NFA NATIONAL FUTURES ASSOCIATION

February 15, 2013

Ms. Melissa Jurgens
Secretary
Commodity Futures Trading Commission
1151 21st Street NW
Washington, DC 20581

Re: RIN 3038-AD88: Enhancing Customer Protections Afforded Customers and Customer Funds Held by Futures Commission Merchants and Derivatives Clearing Organizations

Dear Ms. Jurgens:

National Futures Association (NFA) welcomes the opportunity to comment on the Commodity Futures Trading Commission's (CFTC or Commission) proposal to enhance customer protections afforded customers and customer funds held by futures commission merchants (FCMs) and derivatives clearing organizations (DCOs). For years, the futures industry had an impeccable reputation for safeguarding customer funds deposited at FCMs. Now, within a very short time frame, we are dealing with a shortfall in customer segregated funds at two FCMs, and their ensuing bankruptcies. Customers at both firms suffered real harm, the type of harm that all regulators attempt to prevent.

The MF Global and Peregrine Financial Group (PFG) customer losses are a painful reminder that regulators must continuously improve surveillance, examination and fraud detection techniques to keep pace with changing technology and an ever-more-complicated global financial marketplace. While we can never completely eliminate fraud, we must continue to adopt rules and surveillance techniques to try to reduce the opportunity for fraud as much as possible. NFA therefore strongly believes that the process to refine and improve regulatory protections must be ongoing and constant.

After the MF Global bankruptcy, NFA and CME Group in conjunction with the IntercontinentalExchange, the Kansas City Board of Trade and the Minneapolis Grain Exchange announced the formation of a joint committee to review what steps self-regulatory organizations (SRO) could take to strengthen safeguards for customer segregated funds held at the firm level. The SRO committee's most significant recommendation—one that will greatly enhance customer protection—is the

confirmation by depositories of customer segregated and secured amount funds on a daily basis. Additionally, NFA Board of Directors (Board) formed the Special Committee on the Protection of Customer Funds, comprised of NFA's public directors. The Special Committee recommended that NFA's Board adopt approval and notice requirements relating to an FCM's withdrawal of more than 25% of its residual interest not for the benefit of customers, enhance FCM financial reporting to NFA, and make certain FCM financial information fully transparent to customers via posting the information on NFA's Background Affiliation Status Information Center (BASIC) system. The Board approved the Special Committee's proposals in August 2012, and NFA fully appreciates the Commission's efforts in approving these measures.

In reviewing and commenting upon the Commission's proposed requirements relating to risk management programs, internal controls, capital and liquidity standards, customer disclosures, and self-regulatory auditing and examination programs for FCMs, NFA believes that the significant regulatory protections and surveillance techniques already adopted should not be cast aside and should be afforded the time necessary to determine their effectiveness. To that end, while NFA recognizes that many of the Commission's proposals complement and enhance the regulatory safeguards already developed, others do not and likely do not provide a regulatory benefit any greater than the recently adopted protections and surveillance techniques.

Therefore, while we agree with the regulatory purposes underlying the Commission's proposed requirements, we believe that the Commission should carefully weigh the regulatory benefits and costs (e.g., staffing, systems, and financial) to FCMs and SROs of each respective proposal. The Commission should also identify which of the increased disclosure items will yield a meaningful benefit to customers and recognize that FCMs have different sizes, customer bases, and resources available to implement the Commission's proposed requirements if adopted. Specifically, we request that the Commission consider the following comments.

SRO Examination Programs under Regulation 1.52

The Commission proposes to make significant amendments to Regulation 1.52, which contains requirements relating to an SRO's adoption and surveillance of minimum financial requirements. In proposing "significantly new" requirements to the supervisory program for FCMs, the Commission notes that the program will now explicitly require, among other things, controls testing as well as substantive testing, and that the examination process for each FCM must be driven by the risk profile of each FCM. In addition, the supervisory program must conform to U.S. GAAS after giving full consideration to those auditing standards as prescribed by the PCAOB.

NFA fully supports the Commission's specific requirement that the supervisory program include both controls testing and substantive testing and that the examination process be driven by the risk profile of the FCM. NFA has been modifying its procedures recently to enhance our examination of FCM internal controls as well as substantive testing. We have also updated our risk system to create risk profiles of each of our FCMs. We also agree with the Commission that we should identify those FCMs that pose a high degree of potential risk so that we can increase our monitoring of those firms and that our examinations should focus primarily on the highest risk areas at each FCM, and we have implemented programs to do so.

