

May 21, 2019

**Via Federal Express**

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 Interpretive Notice *Compliance Rule 2-9: Supervision of Branch Offices and Guaranteed IBs*

Dear Mr. Kirkpatrick:

Pursuant to Section 17(j) of the Commodity Exchange Act ("CEA"), as amended, National Futures Association ("NFA") hereby submits to the Commodity Futures Trading Commission ("CFTC" or "Commission") the proposed amendments to NFA Interpretive Notice *Compliance Rule 2-9: Supervision of Branch Offices and Guaranteed IBs*. The proposed amendments will replace and supersede an existing Interpretive Notice with the same title. NFA's Board of Directors ("Board") unanimously approved the proposal on May 16, 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.

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

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**NATIONAL FUTURES ASSOCIATION**

**INTERPRETIVE NOTICES**

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**9019 - COMPLIANCE RULE 2-9: SUPERVISION OF BRANCH OFFICES AND  
GUARANTEED IBs**

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NFA Compliance Rule 2-9(a) places a continuing responsibility on every FCM, IB, CPO and CTA Member to diligently supervise its employees and agents in all aspects of their commodity interest activities. Similarly, NFA Compliance Rule 2-36(e) places a continuing responsibility on every FDM to diligently supervise its employees and agents in all aspects of their forex activities. Additionally, NFA Compliance Rule 2-23 provides that a guarantor FCM or RFED (i.e., FDM) is jointly and severally subject to discipline by NFA for violations of NFA Requirements committed by an IB guaranteed by the FCM or FDM, and NFA's Business Conduct Committee has initiated disciplinary action under Rule 2-23 in instances where it appears a guarantor FCM or FDM has failed to supervise its guaranteed IBs.

In order to comply with NFA Compliance Rules 2-9, 2-36 and 2-23, as applicable, each FCM, IB, CPO and CTA Member and FDM must diligently supervise the commodity interest activities at its branch offices and/or guaranteed IBs. NFA recognizes that given the differences in the size and complexity of Member firm operations, Members must be given some degree of flexibility in determining what constitutes diligent supervision. As in all areas of supervision, NFA expects that Member firm supervisory programs over branch offices and guaranteed IBs will vary and it is NFA's policy to provide firms with flexibility to develop and implement policies and procedures for supervising branch offices and guaranteed IBs that are tailored to the operations of the particular Member firm. Nevertheless, NFA's Board of Directors previously determined and continues to believe that NFA should provide Member firms with specific guidance and minimum standards related to the supervision of branch offices and guaranteed IBs.

As described more fully below, effective supervisory oversight of branch offices and guaranteed IBs begins with a due diligence review of each branch office, guaranteed IB and their personnel. An effective oversight program of branch offices and guaranteed IBs also includes written supervisory policies and procedures describing a Member's process for performing routine surveillance and supervision, as well as annual inspections that are documented through a written report. Finally, Members are responsible for ensuring that branch office and guaranteed IB personnel are properly trained to perform their duties.

## **I. Due Diligence Review**

A Member firm should adopt written policies and procedures designed to ensure that a robust due diligence review is performed before it establishes or modifies a branch office or guaranteed IB relationship. At a minimum, the Member firm's due diligence process should include reviewing the business that will be conducted by the potential branch office or guaranteed IB and the background and employment history of its

personnel to ensure that they are qualified. A Member firm should also review the disciplinary history of prospective APs, their prior employers and, to the extent applicable, the disciplinary history of the potential branch office or guaranteed IB and its principals. In addition, a Member firm should ensure that one or more individuals at the branch office or guaranteed IB are knowledgeable about and will track developments related to the applicable requirements of the Commodity Exchange Act, CFTC Regulations and NFA Requirements. A Member firm should carefully consider information obtained through the due diligence process to evaluate whether it should establish a branch office or guaranteed IB relationship and to determine the scope of the supervisory oversight it needs to perform with respect to a particular branch office or guaranteed IB.

