approved an account that does not meet the specific criteria and standards set forth in the procedures; and
- Specific financial requirements for initial approval and maintenance of customer accounts that engage in security futures transactions.

Compliance with Securities Laws

Compliance Rule 2-37(b) provides that Members must establish, maintain, and enforce written procedures reasonably designed to achieve compliance with applicable securities laws, including Sections 9(a), 9(b), and 10(b) of the Exchange Act and any applicable regulation thereunder. Again, these procedures must be approved, in writing, by a designated security futures principal.

Use and Disclosure of the Member's Name

Members must have supervisory procedures reasonably designed to ensure that the public understands who they are doing business with. It is conduct inconsistent with just and equitable principles of trade, and therefore a violation of NFA Compliance Rule 2-4, for Members and Associates to use misleading names or to fail to disclose their affiliation when dealing with the public. Similarly, Members and their Associates may not refer to another entity or individual in any manner that implies an affiliation that does not exist. Furthermore, CFTC Regulation 166.4 requires branch offices to use the name of the firm for all purposes and to hold itself out to the public under that name, and Appendix A to Part 3 of the CFTC's rules states that a person's registration can be denied, revoked, or conditioned under Section 8a(3)(M) of the Commodity Exchange Act if the person uses a misleading name. Members are, however, allowed to use non-misleading "doing business as" names if those names are reported to NFA on Form 7-R or Form 3-R.

The use of misleading names, affiliations, and qualifications is a violation of Compliance Rule 2-29(a)(1) and (b)(1). For example, if reference is made to membership in any organization (e.g., NFA, SIPC, an exchange), it should be clear which entity belongs to that organization. Similarly, Members and Associates may not state or imply that any individual has any degree or designation that does not exist or is self-conferred, nor may they use bona fide degrees or designations in a misleading manner. Therefore, the Member's supervisory procedures should be reasonably designed to ensure that neither the Member nor its employees use misleading names, affiliations, or qualifications in connection with their security futures activities.

Supervision of Branch Offices and Guaranteed IBs

As with other futures activities, Members must supervise each branch office and guaranteed IB that solicits or accepts accounts or orders for or recommends or engages in transactions in security futures products. A designated security futures principal must approve, in writing, and enforce written procedures that include all of the review steps discussed in the interpretive notice entitled "Compliance Rule 2-9: Supervision of Branch Offices and Guaranteed IBs" (9019). The review must be conducted under the supervision of a designated security futures principal and must include annual (or more frequent) on-site reviews of each branch office and guaranteed IB that solicits or accepts accounts or orders for or recommends or engages in transactions in security futures products.

Hiring Employees and Entering Into Guarantee Agreements

An adequate program for supervision must include thorough screening procedures for prospective employees who will be involved in commodity futures activities. In regard to prospective employees who may be involved in activities regarding security futures products and who have been registered in the securities industry, this screening process must include a check of the Central Registration Depository (CRD) for any derogatory information on the employee and his or her employer.[2] The screening does not have to be done by a designated security futures principal. The designated security futures principal must, however, regularly review hiring practices to ensure that the screening process is taking place and to otherwise ensure that qualified personnel are investigating the good character, business repute, qualifications, and experience of employees who may be involved in security futures activities. Furthermore, all relevant information must be considered in making the hiring decision and determining how much supervision the employee will require.

A Member must obtain and review a copy of the most recent Form 8-T or U-5 (including any amendments) filed by a new employee's most recent security or futures employer if the employee will be involved in registered activities regarding security futures products. The Member shall obtain the Form 8-T or U-5 (including any amendments) no later than sixty days after the individual files an application for registration as an associated person (AP) of the Member under the Commodity Exchange Act. A Member that does not obtain the information within 60 days has the burden of demonstrating that it has made a reasonable effort by attempting to obtain the information both from NFA and FINRA (through the CRD), as applicable, and from the employee. If the Form 8-T or U-5 includes any derogatory information, the employer shall take such action as it deems appropriate.

The procedures must also require the employee to provide a copy of the Form 8-T or U-5 (and any amendments) to the Member within two business days after the Member requests it or, if the former employer did not provide a copy of the Form 8-T or U-5 to the employee, the employee shall promptly request a copy from the former employer (or from NFA or FINRA if the former employer cannot or will not provide it), and must provide the Form 8-T or U-5 to the Member within two business days after receiving it. The procedures must also require the employee to promptly provide the Member with any subsequent amendments to the Form 8-T or U-5.[3]

Guarantor FCMs must also do a due diligence inquiry before entering into a guarantee agreement. If the IB may be involved in activities regarding security futures products, the prospective guarantor must check the CRD for any derogatory information on the IB, its principals, and its employees. Again, all relevant information must be considered when deciding whether to guarantee an IB and determining how much supervision a guaranteed IB will require.

Meetings with Associated Persons

Each employee registered as an associated person under the Commodity Exchange Act and engaging in security futures activities must participate, no less than once a year, in an individual interview or group meeting, conducted by persons designated by the Member, at which compliance matters relevant to the associated person's security futures activities are discussed. The interview or meeting may include other matters and may occur at a central or regional location or at the associated person's place of business.

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[1] This notice does not change the general supervisory responsibilities that Compliance Rule 2-9 imposes on other NFA Members.

[2] If the prospective employer does not have direct access to the CRD, it can obtain the information from the Financial Industry Regulatory Authority (FINRA) using FINRA's public disclosure program. FINRA's public disclosure program can be accessed through its web site at http://www.finra.org/.

[3] It is conduct inconsistent with just and equitable principles of trade, and therefore a violation of Compliance Rule 2-4, for an Associate to violate written procedures that are required by NFA, the CFTC, or the SEC.

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Compliance Rules

RULE 2-29. COMMUNICATIONS WITH THE PUBLIC AND PROMOTIONAL MATERIAL.
[Adopted effective November 19, 1985. Effective date of Amendments: February 1, 1996; August 29, 1996; March 28, 2000; July 24, 2000; December 4, 2000; August 21, 2001; May 1, 2004 and February 1, 2010.]

(a) General Prohibition.

No Member or Associate shall make any communication with the public which:

(1) operates as a fraud or deceit;
(2) employs or is part of a high-pressure approach; or
(3) makes any statement that futures trading is appropriate for all persons.

(b) Content of Promotional Material.

No Member or Associate shall use any promotional material which:

(1) is likely to deceive the public;

(2) contains any material misstatement of fact or which the Member or Associate knows omits a fact if the omission makes the promotional material misleading;

(3) mentions the possibility of profit unless accompanied by an equally prominent statement of the risk of loss;

(4) includes any reference to actual past trading profits without mentioning that past results are not necessarily indicative of future results;

(5) includes any specific numerical or statistical information about the past performance of any actual accounts (including rate of return)

(i) unless such information is and can be demonstrated to NFA to be representative of the actual performance for the same time period of all reasonably comparable accounts and,

(ii) in the case of rate of return figures, unless such figures are calculated in a manner consistent with CFTC Regulation 4.25(a)(7) for commodity pools and with CFTC Regulation 4.35(a)(6), as modified by NFA Compliance Rule 2-34(a), for figures based on separate accounts, or

(6) includes a testimonial that is not representative of all reasonably comparable accounts, does not prominently state that the testimonial is not indicative of future performance or success, and does not prominently state that it is a paid testimonial (if applicable).

(c) Hypothetical Results.

(1) Any Member or Associate who uses promotional material which includes a measurement or description of or makes any reference to hypothetical performance results which could have been achieved had a particular trading system of the Member or Associate been employed in the past must include in the promotional material the following disclaimer prescribed by NFA's Board of Directors:

HYPOTHETICAL PERFORMANCE RESULTS HAVE MANY INHERENT LIMITATIONS, SOME OF WHICH ARE DESCRIBED BELOW. NO REPRESENTATION IS BEING MADE THAT ANY ACCOUNT WILL OR IS LIKELY TO ACHIEVE PROFITS OR LOSSES SIMILAR TO THOSE SHOWN. IN FACT, THERE ARE FREQUENTLY SHARP DIFFERENCES BETWEEN HYPOTHETICAL PERFORMANCE RESULTS AND THE ACTUAL RESULTS SUBSEQUENTLY ACHIEVED BY ANY PARTICULAR TRADING PROGRAM.

ONE OF THE LIMITATIONS OF HYPOTHETICAL PERFORMANCE RESULTS IS THAT THEY ARE GENERALLY PREPARED WITH THE BENEFIT OF HINDSIGHT. IN ADDITION, HYPOTHETICAL TRADING DOES NOT INVOLVE FINANCIAL RISK, AND NO HYPOTHETICAL TRADING RECORD CAN COMPLETELY ACCOUNT FOR THE IMPACT OF FINANCIAL RISK IN ACTUAL TRADING. FOR EXAMPLE, THE ABILITY TO WITHSTAND LOSSES OR TO ADHERE TO A PARTICULAR TRADING PROGRAM IN SPITE OF TRADING LOSSES ARE MATERIAL POINTS WHICH CAN ALSO ADVERSELY AFFECT ACTUAL TRADING RESULTS. THERE ARE NUMEROUS OTHER FACTORS RELATED TO THE MARKETS IN GENERAL OR TO THE IMPLEMENTATION OF ANY SPECIFIC TRADING PROGRAM WHICH CANNOT BE FULLY ACCOUNTED FOR IN THE PREPARATION OF HYPOTHETICAL PERFORMANCE RESULTS AND ALL OF WHICH CAN ADVERSELY AFFECT ACTUAL TRADING RESULTS.

If a Member or Associate has either less than one year of experience in directing customer accounts or trading proprietary accounts, then the disclaimer must also contain the following statement:

> (THE MEMBER) HAS HAD LITTLE OR NO EXPERIENCE IN TRADING ACTUAL ACCOUNTS FOR ITSELF OR FOR CUSTOMERS. BECAUSE THERE ARE NO ACTUAL TRADING RESULTS TO COMPARE TO THE HYPOTHETICAL PERFORMANCE RESULTS, CUSTOMERS SHOULD BE PARTICULARLY WARY OF PLACING UNDUE RELIANCE ON THESE HYPOTHETICAL PERFORMANCE RESULTS.

(2) Any Member or Associate who uses promotional material which includes a measurement or description of or makes any reference to a hypothetical composite performance record showing what a multi-advisor account portfolio or pool could have achieved in the past if assets had been allocated among particular trading advisors must include in the promotional material the following disclaimer prescribed by NFA's Board of Directors instead of the disclaimer prescribed by Section (c) (1) of this Rule:

> THIS COMPOSITE PERFORMANCE RECORD IS HYPOTHETICAL AND THESE TRADING ADVISORS HAVE NOT TRADED TOGETHER IN THE MANNER SHOWN IN THE COMPOSITE. HYPOTHETICAL PERFORMANCE RESULTS HAVE MANY INHERENT LIMITATIONS, SOME OF WHICH ARE DESCRIBED BELOW. NO REPRESENTATION IS BEING MADE THAT ANY MULTI-ADVISOR MANAGED ACCOUNT OR POOL WILL OR IS LIKELY TO ACHIEVE A COMPOSITE PERFORMANCE RECORD SIMILAR TO THAT SHOWN. IN FACT, THERE ARE FREQUENTLY SHARP DIFFERENCES BETWEEN A HYPOTHETICAL COMPOSITE PERFORMANCE RECORD AND THE ACTUAL RECORD SUBSEQUENTLY ACHIEVED.
>
> ONE OF THE LIMITATIONS OF A HYPOTHETICAL COMPOSITE PERFORMANCE RECORD IS THAT DECISIONS RELATING TO THE SELECTION OF TRADING ADVISORS AND THE ALLOCATION OF ASSETS AMONG THOSE TRADING ADVISORS WERE MADE WITH THE BENEFIT OF HINDSIGHT BASED UPON THE HISTORICAL RATES OF RETURN OF THE SELECTED TRADING ADVISORS. THEREFORE, COMPOSITE PERFORMANCE RECORDS INVARIABLY SHOW POSITIVE RATES OF RETURN. ANOTHER INHERENT LIMITATION ON THESE RESULTS IS THAT THE ALLOCATION DECISIONS REFLECTED IN THE PERFORMANCE RECORD WERE NOT MADE UNDER ACTUAL MARKET CONDITIONS AND, THEREFORE, CANNOT COMPLETELY ACCOUNT FOR THE IMPACT OF FINANCIAL RISK IN ACTUAL TRADING. FURTHERMORE, THE COMPOSITE PERFORMANCE RECORD MAY BE DISTORTED BECAUSE THE ALLOCATION OF ASSETS CHANGES FROM TIME TO TIME AND THESE ADJUSTMENTS ARE NOT REFLECTED IN THE COMPOSITE.

If a Member or Associate has less than one year of experience allocating assets among particular trading advisors, then the disclaimer must also contain the following statement:

> (THE MEMBER) HAS HAD LITTLE OR NO EXPERIENCE ALLOCATING ASSETS AMONG PARTICULAR TRADING ADVISORS. BECAUSE THERE ARE NO ACTUAL ALLOCATIONS TO COMPARE TO THE PERFORMANCE RESULTS FROM THE HYPOTHETICAL ALLOCATION, CUSTOMERS SHOULD BE PARTICULARLY WARY OF PLACING UNDUE RELIANCE ON THESE RESULTS.

(3) Any Member or Associate who uses promotional material which includes a measurement or description of or makes any reference to hypothetical performance results which could have been achieved had a particular trading system of the Member or Associate been employed in the past must include in the promotional material comparable information regarding:

> (i) past performance results of all customer accounts directed by the Member pursuant to a power of attorney over at least the last five years or over the entire performance history if less than five years;
>
> (ii) if the Member has less than one year of experience in directing customer accounts, past performance results of his proprietary trading over at least the last five years or over the entire performance history if less than five years.

(4) No Member or Associate may use promotional material which includes a measurement or description of or makes any reference to hypothetical performance results which could have been achieved had a particular trading system of the Member or Associate been employed in the past if the Member or Associate has three months of actual trading results for that system.

(5) Any Member or Associate utilizing promotional material containing hypothetical performance results must adhere to all the requirements contained in the Board's Interpretive Notice relating to this issue.

[See Interpretive Notice Compliance Rule 2-29: Use of Promotional Material Containing Hypothetical Performance Results.]