NFA seeks further clarity, however, from the Commission as to the requirement set forth in proposed Regulation 1.52(c)(2)(ii) that all aspects of the supervisory program must, at a minimum, "conform to generally accepted auditing standards after giving full consideration to those auditing standards as prescribed by the PCAOB." Specifically, this standard and its specific application to DSRO examinations of FCMs are unclear. NFA has reviewed several comment letters on this proposal from certified public accountant (CPA) firms that also appear to find this standard unclear.[1]

Equally important, to the extent that the Commission is now requiring DSROs to conduct their FCM examinations in strict adherence to U.S. GAAS, then NFA objects to the use of this standard for DSRO examinations. As the Commission is aware, each year, an FCM must have a certified financial audit performed by a CPA. Further, every 12-15 months, an FCM's DSRO performs a regulatory examination of the FCM's operations. While there is an overlap in testing between the CPA's audit and DSRO's examination in the capital, segregation, and internal controls areas, the purposes of the CPA's audit and DSRO's regulatory examination are different. Specifically, in the case of NFA, our examinations are aimed at assessing the FCM's compliance with NFA and CFTC requirements. Unlike a CPA examination, which does have to be performed in accordance with U.S. GAAS, NFA does not issue a report that expresses an opinion with respect to the FCM's financial statements or issue an Accountant's Report on Material Inadequacies. Given these differing purposes and results, NFA strongly believes that the Commission should not require regulatory examinations to be performed in strict adherence to U.S. GAAS.

While we note our concerns with requiring DSRO examinations to strictly adhere to GAAS and PCAOB standards, NFA also recognizes that certain GAAS and PCAOB accounting standards and practices should be followed by DSROs in

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[1] *See* KPMG LLP comment letter dated January 11, 2012, Ernst& Young LLP comment letter dated January 14, 2014, Delloitte & Touche LLP comment letter dated January 14, 2013, as well as the January 14, 2013 letter from Center for Audit Quality.

performing their regulatory examinations. These standards may focus on recordkeeping, training and experience, scoping, the confirmation process and other related examination practices. While NFA already integrates many of these standards in our FCM examination programs, we recognize that further enhancements could be made. Therefore, we encourage the Commission in finalizing proposed Regulation 1.52(c)(2)(ii) to work with the DSROs and CPA firms to identify specific GAAS and PCAOB standards that should be utilized during a DSRO regulatory examination, and not as suggested by the proposed language apply GAAS and PCAOB standards wholesale to DSRO examinations.

The Commission's proposal also requires an SRO to engage an examinations expert (defined as a nationally recognized accounting and auditing firm with substantial expertise in audits of FCMs, risk assessment and internal control reviews) to evaluate the SRO's FCM supervisory program and the SRO's application of the program at least once every two years. Among other things, the examination expert will be required to provide an opinion as to whether the supervisory program is reasonably likely to identify a material weakness in internal controls over financial and/or regulatory reporting and in any of the other items that are the subject of an examination conducted in accordance with the supervisory program. The examination expert is also required to provide recommendations on new or best practices prescribed by industry sources that should be incorporated in the supervisory program.

With regard to engaging an examination expert, while NFA does not question the importance of input from CPAs regarding the DSRO examination process, NFA questions the breadth of this requirement and the ability of CPAs to even provide an opinion (as to undefined standards) as to the sufficiency of the supervisory program. Therefore, NFA encourages the Commission to work with SROs and CPAs with experience auditing FCMs to accomplish its intended result. As the Commission is aware, Commission staff already provides effective and meaningful oversight of SRO FCM examination programs. Specifically, Commission staff participates in the Joint Audit Committee (JAC) and the DSROs annually provide the Commission with their FCM examination programs for review. Additionally, the Commission's Division of Swap Dealer and Intermediary Oversight (DSIO) performs a review each quarter of NFA's financial surveillance of FCMs and DSIO subsequently provides comments and suggestions for improvement to NFA based on these quarterly reviews.

Since the Commission, the expert in its own financial regulatory requirements, already provides NFA with a meaningful review of its FCM examination programs, NFA questions the necessity of having yet another layer of review by a third party every two years of FCM examination programs. As previously stated, however, NFA agrees that nationally recognized CPA firms that are involved in FCM audits may

be able to provide valuable suggestions regarding audit practices to improve the SRO examination programs. A significant objective of both CPA audits and DSRO examinations is to detect conduct that may be indicative that an FCM is engaging in unlawful activities that threaten the safety of customer funds or the ability of an FCM to meet its obligations to market participants. The Commission, DSROs and CPA firms should work cooperatively and more closely to accomplish this objective, which is in all our interests and that of the investing public.