## **II. Written Supervisory Policies and Procedures**

The starting point for diligently supervising a branch office or guaranteed IB is to adopt and implement written policies and procedures describing the manner in which a Member firm provides supervisory oversight for the commodity interest business of its branches and guaranteed IBs. NFA recognizes that Members need some degree of flexibility to implement supervisory policies and procedures that are tailored to the unique needs of their business. On the other hand, to be effective, written supervisory policies and procedures for branch offices and guaranteed IBs must be designed to address applicable regulatory requirements, identify the areas that will be supervised and describe the specific procedures that the Member firm will implement to provide adequate supervisory oversight. To assist firms in developing appropriate supervisory policies and procedures, Section II.A of this Interpretive Notice provides a detailed description of several areas that, to the extent applicable, must be addressed in a Member's written supervisory policies and procedures for branch offices and guaranteed IBs.

Effective supervision of branch offices and guaranteed IBs requires both routine supervision and surveillance designed to identify and address potential issues as they arise and annual inspections designed to perform a more comprehensive and detailed review of a branch office or guaranteed IB's activities. NFA recognizes that Member firms may use different routine supervision and surveillance processes. For example, some Member firms may implement automated surveillance tools to help review and analyze account activity while others may utilize a periodic manual review process. Likewise, Members may elect to perform routine surveillance and supervision at different intervals (e.g., on a real-time, daily, weekly, monthly, quarterly or an as needed basis). A Member firm's policies and procedures should also address when it will escalate to NFA and/or other appropriate regulators, identified significant findings (e.g., findings related to fraud or customer harm) during its routine supervision and surveillance or annual inspection. As described more fully in Section II.B, Members are also required to perform an annual inspection of each branch office or guaranteed IB.

The personnel who perform routine surveillance and supervision and inspections must be appropriately qualified and knowledgeable of the industry and the nature of the firm's business, and should be able to perform their work with an independent and objective perspective. Written supervisory procedures should provide sufficient detail to ensure that the inspection process is performed in a consistent manner and will not vary due to the involvement of different personnel in the inspection process. Third-party vendors may be used to assist in performing routine supervision and surveillance and/or inspections; however, Member firms must perform due diligence to confirm that a vendor is qualified to perform the services they will be providing. Likewise, supervisory personnel at the branch office or guaranteed IB may perform certain supervisory procedures. Member firms remain responsible for all applicable regulatory requirements including any supervisory functions performed by a third-party vendor or supervisory personnel at a branch office or guaranteed IB.

The Member firm should ensure that the appropriate personnel at each branch office and/or guaranteed IB have a copy of and understand the policies and procedures related to their duties. The Member firm should also ensure that all supervisory personnel are knowledgeable of the firm's supervisory requirements. Each branch office and guaranteed IB should have a readily available copy of the Member firm's policies and procedures that govern the operation of their business.

#### **A. Supervisory Procedures for Branch Offices and Guaranteed IBs**

Members that supervise a branch office or guaranteed IB should implement written supervisory policies and procedures that are reasonably designed to achieve compliance with all NFA and CFTC requirements applicable to the commodity interest business of its branch offices and guaranteed IBs. Such policies and procedures should specify the manner and frequency of specific supervisory procedures that have been implemented to address each of the following areas, to the extent applicable to the business conducted by the Member and its branch offices or guaranteed IBs.

**Registration.** A Member firm's branch offices and guaranteed IBs should hold themselves out to the public in their registered names only, and branch offices should not be separately incorporated entities. Only individuals who are registered as APs and are NFA Associates may conduct sales activities at a branch office or guaranteed IB. Members should implement supervisory procedures that are reasonably designed to ensure that any individual performing AP activities is registered as an AP and that AP activities are only performed from a main or branch office of a Member firm. For example, a Member could adopt procedures to monitor or review commission payments to confirm that commissions are only paid to registered individuals located at the main or branch office of a Member firm.

