December 3, 2019

Via Federal Express and E-mail (Ckirkpatrick@cftc.gov)
Mr. Christopher J. Kirkpatrick
Secretary
Office of the Secretariat
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, DC 20581

Re: National Futures Association: Proposed Amendments to NFA Compliance Rules 2-8 and 2-30; Interpretive Notice 9004 – *NFA Compliance Rule 2-30: Customer Information and Risk Disclosure*; Interpretive Notice 9013 – *NFA Compliance Rule 2-30: Customer Information and Risk Disclosure*; Interpretive Notice 9029 – *NFA Compliance Rule 2-10: The Allocation of Bunched Orders for Multiple Accounts*; and Interpretive Notice 9065 – *NFA Compliance Rule 2-10: The Allocation of Bunched Retail Forex Orders for Multiple Accounts*

Dear Mr. Kirkpatrick:

Pursuant to Section 17(j) of the Commodity Exchange Act ("CEA" or "Act"), as amended, National Futures Association ("NFA") hereby submits to the Commodity Futures Trading Commission ("CFTC" or "Commission") proposed amendments to NFA Compliance Rules 2-8 and 2-30; Interpretive Notice 9004 – *NFA Compliance Rule 2-30: Customer Information and Risk Disclosure*; Interpretive Notice 9013 – *NFA Compliance Rule 2-30: Customer Information and Risk Disclosure*; Interpretive Notice 9029 – *NFA Compliance Rule 2-10: The Allocation of Bunched Orders for Multiple Accounts*; and Interpretive Notice 9065 – *NFA Compliance Rule 2-10: The Allocation of Bunched Retail Forex Orders for Multiple Accounts*. NFA's Board of Directors ("Board") unanimously approved the proposed amendments at its meeting on November 21, 2019.

NFA is invoking the "ten-day" provision of Section 17(j) of the CEA and plans to issue a Notice to Members establishing an effective date for this proposal as early as ten days after receipt of this submission by the Commission unless NFA is notified that the Commission has determined to review the proposal for approval.

PROPOSED AMENDMENTS
(additions are <u>underscored</u> and deletions are ~~stricken through~~)

COMPLIANCE RULES

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

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RULE 2-8. DISCRETIONARY CUSTOMER ACCOUNTS.

(a) Grant of Discretion Must Be in Writing.

No Member or Associate shall exercise discretion over a customer's commodity futures or cleared swaps account unless the customer or account controller has authorized the Member or Associate, in writing (by power of attorney or other instrument) to exercise such discretion. No Member or Associate shall exercise discretion with regard to foreign futures or foreign options transactions on behalf of a foreign futures or foreign options customer unless the customer or account controller has specifically authorized the Member or Associate, in writing, to exercise discretion with regard to foreign futures or foreign options transactions. The Member or Associate does not need written authorization to exercise discretion with regard to time and price only. Each Member must maintain records ~~which~~ that clearly identify ~~which of~~ the ~~Member's~~ accounts ~~are accounts~~ over which ~~the Member or Associate thereof has~~ discretionary authority has been granted. In addition, each FCM and IB Member must maintain a record that identifies the Member, any Associate or any Third Party Controller (per subsection (d) of this Rule) that exercises discretionary authority over each account.

(b) Review of Discretionary Trades.

Each futures trade or cleared swap ~~initiated~~ in an account that a Member or Associate has written authorization to trade shall be presumed to have been made pursuant to that trading authorization unless otherwise indicated, in writing, at the time the trade was placed. Each Member initiating ~~such~~ discretionary trades (other than a Member who employs only one individual having discretionary authority if that individual is also the only principal who supervises futures activity) must adopt and enforce written procedures that:

> (1) ~~Which e~~ Ensure that a partner, officer, director, branch office manager or supervisory employee of the Member (other than any individual who exercises discretion in trading the account) regularly reviews discretionary trading activity for compliance with applicable regulatory requirements and that a designated security futures principal regularly reviews discretionary security futures trading activity if the Member is registered as a broker-dealer under Section 15(b)(11) of the Exchange Act; and

(2) ~~Which r~~ Require such partner, officer, director, branch office manager or supervisory employee or designated security futures principal to make a written record that such review procedures were performed.

~~Discretionary trading activity must be regularly reviewed, and a written record of the review must be made, as required above.~~

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RULE 2-30. CUSTOMER INFORMATION AND RISK DISCLOSURE.