Therefore, instead of adding an additional third party layer to the oversight of SRO programs, NFA recommends that the Commission consider an alternative that may be more practical and less costly[2]; focuses on achieving the shared objective of the Commission, DSROs, and CPA firms; and achieves the Commission's objective to ensure that adequate FCM supervisory programs are in place. Specifically, the Commission should consider requiring JAC to formally include, as *ex-officio* members, representatives from the nationally recognized accounting firms with expertise in auditing FCMs to participate in the review of the JAC examination programs relating to segregated funds, capital, and internal controls and provide input and guidance regarding their audit practices to improve those programs. We believe that this process will permit the DSROs, CPAs, and Commission staff to share general information and issues arising in FCM examinations, exchange information regarding FCM examination practices, and modify examination programs to account for any new or best accounting practices. NFA believes that all of us could benefit from this type of participatory role rather than the oversight role contemplated by the current examinations expert proposal.

NFA is also aware that JAC is filing a separate comment letter addressing the Commission's proposed changes to Regulation 1.52. As a JAC member, NFA joins in the comments made by JAC.

Amendments to Regulations 1.20 and 30.7 Regarding Depositories for Customer Segregated and 30.7 Funds

The Commission's proposal also amends Regulations 1.20 and 30.7 to provide that an FCM may deposit futures customer funds and 30.7 funds only with a depository that provides the Commission and the FCM's DSRO with direct, read-only

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[2] NFA attempted to obtain cost information from a few nationally recognized accounting firms on the potential costs associated with the requirements proposed in Commission Regulation 1.52. During informal discussions, representatives from these firms indicated that they would be unable to provide this cost information until they had a better understanding of the type of review the Commission was proposing.

access to account information on a 24 hour basis. In the Federal Register release, the Commission acknowledges that depositories may not have the capability to provide real time account balances and position information and therefore the depository would meet this obligation if it had the capability to provide read-only access to account information as of the close of the prior business day. For the reasons explained below, NFA believes that the segregated funds monitoring system now in place offers surveillance capabilities far superior to that offered by view-only on line access and, therefore, this requirement is unnecessary and unworkable from a practical standpoint.

NFA certainly agrees that the Commission and the DSROs must have access to timely information regarding the account balances in FCM customer segregated fund accounts at depositories. In fact, as described below, NFA and CME have developed a system to receive from banks (and other segregated fund depositories) the end of day account balances in customer segregated accounts and perform an automated comparison of that information with the daily segregation and secured amount reports filed by the FCMs to identify any material discrepancies. NFA began the process to collect this information in August 2012.

Specifically, last August, NFA's Board adopted Financial Requirements Section 4 that requires FCMs to provide their DSRO with view-only on-line access very similar to the one currently proposed by the Commission. The purpose of this requirement was to permit NFA and CME to perform periodic checks of the account balances held at depositories. In adopting this requirement, NFA's Board recognized that this requirement would be labor intensive and it raised security issues as to access to this information. Specifically, NFA would have to obtain and maintain user IDs and passwords for approximately 200 bank accounts and limit access to those accounts for security purposes.[3] Due to these issues and the fact that view-only on-line access only provided the ability to periodically check these accounts, NFA recognized that this surveillance method should be a temporary solution until NFA and CME could develop an automated daily segregation confirmation system.

Shortly after the Board adopted Financial Requirements Section 4, NFA and CME staff learned that it was possible to implement quickly an automated system via a third party vendor, Alphametrix360, LLC, for the daily monitoring of all customer segregated and secured amount accounts held at banks. For purposes of monitoring segregated funds balances held at banks, this daily system was far superior to the less frequent capabilities afforded by direct, on-line access functionalities. As a

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[3] The FCMs for which NFA is the DSRO have approximately 200 bank accounts. If combined with the FCMs for which the CME is DSRO, then the number of bank accounts is approximately 2,000.

result, NFA proposed additional amendments to Financial Requirements Section 4 to require an FCM to instruct its depositories holding segregated, secured amount and cleared swaps customer collateral to report the balances in the FCM's segregated, secured amount and cleared swaps customer collateral accounts to a third party designated by NFA. The amended rule also provides that in order for a depository to be an acceptable depository it must report the FCM's customer segregated and secured amount balances and cleared swaps customer collateral balances to a third party designated by NFA.