**Hiring.** Members should implement supervisory procedures designed to ensure that all prospective employees at a branch office or guaranteed IB are screened and qualified. Such procedures should include inquiring about prior or pending disciplinary matters, reviewing the prospective employee's educational background and contacting prior employers to confirm previous work experience. If a prospective employee is required to complete CFTC Form 8-R (i.e., a new AP), the form should be carefully reviewed with the prospective employee to ensure that he/she provided all required information. Additionally, documentation to support any "yes" answers to the Form 8-R Disciplinary Information questions must be obtained and reviewed for potential disqualifying conduct. Policies and procedures should also require APs to notify the branch office, guaranteed IB and/or Member firm if any new circumstances arise that may require an additional disclosure. If a prospective employee was previously registered as an AP, information related to the prospective employee's disciplinary and registration history must be obtained from NFA. The registration and disciplinary history (if any) of the prospective employee's prior employers should also be reviewed. Information obtained through this screening process should be considered by the Member firm, branch office and/or guaranteed IB in determining the scope of supervision necessary to adequately supervise the prospective employee.

**Promotional Material.** Members should adopt supervisory procedures reasonably designed to ensure that any promotional material used by a branch office or guaranteed IB has been reviewed and approved by the appropriate supervisory personnel prior to its first use. In some circumstances, or as a matter of policy, a Member firm may require that all promotional material used by a branch office or guaranteed IB be approved by the main office or guarantor prior to its first use. Member firms should also verify that documentation of supervisory reviews and approvals is created and retained and that a branch office or guaranteed IB is not using any promotional material that has not received prior approval.

**Sales Practices.** A Member's supervisory procedures for branch offices and guaranteed IBs should provide for the review of sales solicitation practices. 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. Members should ensure that, when appropriate, enhanced supervisory procedures are implemented for APs that have a disciplinary history. Adequate procedures will also incorporate a review of sales solicitations through in-person monitoring or technological means (e.g., listening to phone calls or reviewing electronic communications). When appropriate (e.g., a potential pattern of wrongdoing or observation of unusual account activity), a Member firm should consider interviewing selected customer(s) about the solicitation process and the handling of their account(s).

**Customer Information and Risk Disclosure.** All Members are required to implement policies and procedures for collecting specific customer information and providing required risk disclosures. A branch office or guaranteed IB's procedures for opening new accounts should specify that appropriate account documentation must be forwarded to the main office of the Member firm or the firm's guarantor. The main office or guarantor should implement policies and procedures for reviewing account documentation to ensure that required risk disclosures were made and acknowledged and that the appropriate supervisory personnel approved the account. Such procedures could include requiring main office or guarantor approval before opening an account and/or contacting customers to verify that they received and understood the risk disclosure document.

**Anti-Money Laundering Program.** Member firms that are required to develop and implement anti-money laundering programs should ensure that their branch offices and/or guaranteed IBs have adopted and implemented a program that satisfies NFA's anti-money laundering program requirements, which could include adopting and implementing the program of the main office or guarantor.

**Handling of Customer Funds.** Supervisory policies and procedures for branch offices and guaranteed IBs should be designed to ensure that all records related to customer funds, including copies of checks, are created, retained and reviewed for compliance with applicable regulatory requirements, including as applicable to guaranteed IBs CFTC Regulation 1.57(c). Such policies and procedures should be designed to confirm that any funds accepted from customers are received in the name of the FCM or FDM and that proper procedures for depositing the funds into a qualifying bank account have been established and are followed. In general, third-party payments should not be accepted. If a third-party payment is accepted, it must be scrutinized to ensure that no customers are acting as unregistered FCMs, FDMs or CPOs.

**Customer Order Procedures.** Members should adopt supervisory procedures that are reasonably designed to achieve compliance with regulatory requirements for handling and recording customer orders. As part of these procedures, the individuals responsible for accepting customer orders should be identified and a sample of order tickets and/or electronic orders should be reviewed. NFA recommends that order tickets be pre-numbered and that the review test to ensure that all order tickets within the chosen samples have been retained. Order tickets may be reviewed through electronic records (e.g., scanned copies of order tickets), provided that such records are sufficient to confirm that all order tickets are properly time stamped and that all information required by CFTC Regulation 1.35 has been captured and retained. Likewise, Members should implement policies and procedures designed to ensure that all required records related to electronic orders are captured and retained.

