NFA NATIONAL FUTURES ASSOCIATION

January 24, 2011

Mr. David A. Stawick
Secretariat
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st St. NW
Washington, DC 20581

Re: RIN 3038-AC95

Dear Mr. Stawick:

National Futures Association appreciates the opportunity to comment on the Commission's proposed rulemaking regarding the registration of Swap Dealers and Major Swap Participants (SD, MSP and, collectively, Swap Entity) under Part 3 of the Commission's Rules and Commission Rules 23.21 and 23.22, and proposed Commission Regulation 170.16, which requires Swap Entities to become and remain members of a registered futures association ("RFA"). NFA also wishes to extend its appreciation to the Commission and Commission staff for the opportunity extended to NFA to provide input and technical assistance in the development of the proposed rules prior to their adoption.

In general, NFA believes that, to the extent consistent with statutory requirements, the registration of Swap Entities should be incorporated into the current registration framework in a manner that parallels the requirements imposed on the current registration categories. In NFA's view, the Commission's proposed rules largely accomplish this but contain certain provisions that require clarification and amplification. This letter addresses these provisions and responds to the Commission's requests for comment concerning NFA's role in the registration process and the manner in which Swap Entities might fulfill their due diligence requirements concerning their Associated Persons ("Swap APs").

Proposed Commission Regulation 170.16—NFA Membership

The Commission specifically requests comment regarding proposed Commission Regulation 170.16, which would require Swap Entities to become and remain members of a registered futures association ("RFA"). Given the success of self-regulation in the futures industry and the difficulty of allocating regulatory resources, NFA believes this proposal is both appropriate and prudent.

Over the years, self-regulation has achieved a successful track record in the U.S. futures industry. Since NFA began operations in 1982, volume on U.S. futures markets has increased by over 2,000%. During that same time period customer complaints in the futures industry are down by almost 80%. That dramatic drop was not an accident. NFA has worked in very close partnership with the Commission and the futures exchanges to make sure that resources are properly allocated where they are most needed, that regulatory efforts are not duplicated unless absolutely necessary, and that precious regulatory resources are not squandered. While NFA's jurisdiction always overlaps the Commission's, frequently the futures exchanges' and occasionally the SEC's, it has dealt with those issues through intense coordination to the benefit of customers. With stringent oversight by the Commission, self-regulation has served the futures industry very well for a very long time and would offer comparable benefits to Swap Entities as well.

Over the last 29 years NFA has repeatedly demonstrated its ability to take on additional responsibilities. While we are confident that we can do so as well with respect to Swap Entities, we do not in any way underestimate the challenges in doing so. Taking on this additional responsibility would have a dramatic impact on NFA's governance, staffing and funding requirements. We have reviewed these issues with our Board of Directors, and the Board has committed to ensure that NFA has adequate resources to perform any additional responsibilities the Commission may assign to NFA at the same high level that the Commission has rightfully come to expect.

If the Commission adopts option two, then the Commission should clarify the manner in which it assigns the responsibility to NFA to monitor for compliance with the 4s requirements, subject to Commission oversight. The comments to the proposed rules indicate that the Commission has delegated to NFA the responsibility for conducting all aspects of the current registration process and monitoring for compliance with all subsequent requirements. However, to be more precise, the Commission's prior delegation orders in the registration area have been limited to authorizing NFA to perform the registration function not the subsequent monitoring of continued compliance with regulatory requirements.

Currently, for example, under Section 8a(3)(I) of the Act, an FCM or IB applicant for registration may be disqualified from registration if it fails to meet minimum financial requirements. Hence, both Commission Rule 3.10 and NFA Registration Rule 204 require FCM and IB applicants to file financial statements as part of the application.

NFA reviews those financial statements as part of the registration process to ensure that the applicant meets the minimum financial requirements prior to granting the firm's registration. However, after registration is granted, NFA conducts the subsequent monitoring of its Members' compliance with minimum financial requirements in its self-regulatory role as authorized pursuant to Section 17 of the Act rather than as the Commission's delegate. Similarly, NFA suggests that if the Commission adopts option 2, then it makes clear in any delegation order that NFA acts as the Commission's delegate in determining an applicant's compliance with the 4s requirements only in order to become registered. Afterwards, NFA would monitor the Swap Entities Members' compliance with all applicable regulatory requirements, including the 4s requirements, in its self-regulatory role.