Although the effective date of the amendments to Financial Requirements Section 4 is February 15, NFA began receiving the daily report from the third party vendor in early January. NFA currently receives end of day balance information directly from banks for 93% of the accounts holding customer segregated funds on behalf of the FCMs for which NFA is the DSRO. We expect to have full compliance by Section 4's effective date. Although the first phase is limited to banks and trust companies and segregated cash and securities balances, NFA intends to expand the requirements over the next several months to require all segregated funds depositories, including derivatives clearing organizations and other clearing FCMs, to report all customer segregated funds balances.

NFA understands that the Commission is concerned that the current segregated funds monitoring system in place may not be adequate in an emergency situation where the Commission and DSROs need immediate access to account information that is more up to date than the prior day's close of business. NFA, however, is fully capable of obtaining this updated information (provided it is available via the bank's on-line system) using its existing rules. Specifically, NFA Compliance Rule 2-5 requires FCMs to cooperate promptly with any requests from NFA. If an FCM was in distress or in another emergency situation, NFA would demand that the FCM provide NFA with on-line access to their bank account information. We would either require that the FCM provide this information to NFA remotely or while NFA examiners were in the FCM's offices. If the FCM refused to provide this on-line access, then NFA would consider this a serious violation of NFA Compliance Rule 2-5, and we would immediately request our Executive Committee to issue a Member Responsibility Action under Compliance Rule 3-15 against the firm that would shut down its operations. We would, of course, keep the CFTC fully apprised of this type of situation.

Given the segregated funds monitoring system NFA currently has in place, combined with our authority under Compliance Rules 2-5 and 3-15, NFA respectfully requests that the Commission rescind its proposed requirement that an FCM provide the CFTC and its DSRO with view-only on line access. NFA also encourages the Commission to discuss with NFA, CME and Alphametrix360 how the Commission can

have access to the information currently being collected daily from banks by the segregated funds monitoring system.

Reporting Requirements Under Regulation 1.10

a. Leverage Ratio Calculation

The Commission is proposing to amend Regulation 1.10 to add a requirement that each FCM file with the Commission on a monthly basis its balance sheet leverage ratio, which the Commission defines in the same manner as set forth in NFA Financial Requirement Section 16 (total balance sheet assets, less any instruments guaranteed by the U.S. Government and held as an asset to collateralize an asset (e.g., reverse repo) divided by total capital (the sum of stockholder's equity and subordinated debt)). NFA agrees with the Commission that an FCM's leverage ratio may provide important information for assessing an FCM's financial condition and risk, and it is appropriate to require that the FCM report this information on a monthly basis. NFA cautions the Commission, however, that the definition proposed by the Commission and currently set forth in NFA Financial Requirement Section 16 may not be the most appropriate measure.

Specifically, at the time NFA adopted Financial Requirements Section 16, NFA's Board directed staff to collect and analyze this information over a several month period to ensure that it is an appropriate measure of an FCM's risk. The Board also directed staff to consider an alternative calculation that utilizes the above calculation but subtracts segregated funds, secured amounts, cleared swaps customer collateral funds and, if applicable, the firm's broker/dealer reserve requirement under the theory that these are customer funds and not assets of the FCM. Therefore, NFA has collected FCM leverage ratio information for several months using both calculation methods and we plan on discussing the results with NFA's Special Committee in order to determine which of these calculations provides the best measure of risk or whether further adjustments need to be made to the calculation. Based upon the information collected, however, the Commission should be aware that the leverage ratio for many FCMs differs significantly based upon the calculation method utilized. Given these results, NFA encourages the Commission to defer codifying a single definition of the leverage ratio until it has had an opportunity to examine NFA's calculation results, and any other possible variations to its calculation method that could provide a meaningful leverage metric.

NFA further notes that the definition proposed by the Commission and currently set forth in Financial Requirements Section 16 tracks the definition used by the Financial Industry Regulatory Authority (FINRA) for internal monitoring purposes—

FINRA does not make this information publicly available. It is our understanding that in circumstances where FINRA is concerned about a particular broker dealer's leverage ratio based on this calculation, then FINRA contacts the firm to collect additional financial information that may result in further adjustments to the firm's ratio.