(6) These restrictions on the use of hypothetical trading results shall not apply to promotional material directed exclusively to persons who meet the standards of a "Qualified Eligible Person" under CFTC Regulation 4.7.

(d) Statements of Opinion.

Statements of opinion included in promotional material must be clearly identifiable as such and must have a reasonable basis in fact.

(e) Supervisory Requirements

Every Member shall adopt and enforce written procedures to supervise its Associates and employees for compliance with this Rule. Prior to its first use, all promotional material shall be reviewed and approved, in writing, by an officer, general partner, sole proprietor, branch office manager or other supervisory employee other than the individual who prepared such material (unless such material was prepared by the only individual qualified to review and approve such material). If the Member is registered as a broker-dealer under Section 15(b)(11) of the Exchange Act and the promotional material specifically refers to security futures products, the individual reviewing and approving the promotional material must be a designated security futures principal.

(f) Recordkeeping.

Copies of all promotional material along with a record of the review and approval required under paragraph (e) of this Rule and supporting materials for any results described under paragraphs (b)(5)-(6) or (c) of this Rule must be maintained by each Member and be available for examination for the periods specified in CFTC Regulation 1.31, measured from the date of the last use. Each Member who uses promotional material of the types described in paragraph (b)(5)-(6) or (c) of this Rule shall demonstrate the basis for any reported results to NFA upon

request.

(g) Filing with NFA.

The Compliance Director may require any Member for any specified period to file copies of all promotional material with NFA promptly after its first use.

(h) Radio and Television Advertisements.

No Member shall use or directly benefit from any radio or television advertisement or any other audio or video advertisement distributed through media accessible by the public if the advertisement makes any specific trading recommendation or refers to or describes the extent of any profit obtained in the past that can be achieved in the future unless the Member submits the advertisement to NFA's Promotional Material Review Team for its review and approval at least 10 days prior to first use or such shorter period as NFA may allow in particular circumstances.

(i) Definitions.

(1) For purposes of this Rule "promotional material" includes: (i) Any text of a standardized oral presentation, or any communication for publication in any newspaper, magazine or similar medium, or for broadcast over television, radio, or other electronic medium, which is disseminated or directed to the public concerning a futures account, agreement or transaction; (ii) any standardized form of report, letter, circular, memorandum or publication which is disseminated or directed to the public; and (iii) any other written material disseminated or directed to the public for the purpose of soliciting a futures account, agreement or transaction.

(2) "Futures account, agreement or transaction" includes futures accounts and orders, commodity pool participations, agreements to direct or guide trading in futures accounts, and agreements and transactions involving the sale, through publications or otherwise, of non-personalized trading advice concerning futures.

(j) Security Futures Products

In addition to the other requirements of this Rule, Members registered as broker-dealers under Section 15(b)(11) of the Exchange Act and their Associates shall not use any promotional material that specifically refers to security futures products unless the promotional material:

(1) prominently identifies the Member;

(2) includes the date that the material was first used;

(3) provides contact information for obtaining a copy of the disclosure statement for security futures products;

(4) states that security futures products are not suitable for all customers;

(5) does not include any statement suggesting that security futures positions can be liquidated at any time;

(6) does not include any cautionary statement, caveat, or disclaimer that is not legible, that attempts to disclaim responsibility for the content of the promotional material or the opinions expressed in the material, that is misleading, or that is otherwise inconsistent with the content of the material;

(7) discloses the source of any statistical tables, charts, graphs, or other illustrations from a source other than the Member, unless the source of the information is otherwise obvious;

(8) states that supporting documentation will be furnished upon request if it includes any claims, comparisons, recommendations, statistics or other technical data;

(9) if soliciting for a trading program that will be managed by an FCM or IB or Associate of an FCM or IB, it includes the cumulative performance history of the Member's customers who have used the trading program; provided, however, that if the Member does not have customers who have traded the program through the Member, the promotional material must state that the trading program is unproven and must include all of the information required by section (c) of this Rule and the Interpretive Notice on the Use of Promotional Material Containing Hypothetical Performance Results (9025);

(10) refers to past recommendations regarding security futures products, the underlying securities, or a derivative thereof only if it sets forth all recommendations as to the same type, kind, grade, or classification of securities (including security futures products and other security derivatives) made by the Member or Associate within the last year; which information must include the name of each security recommended with the date and nature of each recommendation (e.g., whether to buy or sell), the price at the time of the recommendation, the price at which or the price range within which the recommendation was to be acted upon, and the general market conditions during the period covered if the promotional material refers to past recommendations regarding security futures products, the underlying securities, or a derivative thereof;

(11) includes current recommendations regarding security futures products only if: (i) the Member has a reasonable basis for the recommendation; (ii) the material discloses all material conflicts of interest created by the Member's or Associate's activities in the underlying security; and (iii) the material contains contact information for obtaining the list of prior recommendations described in subsection (10);

(12) includes only a general description of the security futures products for which accounts, orders, trading authorization, or pool participations are being solicited; the name of the Member; and contact information for obtaining a copy of the current disclosure statement for security futures products; provided, however, that this subsection does not apply if the promotional material is accompanied or preceded by the disclosure statement for security futures products; and

(13) has been submitted to NFA for review and approval at least ten days prior to first use if it reaches or is designed to reach a public audience through mass media (e.g., newspapers, magazines, radio, television, or other electronic media). This requirement does not apply to any promotional material in which the only reference to security futures products is contained in a listing of the Member's services.

[See Interpretive Notice NFA Compliance Rule 2-29: Communications with the Public and Promotional Material and Interpretive Notice NFA Compliance Rule 2-29: Review of Promotional Material Prior to its First Use and Interpretive Notice Compliance Rule 2-29: Use of Promotional Material Containing Hypothetical Performance Results and Interpretive Notice NFA Compliance Rule 2-29: Deceptive Advertising (1996) and Interpretive Notice NFA Compliance Rule 2-29: Deceptive Advertising (1998) and Interpretive Notice Compliance Rule 2-29: High Pressure Sales Tactics and Interpretive Notice NFA Compliance Rules 2-29 and 2-9: NFA's Review and Approval of Certain Radio and Television Advertisements]

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Interpretive Notices

9043 - NFA COMPLIANCE RULE 2-29: USE OF PAST OR PROJECTED PERFORMANCE; DISCLOSING CONFLICTS OF INTEREST FOR SECURITY FUTURES PRODUCTS

INTERPRETIVE NOTICE

The Commodity Futures Modernization Act of 2000 (CFMA), which was signed into law on December 21, 2000, lifts the 18-year ban on single-stock futures and narrow-based security indices ("security futures products"). Unlike other futures contracts, however, the CFMA provides that security futures products are securities as well as futures. Therefore, under Section 15A(k) of the Securities Exchange Act of 1934 (Exchange Act), NFA is a national securities association (NSA) for the limited purpose of regulating the activities of Members who are registered as brokers or dealers in security futures products under Section 15(b)(11) of the Exchange Act (i.e., FCMs and IBs who "passport" in to broker-dealer registration because they limit their securities activities to security futures products).

NFA Compliance Rule 2-29 imposes high standards on Members' and Associates' communications with the public in connection with any of their futures activities. When regulating the securities futures activities of Members registered as broker-dealers under Section 15(b)(11) of the Exchange Act, however, Section 15A(k)(2)(B) of the Exchange Act requires NFA to impose sales practice and promotional material requirements reasonably comparable to those of national securities associations registered under Section 15A(a) of the Exchange Act. In light of those requirements, this notice reiterates some of the requirements that apply to all products and describes some of the additional requirements imposed by new section (j) of Compliance Rule 2-29. Section (j) applies to the security futures activities of those Members who are registered as broker-dealers under Section 15(b)(11) of the Exchange Act and their Associates. Sections (a)-(i) apply to all Members.

The requirements described in this interpretation are in addition to — and do not in any way limit or amend — any other requirements imposed by NFA rules, including those discussed in other interpretations issued by the Board of Directors.

Use of Misleading Statements

NFA Compliance Rule 2-29(b)(1) prohibits the use of promotional material that is likely to deceive the public. Additionally, NFA Compliance Rule 2-29(b)(2) prohibits the use of promotional material which contains any material misstatement of fact or which the Member or Associate knows omits a fact which causes the material to be misleading. NFA has always considered the following items to be violations of these Rules:

- Promotional material that uses outdated information to support current claims;[1]
- Promotional material that makes claims regarding research or other facilities beyond those which the Member or Associate actually possesses or has reasonable capacity to provide.[2]
- Promotional material that makes any statement to the effect that any report, analysis, or other service will be furnished free or without any charge unless such report, analysis or other service actually is or will be furnished entirely free and without condition or obligation.[3]

Use of Past or Projected Performance

NFA Compliance Rule 2-29 places certain limitations on the use of past or projected performance in communications with the public. Some of those limitations — most of which apply to all futures contracts regardless of the underlying commodity — are discussed in this section.

Provided that the performance is representative of all reasonably comparable accounts, most promotional material may discuss past performance of actual or recommended transactions if it meets a number of standards.

- Performance must be presented in a balanced manner. (See NFA Compliance Rule 2-29(b)(2) and (b)(5).)
- The promotional material must disclose all relevant costs, including commissions and fees. (See NFA Compliance Rule 2-29

(b)(2).)

- Any discussion of the past performance of recommended transactions must comply with NFA Compliance Rule 2-29(c).
- For security futures products, the promotional material must indicate the general market conditions during the period covered. (See NFA Compliance Rule 2-29(b)(1) and (2).)
- Performance information used by FCMs, IBs, and their Associates must include the date of each initial recommendation or transaction; the price at that date; and the date and price at the end of the period or when liquidation was suggested or effected, whichever was earlier. If a summary is used, it must be calculated in a manner consistent with CFTC Regulation 4.25 (a)(7)(i)(F). (See NFA Compliance Rule 2-29(b)(2) and (5).)
- Performance information used by FCMs, IBs, and their Associates must also be current, meaning that it must cover at least the most recent 12-month period or must include the performance in its entirety if less than 12 months. The Member or Associate must disclose more than the last 12 months of performance if the last 12 months is not representative, and the Member or Associate may not include gaps or otherwise cherry-pick the periods for which it discloses performance. (See NFA Compliance Rule 2-29(b)(1) and (2).)
- The Member or Associate must keep records showing how it calculated the performance numbers used in the promotional material. These records must identify the trades and accounts that were used in calculating performance, describe how and why those transactions and accounts were selected, and demonstrate how the results are representative of all reasonably comparable accounts. (See NFA Compliance Rule 2-29(f).)
- A person who is authorized to approve the promotional material must determine that the performance information is accurate and is presented in a manner that is not misleading. (See NFA Compliance Rules 2-9(a) and 2-29(e).)

Promotional material that discusses projected performance must also meet a number of standards.

- The promotional material must disclose, and the projected performance must be adjusted for, all relevant costs, including commissions and fees. (See NFA Compliance Rule 2-29(b)(2).)
- The projected performance must have a reasonable basis in fact. (See NFA Compliance Rule 2-29(d).)
- All material assumptions made in projecting performance must be clearly identified. (See NFA Compliance Rule 2-29(b)(2).)
- The risks must be discussed and balanced with the discussion of projected profits. (See NFA Compliance Rule 2-29(b)(3).)

Annual rates of return may not be used in any promotional material unless they are based on 12 consecutive months of actual performance, and they must be calculated in a manner consistent with CFTC Regulation 4.25(a)(7)(i)(F). (See NFA Compliance Rule 2-29(b)(5).) Furthermore, the promotional material must state that past results are not necessarily indicative of future results. (See NFA Compliance Rule 2-29(b)(4).)

NFA Compliance Rule 2-29(j) imposes additional restrictions on promotional material of Members registered as broker-dealers under Section 15(b)(11) of the Exchange Act and their Associates if the promotional material specifically refers to security futures products. Where the promotional material is accompanied or preceded by the disclosure statement for security futures products, references to past recommendations must include all of the information described in Compliance Rule 2-29(j)(9), and references to current recommendations must include instructions on how to obtain that information. However, promotional material for these products may not contain any discussion of past or projected performance unless accompanied or preceded by the disclosure statement for security futures products. This means that most forms of mass media advertising cannot discuss past or projected performance.

Research reports for underlying securities are not promotional material under NFA Compliance Rule 2-29 merely because the customers who receive the reports may trade security futures products in those securities. Compliance Rule 2-29 does, however, cover any research report that mentions security futures products or discusses any strategy that includes using security futures products.

Disclosing Conflicts of Interest in Security Futures Products by Members Registered as Broker-Dealers Under Section 15(b)(11) of the Exchange Act

Due to the nature of the securities markets, Members may have special conflicts of interest that may not necessarily be known to their customers. NFA Compliance Rule 2-29(j)(11) - which applies to Members registered as broker-dealers under Section 15(b)(11) of the Exchange Act - provides that promotional material that makes a recommendation regarding security futures products must disclose material conflicts of interest that the Member may have due to its activities in the underlying security. In particular, the promotional material must disclose any of the following conflicts, if applicable:

- The Member and/or its officers or partners own options, rights, or warrants to purchase any of the securities of the issuer whose securities underlie the security futures product being recommended, unless the ownership is nominal; and
- Within the last three years, the Member was manager or co-manager of a public offering of any securities of the issuer whose securities underlie the security futures product being recommended.

[1] See, In the Matter of MBH Commodity Advisors, Inc., NFA Case No. 96-BCC-015 (Hearing Panel, May 5, 1998), aff'd, NFA Case No. 98-APP-001 (App. Comm., Feb. 19, 1999); aff'd, CFTC Docket No. CRAA 99-3 (CFTC, Mar. 31, 2000), aff'd, MBH Commodity Advisors, Inc. v. Commodity Futures Trading Commission, No. 00-1957, 7th Cir., May 7, 2001.

[2] See, In re Universal Commodity Corporation, NFA Case No. 95-BCC-20 (Hearing Panel, Feb. 3, 1998), aff'd, In re Parks, NFA Case Nos. 98-APP-1, 98-APP-2, and 98-APP-3 (App. Comm., Mar. 14, 2000); In re JCC, Inc., NFA Case No. 90-BCC-30 (Aug. 25, 1992); aff'd, NFA Case Nos. 92-APP-2 through 92-APP-8 (App. Comm., July 19, 1993); aff'd, CFTC Docket No. CRAA 93-6 (CFTC, June 29, 1994).