Certainly, if Swap Entities are required to become and remain NFA Members and NFA has primary responsibility for ensuring their compliance with the 4s requirements, then Section 17(b)(5) of the Commodity Exchange Act ensuring fair representation would require NFA's Board to include membership categories for Swaps Entities. While the exact governance structure can be decided later, NFA believes that the principles inherent in NFA's current governance structure should apply, including a system of checks and balances so that no membership category has unfettered discretion to write rules favorable to their constituents at the expense of sound public policy.

Of course, implementing those regulatory programs will require NFA to meet additional staffing needs. While the exact number of additional staff needed to monitor Swap Entities for compliance with the 4s requirements will depend upon the number of registrants in each category, the frequency of audits required, and the nature and extent of the final rules adopted pursuant to 4s, NFA's Board is prepared to recruit and hire the staff and expertise necessary. NFA's Board also undoubtedly recognizes that the number of additional staff could be significant depending upon the three aforementioned factors. Given the extensive use of technology in NFA's current regulatory programs applicable to futures, NFA also fully expects to develop technology programs to utilize in NFA's regulatory programs for Swap Entities.

If the Commission implements option two, NFA's Board recognizes that the significant impact on NFA's staffing and technology needs will have a corresponding impact on NFA's costs. Each time NFA has accepted new responsibilities, whether for trade practice and market surveillance or forex regulation, a guiding principle has been

that NFA had to recover its costs of regulation and that each area of regulatory activity must pay its own way. NFA's Board expects to follow the same funding philosophy with regard to recovering the costs (i.e. direct and overhead) associated with implementing regulatory programs for Swap Entities. NFA's overriding principle over the years for recovering these costs is to create a revenue structure that is both equitable and easy to administer for both Members and NFA.[1]

While the aforementioned discussion has primarily focused on NFA's implementation of option two as described in the Federal Register release, NFA recognizes that the Commission could involve NFA in monitoring Swap Entities for compliance with the 4s requirements by implementing option three—whereby certain compliance oversight activities are performed by the Commission and others are performed by NFA. NFA is more than willing to discuss with the Commission this structure and any assignment of responsibilities that may be appropriate. Implementation of option three would have to clearly define NFA's responsibilities, and ensure that NFA receives any necessary data to perform the delegated function. Additionally, if the Commission were to implement option three, many of the areas discussed above—NFA's governance structure, staffing needs, systems development, and funding sources—could be impacted depending upon the extent of NFA's responsibilities.

As previously stated, as a strong proponent of self-regulation, NFA believes that proposed Commission Regulation 170.16 is critical to the Commission as it allocates resources to regulating over-the-counter derivatives. Option two as described in the Federal Register release—which is closely analogous to the current structure applicable to futures—where NFA would be responsible for ensuring compliance with the 4s requirements subject to Commission oversight may be the optimal structure particularly given the historical success of self-regulation in the futures industry and the close working partnership between NFA and the Commission. If the Commission elects to pursue either option two or three, then NFA looks forward to engaging in further discussions with the Commission, and continuing NFA's close

[1] In the cost-benefit analysis section of the release, the Commission indicates that NFA annual membership dues would be $7500 for SDs and $5600 for MSPs. However, these amounts only reflect NFA's estimated costs to conduct the initial inquiry into the Swap Entity's compliance with applicable requirements.

working relationship developed over the past twenty-nine years as we confront the issues associated with the regulation of OTC derivatives.

The Commission's Proposed Registration Rules

As noted above, NFA believes that the Commission's proposed registration rules largely incorporate Swap Entities into the current registration framework in a manner that parallels the requirements imposed on the current registration categories. However, certain proposed requirements require clarification and amplification.

Adverse Registration Actions

The Commission's comments accompanying the proposed rules indicate that the Commission anticipates delegating to NFA the responsibility to process Swap Entity applications and maintain records associated therewith and to conduct background checks of Swap Entity applicants and their principals. However, rather than delegate the authority to NFA to conduct adverse registration actions with respect to Swap Entities, as is the case with all other categories of applicants and registrants, the Commission indicates that NFA will be required to notify the Commission if NFA's background check reveals information that the applicant may be unfit for registration.