FINRA's and NFA's review of firm leverage ratios illustrates the difficulty with determining an appropriate definition for "leverage ratio." While it may be simple to adopt the FINRA leverage ratio's definition for computational purposes, NFA cautions that another definition may be more appropriate to measure the risk, particularly of non-broker dealer FCMs. Additionally, a more meaningful measure of leverage may be associated with subtracting customer funds from the firm's total assets. Based upon our experience in determining an appropriate definition, NFA requests that the Commission not include a specific definition in its rules but rather consider whether it may be more appropriate to have FCMs report a leverage ratio(s) "as defined by a registered futures association." We, of course, are willing to work with Commission staff to further refine the leverage calculation method and can make FCMs' leverage calculations available to Commission staff.

b. FCM's Obligation to Retail Forex Customers

NFA fully supports the Commission's amendment to Form 1-FR which will require an FCM or RFED to specifically disclose its obligation to retail forex customers on line 27.j. NFA requests, however, that the Commission also consider amending the asset portion of Form 1-FR to require an FCM and RFED to report the total funds on deposit for retail forex customers. This amendment will result in more accurate reporting and is consistent with the reporting for customer segregated funds.

c. Annual Report Deadlines

The Commission is also proposing to amend Regulation 1.10(b)(1)(ii) to require that FCM annual reports be submitted within 60 days of the FCM's year end date. As the Commission notes, this amendment only affects FCMs that are not dually registered as broker-dealers since dually registered FCM/BDs are already required under CFTC and SEC regulations to submit the firm's annual report within 60 days of year end. NFA fully supports this amendment and agrees with the Commission that this deadline will provide both the Commission and the DSROs with more timely information for monitoring the financial condition of the FCM. Moreover, NFA supports the amendment to Commission Regulation 3.3(f), which makes it clear that the annual report from the FCM's Chief Compliance Officer (CCO)—that is due with the firm's annual report—will also be due for all FCMs within 60 days of the firm's year end.

FCM Risk Management Program under Proposed Regulation 1.11

NFA also supports proposed Commission Regulation 1.11, which will require all FCMs that carry customer accounts to establish a risk management program designed to monitor and manage the risks associated with the FCM's activities as an FCM. Current Commission Regulation 3.3 requires an FCM's CCO to certify in the annual report that based on his/her knowledge and reasonable belief the information contained in the annual report is accurate and complete. The Commission specifically requests comment regarding whether Regulation 1.11 should contain a separate CCO certification that imposes a higher duty (e.g., strict liability) presumably applicable to the FCM's customer funds safeguards. NFA believes that the "knowledge and reasonable belief" contained in Regulation 3.3 remains appropriate for a CCO's certification regarding an FCM's customer funds safeguards. Moreover, NFA recommends that the Commission consider whether the CCO's annual report should contain a separate certification (with the "knowledge and reasonable belief" language) executed by the FCM's CEO or CFO regarding the adequacy of the FCM's customer funds safeguards.

Regulatory Notices under Regulation 1.12

In general, NFA supports the Commission's amendments to Regulation 1.12. In particular, NFA supports the Commission's amendment to Regulation 1.12(a) that requires an FCM or IB that becomes undercapitalized but is unable to determine its actual financial condition to immediately file notice of its undercapitalization with the Commission and its DSRO along with a statement that it cannot presently calculate its financial condition. NFA agrees with the Commission that it makes no sense for a firm that is undercapitalized to delay filing this notice until such time as it can determine its actual financial condition. In fact, in potentially distressed FCM situations, it may be even more important for the Commission and the firm's DSRO to become immediately aware of the situation so that Commission and DSRO staff can assist in determining the firm's true financial condition.

NFA also encourages the Commission to reconsider the breadth of the amendment to Regulation 1.12(m), which requires an FCM that receives a notice, examination report or any other correspondence from the SEC, securities industry SRO, or DSRO to file a copy of the notice, etc. with the Commission, the firm's DSRO, and with the SEC if the FCM is also a broker-dealer. While NFA agrees that notices of material regulatory actions provide the Commission and the DSROs with important information to carry out oversight responsibilities, NFA is concerned that proposed Regulation 1.12(m) is overly broad and will merely result in the Commission and the DSROs being inundated with routine correspondence between FCMs and their regulators. Therefore, NFA recommends that the Commission delete correspondence

from the coverage of Regulation 1.12(m), and require that FCMs only file non-futures DSRO examination reports and a notice if the FCM is the subject of a formal investigation by a regulatory or self-regulatory authority. With regard to futures DSRO examination reports, NFA notes that NFA already files all FCM examination reports with the CFTC's DSIO.