[3] See, In re Filler Zaner & Associates, NFA Case No. 89-BCC-32 (BCC, Nov. 30, 1989).

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Compliance Rules

RULE 2-30. CUSTOMER INFORMATION AND RISK DISCLOSURE.
[Adopted effective June 1, 1986. Effective date of amendments: January 1, 1990, August 21, 2001 December 10, 2002, December 17, 2007]

(a) Each Member or Associate shall, in accordance with the provisions of this Rule, obtain information about its futures customers who are individuals and provide such customers with disclosure of the risks of futures trading.

Effective January 3, 2011, paragraph (a) will read as follows:

(a) Each Member or Associate shall, in accordance with the provisions of this Rule, obtain information from all individual customers and any other customers who are not eligible contract participants (as defined in Section 1(a)(12) of the Act) and provide such customers with disclosure of the risks of futures trading.

(b) The Member or Associate shall exercise due diligence to obtain the information and shall provide the risk disclosure at or before the time a customer first opens a futures trading account to be carried or introduced by the Member, or first authorizes the Member to direct trading in a futures account for the customer. A Member registered as a broker or dealer under Section 15(b)(11) of the Exchange Act shall provide a copy of the disclosure statement for security futures products at or before the time the Member approves the account to trade security futures products.

Effective January 3, 2011, paragraph (b) will read as follows:

(b) The Member or Associate shall exercise due diligence to obtain the information and shall provide the risk disclosure at or before the time a customer first opens a futures trading account to be carried or introduced by the Member, or first authorizes the Member to direct trading in a futures account for the customer. A Member registered as a broker or dealer under Section 15(b)(11) of the Exchange Act shall provide a copy of the disclosure statement for security futures products at or before the time the Member approves the account to trade security futures products. For an active customer who is an individual, the FCM Member carrying the customer account shall contact the customer, at least annually, to verify that the information obtained from that customer under Section (c) of this Rule remains materially accurate, and provide the customer with an opportunity to correct and complete the information. Whenever the customer notifies the FCM Member carrying the customer's account of any material changes to the information, a determination must be made as to whether additional risk disclosure is required to be provided to the customer based on the changed information. If another FCM or IB introduces the customer's account on a fully disclosed basis or a CTA directs trading in the account, then the carrying FCM must notify that Member of the changes to the customer's information. The Member or Associate who currently solicits and communicates with the customer is responsible for determining if additional risk disclosure is required to be provided based on the changed information. In some cases, this may be the Member introducing or controlling the account; in other cases, it may be the carrying FCM.

(c) The information to be obtained from the customer shall include at least the following:

(1) the customer's true name and address, and principal occupation or business;

(2) the customer's current estimated annual income and net worth;

(3) the customer's approximate age; and

(4) an indication of the customer's previous investment and futures trading experience;

In addition, Members that are not also members of the Financial Industry Regulatory Authority and their Associates must obtain the following information from each customer who is an individual if the customer trades security futures products:

(5) whether the customer's account is for speculative or hedging purposes;

(6) the customer's employment status (e.g., name of employer, self-employed, retired);

(7) the customer's estimated liquid net worth (cash, securities, other);

(8) the customer's marital status and number of dependents;

(9) such other information used or considered to be reasonable by such Member or Associate in making recommendations to the customer.

Effective January 3, 2011, paragraph (c) will read as follows:

(c) The information to be obtained from the customer shall include at least the following:

(1) The customer's true name and address, and principal occupation or business;

(2) For customers who are individuals, the customer's current estimated annual income and net worth. For all other customers, the customer's net worth or net assets and current estimated annual income, or where not available, the previous year's annual income;

(3) For individuals, the customer's approximate age or date of birth;

(4) An indication of the customer's previous investment and futures trading experience; and

(5) Such other information deemed appropriate by such Member or Associate to disclose the risks of futures trading to the customer.

In addition, Members that are not also members of the Financial Industry Regulatory Authority and their Associates must obtain the following information from each customer who is an individual if the customer trades security futures products:

(6) Whether the customer's account is for speculative or hedging purposes;

(7) The customer's employment status (e.g., name of employer, self-employed, retired);

(8) The customer's estimated liquid net worth (cash, securities, other);

(9) The customer's marital status and number of dependents;

(10) Such other information used or considered to be reasonable by such Member or Associate in making recommendations to the customer.

(d) The risk disclosure to be provided to the customer shall include at least the following:

(1) the Risk Disclosure Statement required by CFTC Regulation 1.55, if the Member is required by that Regulation to provide it;

(2) the Disclosure Document required by CFTC Regulation 4.31, if the Member is required by that Regulation to provide it;

(3) the Options Disclosure Statement required by CFTC Regulation 33.7, if the Member is required by that Regulation to provide it; and

(4) the Disclosure Document required by CFTC Regulation 31.11, if the Member is required by that Regulation to provide it.

(e) In the case of an account which is introduced by an FCM or IB or for which a CTA directs trading, and except as otherwise provided in subsections (b) and (j), it shall be the responsibility of the Member soliciting the account to comply with this Rule.

(f) A Member or Associate shall be entitled to rely on the customer [as the sole source] for the information obtained under Section (c) of this Rule and shall not be required to verify such information, except as provided in section (j)(2) of this rule.

(g) Each Member or Associate shall make or obtain a record containing the information obtained under Section (c) of this Rule at the time the information is obtained. If a customer declines to provide the information set forth in Section (c) of this Rule, the Member or Associate shall make a record that the customer declined, except that such a record need not be made in the case of a non-U.S. customer unless such customer trades security futures products. Subject to the provisions of Section (i) of this Rule, a Member may open, introduce or agree to direct a futures trading account for a customer only upon the approval of a partner, officer, director, branch office manager or supervisory employee of the Member. Each Member shall keep copies of all records made pursuant to this Rule in the form and for the period of time set forth in CFTC Regulation 1.31.

(h) Each Member shall establish and enforce adequate procedures to review all records made pursuant to this Rule and to supervise the activities of its Associates in obtaining customer information and providing risk disclosure.

(i) Nothing herein shall relieve any Member from the obligation to comply with all applicable CFTC and SEC Regulations and NFA Requirements.

(j) Members that are not also members of the Financial Industry Regulatory Authority and their Associates shall adhere to the following additional requirements relating to accounts for customers that trade security futures products:

(1) A Member shall exercise due diligence to learn the essential facts relative to the customer, including the customer's investment objectives and financial situation and, based upon those facts (including any information obtained under subsection (c) of this Rule, if applicable), a partner, officer, director, branch office manager, or supervisory employee of the Member shall approve or disapprove the customer's account for security futures transactions. If the Member is an FCM or IB, the account must be approved or disapproved by a designated security futures principal. The approval or disapproval shall be in writing and shall identify the person approving or

disapproving the account. Additionally, the customer's account records shall contain information about the account, including the name of the Associate, how the customer's information was obtained, and the date that the disclosure statement for security futures products was provided.

(2) A Member or Associate shall forward the background and financial information upon which the customer's account has been approved for trading security futures products to each customer who is an individual, unless the information has been obtained in writing from the customer, for verification of accuracy within fifteen days after the customer's account has been approved. A copy of the background and financial information on file with the Member shall also be sent to each customer who is an individual for verification within fifteen days after the Member becomes aware of any material change in the customer's financial status. In all cases, absent notice to the contrary from the customer, the information is deemed verified.

(3) No FCM or IB Member or Associate thereof shall recommend to a non-institutional customer a transaction in security futures products or a particular trading strategy relating to such products without making reasonable efforts to obtain current information regarding the customer's financial status and investment objectives; provided, however, that this requirement does not apply to transactions in discretionary accounts. For purposes of this requirement, a non-institutional customer is any customer who is not:

(i) a bank, savings and loan association, insurance company, registered investment company, a registered commodity pool operator, or a commodity pool operated by a registered commodity pool operator;

(ii) an investment advisor registered either with the Securities and Exchange Commission under Section 203 of the Investment Advisers Act of 1940 or with a state securities commission (or any agency or office performing like functions) or a registered commodity trading advisor;

(iii) an investment company exempt from registration under the Investment Company Act of 1940, a commodity pool operator exempt from registration under the Commodity Exchange Act, a commodity pool operated by a commodity pool operator exempt from registration under the Commodity Exchange Act, an investment advisor exempt from both federal and state registration under the Investment Advisers Act of 1940, or a commodity trading advisor exempt from registration under the Commodity Exchange Act;

(iv) a registered broker-dealer or futures commission merchant; or

(v) any other entity (whether a natural person, corporation, partnership, trust, or otherwise) with total assets of at least $50 million.

(4) No FCM or IB Member or Associate thereof shall recommend to any customer a transaction in security futures products or a particular trading strategy relating to such products without reasonable grounds for believing that the recommendation or strategy is not unsuitable for the customer on the basis of the customer's current investment objectives, financial situation and needs, and any other information known by the Member or Associate.

(5) No FCM or IB Member or Associate shall recommend a security futures transaction to a customer unless the person making the recommendation has a reasonable basis for believing, at the time of making the recommendation, that the customer has such knowledge and experience in financial matters that the customer may reasonably be expected to be capable of evaluating the risks of the recommended transaction, and is financially able to bear the risks of the recommended transaction.

(6) No Member or Associate exercising discretion over an account may effect security futures transactions that are excessive in size or frequency in view of the customer's investment objectives and financial situation.

[See Interpretive Notice NFA Compliance Rule 2-30: Customer Information and Risk Disclosure (Board of Directors) and Interpretive Notice NFA Compliance Rule 2-30: Customer Information and Risk Disclosure (Staff).]

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NFA Manual / Rules

Welcome to the online version of NFA's rulebook, the NFA Manual. We update this version on an ongoing basis. If you want to check out what changes have most recently been made to the NFA Manual, go to Recent Manual Updates. You may view a categorized list of the Interpretive Notices by visiting the Index of Interpretive Notices page.

Interpretive Notices

9050 - NFA COMPLIANCE RULE 2-30(b): RISK DISCLOSURE STATEMENT FOR SECURITY FUTURES CONTRACTS
(Revised December 12, 2002; and December 17, 2007)

INTERPRETIVE NOTICE

NFA Compliance Rule 2-30(b) requires Members and Associates who are registered as brokers or dealers under Section 15(b)(11) of the Securities Exchange Act of 1934 to provide a disclosure statement for security futures products to a customer at or before the time the Member approves the account to trade security futures products.[1]

NFA Compliance Rule 2-30(j)(1) requires these Members and Associates to make a record of when the disclosure statement was provided, and Compliance Rule 2-29(j)(12) prohibits them from including anything other than basic information in promotional material unless the promotional material is preceded or accompanied by the disclosure statement.[2] The disclosure statement for security futures products referred to in these Rules is a uniform statement that has been jointly developed by NFA, the Financial Industry Regulatory Authority, and a number of securities and futures exchanges.

The uniform disclosure statement, which is titled "Risk Disclosure Statement for Security Futures Contracts," can be downloaded from NFA's web site at www.nfa.futures.org/NFA-compliance/publication-library/security-futures-disclosure-brochure.pdf. Copies are also available by calling NFA's Information Center at 800-621-3570.[3]

Members must be able to demonstrate to NFA, during an audit, that they provided the disclosure statement as required. Members are not, however, required to obtain a written acknowledgment from the customer regarding the disclosure statement.

* * *

RISK DISCLOSURE STATEMENT FOR SECURITY FUTURES CONTRACTS

This disclosure statement discusses the characteristics and risks of standardized security futures contracts traded on regulated U.S. exchanges. At present, regulated exchanges are authorized to list futures contracts on individual equity securities registered under the Securities Exchange Act of 1934 (including common stock and certain exchange-traded funds and American Depositary Receipts), as well as narrow-based security indices. Futures on other types of securities and options on security futures contracts may be authorized in the future. The glossary of terms appears at the end of the document.

Customers should be aware that the examples in this document are exclusive of fees and commissions that may decrease their net gains or increase their net losses. The examples also do not include tax consequences, which may differ for each customer.

Section 1 – Risks of Security Futures

1.1. Risks of Security Futures Transactions
Trading security futures contracts may not be suitable for all investors. You may lose a substantial amount of money in a very short period of time. The amount you may lose is potentially unlimited and can exceed the amount you originally deposit with your broker. This is because futures trading is highly leveraged, with a relatively small amount of money used to establish a position in assets having a much greater value. If you are uncomfortable with this level of risk, you should not trade security futures contracts.

1.2. General Risks

- *Trading security futures contracts involves risk and may result in potentially unlimited losses that are greater than the amount you deposited with your broker.* As with any high risk financial product, you should not risk any funds that you cannot afford to lose, such as your retirement savings, medical and other emergency funds, funds set aside for purposes such as education or home ownership, proceeds from student loans or mortgages, or funds required to meet your living expenses.
- *Be cautious of claims that you can make large profits from trading security futures contracts.* Although the high degree of leverage in security futures contracts can result in large and immediate gains, it can also result in large and immediate losses. As with any financial product, there is no such thing as a "sure winner."

- *Because of the leverage involved and the nature of security futures contract transactions, you may feel the effects of your losses immediately.* Gains and losses in security futures contracts are credited or debited to your account, at a minimum, on a daily basis. If movements in the markets for security futures contracts or the underlying security decrease the value of your positions in security futures contracts, you may be required to have or make additional funds available to your carrying firm as margin. If your account is under the minimum margin requirements set by the exchange or the brokerage firm, your position may be liquidated at a loss, and you will be liable for the deficit, if any, in your account. Margin requirements are addressed in Section 4.

- *Under certain market conditions, it may be difficult or impossible to liquidate a position.* Generally, you must enter into an offsetting transaction in order to liquidate a position in a security futures contract. If you cannot liquidate your position in security futures contracts, you may not be able to realize a gain in the value of your position or prevent losses from mounting. This inability to liquidate could occur, for example, if trading is halted due to unusual trading activity in either the security futures contract or the underlying security; if trading is halted due to recent news events involving the issuer of the underlying security; if systems failures occur on an exchange or at the firm carrying your position; or if the position is on an illiquid market. Even if you can liquidate your position, you may be forced to do so at a price that involves a large loss.