In August 1983, the Commission delegated to NFA the authority to register Introducing Brokers and their Associated Persons. Since then, through a series of delegation orders, the Commission has delegated to NFA the authority to register, conduct fitness examinations, institute adverse registration actions and maintain the registration records for all categories of Commission registrants. The Commission has conducted regular reviews of NFA's Registration Program and concluded that NFA's performance has been satisfactory.

Consequently, NFA recommends that the Commission delegate to NFA not only the authority to process Swap Entity registration applications and conduct background checks but also to conduct adverse registration proceedings. Not only has NFA demonstrated its ability to efficiently and effectively perform that function, having that authority reside with NFA would ensure consistency of treatment and the uniform application of registration policies with respect to all applicants and registrants. The need for consistency of treatment and uniform application of policy will be especially

important when a Swap Entity applicant is either also applying for registration or is registered in another registration category, for example, an FCM or IB.

Proposed Rule 3.3(b)

Proposed Rule 3.1(a)(1) provides that a Chief Compliance Officer (CCO) is a principal who must file a Form 8-R. If the CCO is personally subject to a statutory disqualification, a Swap Entity's registration application could be denied or its registration revoked under either Section 8a(2)(H) or Section 8a(3)(N) of the Act, which provide that a firm is statutorily disqualified from registration if one of its principals is subject to a statutory disqualification. However, proposed Rule 3.3(b) specifically provides no individual who is subject to a statutory disqualification may serve as a CCO. This provision appears to be redundant and potentially problematic, and NFA recommends that it be deleted from the final rules so as not convey the impression that a different fitness standard applies to CCOs than to other principals.

Proposed Rule 3.10

Effective Date for Provisional Registrations

As currently drafted, there is an ambiguity in the proposed rules concerning the date upon which a Swap Entity that files an application between April 15, 2011 and July 21, 2011 will be granted provisional registration. Proposed Rule 3.10(a)(1)(v)(C)(1) provides that Swap Entities may begin filing applications on April 15, 2011, and proposed Rule 3.10(a)(1)(v)(C)(3) provides that a Swap Entity who files an application before all of the 4s requirements are effective will be provisionally registered upon the filing of the "Form 7-R and such documentation as may be required to demonstrate compliance" with the 4s requirements that are effective as of the date of the filing of the application. However, the comments indicate that the Commission is proposing that provisional registration would be available only during the transitional period between July 21, 2011 (the date by which the proposed registration rules must be effective) and the effective dates of the definitional rules and the 4s requirements, which may be later than July 21, 2011. NFA requests that the Commission clarify this ambiguity by providing the date on which provisional registrations may be initially granted.

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Compliance with 4s Requirements

Proposed Rule 3.10(a)(1)(v)(A) requires Swap Entity applicants to demonstrate, concurrently with or subsequent to the filing of a Form 7-R, compliance with the 4s requirements. However, the proposed rule does not specify the manner in which such demonstration of compliance is to be made. Proposed Rule 3.10(a)(1)(v)(C)(3) already provides that Swap Entity applicants will be provisionally registered upon the filing of a Form 7-R and "such documentation as may be required to demonstrate compliance" with the 4s requirements. NFA suggests that the Commission amend proposed Rule 3.10(a)(1)(v)(A) to similarly provide that the applicant must demonstrate compliance with the 4s requirements by filing "such documentation as may be required to demonstrate compliance with the 4s requirements."

NFA further recommends that the Commission identify what documentation must be filed in order to demonstrate such compliance. As currently written, these proposed rules do not provide any guidance to Swap Entity applicants with respect to this issue. Presumably, if a Commission rule implementing a 4s requirement requires the Swap Entity to adopt specific written policies and procedures, the filing of adequate written policies and procedures would demonstrate compliance. However, not all of the proposed rules implementing the 4s requirements specify the adoption of written policies and procedures. For example, proposed Rules 23.200-205 implement the reporting, recordkeeping and daily trading records requirements contained in 4s(f) but do not specify that the Swap Entity adopt written policies and procedures in connection with the requirements. NFA suggests that the Commission clarify that the documentation required to demonstrate compliance with the 4s requirements consist of adequate written policies and procedures that are either required by a 4s requirement or, if not specifically required, address the Swap Entity's implementation of the 4s requirement.