In addition, NFA requests the Commission clarify that FCMs do not have to file notices of public regulatory actions taken by the futures SROs against the FCM since NFA already provides the Complaint associated with these actions to the Commission and the action is made available on NFA's BASIC system.

Finally, NFA emphasizes that while we believe it is important for the Commission and the DSROs to receive notice of certain regulatory matters, we do not believe that the Commission should make these filings public, particularly those that are not a formal public action.

Qualification of Accountants Under Regulation 1.16

The Commission is proposing to amend Regulation 1.16 to provide that in order for a CPA to be qualified to conduct the annual examination of an FCM, the CPA firm must be registered with PCAOB, have undergone a PCAOB investigation and remediated any deficiencies noted in the examination within three years of receiving PCAOB's report. As the Commission notes in the Federal Register release, there are currently a number of CPAs who have not been subject to a PCAOB examination and who examine FCMs. As a result, the Commission specifically requests comment on whether those CPAs should be "permitted to contractually engage for peer review from a qualified CPA who is aware of the reason for the peer review" as a short term measure to permit the CPA to continue to conduct FCM examinations.

NFA supports a temporary alternative to the PCAOB examination in order to ensure that CPAs, unable to obtain a PCAOB review within the time period required by the CFTC, will not automatically be prohibited from conducting FCM examinations. This should be a temporary alternative, however, and NFA recommends that these CPAs obtain a peer review under the American Institute of Certified Public Accountants' (AICPA) program. By specifically designating this program, the Commission will alleviate any uncertainty as to whether a CPA is "qualified" to conduct the peer review.

While NFA also supports the Commission's efforts to ensure the qualifications of CPAs examining FCMs, we encourage the Commission to carefully consider the comments of current CPAs regarding the purpose of the PCAOB reviews and recommendations to ensure that the Commission's requirements are not misplaced.

Amendment to Regulation 1.17 Regarding Charges for Undermargined Accounts and Amendment to Regulation 1.20(i)(4), 22(f)(6) and 30.7(a) Regarding Residual Interest in Excess of Sum of All Margin Deficits

With respect to the proposed requirement under Commission Regulations 1.20(i(4), 22.2(f)(6) and 30.7(a) that FCMs maintain at all times a residual interest sufficient to exceed the sum of all margin deficits that the customers in each account class have, the Commission requests comment on the timing of when an FCM must have sufficient funds to cover all margin deficits. This proposed amendment appears wholly unrelated to the MF Global and PFG bankruptcy situations and, therefore, NFA believes the amendment is not a response to those situations.

NFA understands that it is not operationally feasible for an FCM to accurately determine the sum of all margin deficiencies at all times throughout the day. Moreover, NFA believes that FCMs should be given a reasonable amount of time for customers to meet margin calls. In order to comply with the Commission's proposal, an FCM would have to assume that every customer that has a margin requirement will fail to meet that requirement. Therefore, NFA recommends that the Commission carefully consider the comments of FIA and others, which we understand may recommend that for purposes of this proposed requirement FCMs be permitted to calculate the sum of margin deficits once each day, as of the close of business on the first day following trade date.

Additionally, in finalizing the requirements related to FCM residual interest obligations with respect to undermargined accounts, NFA encourages the Commission to consider whether these new requirements will cause two unintended detrimental results. First, there likely would be a substantial increase in regulatory costs to a point that there will be fewer FCMs, resulting in the risk being more concentrated in fewer firms, which does not serve the end users or the markets. Second, a significant number of customers do not currently maintain excess margin funds at their FCMs, and the MF Global and PFG bankruptcies caused customers to further reduce the funds held at FCMs. The Commission's proposed requirement will likely cause FCMs to require additional funds from their customers to be held at the FCM in order to cover any potential margin deficits, which will conflict directly with the customers' desire to hold less funds at FCMs and alter the current funding relationship between customers and their FCMs.

The Commission is proposing to amend Regulation 1.17 to shorten the period of time that an FCM has to collect a margin call before being required to take a capital charge for the amount of the call needed to restore the account to the

maintenance margin level. In particular, the Commission is proposing to require an FCM to take a capital charge for undermargined customer, noncustomer, and omnibus accounts that are undermargined for more than one business day after a margin call is issued. In proposing this change, the Commission notes that while the current time frame provided in Regulation 1.17 (e.g., three business days for customer accounts and two business days for non-customer an omnibus accounts) may have been appropriate when adopted in the 1970s because many margins calls were met by checks sent through the mail, this time frame should be shortened given the increased use of technology and wire transfers.