**Account Activity.** A Member firm should also conduct regular reviews of the trading activity in customer accounts, and, if applicable, the trading activity in personal accounts of APs and principals. A number of procedures can be performed to identify problematic activity and accounts that should be flagged for additional scrutiny. For example:

- Accounts with significant losses, commission charges or a large number of trades should be reviewed to determine if trading strategies that are not appropriate for the customers have been recommended or implemented;
- Unusual or patterns of position transfers or error trades should be investigated to ensure these transactions were legitimate and properly effected;
- Commission to equity ratios should be calculated regularly for discretionary accounts to identify potential excessive trading or churning;
- Trading in the personal trading accounts of APs and principals should be regularly reviewed and compared with the trading in customer accounts to identify potential improper trade allocations or frontrunning; and
- Trading results among a particular AP's customers should be compared to identify potential preferential treatment.

Written supervisory policies and procedures should be designed to ensure that any potentially problematic account activity is thoroughly reviewed and, when appropriate, escalated to appropriate supervisory personnel.

**Discretionary Accounts.** NFA Members and Associates are subject to detailed requirements regarding discretionary customer accounts. If a Member firm's branch office or guaranteed IB handles discretionary customer accounts, the Member firm must adopt supervisory policies and procedures reasonably designed to ensure that the branch office or guaranteed IB achieves compliance with these requirements. Trading authorizations granting discretionary authority and all related records should be forwarded to the main office or guarantor. The main office or guarantor should implement policies and procedures to identify discretionary accounts and perform a documented review of the trading activity in those accounts. Member firms should also confirm that all APs exercising discretionary authority have been continually registered for at least two years.

**Proprietary Trading.** To the extent feasible, a Member's written supervisory policies and procedures should provide for 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 the misuse of non-public information or the occurrence of other trading abuses.

**Bunched Orders.** NFA has adopted specific requirements related to the execution and allocation of bunched orders. Main offices and guarantors should implement

supervisory procedures that are reasonably designed to ensure that bunched orders executed by or through a branch office or guaranteed IB achieve compliance with these requirements. For example, a Member firm should review a branch office or guaranteed IB's allocations for bunched orders to confirm that fills are allocated based on a permitted methodology that is applied in an appropriate and consistent manner.

**Customer Complaints.** A Member firm should require that its branch offices and guaranteed IBs create and maintain a record of all verbal and written complaints in the form and manner and for the period set forth in CFTC Regulation 1.31. Written supervisory procedures should also require that any customer complaints that meet pre-defined criteria established by the Member (e.g., criteria based on the seriousness of the allegations, monetary amount involved, APs or principals involved, or number of complaints against a certain AP or principal) be sent to the main office or guarantor. In some circumstances, or as a matter of policy, a Member firm may require that all customer complaints be forwarded to the main office or guarantor. A Member firm should also contact any customer that files a written or verbal complaint that alleges serious wrongdoing. In addition, written supervisory procedures should provide that the main office or guarantor will review the status of unresolved complaints and the resolution of each complaint to identify possible rule violations or patterns indicative of problematic behavior.

**Information System Security Programs.** All NFA Members are required to implement an information systems security program (ISSP). A Member firm must ensure that its branch offices comply with its ISSP and its guaranteed IBs adopt and implement an ISSP that satisfies NFA's requirements.

## **B. Annual Inspection Requirement**

A Member firm that supervises one or more branch offices and/or guaranteed IBs must perform an on-site inspection of every branch office and guaranteed IB on at least an annual (i.e., calendar year) basis. Member firms may implement risk-based procedures to tailor the scope (e.g., areas covered), depth (e.g., number of documents reviewed) and nature (e.g., announced or unannounced) of the inspection based on the specific risks of the Member and/or a particular branch office or guaranteed IB. There are two exceptions to the annual on-site inspection requirement.

First, Members must promptly perform an on-site inspection of a branch office or guaranteed IB if the Member becomes aware of any indicia of irregularities or misconduct involving the branch office or guaranteed IB, including but not limited to: disciplinary actions, customer complaints that upon inquiry appear bona fide, significant operational issues or irregularities or misconduct identified through routine surveillance or supervision.