- *Under certain market conditions, it may also be difficult or impossible to manage your risk from open security futures positions by entering into an equivalent but opposite position in another contract month, on another market, or in the underlying security.* This inability to take positions to limit your risk could occur, for example, if trading is halted across markets due to unusual trading activity in the security futures contract or the underlying security or due to recent news events involving the issuer of the underlying security.

- *Under certain market conditions, the prices of security futures contracts may not maintain their customary or anticipated relationships to the prices of the underlying security or index.* These pricing disparities could occur, for example, when the market for the security futures contract is illiquid, when the primary market for the underlying security is closed, or when the reporting of transactions in the underlying security has been delayed. For index products, it could also occur when trading is delayed or halted in some or all of the securities that make up the index.

- *You may be required to settle certain security futures contracts with physical delivery of the underlying security.* If you hold your position in a physically settled security futures contract until the end of the last trading day prior to expiration, you will be obligated to make or take delivery of the underlying securities, which could involve additional costs. The actual settlement terms may vary from contract to contract and exchange to exchange. You should carefully review the settlement and delivery conditions before entering into a security futures contract. Settlement and delivery are discussed in Section 5.

- *You may experience losses due to systems failures.* As with any financial transaction, you may experience losses if your orders for security futures contracts cannot be executed normally due to systems failures on a regulated exchange or at the brokerage firm carrying your position. Your losses may be greater if the brokerage firm carrying your position does not have adequate back-up systems or procedures.

- *All security futures contracts involve risk, and there is no trading strategy that can eliminate it.* Strategies using combinations of positions, such as spreads, may be as risky as outright long or short positions. Trading in security futures contracts requires knowledge of both the securities and the futures markets.

- *Day trading strategies involving security futures contracts and other products pose special risks.* As with any financial product, persons who seek to purchase and sell the same security future in the course of a day to profit from intra-day price movements ("day traders") face a number of special risks, including substantial commissions, exposure to leverage, and competition with professional traders. You should thoroughly understand these risks and have appropriate experience before engaging in day trading. The special risks for day traders are discussed more fully in Section 7.

- *Placing contingent orders, if permitted, such as "stop-loss" or "stop-limit" orders, will not necessarily limit your losses to the intended amount.* Some regulated exchanges may permit you to enter into stop-loss or stop-limit orders for security futures contracts, which are intended to limit your exposure to losses due to market fluctuations. However, market conditions may make it impossible to execute the order or to get the stop price.

- *You should thoroughly read and understand the customer account agreement with your brokerage firm before entering into any transactions in security futures contracts.*

- *You should thoroughly understand the regulatory protections available to your funds and positions in the event of the failure of your brokerage firm.* The regulatory protections available to your funds and positions in the event of the failure of your brokerage firm may vary depending on, among other factors, the contract you are trading and whether you are trading through a securities account or a futures account. Firms that allow customers to trade security futures in either securities accounts or futures accounts, or both, are required to disclose to customers the differences in regulatory protections between such accounts, and, where appropriate, how customers may elect to trade in either type of account.

Section 2 – Description of a Security Futures Contract

2.1. What is a Security Futures Contract?

A security futures contract is a legally binding agreement between two parties to purchase or sell in the future a specific quantity of shares of a security or of the component securities of a narrow-based security index, at a certain price. A person who buys a security futures contract enters into a contract to purchase an underlying security and is said to be "long" the contract. A person who sells a security futures contract enters into a contract to sell the underlying security and is said to be "short" the contract. The price at which the contract trades (the "contract price") is determined by relative buying and selling interest on a regulated exchange.

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In order to enter into a security futures contract, you must deposit funds with your brokerage firm equal to a specified percentage (usually at least 20 percent) of the current market value of the contract as a performance bond. Moreover, all security futures contracts are marked-to-market at least daily, usually after the close of trading, as described in Section 3 of this document. At that time, the account of each buyer and seller reflects the amount of any gain or loss on the security futures contract based on the contract price established at the end of the day for settlement purposes (the "daily settlement price").

An open position, either a long or short position, is closed or liquidated by entering into an offsetting transaction (i.e., an equal and opposite transaction to the one that opened the position) prior to the contract expiration. Traditionally, most futures contracts are liquidated prior to expiration through an offsetting transaction and, thus, holders do not incur a settlement obligation.

Examples:

> Investor A is long one September XYZ Corp. futures contract. To liquidate the long position in the September XYZ Corp. futures contract, Investor A would sell an identical September XYZ Corp. contract.
>
> Investor B is short one December XYZ Corp. futures contract. To liquidate the short position in the December XYZ Corp. futures contract, Investor B would buy an identical December XYZ Corp. contract.

Security futures contracts that are not liquidated prior to expiration must be settled in accordance with the terms of the contract. Some security futures contracts are settled by physical delivery of the underlying security. At the expiration of a security futures contract that is settled through physical delivery, a person who is long the contract must pay the final settlement price set by the regulated exchange or the clearing organization and take delivery of the underlying shares. Conversely, a person who is short the contract must make delivery of the underlying shares in exchange for the final settlement price.

Other security futures contracts are settled through cash settlement. In this case, the underlying security is not delivered. Instead, any positions in such security futures contracts that are open at the end of the last trading day are settled through a final cash payment based on a final settlement price determined by the exchange or clearing organization. Once this payment is made, neither party has any further obligations on the contract.

Physical delivery and cash settlement are discussed more fully in Section 5.

2.2. Purposes of Security Futures
Security futures contracts can be used for speculation, hedging, and risk management. Security futures contracts do not provide capital growth or income.

Speculation

Speculators are individuals or firms who seek to profit from anticipated increases or decreases in futures prices. A speculator who expects the price of the underlying instrument to increase will buy the security futures contract. A speculator who expects the price of the underlying instrument to decrease will sell the security futures contract. Speculation involves substantial risk and can lead to large losses as well as profits.

The most common trading strategies involving security futures contracts are buying with the hope of profiting from an anticipated price increase and selling with the hope of profiting from an anticipated price decrease. For example, a person who expects the price of XYZ stock to increase by March can buy a March XYZ security futures contract, and a person who expects the price of XYZ stock to decrease by March can sell a March XYZ security futures contract. The following illustrates potential profits and losses if Customer A purchases the security futures contract at $50 a share and Customer B sells the same contract at $50 a share (assuming 100 shares per contract).

Price of XYZ at Liquidation	Customer A Profit/Loss	Customer B Profit/Loss
$55	$500	- $500
$50	0	0
$45	- $500	$500

Speculators may also enter into spreads with the hope of profiting from an expected change in price relationships. Spreaders may purchase a contract expiring in one contract month and sell another contract on the same underlying security expiring in a different month (e.g., buy June and sell September XYZ single stock futures). This is commonly referred to as a "calendar spread."

Spreaders may also purchase and sell the same contract month in two different but economically correlated security futures contracts. For example, if ABC and XYZ are both pharmaceutical companies and an individual believes that ABC will have stronger growth than XYZ between now and June, he could buy June ABC futures contracts and sell June XYZ futures contracts. Assuming that each contract is 100 shares, the following illustrates how this works.

Opening Position	Price at Liquidation	Gain or Loss	Price at Liquidation	Gain or Loss
Buy ABC at 50	$50	$300	53	$300
Sell XYZ at 45	$46	- $100	$50	- $500
	Net Gain or Loss	$200		- $200

Speculators can also engage in arbitrage, which is similar to a spread except that the long and short positions occur on two different markets. An arbitrage position can be established by taking an economically opposite position in a security futures contract on another exchange, in an options contract, or in the underlying security.

Hedging

Generally speaking, hedging involves the purchase or sale of a security future to reduce or offset the risk of a position in the underlying security or group of securities (or a close economic equivalent). A hedger gives up the potential to profit from a favorable price change in the position being hedged in order to minimize the risk of loss from an adverse price change.

An investor who wants to lock in a price now for an anticipated sale of the underlying security at a later date can do so by hedging with security futures. For example, assume an investor owns 1,000 shares of ABC that have appreciated since he bought them. The investor would like to sell them at the current price of $50 per share, but there are tax or other reasons for holding them until September. The investor could sell ten 100-share ABC futures contracts and then buy back those contracts in September when he sells the stock. Assuming the stock price and the futures price change by the same amount, the gain or loss in the stock will be offset by the loss or gain in the futures contracts.

Price in September	Value of 1,000 Shares of ABC	Gain or Loss on Futures	Effective Selling Price
$40	$40,000	$10,000	$50,000
$50	$50,000	$ 0	$50,000
$60	$60,000	-$10,000	$50,000

Hedging can also be used to lock in a price now for an anticipated purchase of the stock at a later date. For example, assume that in May a mutual fund expects to buy stocks in a particular industry with the proceeds of bonds that will mature in August. The mutual fund can hedge its risk that the stocks will increase in value between May and August by purchasing security futures contracts on a narrow-based index of stocks from that industry. When the mutual fund buys the stocks in August, it also will liquidate the security futures position in the index. If the relationship between the security futures contract and the stocks in the index is constant, the profit or loss from the futures contract will offset the price change in the stocks, and the mutual fund will have locked in the price that the stocks were selling at in May.

Although hedging mitigates risk, it does not eliminate all risk. For example, the relationship between the price of the security futures contract and the price of the underlying security traditionally tends to remain constant over time, but it can and does vary somewhat. Furthermore, the expiration or liquidation of the security futures contract may not coincide with the exact time the hedger buys or sells the underlying stock. Therefore, hedging may not be a perfect protection against price risk.

Risk Management
Some institutions also use futures contracts to manage portfolio risks without necessarily intending to change the composition of their portfolio by buying or selling the underlying securities. The institution does so by taking a security futures position that is opposite to some or all of its position in the underlying securities. This strategy involves more risk than a traditional hedge because it is not meant to be a substitute for an anticipated purchase or sale.

2.3. Where Security Futures Trade
By law, security futures contracts must trade on a regulated U.S. exchange. Each regulated U.S. exchange that trades security futures contracts is subject to joint regulation by the Securities and Exchange Commission (SEC) and the Commodity Futures Trading Commission (CFTC).

A person holding a position in a security futures contract who seeks to liquidate the position must do so either on the regulated exchange where the original trade took place or on another regulated exchange, if any, where a fungible security futures contract trades. (A person may also seek to manage the risk in that position by taking an opposite position in a comparable contract traded on another regulated exchange.)

Security futures contracts traded on one regulated exchange might not be fungible with security futures contracts traded on another regulated exchange for a variety of reasons. Security futures traded on different regulated exchanges may be non-fungible because they have different contract terms (e.g., size, settlement method), or because they are cleared through different clearing organizations. Moreover, a regulated exchange might not permit its security futures contracts to be offset or liquidated by an identical contract traded on another regulated exchange, even though they have the same contract terms and are cleared through the same clearing organization. You should consult your broker about the fungibility of the contract you are considering purchasing or selling, including which exchange(s), if any, on which it may be offset.

Regulated exchanges that trade security futures contracts are required by law to establish certain listing standards. Changes in the underlying security of a security futures contract may, in some cases, cause such contract to no longer meet the regulated exchange's listing standards. Each regulated exchange will have rules governing the continued trading of security futures contracts that no longer meet the exchange's listing standards. These rules may, for example, permit only liquidating trades in security futures contracts that no longer satisfy the listing standards.

2.4. How Security Futures Differ from the Underlying Security
Shares of common stock represent a fractional ownership interest in the issuer of that security. Ownership of securities confers various rights that are not present with positions in security futures contracts. For example, persons owning a share of common stock may be entitled to vote in matters affecting corporate governance. They also may be entitled to receive dividends and corporate disclosure, such as annual and quarterly reports.

The purchaser of a security futures contract, by contrast, has only a contract for future delivery of the underlying security. The purchaser of the security futures contract is not entitled to exercise any voting rights over the underlying security and is not entitled to

any dividends that may be paid by the issuer. Moreover, the purchaser of a security futures contract does not receive the corporate disclosures that are received by shareholders of the underlying security, although such corporate disclosures must be made publicly available through the SEC's EDGAR system, which can be accessed at www.sec.gov. You should review such disclosures before entering into a security futures contract. See Section 9 for further discussion of the impact of corporate events on a security futures contract.

All security futures contracts are marked-to-market at least daily, usually after the close of trading, as described in Section 3 of this document. At that time, the account of each buyer and seller is credited with the amount of any gain, or debited by the amount of any loss, on the security futures contract, based on the contract price established at the end of the day for settlement purposes (the "daily settlement price"). By contrast, the purchaser or seller of the underlying instrument does not have the profit and loss from his or her investment credited or debited until the position in that instrument is closed out.

Naturally, as with any financial product, the value of the security futures contract and of the underlying security may fluctuate. However, owning the underlying security does not require an investor to settle his or her profits and losses daily. By contrast, as a result of the mark-to-market requirements discussed above, a person who is long a security futures contract often will be required to deposit additional funds into his or her account as the price of the security futures contract decreases. Similarly, a person who is short a security futures contract often will be required to deposit additional funds into his or her account as the price of the security futures contract increases.

Another significant difference is that security futures contracts expire on a specific date. Unlike an owner of the underlying security, a person cannot hold a long position in a security futures contract for an extended period of time in the hope that the price will go up. If you do not liquidate your security futures contract, you will be required to settle the contract when it expires, either through physical delivery or cash settlement. For cash-settled contracts in particular, upon expiration, an individual will no longer have an economic interest in the securities underlying the security futures contract.

2.5. Comparison to Options

Although security futures contracts share some characteristics with options on securities (options contracts), these products are also different in a number of ways. Below are some of the important distinctions between equity options contracts and security futures contracts.

If you purchase an options contract, you have the right, but not the obligation, to buy or sell a security prior to the expiration date. If you sell an options contract, you have the obligation to buy or sell a security prior to the expiration date. By contrast, if you have a position in a security futures contract (either long or short), you have both the right and the obligation to buy or sell a security at a future date. The only way that you can avoid the obligation incurred by the security futures contract is to liquidate the position with an offsetting contract.