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(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)(18) of the Act) and provide such customers with disclosure of the risks of ~~futures~~ trading futures and/or cleared swaps.

(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 or cleared swaps ~~trading~~ account to be carried or introduced by the Member, or first authorizes the Member to direct trading in a futures or cleared swaps 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) 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 or swaps trading experience; and

(5) Such other information deemed appropriate by such Member or Associate to disclose the risks of futures and/or cleared swaps 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; and~~.~~

(5) the disclosures required by CFTC Regulation 22.16, 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 trading in a futures or cleared swaps ~~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.

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INTERPRETIVE NOTICES

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9004 - NFA COMPLIANCE RULE 2-30: CUSTOMER INFORMATION AND RISK DISCLOSURE

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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 commodity futures and swaps business. NFA's Advisory Committees ("the Committees") have considered ~~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~~ an 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 generally 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~~ its Business Conduct Committee ("BCC") and Hearing Panels, which ~~is~~ are 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~~ Rule 2-30 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 Member or Associate ~~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 "suitability" standard that would bar some persons from using the futures markets.

NFA believes that the principles set forth above also apply when individuals and non-ECP entities trade cleared swaps, and therefore has determined that Members must comply with the requirements of Compliance Rule 2-30 with respect to cleared swaps accounts of individual and other non-ECP customers. Like futures contracts, cleared swaps are generally recognized as highly volatile instruments and the risk associated with these products should be disclosed and understood at the time a customer first opens a cleared swaps customer account.

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 or cleared swaps 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 trading futures or cleared swaps ~~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 1a(18) 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 futures ~~customer~~ business with non-Members who are required to be registered).

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~~ an account with the Member for trading futures or cleared swaps. 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 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 previous 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 <u>or swaps</u> 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 trades 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 and/or cleared swaps trading.

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)'s disclosure statement for non-cash margin, which may apply to particular accounts.)[5] 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 futures or cleared swaps as too risky for that customer. In these instances, the only adequate risk disclosure by the Member and Associate is that ~~futures~~ trading futures or cleared swaps 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 or cleared swaps 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 futures or cleared swaps 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 risk disclosure that satisfies 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~~ examine 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~~ basic 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~~ applies to all new accounts. This is consistent with the Member's responsibility to supervise the futures and swaps 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 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~~ no later than the time the trading advisor delivers to the prospective client an advisory agreement to direct or guide the client's account. 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] 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.

[5] NFA acknowledges that many FCMs and IBs use the FIA Combined Risk Disclosure Statement to comply with the disclosure statement requirements of CFTC Regulations 1.55(a), 1.55(b), 30.6(a), 33.7(a) and 190.10(c) and NFA Compliance Rule 2-30.

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9013 - NFA COMPLIANCE RULE 2-30: CUSTOMER INFORMATION AND RISK DISCLOSURE

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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~~ The Rule ~~was~~ is 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 9004 – *NFA Compliance Rule 2-30: Customer Information and Risk Disclosure* ~~("Interpretive Notice")[1]~~, and the decisions NFA's ~~Regional~~ Business Conduct Committee~~s~~ ("BCC~~s~~") and Hearing Panels have made in specific disciplinary cases ~~which allege~~ alleging 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~~ alleging 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 9004 – *NFA Compliance Rule 2-30: Customer Information and Risk Disclosure*, 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 trading futures or cleared swaps ~~trading~~ is too risky for that customer. Once adequate disclosure is given, however, the customers are free to decide whether to trade in futures or cleared swaps 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 BCC~~s~~.

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 <u>or swaps</u> trading experience) or a failure to retain the appropriate records. Although the Rule 2-30 recordkeeping violations have ~~never~~ <u>rarely if ever</u> 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 BCC~~s~~ 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 9004 – *NFA Compliance Rule 2-30: Customer Information and Risk Disclosure*, 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.~~

~~[1] See NFA Manual at 9004.~~

~~[2] See NFA Manual at 9004.~~

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9029 - NFA COMPLIANCE RULE 2-10: THE ALLOCATION OF BUNCHED ORDERS FOR MULTIPLE ACCOUNTS

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NFA Compliance Rule 2-10 adopts by reference CFTC Regulation 1.35, which, among other things, imposes on futures commission merchants (FCMs) and introducing brokers (IBs) recordkeeping requirements for ~~relating to~~ customer orders ~~on futures and options on futures contracts~~ in commodity interests. The purpose of the regulation is to prevent various forms of customer abuse, such as the 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~~ provides that FCMs and IBs receiving a customer order that cannot immediately be entered into a trade matching engine must ~~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 has interpreted Regulation 1.35~~[1]~~ 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, 3]~~ CFTC Regulation 1.35(b)(5) provides~~, The CFTC adopted~~ an exception to this requirement ~~in CFTC Regulation 1.35(a-1)(5), which~~ that allows ~~authorized~~ certain ~~eligible~~ account managers, including registered commodity trading advisors (CTAs), FCMs and IBs that have been granted discretionary trading authority in writing (collectively, "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").