Second, Member firms may use a risk-based approach to identify branch offices or guaranteed IBs for which the Member determines it may be appropriate to examine through an on-site inspection every other calendar year. In making this determination, a Member firm should consider a number of factors including, but not limited to the following:

- The amount of revenue generated by the branch office or guaranteed IB;
- The type of business conducted (e.g., hedging v. speculative; discretionary v. non-discretionary);
- Whether the branch office or guaranteed IB solicits new clients or only services existing clients and if it solicits new clients the number of new accounts opened;
- The number of APs;
- The number and nature of customer complaints received;
- The previous training, experience and disciplinary history of the branch office or guaranteed IB and its personnel;
- Whether there has been a change in either ownership or supervisory personnel at the branch office or guaranteed IB;
- Whether a guaranteed IB has one or more branch offices;
- The frequency and nature of problems or concerns that arise from routine surveillance or supervision of the branch office or guaranteed IB's activities; and
- If the branch office or guaranteed IB directly accepts customer funds.

A Member firm must document and retain its rationale if it determines that it is appropriate to examine a branch office or guaranteed IB via an on-site inspection every other calendar year. The Member firm must also inspect remotely the branch office or guaranteed IB during the calendar year in which an on-site inspection is not performed. The Member firm must ensure that it has access to books, records and technology (e.g., video conferencing systems, electronic communications and information related to order and/or trading activity) that will enable it to perform a robust inspection from a remote location.

### *Inspection Report*

Promptly after completing either an on-site or remote inspection, the Member firm should prepare a written report fully describing the inspection, including the scope of the inspection, a summary of the testing performed and any findings or deficiencies identified during the inspection. Any findings or deficiencies should also be discussed with the branch office or guaranteed IB's managers, principals and/or supervisory personnel. The Member firm should also conduct follow-up procedures to ensure that any deficiencies identified during an inspection are promptly corrected. Repeated problems in any particular area should heighten the level of scrutiny and follow-up by the main office or guarantor.

### **III. Ongoing Training**

A Member's supervisory responsibilities include the obligation to ensure that its employees are properly trained to perform their duties. Policies and procedures must be in place to ensure that branch office and guaranteed IB personnel receive adequate training to abide by industry rules and regulations and to properly handle customer accounts and that APs have satisfied ethics training requirements. Employees must be educated on developments and changes in the markets, commodity interest products, rules and regulations, technology and firm policies and procedures applicable to their activities. 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 one or more firms disciplined by NFA or the CFTC for sales practice fraud and has therefore received his or her training from one or more such firms, then the Member firm may have to provide the AP with specialized training in proper sales practices.

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

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~~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.<sup>4</sup> 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.<sup>2</sup> 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.<sup>3</sup>

**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.<sup>4</sup> 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.<sup>5</sup> 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.<sup>6</sup> 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 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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~~<sup>1</sup>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.~~

~~<sup>2</sup>Information concerning futures-related disciplinary proceedings can be obtained by checking the BASIC system on NFA's web site at [www.nfa.futures.org](http://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.~~



~~<sup>3</sup>Registration Information is also available by checking the BASIC system on NFA's web site at [www.nfa.futures.org](http://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.~~

~~<sup>4</sup>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.~~

~~<sup>5</sup>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.~~

~~<sup>6</sup>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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## EXPLANATION OF PROPOSED AMENDMENTS

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NFA's Interpretive Notice entitled *Compliance Rule 2-9: Supervision of Branch Offices and Guaranteed IBs* establishes minimum requirements that a Member firm should implement to supervise its branch offices' and guaranteed IBs' compliance with specific regulatory requirements. NFA's Board has approved an updated Interpretive Notice that reflects advances in electronic trading, electronic communications and other technologies that have impacted both the ways Members conduct their commodity interest business and the methods they use to perform supervision and surveillance. The updated Interpretive Notice also provides Members with increased flexibility, particularly regarding the on-site inspection that Members are required to perform on their branch office(s) and guaranteed IB(s) each year, while ensuring that branch offices and guaranteed IBs remain subject to robust supervision, surveillance and annual inspection requirements. The Interpretive Notice has also been substantially restructured, therefore, NFA is electing to delete the existing Interpretive Notice in its entirety and replace it with the updated Interpretive Notice set forth above.