A person purchasing an options contract runs the risk of losing the purchase price (premium) for the option contract. Because it is a wasting asset, the purchaser of an options contract who neither liquidates the options contract in the secondary market nor exercises it at or prior to expiration will necessarily lose his or her entire investment in the options contract. However, a purchaser of an options contract cannot lose more than the amount of the premium. Conversely, the seller of an options contract receives the premium and assumes the risk that he or she will be required to buy or sell the underlying security on or prior to the expiration date, in which event his or her losses may exceed the amount of the premium received. Although the seller of an options contract is required to deposit margin to reflect the risk of its obligation, he or she may lose many times his or her initial margin deposit.

By contrast, the purchaser and seller of a security futures contract each enter into an agreement to buy or sell a specific quantity of shares in the underlying security. Based upon the movement in prices of the underlying security, a person who holds a position in a security futures contract can gain or lose many times his or her initial margin deposit. In this respect, the benefits of a security futures contract are similar to the benefits of purchasing an option, while the risks of entering into a security futures contract are similar to the risks of selling an option.

Both the purchaser and the seller of a security futures contract have daily margin obligations. At least once each day, security futures contracts are marked-to-market and the increase or decrease in the value of the contract is credited or debited to the buyer and the seller. As a result, any person who has an open position in a security futures contract may be called upon to meet additional margin requirements or may receive a credit of available funds.

Example:

Assume that Customers A and B each anticipate an increase in the market price of XYZ stock, which is currently $50 a share. Customer A purchases an XYZ 50 call (covering 100 shares of XYZ at a premium of $5 per share). The option premium is $500 ($5 per share X 100 shares). Customer B purchases an XYZ security futures contract (covering 100 shares of XYZ). The total value of the contract is $5000 ($50 share value X 100 shares). The required margin is $1000 (or 20% of the contract value).

Price of XYZ at expiration	Customer A Profit/Loss	Customer B Profit/Loss
65	1000	1500
60	500	1000
55	0	500
50	-500	0
45	-500	-500
40	-500	-1000
35	-500	-1500

The most that Customer A can lose is $500, the option premium. Customer A breaks even at $55 per share, and makes money at higher prices. Customer B may lose more than his initial margin deposit. Unlike the options premium, the margin on a futures contract is not a cost but a performance bond. The losses for Customer B are not limited by this performance bond. Rather, the losses or gains are determined by the settlement price of the contract, as provided in the example above. Note that if the price of XYZ falls to $35 per share, Customer A loses only $500, whereas Customer B loses $1500.

2.6. Components of a Security Futures Contract
Each regulated exchange can choose the terms of the security futures contracts it lists, and those terms may differ from exchange to exchange or contract to contract. Some of those contract terms are discussed below. However, you should ask your broker for a copy of the contract specifications before trading a particular contract.

2.6.1. Each security futures contract has a set size. The size of a security futures contract is determined by the regulated exchange on which the contract trades. For example, a security futures contract for a single stock may be based on 100 shares of that stock. If prices are reported per share, the value of the contract would be the price times 100. For narrow-based security indices, the value of the contract is the price of the component securities times the multiplier set by the exchange as part of the contract terms.

2.6.2. Security futures contracts expire at set times determined by the listing exchange. For example, a particular contract may expire on a particular day, e.g., the third Friday of the expiration month. Up until expiration, you may liquidate an open position by offsetting your contract with a fungible opposite contract that expires in the same month. If you do not liquidate an open position before it expires, you will be required to make or take delivery of the underlying security or to settle the contract in cash after expiration.

2.6.3. Although security futures contracts on a particular security or a narrow-based security index may be listed and traded on more than one regulated exchange, the contract specifications may not be the same. Also, prices for contracts on the same security or index may vary on different regulated exchanges because of different contract specifications.

2.6.4. Prices of security futures contracts are usually quoted the same way prices are quoted in the underlying instrument. For example, a contract for an individual security would be quoted in dollars and cents per share. Contracts for indices would be quoted by an index number, usually stated to two decimal places.

2.6.5. Each security futures contract has a minimum price fluctuation (called a tick), which may differ from product to product or exchange to exchange. For example, if a particular security futures contract has a tick size of 1¢, you can buy the contract at $23.21 or $23.22 but not at $23.215.

2.7. Trading Halts
The value of your positions in security futures contracts could be affected if trading is halted in either the security futures contract or the underlying security. In certain circumstances, regulated exchanges are required by law to halt trading in security futures contracts. For example, trading on a particular security futures contract must be halted if trading is halted on the listed market for the underlying security as a result of pending news, regulatory concerns, or market volatility. Similarly, trading of a security futures contract on a narrow-based security index must be halted under such circumstances if trading is halted on securities accounting for at least 50 percent of the market capitalization of the index. In addition, regulated exchanges are required to halt trading in all security futures contracts for a specified period of time when the Dow Jones Industrial Average ("DJIA") experiences one-day declines of 10-, 20- and 30-percent. The regulated exchanges may also have discretion under their rules to halt trading in other circumstances – such as when the exchange determines that the halt would be advisable in maintaining a fair and orderly market.

A trading halt, either by a regulated exchange that trades security futures or an exchange trading the underlying security or instrument, could prevent you from liquidating a position in security futures contracts in a timely manner, which could prevent you from liquidating a position in security futures contracts at that time.

2.8. Trading Hours
Each regulated exchange trading a security futures contract may open and close for trading at different times than other regulated exchanges trading security futures contracts or markets trading the underlying security or securities. Trading in security futures contracts prior to the opening or after the close of the primary market for the underlying security may be less liquid than trading during regular market hours.

Section 3 – Clearing Organizations and Mark-to-Market Requirements

Every regulated U.S. exchange that trades security futures contracts is required to have a relationship with a clearing organization that serves as the guarantor of each security futures contract traded on that exchange. A clearing organization performs the following functions: matching trades; effecting settlement and payments; guaranteeing performance; and facilitating deliveries.

Throughout each trading day, the clearing organization matches trade data submitted by clearing members on behalf of their customers or for the clearing member's proprietary accounts. If an account is with a brokerage firm that is not a member of the clearing organization, then the brokerage firm will carry the security futures position with another brokerage firm that is a member of the clearing organization. Trade records that do not match, either because of a discrepancy in the details or because one side of the transaction is missing, are returned to the submitting clearing members for resolution. The members are required to resolve such "out trades" before or on the open of trading the next morning.

When the required details of a reported transaction have been verified, the clearing organization assumes the legal and financial obligations of the parties to the transaction. One way to think of the role of the clearing organization is that it is the "buyer to every seller and the seller to every buyer." The insertion or substitution of the clearing organization as the counterparty to every transaction enables a customer to liquidate a security futures position without regard to what the other party to the original security futures contract decides to do.

The clearing organization also effects the settlement of gains and losses from security futures contracts between clearing members.

At least once each day, clearing member brokerage firms must either pay to, or receive from, the clearing organization the difference between the current price and the trade price earlier in the day, or for a position carried over from the previous day, the difference between the current price and the previous day's settlement price. Whether a clearing organization effects settlement of gains and losses on a daily basis or more frequently will depend on the conventions of the clearing organization and market conditions. Because the clearing organization assumes the legal and financial obligations for each security futures contract, you should expect it to ensure that payments are made promptly to protect its obligations.

Gains and losses in security futures contracts are also reflected in each customer's account on at least a daily basis. Each day's gains and losses are determined based on a daily settlement price disseminated by the regulated exchange trading the security futures contract or its clearing organization. If the daily settlement price of a particular security futures contract rises, the buyer has a gain and the seller a loss. If the daily settlement price declines, the buyer has a loss and the seller a gain. This process is known as "marking-to-market" or daily settlement. As a result, individual customers normally will be called on to settle daily.

The one-day gain or loss on a security futures contract is determined by calculating the difference between the current day's settlement price and the previous day's settlement price.

For example, assume a security futures contract is purchased at a price of $120. If the daily settlement price is either $125 (higher) or $117 (lower), the effects would be as follows:
(1 contract representing 100 shares)

Daily Settlement Value	Buyer's Account	Seller's Account
$125	$500 gain (credit)	$500 loss (debit)
$117	$300 loss (debit)	$300 gain (credit)

The cumulative gain or loss on a customer's open security futures positions is generally referred to as "open trade equity" and is listed as a separate component of account equity on your customer account statement.

A discussion of the role of the clearing organization in effecting delivery is discussed in Section 5.

Section 4 – Margin and Leverage

When a broker-dealer lends a customer part of the funds needed to purchase a security such as common stock, the term "margin" refers to the amount of cash, or down payment, the customer is required to deposit. By contrast, a security futures contract is an obligation and not an asset. A security futures contract has no value as collateral for a loan. Because of the potential for a loss as a result of the daily marked-to-market process, however, a margin deposit is required of each party to a security futures contract. This required margin deposit also is referred to as a "performance bond."

In the first instance, margin requirements for security futures contracts are set by the exchange on which the contract is traded, subject to certain minimums set by law. The basic margin requirement is 20% of the current value of the security futures contract, although some strategies may have lower margin requirements. Requests for additional margin are known as "margin calls." Both buyer and seller must individually deposit the required margin to their respective accounts.

It is important to understand that individual brokerage firms can, and in many cases do, require margin that is higher than the exchange requirements. Additionally, margin requirements may vary from brokerage firm to brokerage firm. Furthermore, a brokerage firm can increase its "house" margin requirements at any time without providing advance notice, and such increases could result in a margin call.

For example, some firms may require margin to be deposited the business day following the day of a deficiency, or some firms may even require deposit on the same day. Some firms may require margin to be on deposit in the account before they will accept an order for a security futures contract. Additionally, brokerage firms may have special requirements as to how margin calls are to be met, such as requiring a wire transfer from a bank, or deposit of a certified or cashier's check. You should thoroughly read and understand the customer agreement with your brokerage firm before entering into any transactions in security futures contracts.

If through the daily cash settlement process, losses in the account of a security futures contract participant reduce the funds on deposit (or equity) below the maintenance margin level (or the firm's higher "house" requirement), the brokerage firm will require that additional funds be deposited.

If additional margin is not deposited in accordance with the firm's policies, the firm can liquidate your position in security futures contracts or sell assets in any of your accounts at the firm to cover the margin deficiency. You remain responsible for any shortfall in the account after such liquidations or sales. Unless provided otherwise in your customer agreement or by applicable law, you are not entitled to choose which futures contracts, other securities or other assets are liquidated or sold to meet a margin call or to obtain an extension of time to meet a margin call.

Brokerage firms generally reserve the right to liquidate a customer's security futures contract positions or sell customer assets to meet a margin call at any time without contacting the customer. Brokerage firms may also enter into equivalent but opposite positions for your account in order to manage the risk created by a margin call. Some customers mistakenly believe that a firm is required to contact them for a margin call to be valid, and that the firm is not allowed to liquidate securities or other assets in their accounts to meet a margin call unless the firm has contacted them first. This is not the case. While most firms notify their customers of margin calls and allow some time for deposit of additional margin, they are not required to do so. Even if a firm has notified a customer of a margin call and set a specific due date for a margin deposit, the firm can still take action as necessary to protect its financial interests,

including the immediate liquidation of positions without advance notification to the customer.

Here is an example of the margin requirements for a long security futures position.

A customer buys 3 July EJG security futures at 71.50. Assuming each contract represents 100 shares, the nominal value of the position is $21,450 (71.50 x 3 contracts x 100 shares). If the initial margin rate is 20% of the nominal value, then the customer's initial margin requirement would be $4,290. The customer deposits the initial margin, bringing the equity in the account to $4,290.

First, assume that the next day the settlement price of EJG security futures falls to 69.25. The marked-to-market loss in the customer's equity is $675 (71.50 - 69.25 x 3 contacts x 100 shares). The customer's equity decreases to $3,615 ($4,290 - $675). The new nominal value of the contract is $20,775 (69.25 x 3 contracts x 100 shares). If the maintenance margin rate is 20% of the nominal value, then the customer's maintenance margin requirement would be $4,155. Because the customer's equity had decreased to $3,615 (see above), the customer would be required to have an additional $540 in margin ($4,155 - $3,615).

Alternatively, assume that the next day the settlement price of EJG security futures rises to 75.00. The mark-to-market gain in the customer's equity is $1,050 (75.00 - 71.50 x 3 contacts x 100 shares). The customer's equity increases to $5,340 ($4,290 + $1,050). The new nominal value of the contract is $22,500 (75.00 x 3 contracts x 100 shares). If the maintenance margin rate is 20% of the nominal value, then the customer's maintenance margin requirement would be $4,500. Because the customer's equity had increased to $5,340 (see above), the customer's excess equity would be $840.

The process is exactly the same for a short position, except that margin calls are generated as the settlement price rises rather than as it falls. This is because the customer's equity decreases as the settlement price rises and increases as the settlement price falls.

Because the margin deposit required to open a security futures position is a fraction of the nominal value of the contracts being purchased or sold, security futures contracts are said to be highly leveraged. The smaller the margin requirement in relation to the underlying value of the security futures contract, the greater the leverage. Leverage allows exposure to a given quantity of an underlying asset for a fraction of the investment needed to purchase that quantity outright. In sum, buying (or selling) a security futures contract provides the same dollar and cents profit and loss outcomes as owning (or shorting) the underlying security. However, as a percentage of the margin deposit, the potential immediate exposure to profit or loss is much higher with a security futures contract than with the underlying security.

For example, if a security futures contract is established at a price of $50, the contract has a nominal value of $5,000 (assuming the contract is for 100 shares of stock). The margin requirement may be as low as 20%. In the example just used, assume the contract price rises from $50 to $52 (a $200 increase in the nominal value). This represents a $200 profit to the buyer of the security futures contract, and a 20% return on the $1,000 deposited as margin. The reverse would be true if the contract price decreased from $50 to $48. This represents a $200 loss to the buyer, or 20% of the $1,000 deposited as margin. Thus, leverage can either benefit or harm an investor.

Note that a 4% decrease in the value of the contract resulted in a loss of 20% of the margin deposited. A 20% decrease would wipe out 100% of the margin deposited on the security futures contract.

Section 5 – Settlement

If you do not liquidate your position prior to the end of trading on the last day before the expiration of the security futures contract, you are obligated to either 1) make or accept a cash payment ("cash settlement") or 2) deliver or accept delivery of the underlying securities in exchange for final payment of the final settlement price ("physical delivery"). The terms of the contract dictate whether it is settled through cash settlement or by physical delivery.