Proposed Rule 3.10(a)(1)(v)(C)(3) raises another issue. As proposed, the rule does not clearly specify whether provisional registration will be granted upon the mere filing of the documentation or upon an affirmative determination that the documentation is adequate to demonstrate compliance with the particular 4s requirement. NFA requests the Commission to clarify this ambiguity.

Proposed Rule 3.10(a)(1)(v)(D)(2) provides that if a Swap Entity has been granted provisional registration, the Swap Entity's application will be withdrawn if the Swap Entity fails to timely demonstrate compliance with, presumably, 4s requirements that become effective subsequent to becoming provisionally registered. NFA recommends that the Commission clarify whether the applicant's failure to demonstrate compliance with applicable 4s requirements prior to becoming provisionally registered would also result in the withdrawal of the Swap Entity's application.

Finally, proposed Rule 3.10(a)(1)(v)(C)(3) does not address whether an SD or MSP applicant will be granted provisional registration even if the applicant has an unfit principal. As noted above, provisional registration will only be available to applicants during the transitional period between July 21, 2011 (the date by which the proposed registration rules must be effective) and the effective dates of the definitional rules and the 4s requirements, which may be later than July 21, 2011. If the Swap Entity files its application after the provisional registration is no longer available, presumably a Swap Entity's application could be denied under either Section 8a(2)(H) or Section 8a(3)(N) of the Act, which provide that a firm is statutorily disqualified from registration if one of its principals is subject to a statutory disqualification. Although there is no provisional registration scheme for other categories of registration, there is an analogous temporary licensing provision for guaranteed IBs. Unlike the provisional registration scheme, the guaranteed IB temporary license rules are permissive rather than mandatory - NFA may but is not required to grant a temporary license to an IB. In coordination with Commission staff, NFA has adopted policies regarding temporary licenses for IBs. Specifically, NFA does not grant a temporary license to a guaranteed IB that had an unfit principal. NFA recommends that the Commission clarify whether proposed Rule 3.10(a)(1)(v)(C)(3) should permit a provisional registration if one or more of the Swap Entity's principals is unfit. Similarly, NFA recommends that the Commission clarify whether the Swap Entity's provisional registration should be impacted, and if so in what manner, if after the Swap Entity becomes provisionally registered NFA obtains information that one of its principals is subject to a statutory disqualification.

Rule 23.22

Proposed Rule 23.22 prohibits a Swap Entity from permitting a person who the Swap Entity knows or in the exercise of reasonable care should know is subject to a statutory disqualification to effect or be involved with effecting swaps on its behalf.

The Commission has requested comments on how the Swap Entity might discharge its due diligence obligation in this context and specifically whether it could do so by submitting identifying information and fingerprints to NFA to perform a background check on the person.

NFA recommends, at least in the short term, that the Commission allow, but not require, Swap Entities to satisfy their obligation in this regard by filing the identifying information and fingerprints with NFA. NFA anticipates that in order to perform this function, the Swap Entity would submit a background check request form using NFA's Online Registration System. The form would contain the name of the individual, the name of the Swap Entity submitting the request, the individual's residential address, date and place of birth, social security number (optional but recommended) and CRD/IARD if available, other names the individual is or has been known as and the demographic information required by the FBI to conduct a criminal background check (gender, race, eye color, hair color, height, weight and country of citizenship). Based upon the information provided, NFA would conduct the same type of background check that it performs in connection with APs and principals. NFA would notify the requesting firm of any information that indicates the person may be subject to a statutory disqualification. NFA also recommends that if a firm chooses to follow this procedure, then it would constitute a safe harbor for the firm if the individual is subject to a statutory disqualification but NFA previously notified the firm that the person is not subject to one.

As noted above, the Commission intends to delegate to NFA the responsibility to maintain records associated with processing Swap Entity registration applications. NFA requests that the Commission specify whether the records filed with and maintained by NFA in connection with any background check described above are records that NFA obtains in connection with processing a Swap Entity's registration application and, therefore, are considered Commission records.