Both the Eligible Account Managers that take advantage of post-execution allocation procedures[2] and the IBs that execute or the FCMs that execute or clear these transactions must satisfy several requirements set forth in CFTC Regulation 1.35(b)(5). Among other things, this regulation requires that 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 Eligible Account Managers bear the responsibility for the fair and equitable allocation of bunched orders. Eligible Account Managers are also required to receive written investment discretion, adhere to record retention requirements and make certain information regarding the allocation method available to customers upon request. FCMs that execute or clear orders eligible for post execution allocation and IBs that execute orders eligible for post execution allocation must maintain records that identify each order subject to post execution allocation and the accounts to which contracts executed for such order are allocated. Additionally, FCMs and IBs are prohibited by CFTC Regulation 155.3 and 155.4 from including proprietary trades in a bunched order with customer trades.

~~In 2003, the CFTC amended Regulation 1.35(a-1)(5) to effectively remove certain 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, at that time, Regulation 1.35(a-1)(5) permitted CTAs to 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 CFTC's most recent amendment to Regulation 1.35 (effective January 2, 2013), which in addition to redesignating 1.35(a-1)(5) as 1.35(b)(5), expands the list of eligible account managers that may employ post-execution allocation procedures to include FCMs and IBs. Under this amendment, CTAs, IBs and FCMs (collectively "Eligible Account Managers") may now take advantage of the procedures in Regulation 1.35(b)(5) for the accounts of all clients who grant written investment discretion to the CTA, IB or FCM. However, unlike CTAs, FCMs and IBs are prohibited by CFTC~~

~~Regulation 155.3 and 155.4 from including proprietary trades in a bunched order with customer trades.~~

~~The amendment does not alter the obligations currently imposed on eligible 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 Eligible Account Managers bear the responsibility for the fair and equitable allocation of bunched orders, while FCMs that execute or clear the trade retain the responsibility to monitor for unusual allocation activity.~~

This Notice sets out certain core principles that govern all allocation methodologies and the respective responsibilities of Eligible Account Managers, as well as the FCMs or IBs that execute or carry the accounts of the Eligible Account Managers' clients. The Notice also describes certain methodologies that generally meet these core principles. Although these methodologies were developed to assure compliance with the requirement that allocation instructions be provided at or before the time a bunched order is placed, they also apply to 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 Eligible Account Managers, 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, an Eligible Account Manager 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 that executes the trade 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]~~[4]~~

- 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 Eligible Account Manager must provide the allocation information to FCMs that execute or clear the trade 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 Eligible Account Manager.[4]~~[5]~~ The Eligible Account Manager must confirm, on a daily basis, that all its accounts have the correct allocation of contracts. An Eligible Account Manager 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). This quarterly review is also required for Eligible Account Managers that do not offer trading programs but routinely execute bunched orders on behalf of the same group of accounts (for example, an IB that maintains discretion over a group of customers who routinely trade in the same contracts and the IB bunches these orders together upon execution). 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 Eligible Account Manager'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 Eligible Account Manager must revise its allocation methodology or adopt a different allocation method for application on a prospective basis only. An Eligible Account Manager must document its internal audit procedures and results in writing and maintain these audit procedures and results as firm records subject to review during an NFA examination.

~~Although the Eligible Account Manager is responsible for the allocation of each bunched order, the FCM that executes or clears the trade has certain obligations as well. In particular, each FCM that executes or clears the trade must receive from an Eligible 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 Eligible 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.[6]~~

~~Regulation 1.35(b)(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 Eligible 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

The following are examples of procedures for the allocation of split and partial fills that generally satisfy the core principles described above. These methodologies are the most common that NFA has observed in performing examinations. However, they are not the exclusive means of achieving compliance with Regulation 1.35(b)(5). The appropriateness of any particular method, of course, will depend on the Eligible Account Manager's trading strategy.[5~~7~~]

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.