NFA agrees with the Commission that changes in the manner in which most customers meet their margin calls makes it logical to shorten the three day time period that an FCM has to collect a customer margin call. NFA cautions the Commission, however, to keep in mind that certain segments, particularly farmers and ranchers who use the futures markets for hedging purposes, still regularly meet margin calls by mailing checks and that there will be a corresponding cost placed upon these market users if they need to use wire transfers and market users may be forced to hold funds at FCMs well in excess of their margin requirements. NFA therefore encourages the Commission to carefully consider the comments of these users and the FCMs who service them before finalizing this requirement.

Moreover, NFA believes that if the Commission adopts the amendments to Commission Regulations 1.20(i)(4), 22.2(f)(6) and 30.7(a), as proposed, which effectively requires an FCM to meet all margin deficits when incurred, we suggest the Commission consider whether a capital charge for undermargined accounts remains necessary. Since the FCM will have already accounted for an undermargined account by maintaining a residual interest sufficient at all times to exceed the sum of all margin deficits, then NFA believes capital charges related to an undermargined account appear to impose an additional financial burden without any necessary financial protection.

Amendments to Regulation 1.23 Regarding FCM's Interest in Customer Segregated Funds

The Commission is proposing a number of amendments to Regulation 1.23, which it notes are consistent in most respects with the requirements of NFA Financial Requirements Section 16. NFA fully supports the Commission codifying these requirements into Commission regulations. NFA requests, however, that the Commission consider a slight modification to the language used in Regulation 1.23.

In particular, the amendments to Regulation 1.23(d) prohibit an FCM from withdrawing funds for *its own proprietary use*, in a single transaction or series of

transactions on a given *business* day that exceed 25% of the FCM's residual interest in such accounts unless the FCM's CEO, CFO or other senior official pre-approves the withdrawal or series of withdrawals and files written notice with the Commission and the firm's DSRO. In contrast, NFA Financial Requirements Section 16 applies this prohibition to withdrawals that are made *not for the benefit of commodity and option customers and foreign futures and foreign options customers* and does not limit the prohibition to *business* days.

The Commission does not appear to provide a definition of "proprietary use." NFA is concerned that a withdrawal that may not be for an FCM's *own proprietary use* may still be a withdrawal that is *not for the benefit of customers* and, therefore, would trigger NFA's approval and notice requirements pursuant to NFA Financial Requirements Section 16 but not the Commission's approval and notice requirements pursuant to Regulation 1.23. In adopting Section 16, NFA expended significant efforts working with FIA and Commission staff to provide examples of disbursements, transactions and/or occurrences that are for the benefit of customers and, therefore, should not be included in an FCM's calculation of the 25% disbursement threshold.[4] To avoid confusion and potentially conflicting approval and notice situations, NFA strongly recommends that the Commission revise the language in Regulation 1.23 to keep it consistent with the language in NFA Financial Requirements Section 16. NFA further believes this change will provide greater protection for customer segregated funds. Additionally, to ensure consistency with NFA Financial Requirements Section 16, NFA also recommends that the Commission remove proposed Regulation 1.23(d)'s reference to "business days" in order to ensure that FCMs understand that the requirements related to withdrawals of 25% or more apply at all times.

Finally, NFA recommends that the Commission modify its language relating to the pre-approval requirement. The language in NFA Financial Requirement Section 16 makes it clear that in situations involving a series of disbursements, the FCM's CEO, CFO or senior official must pre-approve the disbursement that causes the FCM to exceed the 25% threshold. Yet proposed Commission Regulation 1.23(d)(1)'s language referencing the preapproval of a "series of withdrawals" could be read to require the pre-approval of any earlier disbursements and not just the specific disbursement causing the FCM to exceed the 25% threshold. NFA does not require the pre-approval of these earlier transactions because it is quite likely that when they occurred the FCM's CEO, CFO, or other senior official did not know that these

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[4] See the Interpretive Notice to NFA Financial Requirements Section 16 entitled: *NFA Financial Requirements Section 16: FCM Financial Practices and Excess Segregated Funds/Secured Amount Disbursements.*

transactions ultimately would cause the FCM to exceed the 25% threshold later that day.