The first section of the revised Interpretive Notice focuses on the due diligence review that Member firms should complete in evaluating whether to establish, and determining the appropriate supervisory oversight structure for, a branch office or guaranteed IB relationship. Due diligence typically occurs as part of an initial review of both guaranteed IB and branch office relationships; therefore, a separate section discussing due diligence has been added and expanded to apply to branch offices. The due diligence requirements discussed in the Interpretive Notice include reviewing the

business and, if applicable, disciplinary history of the potential branch office or guaranteed IB as well as the background, employment history and disciplinary history of the branch office or guaranteed IB's personnel. During this review, the Member firm should also ensure that there is one or more individuals at the branch office or guaranteed IB that is knowledgeable about and will track developments related to the Commodity Exchange Act, CFTC Regulations and NFA Requirements.

The second section of the revised Interpretive Notice establishes minimum requirements for a Member's written supervisory policies and procedures for branch offices and guaranteed IBs. Such policies and procedures must include routine surveillance and supervision designed to identify and address potential issues as they arise and periodic inspections (conducted at least annually) designed to perform a more comprehensive and detailed review of a branch office or guaranteed IB's business. The updated Interpretive Notice also provides Member firms with the flexibility to implement supervisory processes (e.g., automated surveillance systems or manual review processes) and perform routine supervision and surveillance at intervals (e.g., on a real-time, daily, weekly, monthly, quarterly or as needed basis) designed to meet the specific needs of their business.

Under the proposed Interpretive Notice a Member firm's policies and procedures must address when it will escalate to NFA or other appropriate regulators any significant issues uncovered through surveillance or periodic inspection. In addition, the Interpretive Notice articulates minimum standards for supervisory personnel, requirements related to the use of and responsibility for third-party vendors, and specifies that branch offices must have a copy and understanding of the policies and procedures that govern the operation of their business.

Section II.A of the Notice identifies several areas that must, to the extent applicable, be addressed in a Member's written supervisory policies and procedures for branch offices and guaranteed IBs. NFA added new headings related to anti-money laundering and information systems security program requirements and separately described requirements related to bunched orders, which were previously referenced under discretionary accounts. All other areas described in the proposal appear in the existing Interpretive Notice. Other material changes include an expanded discussion of branch office and AP registration requirements, specifying that documentation supporting any affirmative responses on Form 8-R must be obtained and reviewed and that APs must provide notice of any circumstances that may give rise to an additional disclosure, and several modifications to better reflect electronic trading terminology as well as current technology and supervisory practices.

Members will remain obligated to perform an on-site annual inspection of each branch office and guaranteed IB and prepare a report summarizing the results of the inspection. A Member's written supervisory policies and procedures may

incorporate a risk-based approach to determine the scope (e.g., areas covered) and depth (e.g., number of records reviewed) of the inspection. The Notice also provides two exceptions to the on-site inspection requirement. First, a Member must promptly perform an on-site inspection of a branch office or guaranteed IB if it becomes aware of any indicia of irregularities. Second, a Member may identify certain branch offices and guaranteed IBs for which the Member determines, based on factors (including those set out in the Interpretive Notice), that it is appropriate to perform the annual inspection remotely every other year. Members that perform remote inspections must have sufficient information and technology to complete a robust inspection from a remote location and must document and retain the rationale supporting their determination that it is appropriate to perform a remote inspection of a particular branch office or guaranteed IB.

Finally, the updated Interpretive Notice retains a requirement that Members implement policies and procedures designed to ensure that branch office and guaranteed IB personnel receive adequate training to abide by industry rules and regulations, properly handle customer accounts and satisfy ethics training requirements.

NFA staff presented the revised Interpretive Notice to the FCM, IB and CPO/CTA Advisory Committees. All three Advisory Committees supported these updates. NFA's Board unanimously approved the proposed amendments on May 16, 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 Interpretive Notice *Compliance Rule 2-9: Supervision of Branch Offices and Guaranteed IBs* as early as ten days after receipt of this submission by the Commission, unless the Commission notifies NFA that the Commission has determined to review the proposal for approval.

Respectfully submitted,

A handwritten signature in black ink that reads "Carol A. Wooding". The signature is written in a cursive, flowing style.

Carol A. Wooding  
Vice President and General Counsel