Cash Residuals

In certain instances, a bunched order may be filled at multiple prices and allocated to participating accounts at an average price. The average price of a bunched order allocation may be rounded up for a buy order (or down for a sell order) to the next price increment supported by the relevant clearing and accounting systems, provided that the residual created by the rounding process is paid to the customer. For example, if a buy order with an average price of $1.98 in a market with a tick increment of $.05 is rounded up to the nearest tick (e.g., $2.00) and a sell order with an average price of $1.98 is rounded down to the nearest tick (i.e., $1.95), a cash residual of $.02 for the buy orders and $.03 for the sell orders must be distributed to the participating customers. An average pricing system may produce prices that do not conform to whole cent increments. In such cases, any amounts less than one cent need not be distributed to the customer. NFA's Business Conduct Committee and Hearing Panels have found that failing to properly allocate cash residuals to customers can constitute a violation of NFA Rules.

FCM and IB Responsibilities

Although the Eligible Account Manager is responsible for the allocation of each bunched order, the IB that executes or FCM that executes or clears the trade has certain obligations as well. In particular, each IB that executes or FCM that executes or clears the trade must receive from an Eligible Account Manager sufficient information to allow it to perform its functions. For executing FCMs or IBs in a give-up arrangement, this includes, at a minimum, information that identifies the Eligible Account Manager at the time the order is placed and instructions, which the FCM or IB 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.[6]

Regulation 1.35(b)(5) requires each IB that executes or 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 or IB can meet this recordkeeping requirement is to maintain a copy of the allocation instructions provided by the Eligible Account Manager by facsimile, e-mail, or other form of electronic transmission. If the allocation is provided orally, however, the FCM or IB must create and maintain a written record.

Also, if the FCM or IB has actual or constructive notice that allocations for its customers may be fraudulent, the FCM or IB must take appropriate action. For example, if an FCM or IB has notice of unusual allocation activity, the FCM or IB must make a reasonable inquiry into the matter and, if appropriate, refer the matter to the proper regulatory authorities (e.g., the CFTC, NFA or the FCM's DSRO). Whether an FCM or IB 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 or IB. An FCM that both executes and clears an entire bunched order will possess more information than an IB that executes or an FCM that executes or clears only a portion of an order. Where there are multiple FCMs executing and clearing the bunched order or IBs involved in execution, some FCMs or IBs may have more information available than others, and it is likely that no single FCM or IB 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 or IB may not possess adequate information to evaluate the allocation activity. However, if the FCM or IB has actual or constructive notice that the allocations may be fraudulent, the FCM or IB must take appropriate action.

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

~~[1] 58 FR 26270 (May 3, 1993)~~

[2] ~~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.~~

~~[1]~~[3] Consistent with the provisions of CFTC Regulation 1.35(b)(5), Eligible Account Managers that place orders for a single account must still provide account identification information at the time of order entry.

[2]Although this Interpretive Notice addresses the allocation of bunched futures or cleared swaps orders, an Eligible Account Manager that executes a bilateral swap transaction for post-execution allocation to individual clients must comply with the applicable sections of CFTC Regulation 1.35(b)(5) and is subject to discipline under NFA Compliance Rule 2-10 for failure to do so.

[3] ~~[4]~~ Because customers must have access to information that allows them to assess the fairness of the allocation process, Eligible Account Managers are required to make the following information available to customers upon request: (1) the general nature of the Eligible Account Manager'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 Eligible Account Manager has an interest.

[4]~~[5]~~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 Eligible Account Manager. For example, the Eligible Account Manager and FCM that executes or clears the trade may agree that the FCM that executes or clears the trade will allocate a bunched order in accordance with instructions that the Eligible Account Manager files with the FCM that executes or clears the trade either prior to or concurrently with placing the bunched order. Any division of responsibilities agreed to by the FCM that executes or clears the trade and Eligible Account Manager should be clearly documented.

[5]~~[7]~~For example, certain allocation methodologies may satisfy the general standards for Eligible Account Managers who trade on a daily basis but be inappropriate for Eligible Account Managers who trade less frequently.

[6]As noted, an Eligible 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.