The expiration of a security futures contract is established by the exchange on which the contract is listed. On the expiration day, security futures contracts cease to exist. Typically, the last trading day of a security futures contract will be the third Friday of the expiring contract month, and the expiration day will be the following Saturday. This follows the expiration conventions for stock options and broad-based stock indexes. Please keep in mind that the expiration day is set by the listing exchange and may deviate from these norms.

5.1. Cash settlement

In the case of cash settlement, no actual securities are delivered at the expiration of the security futures contract. Instead, you must settle any open positions in security futures by making or receiving a cash payment based on the difference between the final settlement price and the previous day's settlement price. Under normal circumstances, the final settlement price for a cash-settled contract will reflect the opening price for the underlying security. Once this payment is made, neither the buyer nor the seller of the security futures contract has any further obligations on the contract.

5.2. Settlement by physical delivery

Settlement by physical delivery is carried out by clearing brokers or their agents with National Securities Clearing Corporation ("NSCC"), an SEC-regulated securities clearing agency. Such settlements are made in much the same way as they are for purchases and sales of the underlying security. Promptly after the last day of trading, the regulated exchange's clearing organization will report a purchase and sale of the underlying stock at the previous day's settlement price (also referred to as the "invoice price") to NSCC. If NSCC does not reject the transaction by a time specified in its rules, settlement is effected pursuant to the rules of NSCC within the normal clearance and settlement cycle for securities transactions, which currently is three business days.

If you hold a short position in a physically settled security futures contract to expiration, you will be required to make delivery of the underlying securities. If you already own the securities, you may tender them to your brokerage firm. If you do not own the securities, you will be obligated to purchase them. Some brokerage firms may not be able to purchase the securities for you. If your brokerage firm cannot purchase the underlying securities on your behalf to fulfill a settlement obligation, you will have to purchase the securities through a different firm.

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Section 6 – Customer Account Protections

Positions in security futures contracts may be held either in a securities account or in a futures account. Your brokerage firm may or may not permit you to choose the types of account in which your positions in security futures contracts will be held. The protections for funds deposited or earned by customers in connection with trading in security futures contracts differ depending on whether the positions are carried in a securities account or a futures account. If your positions are carried in a securities account, you will not receive the protections available for futures accounts. Similarly, if your positions are carried in a futures account, you will not receive the protections available for securities accounts. You should ask your broker which of these protections will apply to your funds.

You should be aware that the regulatory protections applicable to your account are not intended to insure you against losses you may incur as a result of a decline or increase in the price of a security futures contract. As with all financial products, you are solely responsible for any market losses in your account.

Your brokerage firm must tell you whether your security futures positions will be held in a securities account or a futures account. If your brokerage firm gives you a choice, it must tell you what you have to do to make the choice and which type of account will be used if you fail to do so. You should understand that certain regulatory protections for your account will depend on whether it is a securities account or a futures account.

6.1. Protections for Securities Accounts
If your positions in security futures contracts are carried in a securities account, they are covered by SEC rules governing the safeguarding of customer funds and securities. These rules prohibit a broker/dealer from using customer funds and securities to finance its business. As a result, the broker/dealer is required to set aside funds equal to the net of all its excess payables to customers over receivables from customers. The rules also require a broker/dealer to segregate all customer fully paid and excess margin securities carried by the broker/dealer for customers.

The Securities Investor Protection Corporation (SIPC) also covers positions held in securities accounts. SIPC was created in 1970 as a non-profit, non-government, membership corporation, funded by member broker/dealers. Its primary role is to return funds and securities to customers if the broker/dealer holding these assets becomes insolvent. SIPC coverage applies to customers of current (and in some cases former) SIPC members. Most broker/dealers registered with the SEC are SIPC members; those few that are not must disclose this fact to their customers. SIPC members must display an official sign showing their membership. To check whether a firm is a SIPC member, go to www.sipc.org, call the SIPC Membership Department at (202) 371-8300, or write to SIPC Membership Department, Securities Investor Protection Corporation, 805 Fifteenth Street, NW, Suite 800, Washington, DC 20005-2215.

SIPC coverage is limited to $500,000 per customer, including up to $100,000 for cash. For example, if a customer has 1,000 shares of XYZ stock valued at $200,000 and $10,000 cash in the account, both the security and the cash balance would be protected. However, if the customer has shares of stock valued at $500,000 and $100,000 in cash, only a total of $500,000 of those assets will be protected.

For purposes of SIPC coverage, customers are persons who have securities or cash on deposit with a SIPC member for the purpose of, or as a result of, securities transactions. SIPC does not protect customer funds placed with a broker/dealer just to earn interest. Insiders of the broker/dealer, such as its owners, officers, and partners, are not customers for purposes of SIPC coverage.

6.2. Protections for Futures Accounts
If your security futures positions are carried in a futures account, they must be segregated from the brokerage firm's own funds and cannot be borrowed or otherwise used for the firm's own purposes. If the funds are deposited with another entity (e.g., a bank, clearing broker, or clearing organization), that entity must acknowledge that the funds belong to customers and cannot be used to satisfy the firm's debts. Moreover, although a brokerage firm may carry funds belonging to different customers in the same bank or clearing account, it may not use the funds of one customer to margin or guarantee the transactions of another customer. As a result, the brokerage firm must add its own funds to its customers' segregated funds to cover customer debits and deficits. Brokerage firms must calculate their segregation requirements daily.

You may not be able to recover the full amount of any funds in your account if the brokerage firm becomes insolvent and has insufficient funds to cover its obligations to all of its customers. However, customers with funds in segregation receive priority in bankruptcy proceedings. Furthermore, all customers whose funds are required to be segregated have the same priority in bankruptcy, and there is no ceiling on the amount of funds that must be segregated for or can be recovered by a particular customer.

Your brokerage firm is also required to separately maintain funds invested in security futures contracts traded on a foreign exchange. However, these funds may not receive the same protections once they are transferred to a foreign entity (e.g., a foreign broker, exchange or clearing organization) to satisfy margin requirements for those products. You should ask your broker about the bankruptcy protections available in the country where the foreign exchange (or other entity holding the funds) is located.

Section 7 – Special Risks for Day Traders

Certain traders who pursue a day trading strategy may seek to use security futures contracts as part of their trading activity. Whether day trading in security futures contracts or other securities, investors engaging in a day trading strategy face a number of risks.

- *Day trading in security futures contracts requires in-depth knowledge of the securities and futures markets and of trading techniques and strategies.* In attempting to profit through day trading, you will compete with professional traders who are knowledgeable and sophisticated in these markets. You should have appropriate experience before engaging in day trading.
- *Day trading in security futures contracts can result in substantial commission charges, even if the per trade cost is low.* The more trades you make, the higher your total commissions will be. The total commissions you pay will add to your losses and reduce your profits. For instance, assuming that a round-turn trade costs $16 and you execute an average of 29 round-turn transactions per day each trading day, you would need to generate an annual profit of $111,360 just to cover your commission

expenses.

- *Day trading can be extremely risky.* Day trading generally is not appropriate for someone of limited resources and limited investment or trading experience and low risk tolerance. You should be prepared to lose all of the funds that you use for day trading. In particular, you should not fund day trading activities with funds that you cannot afford to lose.

Section 8 – Other

8.1. Corporate Events
As noted in Section 2.4, an equity security represents a fractional ownership interest in the issuer of that security. By contrast, the purchaser of a security futures contract has only a contract for future delivery of the underlying security. Treatment of dividends and other corporate events affecting the underlying security may be reflected in the security futures contract depending on the applicable clearing organization rules. Consequently, individuals should consider how dividends and other developments affecting security futures in which they transact will be handled by the relevant exchange and clearing organization. The specific adjustments to the terms of a security futures contract are governed by the rules of the applicable clearing organization. Below is a discussion of some of the more common types of adjustments that you may need to consider.

Corporate issuers occasionally announce stock splits. As a result of these splits, owners of the issuer's common stock may own more shares of the stock, or fewer shares in the case of a reverse stock split. The treatment of stock splits for persons owning a security futures contract may vary according to the terms of the security futures contract and the rules of the clearing organization. For example, the terms of the contract may provide for an adjustment in the number of contracts held by each party with a long or short position in a security future, or for an adjustment in the number of shares or units of the instrument underlying each contract, or both.

Corporate issuers also occasionally issue special dividends. A special dividend is an announced cash dividend payment outside the normal and customary practice of a corporation. The terms of a security futures contract may be adjusted for special dividends. The adjustments, if any, will be based upon the rules of the exchange and clearing organization. In general, there will be no adjustments for ordinary dividends as they are recognized as a normal and customary practice of an issuer and are already accounted for in the pricing of security futures.

Corporate issuers occasionally may be involved in mergers and acquisitions. Such events may cause the underlying security of a security futures contact to change over the contract duration. The terms of security futures contracts may also be adjusted to reflect other corporate events affecting the underlying security.

8.2. Position Limits and Large Trader Reporting
All security futures contracts trading on regulated exchanges in the United States are subject to position limits or position accountability limits. Position limits restrict the number of security futures contracts that any one person or group of related persons may hold or control in a particular security futures contract. In contrast, position accountability limits permit the accumulation of positions in excess of the limit without a prior exemption. In general, position limits and position accountability limits are beyond the thresholds of most retail investors. Whether a security futures contract is subject to position limits, and the level for such limits, depends upon the trading activity and market capitalization of the underlying security of the security futures contract.

Position limits apply are required for security futures contracts that overlie a security that has an average daily trading volume of 20 million shares or fewer. In the case of a security futures contract overlying a security index, position limits are required if any one of the securities in the index has an average daily trading volume of 20 million shares or fewer. Position limits also apply only to an expiring security futures contract during its last five trading days. A regulated exchange must establish position limits on security futures that are no greater than 13,500 (100 share) contracts, unless the underlying security meets certain volume and shares outstanding thresholds, in which case the limit may be increased to 22,500 (100 share) contracts.

For security futures contracts overlying a security or securities with an average trading volume of more than 20 million shares, regulated exchanges may adopt position accountability rules. Under position accountability rules, a trader holding a position in a security futures contract that exceeds 22,500 contracts (or such lower limit established by an exchange) must agree to provide information regarding the position and consent to halt increasing that position if requested by the exchange.

Brokerage firms must also report large open positions held by one person (or by several persons acting together) to the CFTC as well as to the exchange on which the positions are held. The CFTC's reporting requirements are 1,000 contracts for security futures positions on individual equity securities and 200 contracts for positions on a narrow-based index. However, individual exchanges may require the reporting of large open positions at levels less than the levels required by the CFTC. In addition, brokerage firms must submit identifying information on the account holding the reportable position (on a form referred to as either an "Identification of Special Accounts Form" or a "Form 102") to the CFTC and to the exchange on which the reportable position exists within three business days of when a reportable position is first established.

8.3. Transactions on Foreign Exchanges
U.S. customers may not trade security futures on foreign exchanges until authorized by U.S. regulatory authorities. U.S. regulatory authorities do not regulate the activities of foreign exchanges and may not, on their own, compel enforcement of the rules of a foreign exchange or the laws of a foreign country. While U.S. law governs transactions in security futures contracts that are effected in the U.S., regardless of the exchange on which the contracts are listed, the laws and rules governing transactions on foreign exchanges vary depending on the country in which the exchange is located.

8.4. Tax Consequences
For most taxpayers, security futures contracts are not treated like other futures contracts. Instead, the tax consequences of a security futures transaction depend on the status of the taxpayer and the type of position (e.g., long or short, covered or uncovered). Because of the importance of tax considerations to transactions in security futures, readers should consult their tax advisors as to the tax consequences of these transactions.

Section 9 – Glossary of Terms

This glossary is intended to assist customers in understanding specialized terms used in the futures and securities industries. It is not inclusive and is not intended to state or suggest the legal significance or meaning of any word or term.

Arbitrage – taking an economically opposite position in a security futures contract on another exchange, in an options contract, or in the underlying security.

Broad-based security index – a security index that does not fall within the statutory definition of a narrow-based security index (see Narrow-based security index). A future on a broad-based security index is not a security future. This risk disclosure statement applies solely to security futures and generally does not pertain to futures on a broad-based security index. Futures on a broad-based security index are under exclusive jurisdiction of the CFTC.

Cash settlement – a method of settling certain futures contracts by having the buyer (or long) pay the seller (or short) the cash value of the contract according to a procedure set by the exchange.

Clearing broker – a member of the clearing organization for the contract being traded. All trades, and the daily profits or losses from those trades, must go through a clearing broker.

Clearing organization – a regulated entity that is responsible for settling trades, collecting losses and distributing profits, and handling deliveries.

Contract – 1) the unit of trading for a particular futures contract (e.g., one contract may be 100 shares of the underlying security), 2) the type of future being traded (e.g., futures on ABC stock).

Contract month – the last month in which delivery is made against the futures contract or the contract is cash-settled. Sometimes referred to as the delivery month.

Day trading strategy – an overall trading strategy characterized by the regular transmission by a customer of intra-day orders to effect both purchase and sale transactions in the same security or securities.

EDGAR – the SEC's Electronic Data Gathering, Analysis, and Retrieval system maintains electronic copies of corporate information filed with the agency. EDGAR submissions may be accessed through the SEC's Web site, www.sec.gov.

Futures contract – a futures contract is (1) an agreement to purchase or sell a commodity for delivery in the future; (2) at a price determined at initiation of the contract; (3) that obligates each party to the contract to fulfill it at the specified price; (4) that is used to assume or shift risk; and (5) that may be satisfied by delivery or offset.

Hedging – the purchase or sale of a security future to reduce or offset the risk of a position in the underlying security or group of securities (or a close economic equivalent).

Illiquid market – a market (or contract) with few buyers and/or sellers. Illiquid markets have little trading activity and those trades that do occur may be done at large price increments.

Liquidation – entering into an offsetting transaction. Selling a contract that was previously purchased liquidates a futures position in exactly the same way that selling 100 shares of a particular stock liquidates an earlier purchase of the same stock. Similarly, a futures contract that was initially sold can be liquidated by an offsetting purchase.

Liquid market – a market (or contract) with numerous buyers and sellers trading at small price increments.

Long – 1) the buying side of an open futures contact, 2) a person who has bought futures contracts that are still open.