Amendments to Regulation 1.55 Regarding Public Display of FCM Information

The Commission is proposing a number of changes to Regulation 1.55 that will require FCMs to provide additional disclosures to customers in a number of areas. NFA fully supports the Commission's goal of ensuring that customers receive a full description of the risks associated with futures trading. For the reasons identified by the Commission in the Federal Register release, NFA also agrees that it is important to update the risk disclosure statement to provide information on the extent to which customer funds are protected when deposited with an FCM as margin or to guarantee performance for trading commodity interests.

NFA also believes that it is important for customers to have access to financial and other information regarding FCMs to assist them in conducting due diligence on the firm. In fact, as the Commission is aware, NFA Financial Requirements Section 16 requires FCMs to submit specific financial information to NFA on a monthly and semi-monthly basis. NFA uses this information for its own monitoring purposes and NFA's Board decided in August 2012 to provide the vast majority of that information to customers in monthly and semi-monthly reports available through NFA's BASIC system on an FCM by FCM basis. By providing this information through the BASIC system, customers are able to go to one source to obtain not only FCM financial information, but also information on the firm's business and regulatory background. Moreover, NFA provides the information in a consistent format, which allows customers to easily make comparisons between FCMs.

In adopting these requirements, NFA considered requiring an FCM to make this information available to customers on its own website. We concluded, however, that if NFA could provide this information on all FCMs at one source, then it was more useful to customers. Therefore, NFA recommends that the Commission consider revising its amendments to Regulation 1.55 to require FCMs to include a link on their website that directs customers to each respective FCM's disclosure information available through NFA's BASIC system rather than requiring each FCM to provide the information on its own website. Requiring FCMs to provide the link on their website addresses any concerns that certain customers may not be aware that the information is available through NFA.

While NFA fully supports providing customers with information to conduct meaningful due diligence on FCMs, NFA is concerned that some of the information proposed by the Commission, particularly the information identified in 1.55(k)(10)(ii)-

(vii), may not be understandable to certain customers. NFA's Special Committee spent a significant amount of time reviewing information that FCMs should make available, while focusing on the needs of smaller, less sophisticated customers. After careful consideration, the Special Committee was concerned that much of the information being proposed to make public by Commission Regulation 1.55(k)(10)(ii)-(vii) is complicated and not meaningful for those customers. The Special Committee also recognized, however, that more sophisticated institutional customers could request and are likely to receive this information directly from an FCM. As a result, the Special Committee determined and NFA's Board agreed that the FCMs should be required to make the following information available:

On a semi-monthly basis (as of the 15th and last day of the month):

- The FCM's total segregated funds/secured amount requirements and how much is held as excess customer segregated funds/secured amount funds (listed in a dollar figure); and

- The percentage of customer segregated funds and secured amount funds held in each permitted investment identified in Regulation 1.25(a).

On a monthly basis:

- Total regulatory capital, minimum net capital, and excess net capital (listed in a dollar figure); and

- Whether any depository used to hold customer segregated funds during the month is an affiliate of the FCM.

Certainly, NFA is willing to discuss with the Commission, our Special Committee and NFA's Board what, if any, further financial information NFA could make available on the BASIC system. NFA requests, however, that the Commission recognize that certain, but not all, FCM financial information will be helpful to customers in conducting due diligence on an FCM. Other information may simply be too sensitive, and subject to misinterpretation, if made publicly available.

Therefore, in finalizing the requirements in this area, NFA encourages the Commission to distinguish between the information that is useful to regulators in their oversight of FCMs but which should not be available to the public, information that is meaningful to all customers and should be readily available, and information that may be meaningful to more sophisticated customers and that FCMs should be required to provide if requested to do so. NFA also requests that the Commission take into account

what, if any, information is made publicly available by other regulators, particularly in the securities industry.

NFA appreciates the opportunity to provide comment on this very important rulemaking. As we stated at the outset, NFA fully supports the Commission's goal of enhancing the protections afforded customers and customer funds. We are concerned, however, that some of the proposed requirements do not provide any greater regulatory benefit than the recently enacted changes while at the same time impose significant cost on the industry, as well as market users. We therefore encourage the Commission to carefully review all of the comments received in order to ensure that any final changes provide meaningful regulatory benefit.

Very truly yours,

Thomas W. Sexton, III
Senior Vice President, General Counsel
and Secretary

(caw:Regulatory_comment letter – customer protections_2.13v2)