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9065 - NFA COMPLIANCE RULE 2-10: THE ALLOCATION OF BUNCHED RETAIL FOREX ORDERS FOR MULTIPLE ACCOUNTS

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NFA Compliance Rule 2-10 adopts by reference CFTC Regulation 1.35, which, among other things, imposes on futures commission merchants ("FCMs") and retail foreign exchange dealers ("RFEDs") certain recordkeeping requirements relating to customer forex[1] orders. The purpose of the regulation is to prevent various forms of customer abuse, such as the 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~~ provides that FCMs and RFEDs receiving a customer order that cannot immediately be entered into a trade matching engine must ~~to~~ prepare a written record of the order immediately upon receipt, including an appropriate account identifier.

With respect to bunched orders placed by a commodity trading advisor ("CTA") on behalf of multiple clients, the CFTC has interpreted Regulation 1.35 to require that, at or before the time the order is placed, the CTA must provide the FCM with information that identifies the accounts included in the bunched order and specifies the number of contracts to be allotted to each account,[2] ~~[3]~~ (unless the order is done in accordance with the post-execution allocation of bunched order requirements).[3] ~~[4]~~ ~~Recent NFA examinations have~~ NFA has found that many CTAs who manage retail ~~F~~forex customer accounts ~~are using~~ use a percentage allocation management module ("PAMM") to allocate bunched orders placed by them on behalf of multiple clients.

CTAs utilizing PAMM trade an unlimited number of customer accounts under one "Master Account" at an FCM or RFED. Each individual customer then has a sub-account under the Master Account. CTAs utilize the total equity of the Master Account—the aggregate of all individual customers' funds—to place a bunched order for forex lots or contracts and then subsequently allocate a percentage of the lot(s) or contract(s) to each individual customer's sub-account based on each customer's account equity as a percentage of the overall total equity in the Master Account.~~[5]~~[4]

If PAMM resulted in the fair and non-preferential allocation of regularly offered and tradable sized lot(s) or contract(s)~~[6]~~[5] to each customer's sub-account—and was not based on the customer's account equity as a percentage of the overall total equity in the Master Account—then this method would be consistent with prior interpretations of Regulation 1.35. However, certain CTAs trading customer accounts and FCMs and RFEDs acting as counterparty to these accounts ~~do~~ have not ~~apply~~ applied PAMM in this manner. Specifically, NFA has found that some CTAs determine the quantity of regularly offered and tradable sized lots or contracts for a bunched order based on the Master Account's equity, rather than on the quantity of regularly offered and tradable sized lots or contracts that would be permitted based on the margin equity in each individual account, which is often too low to place a trade for a regularly offered and tradable sized lot or contract. ~~Therefore~~ In such a case, after the FCM or RFED executes the order, PAMM's application does not result in regularly offered and tradable sized lot(s) or contract(s) being allocated to the individual sub-accounts. Rather, pursuant to PAMM, a percentage of the lot(s) or contract(s) are allocated to each customer based upon their percentage of equity in the Master Account. For example, if two customers had equity that equaled 40% and 12.5% of the Master Account's equity, respectively, then the customers would be allocated .4 and .125 of the regularly offered and tradable sized lot or contract, respectively, if the account manager traded one contract.

The placement of trades based upon the Master Account's total equity and subsequent allocation of a percentage of the lot(s) or contract(s) to individual client accounts pursuant to PAMM, rather than based upon the equity in each individual account causes these individual accounts to be treated similar to a commodity pool's participant units—without the Master Account being legally structured as a commodity pool. Moreover, PAMM leads to certain client accounts not being treated fairly and in a non-preferential manner. Specifically, because FCMs and RFEDs are likely to only act as counterparty with respect to the regularly offered and tradable sized lot(s) or contract(s) margined and traded at the Master Account level, PAMM often restricts the ability of account managers to offset an open position in a smaller percentage lot or contract without affecting the positions of all the sub-accounts underlying the Master Account.

NFA also noted that each FCM and RFED that utilizes PAMM impose ~~imposes~~ varying restrictions applicable to the process by which customers withdraw and add funds to their accounts. In the extreme situation, individual client withdrawal requests are held up indefinitely because the customer's percentage lot open forex position may not be offset until the regularly offered and tradable sized position is offset for all customers at the Master Account level. In another situation, NFA found that if an individual customer is removed from the PAMM module without their open percentage position being offset, then this customer account may not incur a profit or loss for this position and the original regularly offered and tradable lot sized position is simply ~~subsequently~~ reallocated to the remaining sub-accounts, thereby immediately increasing the percentage of equity each individual account has in the regularly offered and tradable sized position established based on the Master Account's equity. Due to these restrictions, NFA is concerned that customers may not be able to close their accounts and have timely access to their funds, and customers are not being treated fairly as a result of this trade allocation method.