Margin – the amount of money that must be deposited by both buyers and sellers to ensure performance of the person's obligations under a futures contract. Margin on security futures contracts is a performance bond rather than a down payment for the underlying securities.

Mark-to-market – to debit or credit accounts daily to reflect that day's profits and losses.

Narrow-based security index – in general, and subject to certain exclusions, an index that has any one of the following four characteristics: (1) it has nine or fewer component securities; (2) any one of its component securities comprises more than 30% of its weighting; (3) the five highest weighted component securities together comprise more than 60% of its weighting; or (4) the lowest weighted component securities comprising, in the aggregate, 25% of the index's weighting have an aggregate dollar value of average daily trading volume of less than $50 million (or in the case of an index with 15 or more component securities, $30 million). A security index that is not narrow-based is a "broad based security index." (See Broad-based security index).

Nominal value – the face value of the futures contract, obtained by multiplying the contract price by the number of shares or units per contract. If XYZ stock index futures are trading at $50.25 and the contract is for 100 shares of XYZ stock, the nominal value of the futures contract would be $5025.00.

Offsetting – liquidating open positions by either selling fungible contracts in the same contract month as an open long position or buying fungible contracts in the same contract month as an open short position.

Open interest – the total number of open long (or short) contracts in a particular contract month.

Open position – a futures contract position that has neither been offset nor closed by cash settlement or physical delivery.

Performance bond – another way to describe margin payments for futures contracts, which are good faith deposits to ensure performance of a person's obligations under a futures contract rather than down payments for the underlying securities.

Physical delivery – the tender and receipt of the actual security underlying the security futures contract in exchange for payment of the final settlement price.

Position – a person's net long or short open contracts.

Regulated exchange – a registered national securities exchange, a national securities association registered under Section 15A(a) of the Securities Exchange Act of 1934, a designated contract market, a registered derivatives transaction execution facility, or an alternative trading system registered as a broker or dealer.

Security futures contract – a legally binding agreement between two parties to purchase or sell in the future a specific quantify of shares of a security (such as common stock, an exchange-traded fund, or ADR) or a narrow-based security index, at a specified price.

Settlement price – 1) the daily price that the clearing organization uses to mark open positions to market for determining profit and loss and margin calls, 2) the price at which open cash settlement contracts are settled on the last trading day and open physical delivery contracts are invoiced for delivery.

Short – 1) the selling side of an open futures contract, 2) a person who has sold futures contracts that are still open.

Speculating – buying and selling futures contracts with the hope of profiting from anticipated price movements.

Spread – 1) holding a long position in one futures contract and a short position in a related futures contract or contract month in order to profit from an anticipated change in the price relationship between the two, 2) the price difference between two contracts or contract months.

Stop limit order – an order that becomes a limit order when the market trades at a specified price. The order can only be filled at the stop limit price or better.

Stop loss order – an order that becomes a market order when the market trades at a specified price. The order will be filled at whatever price the market is trading at. Also called a stop order.

Tick – the smallest price change allowed in a particular contract.

Trader – a professional speculator who trades for his or her own account.

Underlying security – the instrument on which the security futures contract is based. This instrument can be an individual equity security (including common stock and certain exchange-traded funds and American Depositary Receipts) or a narrow-based index.

Volume – the number of contracts bought or sold during a specified period of time. This figure includes liquidating transactions.

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[1]Since CTAs are not required to provide the disclosure statement for security futures products, the Member carrying the account must provide that statement to customers whose accounts are solicted by CTAs.

[2] Financial Industry Regulatory Authority ("FINRA") members are subject to equivalent FINRA requirements.

[3] There is a small charge for bulk orders.

NFA Manual / Rules

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Compliance Rules

RULE 2-4. JUST AND EQUITABLE PRINCIPLES OF TRADE.

Members and Associates shall observe high standards of commercial honor and just and equitable principles of trade in the conduct of their commodity futures business.

[See Interpretive Notice Interpretation of NFA Compliance Rule 2-4: Guideline for the Disclosure by FCMs and IBs of Costs Associated with Futures Transactions and Interpretive Notice NFA Compliance Rule 2-4:Confidentiality Language in Release Agreements.]

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Interpretive Notices

9041 - OBLIGATIONS TO CUSTOMERS AND OTHER MARKET PARTICIPANTS

INTERPRETIVE NOTICE

The Commodity Futures Modernization Act of 2000 (CFMA), which was signed into law on December 21, 2000, lifts the 18-year ban on single-stock futures and narrow-based security indices ("security futures products"). Unlike other futures contracts, however, the CFMA provides that security futures products are securities as well as futures. Therefore, under Section 15A(k) of the Securities Exchange Act of 1934 (Exchange Act), NFA is a national securities association (NSA) for the limited purpose of regulating the activities of Members who are registered as brokers or dealers in security futures products under Section 15(b)(11) of the Exchange Act (i.e., FCMs and IBs who "passport" in to broker-dealer registration because they limit their securities activities to security futures products).

Since NFA is a registered futures association, the Commodity Exchange Act requires it to have rules designed to promote fair dealing with customers and other market participants for all futures contracts, including security futures.[1] Since NFA is a limited purpose NSA, the Exchange Act also requires it to have rules that are designed to promote fair dealing for security futures products.[2] All of NFA's rules apply to activities involving security futures products. However, certain additional requirements apply to activities in security futures products by Members registered as broker-dealers under Section 15(b)(11) of the Exchange Act and their Associates.

NFA Compliance Rule 2-4 requires all Members and Associates to observe high standards of commercial honor and just and equitable principles of trade in the conduct of their commodity futures business. This includes a requirement to deal fairly with customers and other market participants at all times. This interpretive notice reminds all Members and Associates of their obligation not to trade ahead of customer orders in any commodity. It also discusses those fair dealing obligations that are unique to security futures products.

Trading Ahead of Customer Orders

CFTC Regulations 155.3 and 155.4 — which are incorporated into NFA rules through Compliance Rule 2-26 — require FCMs and IBs to establish and enforce internal rules, procedures, and controls to insure, to the extent possible, that those firms and their employees do not trade ahead of customer orders that are executable at or near the market price. Literally read, those regulations require procedures but do not contain an outright prohibition on trading ahead. However, knowingly trading ahead of customer orders in any commodity violates NFA Compliance Rule 2-4, which requires Members and Associates to observe high standards and just and equitable principles of trade.

Further, Compliance Rule 2-4 also requires Members and Associates to exercise due care to avoid trading ahead of customer orders. Members and Associates will be considered to be exercising due care if they do not know or should not reasonably have known of the customer order. For example, absent knowledge, a Member will not be held accountable for trading ahead of customer orders that originate in a different branch office or for proprietary orders that originate in a trading department that does not have access to information regarding customer orders.

Trading Based on Material, Non-Public Information

Other than trading ahead, the Commodity Exchange Act, CFTC regulations, and NFA and exchange rules do not generally prohibit trading futures based on material, non-public information.[3] The securities laws, on the other hand, generally do prohibit this conduct. As required by the CFMA, NFA Compliance Rule 2-37(a) prohibits Members registered as broker-dealers under Section 15(b)(11) of the Exchange Act and their Associates from violating Sections 9(a), 9(b) and 10(b) of the Exchange Act and the regulations thereunder in connection with security futures products. Insider trading and other forms of trading based on material, non-public information that are violations of SEC Rule 10b-5 would also be violations of NFA Compliance Rule 2-37(a).[4]

Members registered as broker-dealers under Section 15(b)(11) of the Exchange Act and their Associates may not purposefully establish, increase, decrease, or liquidate a position in any security futures product in anticipation of the issuance of a research report regarding the underlying security or a derivative based primarily upon the underlying security (including the security futures product itself). Members should consider developing and implementing firewalls to isolate specific information within research and other relevant departments of the firm so as to prevent the trading department from utilizing the advance knowledge of the issuance of the

research report. Firms that choose not to develop these firewalls bear the burden of demonstrating that the change in position was not done in anticipation of the issuance of the report.

Block Orders

It shall be considered conduct inconsistent with just and equitable principles of trade for a Member registered as a broker-dealer under Section 15(b)(11) of the Exchange Act or an AP of such a Member, acting for an account in which such Member or AP has an interest, for an account with respect to which such Member or AP exercises investment discretion, or for certain customer accounts, to cause to be executed:

(a) an order to buy or sell a security futures product when such Member or AP causing such order to be executed has material, non-public market information concerning an imminent block transaction in the underlying security, or when the customer has been provided such material non-public market information by the Member or AP; or

(b) an order to buy or sell an underlying security when such Member or AP causing such order to be executed has material, non-public market information concerning an imminent block transaction in a security futures product overlying that security, or when the customer has been provided such material, non-public market information by the Member or AP;

prior to the time information concerning the block transaction has been reported to the exchange.[5]

The violative practice noted above may include transactions which are executed based upon knowledge of less than all of the terms of the block transaction, so long as there is knowledge that all of the material terms of the transaction have been or will be agreed upon imminently. A Member will not, however, violate this requirement if it has exercised due care to avoid trading on that information and the individual or individuals causing the order to be executed do not know and should not reasonably have known about the imminent block transaction.

The general prohibitions stated above shall not apply to transactions executed by member participants in automatic execution systems in those instances where participants must accept automatic executions. These prohibitions also do not include situations in which a Member or AP receives a customer's order of block size relating to both security futures product and the underlying security. In such cases, the Member and AP may position the other side of one or both components of the order. However, in these instances, the Member and AP would not be able to cover any resulting proprietary position(s) by entering an offsetting order until information concerning the block transaction involved has been reported to the exchange.

Additionally, a contract market or derivatives transaction execution facility may have a specific rule that permits block transactions that are privately negotiated. Pursuant to these rules, a block transaction must be reported to a designated exchange official and/or the exchange's clearing house within a specified time period after execution of the block transaction. During this time period after execution but prior to reporting, Member firms that are a party to the block transaction have a legitimate need to hedge their own risk exposure. Therefore, the general prohibitions stated above shall not apply to transactions executed by Member firms if done in conjunction with hedging the Member firm's own risk in a block transaction executed under the applicable rules of a contract market or derivatives transaction execution facility.

A transaction involving 10,000 shares or more of an underlying security or security futures product covering such number of shares is generally deemed to be a block transaction, although a transaction of less than 10,000 shares could be considered a block transaction in appropriate cases. A block transaction that has been agreed upon does not lose its identity as such by arranging for partial executions of the full transaction in portions which themselves are not of block size if the execution of the full transaction may have a material impact on the market. In this situation, the requirement that information concerning the block transaction be reported to the exchange will not be satisfied until the entire block transaction has been completed and reported to the exchange.

Communications with the Public

Under NFA Compliance Rules 2-4 and 2-29(a)(1), all communications with the public regarding security futures products must be based on principles of fair dealing and good faith and no material fact or qualification may be omitted if the omission, in the light of the context of the material presented, would cause the communication to be misleading. Furthermore, Members registered under Section 15(b)(11) of the Exchange Act and their Associates should provide a sound basis for evaluating the facts regarding any particular security futures product, including facts regarding the underlying security, industry, or group of securities.

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[1]See Section 17(b)(7) of the Commodity Exchange Act (7 U.S.C. 21(b)(7)).

[2]See Section 15A(k)(2)(B) of the Securities Exchange Act of 1934 (15 U.S.C. 78o-3(k)(2)(B)).

[3]CFTC Regulation 1.59 prohibits self-regulatory organization board and committee members from using or disclosing material, non-public information obtained as part of their service on the board or committee. Depending on the circumstances, Members and Associates may also violate a fiduciary obligation by trading on material, non-public information obtained from their customers or employer or making use of information that the Member or Associate knows was wrongfully disclosed.

[4]Although Compliance Rule 2-37(a) applies only to Members registered as broker-dealers under Section 15(b)(11) of the Exchange Act and their Associates, all Members and Associates are subject to the securities laws in connection with their security futures activities. Violating any law that applies to a Member or Associate's futures business — including securities laws that apply to security futures activities — is conduct inconsistent with just and equitable principles of trade under NFA Compliance Rule 2-4.

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[5]Commodity pool operators and commodity trading advisors who engage in similar conduct would violate NFA Compliance Rule 2-4 if they abuse their fiduciary relationship with pool participants or clients.

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Interpretive Notices

9044 - NFA COMPLIANCE RULE 2-4: BROKER-DEALER REGISTRATION REQUIREMENTS FOR SECURITY FUTURES PRODUCTS

INTERPRETIVE NOTICE

The Commodity Futures Modernization Act of 2000 (CFMA), which was signed into law on December 21, 2000, amended the Commodity Exchange Act (CEA) to lift the ban on single-stock futures and narrow-based security indices ("security futures products"). Under the CFMA, security futures products are securities as well as futures and, therefore, trading in these products is subject to regulatory schemes in both the futures and securities industries, including registration requirements. As a result, NFA Member FCMs and IBs that solicit or accept orders or carry accounts for security futures products are also required to be registered as broker-dealers under the Securities Exchange Act of 1934 (Exchange Act). NFA Member FCMs and IBs that are not fully registered broker-dealers may fulfill the broker-dealer registration requirement through notice registration by filing Form BD-N with NFA.

NFA Compliance Rule 2-4 requires all Members and Associates to observe high standards of commercial honor and just and equitable principles of trade in the conduct of their commodity futures business. This includes the requirement that Members abide by all applicable state and federal laws and regulations governing their commodity futures business, including security futures products. It is a violation of NFA Compliance Rule 2-4 for an NFA Member FCM or IB to solicit or accept orders, carry accounts, or otherwise act as a broker-dealer for security futures products unless the Member is properly registered either as a full broker-dealer under Section 15(b)(1) or as a notice registered broker-dealer under Section 15(b)(11) of the Exchange Act.

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Interpretive Notices

9048 - NFA COMPLIANCE RULE 2-4: THE BEST EXECUTION OBLIGATION OF NFA MEMBERS REGISTERED AS BROKER-DEALERS UNDER SECTION 15(b)(11) OF THE SECURITIES EXCHANGE ACT OF 1934

INTERPRETIVE NOTICE

Under Section 15A(k) of the Securities Exchange Act of 1934 ("Exchange Act"), NFA is a national securities association for the limited purpose of regulating the activities of NFA Members who are registered as brokers or dealers in security futures products under Section 15(b)(11) of the Exchange Act (i.e. FCMs and IBs that passport in to broker-dealer registration because they limit their securities activities to security futures products). NFA Compliance Rule 2-4 requires Members and Associates to observe high standards of commercial honor and just and equitable principles of trade. This rule imposes an obligation on all Members and Associates to put their customers' interests before their own when soliciting and executing futures transactions. To this end, in executing security futures transactions, Members and Associates have an obligation to use reasonable diligence to ensure that customer orders receive the most favorable terms under the circumstances.