In the longer term, particularly if NFA has regulatory responsibility for Swap Entities, NFA may require these individuals to become Associates of NFA so that it has regulatory jurisdiction over them. Section 17(b)(4)(F) of the Act permits NFA to "require any class of persons associated with a member to be registered with" NFA. If NFA determines that these individuals should be NFA Associates, Section 17(b)(4)(E) authorizes NFA to require them to submit fingerprints, and NFA may submit those

fingerprints to the FBI for a criminal background check. NFA would maintain these records as NFA records rather than as Commission records.

Rule 3.12(f)

NFA recommends that the Commission adopt a rule to address the situations in which an individual conducts swaps-related activity on behalf of more than one Swap Entity or conducts swaps activity on behalf of a Swap Entity and is also registered as an AP of a different firm. Currently, Rule 3.12(f) provides that in the event of such multiple associations the sponsors are jointly and severally responsible for the person's activities with respect to common customers. NFA recommends either expansion of this rule or adoption of a new rule to cover the above-described situations.

Processes For Contesting Adverse Determinations

As described above, proposed Rule 3.10(a)(1)(v)(C)(3) provides for provisional registration upon the filing of the application and documentation required to demonstrate compliance with the 4s requirements. Similarly, proposed Rule 3.10(a)(1)(v)(D)(2) provides that if a provisionally registered Swap Entity fails to timely demonstrate compliance with 4s requirements as they become effective, the Swap Entity's application will be withdrawn. Neither rule provides for a process by which the Swap Entity can contest the determination of non-compliance with the 4s requirements.

Similarly, proposed Rule 23.22 prohibits a Swap Entity from permitting a person subject to a statutory disqualification to effect or be involved with effecting swaps on its behalf. However, the rule does not provide for a process by which the Swap Entity could contest the existence of a potential statutory disqualification. For example, a criminal background check may contain information indicating that a person had been convicted of a drug-related felony, which constitutes a disqualification under Section 8a(3)(D) of the Act. However, it is possible that the information is incorrect, and that in fact the conviction was for a drug-related misdemeanor, which is not a disqualification. Alternatively, it is possible that the information was incorrectly reported to the FBI as pertaining to the person but in fact relates to a different person.

Moreover, proposed Rule 23.22 does not provide for a process by which the Swap Entity could request that it allow a person who is subject to a statutory disqualification to nonetheless effect or be involved with effecting swaps on its behalf.

The unavailability of such a process could be particularly significant if it resulted in disparate treatment of individuals associated with Swap Entities and individuals associated with other types of registrants. For example, a Swap Entity may either be applying or have already been registered as an IB. In accordance with policies developed by NFA in consultation by the Commission over the past 25 years, one of its APs may have been registered, despite having been convicted of shoplifting 20 years earlier. However, under proposed Rule 23.22, this same individual would not be permitted to effect or be involved with effecting swaps on behalf of the firm, and there would be no procedure pursuant to which the individual could be permitted to engage in these swaps activities despite the statutory disqualification.

Finally, over the years, the Commission has recognized that AP registration should be granted to individuals who are nevertheless able to demonstrate their fitness for registration subject to conditions. Similar to the situation described above, it would be anomalous and not particularly good public policy if an individual could be conditionally registered as an AP but not allowed to engage in swaps activity on behalf of the same entity based upon the same statutory disqualification.

Absent some defined process, the Swap Entity whose provisional registration was not granted or whose application was withdrawn or whose associated person was determined to be subject to a statutory disqualification would be faced with a dilemma. The Swap Entity could either abide by the adverse determination or conduct its activities in a manner that would violate the pertinent statutory or regulatory provisions and defend any subsequent enforcement action on the grounds that the initial adverse determination was incorrect. NFA suggests that the better approach would be for the Commission to establish a process through which the adverse determinations could be contested.

NFA

Mr. David A. Stawick

January 24, 2011

If you have any questions concerning this letter, please do not hesitate to contact either Michael Crowley at (312) 781-1388 or mcrowley@nfa.futures.org or the undersigned at (312) 781-1413 or tsexton@nfa.futures.org.

Respectfully submitted,

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Senior Vice President and General Counsel

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