In summary, CTAs managing retail forex customer accounts may use bunched orders. However, in determining the quantity of lots or contracts for a bunched order, the CTA may not exceed the sum of the quantity of regularly offered and tradable sized contracts that would be permitted based on the equity in each individual account, not the overall equity in the Master Account. In addition, prior to or at the time the CTA places a bunched order with an FCM or RFED, the CTA must inform the FCM or RFED of the number of regularly offered and tradable sized contracts each individual customer account will receive if the order is filled. The CTA must allocate regularly offered and tradable sized lots or contracts to each individual account using a non-preferential predetermined allocation methodology. Further, all customers should be allowed to make additions and withdrawals in a fair and timely manner, and in a manner that does not affect other customers who are managed by the CTA in the same trading program. Given the significant allocation issues with the use of PAMM, NFA at this time is detailing for forex CTAs the longstanding core principles and responsibilities applicable to the allocation of customer bunched orders.

Core Principles and Responsibilities

Allocation instructions for retail forex trades made through bunched orders for multiple accounts must deal with two separate issues. The first involves the question of ~~address~~ 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 and partial fills, which may be somewhat less applicable to retail forex transactions given the counterparty nature of these transactions ~~but involves the allocation of split or partial fills~~. For example, a CTA may place a bunched order of 100 contracts for multiple accounts. This order may be either filled at a number of different prices or if an order is to be filled at a particular price the FCM or RFED may be willing to act as counterparty for some but not all of the 100 lot order. In either example, the question arises of how the different prices of the contracts in the split or partial fill should be allocated among the accounts included in the ~~block~~ bunched 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;[~~7~~6]

- 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 and RFEDs as soon as practicable at the time the order is placed or after the order is filled.[~~8~~7]

The responsibility for allocating contracts executed through a bunched order rests solely with the CTA.[~~9~~8] 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).[~~10~~9] 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 examination.

Although the CTA is responsible for the allocation of each bunched order, FCMs and RFEDs have certain obligations as well. In particular, each FCM and RFED must receive from an account manager sufficient information to allow it to perform its functions, including information concerning the number of contracts to be allocated to each account included in the bunched order along with instructions, if applicable, for the allocation of split and partial fills among accounts. One means by which an FCM or RFED 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 or RFED must create a written record and maintain that record.

Also, if an FCM or RFED has actual or constructive notice that allocations may be fraudulent, the FCM or RFED must take appropriate action. For example, if an FCM or RFED has notice of unusual allocation activity, the FCM or RFED 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 or RFED has such notice depends upon the particular facts involved.

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[1] For purposes of the Notice, the term "forex" has the same meaning as in Bylaw 1507(b).

~~[2] Bunched orders can provide customers with the advantages of better pricing and more efficient execution of orders.~~

[~~3~~2] Consistent with the provisions of CFTC Regulation 1.35(b)(1), account managers that place orders for a single account must still provide account identification information at the time of order entry.

[~~4~~3] CFTC Regulation 1.35(b)(5)'s language governing the post-execution allocation of bunched orders appears inapplicable to retail ~~F~~forex bunched orders.

[~~5~~4] FCMs and RFEDs acting as counterparties to retail Forex customer accounts traded as part of a block order have an obligation to ensure that they have collected and maintained for each individual customer the applicable security deposit requirement pursuant to NFA Financial Requirements Section 12 for each lot or contract placed in a customer's account by a CTA.

[~~6~~5] Forex positions are often regularly traded in the following lot sizes: Standard (100,000 units), Mini (10,000 units) and Micro (1,000 units). CTAs must disclose to their customers the lot size they intend to use.

[~~7~~6] 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.

[~~8~~7] ~~In 1997, NFA adopted~~ Interpretive Notice 9029 - *NFA Compliance Rule 2-10: The Allocation of Bunched Orders for Multiple Accounts* ~~and in the Notice~~ sets out examples of methodologies for the allocation of bunched orders that generally satisfy the core principles described above. Although these methodologies were set forth with regard to on-exchange futures and options transactions, their application may be equally applicable to retail forex transactions.

[~~9~~8] However, NFA rules do not preclude an FCM or RFED from agreeing to undertake this responsibility, pursuant to either its own procedures or to those supplied by the CTA. For example, the CTA and FCM or RFED may agree that an FCM or RFED will allocate a bunched order in accordance with instructions that the CTA files with the FCM or RFED 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.