When a customer's order may be executed on only one exchange, Members do not have to decide where to route the order and, consequently, satisfying their best execution obligation is simpler than when Members must consider the relative merits of routing an orders to two or more markets. In those cases where a customer's order may be executed on two or more markets trading security futures contracts that are not materially different, Members and Associates have an obligation to use reasonable diligence to ascertain the market in which the customer's security futures order will receive the most favorable terms and, in particular, the best price available under prevailing market conditions. This notice provides guidance on how to fulfill that obligation.

First, it should be clear that if a customer or customer's designee[1] requests that a security futures order be directed to a particular market, or specifies the purchase or sale of a particular security futures product that trades on only one market, then the Member or Associate is required to follow the customer's or designee's instructions. In this particular case, a Member does not have an obligation to ascertain the best market for a customer's security futures order.

A Member or Associate must consider the relevant facts and circumstances including, at a minimum, the following factors in discharging its obligation to use reasonable diligence in ascertaining where a customer's security futures order will receive the most favorable execution available:

- The character of the market including, but not limited to, price, volatility, liquidity, depth, speed of execution, and pressure on available communications;
- The size and type of transaction, including the type of order; and
- The location, reliability and accessibility to the customer's intermediary of primary markets and quotation sources.

Members and Associates must also consider differences in the fees and costs to customers (e.g. transaction fees, clearing costs and expenses) associated with executing transactions in each market. Unless specifically instructed by a customer or customer's designee or necessary to obtain the execution of an order, a Member shall not channel an order through a third party unless the Member can show that by doing so the total cost or proceeds of the transaction were better than if the Member decided not to channel the order through the third party. Moreover, a Member through whom a retail order is channeled and who knowingly is a party to an arrangement whereby the initiating Member firm has not fulfilled its best execution obligation will also be deemed to have violated NFA Compliance Rule 2-4. Members should be aware that channeling orders through a third party to receive reciprocation for service or business will not relieve a Member of its best execution obligation. Likewise, Members should not allow an order routing inducement, such as payment for order flow, to interfere with a Member's duty of best execution.

Failure of Member firms to maintain or adequately staff an order room or other department assigned to execute customer orders cannot be considered justification for executing away from the best available market. NFA recognizes that it may be impracticable for Members and Associates to make order routing decisions for retail orders on an order-by-order basis. Members and Associates that do not make order routing decisions for retail orders on an order-by-order basis should, at a minimum, consider the above factors and the materiality of any differences among contracts traded on different markets when establishing their retail order-routing practices and perform a regular and rigorous review of those practices to ensure that their best execution obligation is fulfilled.

This notice describes the best execution obligation of Members that are registered as brokers or dealers in security futures products under Section 15(b)(11) of the Exchange Act for transactions in security futures products only and does not impose such an obligation upon Members for transactions in other products. By necessity, this notice is general in nature since it is issued before security futures products have begun trading. NFA will provide further guidance if necessary as the markets for security futures products evolve.

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[1]A person that exercises discretion over a customer's account.

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Compliance Rules

RULE 2-37. SECURITY FUTURES PRODUCTS.
[Adopted effective August 21, 2001. Effective dates of amendments: April 16, 2002.]

This rule applies to Members registered as broker-dealers under Section 15(b)(11) of the Exchange Act and their Associates.

(a) No Member or Associate shall violate Sections 9(a), 9(b), or 10(b) of the Exchange Act or any applicable regulation thereunder in connection with any security futures product.

(b) In addition to the supervisory requirements contained in NFA Compliance Rule 2-9, Members must establish, maintain and enforce written procedures reasonably designed to achieve compliance with applicable securities laws, including Sections 9 (a), 9(b), and 10(b) of the Exchange Act and any applicable regulation thereunder.

(c) Members who carry security futures accounts Act shall, not less than once a year, provide each security futures customer with written information regarding NFA's Background Affiliation Status Information Center (BASIC), including the web site address.

(d) In addition to complying with Registration Rules 204(a) and 210(a), each Member shall notify NFA within 10 business days after the Member knows or should know that the Member or its associated person:

(1) has been found by a self-regulatory organization or professional association in the accounting, banking, finance, insurance, law, real estate, or securities fields to have violated any provision of the securities laws or regulations or any rule or standard of conduct of the organization or association in connection with security futures transactions or to have engaged in conduct inconsistent with just and equitable principles of trade in connection with security futures transactions;

(2) is the subject of a written customer complaint involving allegations of theft or misappropriation of funds or securities or of forgery in connection with security futures transactions;

(3) is named as a defendant or respondent in any proceeding brought by a self-regulatory organization in the securities or insurance industry in connection with security futures transactions;

(4) is a defendant or respondent in any civil litigation or arbitration proceeding or is subject to any other claim for damages involving security futures transactions that has been disposed of by judgment, award, or settlement for an amount exceeding $15,000 if the claim is against an associated person or $25,000 if the claim is against the Member;

(5) is associated in any business or financial activity involving security futures products with any person who is subject to a statutory disqualification under either Section 8a of the Commodity Exchange Act or Section 15(b)(4) of the Exchange Act; or

(6) is the subject of a disciplinary action taken by the Member for activities involving security futures products if it results in suspension, termination, the withholding of commissions or imposition of fines in excess of $2,500, or any significant limitation on the Associate's activities on a temporary or permanent basis.

(e) In addition to complying with Registration Rules 206(a) and 210(b), each Associate shall promptly notify its sponsor of:

(1) any information the Associate is required to report under Registration Rule 206(a) or 210(b); or

(2) the existence of any of the circumstances listed in section (d) of this rule.

(f) Each Member shall file a quarterly report with NFA containing statistical and summary information regarding written customer complaints involving security futures products. The report must be filed with NFA, in the form NFA requires, by the 15th day of the month following the calendar quarter in which the complaints are received. A Member is not required to file a quarterly report for any quarter in which no complaints were received.

(g) Members shall not charge customers more than a fair commission or service charge for transactions in security futures products, taking into consideration all relevant circumstances, including the expense of executing the order and the value of any service the Member may have rendered by reason of its experience in and knowledge of the security futures product and the market in that product.

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Interpretive Notices

9047 - NFA COMPLIANCE RULE 2-37: FAIR COMMISSIONS
(Revised December 17, 2007)

INTERPRETIVE NOTICE

Under Section 15A(k) of the Securities and Exchange Act of 1934 (Exchange Act), NFA is a national securities association for the limited purpose of regulating the activities of Members who are registered as brokers and dealers in security futures products under Section 15(b)(11) of the Exchange Act (i.e., FCMs and IBs who "passport" in to broker-dealer registration because they limit their securities activities to security futures products). Section 15A(k) also requires NFA to impose customer protection requirements reasonably comparable to those of national securities associations registered under Section 15A(a) of the Exchange Act. One of these requirements relates to the amount of commissions these Members may charge for security futures transactions.

NFA Compliance Rule 2-37(g) prohibits Members registered as broker-dealers under Section 15(b)(11) of the Exchange Act from charging more than a fair commission for security futures transactions. That rule also provides that what is a fair commission depends on all of the relevant circumstances, including the expense of executing the order and the value of any service the Member may have rendered based on its experience and knowledge.

The vast majority of NFA Members charge fair commissions, and Compliance Rule 2-37(g) will not require them to make any changes to their commission practices for security futures products. Commissions for futures transactions have been set competitively since the 1970s. They are usually based on the Member's costs plus a reasonable profit. Commission rates also vary based on the services provided by the Member. Additionally, Members who deal with institutional customers often negotiate commissions based on volume or similar measures. All of these practices continue to be acceptable for security futures products.[1]

NFA has occasionally encountered retail firms that have charged fees significantly out-of-line with the Member's costs and services and the industry norm. In most of these cases, customers have been misled as to either the amount of the commission, the effect of the commission on profitability, or how the commission rate compares with other firms in light of the services offered. High commissions also have a significant effect on commission-to-equity ratios and increase the likelihood that the Member will churn accounts over which they or their Associates have discretionary authority or de facto control. As a result, NFA has consistently responded to unreasonably high commission rates by charging the firms and their Associates with violating NFA Compliance Rule 2-2 (a) and/or NFA Compliance Rule 2-29, and NFA will continue to do so.[2]

NFA Compliance Rule 2-37(g) and this interpretive notice do not relieve Members of their obligation to make the applicable per trade or round-term commission charges available to customers prior to the commencement of trading and to fully explain any fees and charges that are not determined on a per trade or round-turn basis.[3]

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[1] NFA does not believe it is appropriate to apply a guideline similar to the Financial Industry Regulatory Authority's 5% guideline for securities mark-ups. The cost of executing orders in the futures markets tends to have little correlation with either the notional value of the contract or the amount of margin. Although nothing prohibits NFA Members from setting commissions for security futures contracts based on the notional value of the contract or the amount of margin, those commissions must be reasonable in light of all of the circumstances, including the Member's expenses and the value of the Member's services.

[2] See, e.g., In re Bachus & Stratton Commodities, Inc., NFA Case No. 92-BCC-15 (Hearing Panel, Feb. 18, 1993), aff'd, NFA Case No. 93-APP-2 (App. Comm., Nov. 11, 1993); In re Churchill Group, Inc., NFA Case No. 90-BCC-12 (BCC, Sep. 5, 1990) (settlement); In re The Siegel Trading Co., Inc., NFA Case No. 97-BCC-7 (Hearing Panel, Jan. 4, 1999) (settlement).

[3] See Interpretation of NFA Compliance Rule 2-4: Guideline for the Disclosure by FCMs and IBs of Costs Associated With Futures Transactions, 9005, NATIONAL FUTURES ASSOCIATION MANUAL.

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Compliance Rules

RULE 2-7. BRANCH OFFICE MANAGERS AND DESIGNATED SECURITY FUTURES PRINCIPALS.
[Adopted effective September 30, 1992. Effective date of amendments: January 28, 1994; August 21, 2001; December 9, 2005; and December 17, 2007.]

(a) No Member shall allow an Associate to be a branch office manager unless:

(1) The Associate has taken and passed the "Branch Manager Exam-Futures": *Provided, however,* that any Associate who subsequently ceases acting as a branch manager will not be required to retake and pass the examination in order to resume acting as a branch manager unless after acting as a branch manager the Associate was not registered in any capacity for a period of more than two years; or

(2) The Associate is sponsored by a registered broker-dealer and is qualified to act as a branch office manager under the rules of either the New York Stock Exchange or the Financial Industry Regulatory Authority.

(b) Each Member registered as a broker-dealer under Section 15(b)(11) of the Exchange Act must have at least one designated security futures principal. No such Member shall designate a person as a security futures principal unless:

(1) The person is a partner, officer, director, branch office manager or supervisory employee of the Member;

(2) The person is a Member or an Associate of the Member as defined in Bylaw 301(b); and

(3) The person has taken and passed the "Branch Manager Exam-Futures."

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Interpretive Notices

9049 - NFA COMPLIANCE RULES 2-7 AND 2-24 AND REGISTRATION RULE 401: PROFICIENCY REQUIREMENTS FOR SECURITY FUTURES PRODUCTS

(Effective Dates of Amendments: May 5, 2003; revised December 4, 2006; December 17, 2007; and December 28, 2009.)

INTERPRETIVE NOTICE

The Commodity Futures Modernization Act of 2000 amended the Securities Exchange Act of 1934 to require NFA to "have rules that ensure that members and natural persons associated with members meet such standards of training, experience, and competence necessary to effect transactions in security futures products and are tested for their knowledge of securities and security futures products."[1] NFA is in the process of updating the Series 3 examination to include questions applicable to security futures products. However, current registrants, and persons who become registered before the Series 3 examination is updated, will be allowed to meet the proficiency requirements by taking an appropriate training course before they engage in activities involving security futures products. This notice describes the conditions under which Members and Associates can substitute training for testing.

Current NFA Members and Associates will be able to satisfy their proficiency requirements for security futures by taking any training program that covers the subject matter included in a content outline that has been jointly developed by NFA, the Financial Industry Regulatory Authority, and a number of securities and futures exchanges. A copy of that outline can be found on NFA's website at www.nfa.futures.org. New registrants can also qualify through training if they take the Series 3 examination and apply for registration before the revised examination becomes available. THE TRAINING MUST BE COMPLETED BEFORE AN INDIVIDUAL REGISTRANT ENGAGES IN ACTIVITIES INVOLVING SECURITY FUTURES PRODUCTS. Any registrant who is eligible to qualify through training has until December 31, 2012 before that eligibility lapses. Registrants who subsequently decide to engage in security futures activities will be required to take the relevant examination.[2]

NFA, in partnership with the Financial Industry Regulatory Authority and the Institute for Financial Markets, has developed a web-based training program that will satisfy the training requirement. That program can be accessed at www.nfa.futures.org. There is no charge for completing this training program.

NFA is also in the process of updating the Series 30 examination to include questions regarding security futures for persons who are designated security futures principals under NFA Compliance Rule 2-7. In order to qualify as a designated security futures principal, current supervisors may take a portion of the training program devoted to supervisory issues as well as the portions intended for all Associates as long as they do so before the revised Series 30 examination becomes available. After the revised Series 30 becomes available, only individuals who were qualified as branch office managers before that date may qualify as security futures principals by taking the training program in lieu of taking a supervisory proficiency exam, and those individuals must take the training program by December 31, 2012.

NFA Members and Associates are not required to notify NFA that they have completed a training program. However, Members must be able to demonstrate to NFA during an audit that those registered individuals who are engaging in security futures activities have completed the necessary training. For example, Members could keep records of Associates who attend internal training programs or require Associates to provide certificates of completion for outside training programs.

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[1] Section 15A(k)(2)(D) of the Securities Exchange Act of 1934.

[2] Securities registrants will be subject to these same standards, although the examinations that qualify them to trade security futures products will be different.

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