[~~10~~9] CTAs must review customer performance at the individual client account level and not the master account level. Moreover, CTAs must maintain the necessary records and calculate customer performance for each trading program in conformity with the CFTC's Part 4 Regulations.

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EXPLANATION OF PROPOSED AMENDMENTS

As described more fully below, the Board has approved amendments to several NFA Rules and Interpretive Notices related to discretionary customer accounts, customer information, risk disclosures and bunched orders to apply to cleared swaps. The proposal also includes other minor amendments to update and clarify certain aspects of these Rules and Interpretive Notices.

The Board amended NFA Compliance Rule 2-8 to specify that NFA's requirements for discretionary accounts apply to cleared swaps customer accounts. NFA's Board also approved an amendment to add the term "customer" to the title of NFA Compliance Rule 2-8 to emphasize that this rule applies to activities in customer accounts and does not apply to a Member's principal-to-principal activities. The amendments also clarify that each FCM and IB Member must maintain a record that identifies the Member, any Associate, or any Third Party Controller that exercises discretionary authority over each account and must review discretionary activity for compliance with applicable regulatory requirements.

NFA Compliance Rule 2-30 and the related Interpretive Notices have been amended to expand existing customer information and risk disclosure requirements to apply to cleared swaps. These amendments are designed to help ensure that Members obtain customer information from and provide adequate risk disclosures to individuals and to other customers that are not eligible contract participants ("non-ECPs") before allowing them to trade cleared swaps on or pursuant to the rules of a designated contract market. The required risk disclosures have been updated to include the disclosures required by CFTC Regulation 22.16 (Disclosures to Cleared Swaps Customers).

NFA's Board also approved amendments to Interpretive Notice 9029 – *NFA Compliance Rule 2-10: The Allocation of Bunched Orders for Multiple Accounts*. The substantive changes include the following:

- Expanding the scope of the Interpretive Notice to apply to bunched orders involving cleared swaps;

- Specifying that the currently required quarterly review of each trading program offered by an Eligible Account Manager to ensure that the allocation method has been fair and equitable also applies when an Eligible Account Manager routinely executes bunched orders on behalf of the same group of customers; and

- Clarifying that the average price of a bunched order may be rounded to the next price increment supported by the relevant clearing house and accounting systems as long as any cash residuals greater than a penny are paid to the relevant customers.

The amendments also revise the Interpretive Notice to track updated language in CFTC Regulation 1.35, which specifies that the requirement to prepare a written order ticket applies to customer orders that cannot immediately be entered into a trade matching engine. In addition, the amendments more clearly delineate CFTC Regulations 1.35(b)(5)'s requirements relating to post-execution allocation of bunched orders for Eligible Account Managers and the FCMs and IBs that execute or clear these transactions. Finally, to distinguish between the obligations of executing and clearing brokers and Eligible Account Managers, the responsibilities of FCMs and IBs that execute or clear bunched orders have been moved to a separate section of the updated Interpretive Notice.

In addition, NFA's Board approved several non-substantive amendments to Interpretive Notice 9065 – *NFA Compliance Rule 2-10: The Allocation of Bunched Retail Forex Orders for Multiple Accounts*. These amendments update and clarify language in the existing notice and do not impose any additional obligations on Members.

NFA staff presented these proposed amendments to the FCM, IB and CPO/CTA Advisory Committees. The Advisory Committees supported the proposed amendments. As stated earlier, NFA's Board unanimously approved the proposed amendments on November 21, 2019.

As mentioned earlier, NFA is invoking the “ten-day” provision of Section 17(j) of the CEA. NFA intends to issue a Notice to Members establishing an effective date for the proposed amendments to NFA Compliance Rules 2-8 and 2-30 and NFA Interpretive Notices entitled: 9004 – *NFA Compliance Rule 2-30: Customer Information and Risk Disclosure*; 9013 – *NFA Compliance Rule 2-30: Customer Information and*

Risk Disclosure; 9029 – *NFA Compliance Rule 2-10: The Allocation of Bunched Orders for Multiple Accounts*; and 9065 – *NFA Compliance Rule 2-10: The Allocation of Bunched Retail Forex Orders for Multiple Accounts* as early as ten days after receipt of this submission by the Commission, unless NFA is notified that the Commission has determined to review the proposal for approval.

Respectfully submitted,

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General Counsel