

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-62651; File No. SR-NFA-2010-03)

August 4, 2010

Self-Regulatory Organizations; National Futures Association; Notice of Filing and Immediate Effectiveness of Proposed Change to Compliance Rule 2-30 and the Related Interpretive Notice Regarding Customer Information and Risk Disclosure

Pursuant to Section 19(b)(7) of the Securities Exchange Act of 1934 (“Act”),<sup>1</sup> and Rule 19b-7 under the Act,<sup>2</sup> notice is hereby given that on July 13, 2010, National Futures Association (“NFA”) filed with the Securities and Exchange Commission (“SEC” or “Commission”) the proposed rule change described in Items I, II, and III below, which Items have been substantially prepared by the NFA. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons. On March 8, 2010, NFA also filed this proposed rule change with the Commodity Futures Trading Commission (“CFTC”) requesting that it review and approve the proposed rule change. On June 28, 2010, the CFTC notified the NFA that the CFTC had approved the rule change.<sup>3</sup>

I. Self-Regulatory Organization’s Description and Text of the Proposed Rule Change

The amendments to NFA Compliance Rule 2-30 and the Related Interpretive Notice expand the customers covered by the rule to reach not just individuals, but all non-Eligible Contract Participants (“ECPs”); require futures commission merchants (“FCMs”) Members to request at least annually that active customers update information obtained

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<sup>1</sup> 15 U.S.C. 78s(b)(7).

<sup>2</sup> 17 CFR 240.19b-7.

<sup>3</sup> See letter from David A. Stawick, Secretary, U.S. Commodity Futures Trading Commission to Thomas W. Sexton, III, General Counsel, National Futures Association dated June 28, 2010.

from the customer pursuant to NFA Compliance Rule 2-30(c), if there are any material changes to the information, and require the FCM, introducing broker (“IB”), or commodity trading advisor (“CTA”) Member, or one of their Associates, that currently solicits and communicates with the customer to determine if additional risk disclosure is required to be provided based on any changed information; and prohibit Members and Associates from making individualized recommendations to those customers whom the Member or Associate has or should have advised that futures trading is too risky for them.

The text of the proposed rule change is available on NFA’s Web site at <http://www.nfa.futures.org>, at the principal office of NFA and at the Commission’s Public Reference Room.

II. Self-Regulatory Organization’s Statement of the Purpose of, and Statutory Basis for the Proposed Rule Change

In its filing with the Commission, NFA included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. NFA has prepared summaries, set forth in sections A, B, and C below, of the most significant aspects of such statements.

A. Self-Regulatory Organization’s Statement of the Purpose of, and Statutory Basis for the Proposed Rule Change

1. Purpose

Section 15A(k) of the Act<sup>4</sup> makes NFA a national securities association for the limited purpose of regulating the activities of NFA Members (“Members”) who are

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<sup>4</sup> 15 U.S.C. 78o-3(k).

registered as brokers or dealers under Section 15(b)(11) of the Act.<sup>5</sup> NFA Compliance Rule 2-30(c) and the related Interpretive Notice apply to all Members, including those who are registered as security futures brokers or dealers under Section 15(b)(11).

In early September 2009, the CFTC and SEC held joint public meetings to discuss regulatory harmonization. At these meetings, one of the many issues discussed related to the similarities and differences between the futures industry's know-your-customer requirements and the securities industry's suitability requirements.

Due, in part, to these harmonization discussions and in light of changes in the futures industry, NFA's Executive Committee asked NFA's Member Advisory Committees to consider whether NFA Compliance Rule 2-30 could be amended to further enhance customer protection. In their review, the Executive and Advisory Committees noted that the futures industry differs from the securities industry in several crucial ways. Most importantly, futures contracts in general are recognized as highly volatile instruments. It therefore makes little sense to presume that a certain futures trade may be appropriate for a customer while others are not. An appreciation of the risks of futures trading and its appropriateness for a particular customer must be made at the time the customer makes a decision to trade futures in the first place. Therefore, the Committees fully supported maintaining the essential character of NFA Compliance Rule 2-30's know-your-customer requirement as a customer-by-customer determination.

The Committees also generally agreed that NFA Compliance Rule 2-30 currently works well and provides strong customer protection. Further, they believed that NFA's know-your-customer requirements and FINRA's suitability rules address the same

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<sup>5</sup> 15 U.S.C. 78o(b)(11).

concerns and achieve substantially the same results and any differences between them are largely semantic. The Committees noted, however, that certain modifications would provide increased customer protection and, therefore, they supported the following changes.

The amendments to NFA Compliance Rule 2-30 and its related Interpretive Notice will: (1) expand the customers covered by the rule to reach not just individuals but all non-ECs; (2) require FCM Members to request at least annually that active customers update information obtained from the customer pursuant to NFA Compliance Rule 2-30(c) if there are any material changes to the information, and require the FCM, IB, or CTA Member, or one of their Associates, that currently solicits and communicates with the customer to determine if additional risk disclosure is required to be provided based on any changed information; and (3) prohibit Members and Associates from making individualized recommendations to those customers whom the Member or Associate has or should have advised that futures trading is too risky for them.

The burden of the update process will fall on the FCM Member that carries the customer account to request updated information at least annually. FCM Members may satisfy this requirement by contacting the customer in writing (by electronic or any other means reasonably designed to reach the customer) and requesting that the customer notify the Member of any material changes to the information previously provided. If the customer informs the FCM that he/she cannot verify the information because the information previously provided to the carrying FCM is not currently available to the customer, then the carrying FCM shall promptly provide any necessary information to the

customer. Absent advice to the contrary from the customer, the information previously provided is deemed verified.

Whenever the customer notifies the FCM Member carrying the customer's account of any material changes to the information (whether through the update process or through the customer's own initiative), a determination must be made as to whether additional risk disclosure is required to be provided to the customer based on the changed information. If another FCM or IB introduces the customer's account on a fully disclosed basis or a CTA directs trading in the account, then the carrying FCM must notify that Member of the changes to the customer's information. The Member or Associate who currently solicits and communicates with the customer is responsible for determining if additional risk disclosure is required to be provided based on the changed information. In some cases, this may be the Member introducing or controlling the account; in other cases, it may be the carrying FCM.

Amendments to NFA Compliance Rule 2-30 and the related Interpretive Notice regarding Customer Information and Risk Disclosure were previously filed with the SEC in SR-NFA-2001-01, SR-NFA-2002-06 and SR-NFA-2007-07.

## 2. Statutory Basis

The rule change is authorized by, and consistent with, Section 15A(k)(2)(B) of the Act.<sup>6</sup> That section requires NFA to have rules that are designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest, including rules governing sales practices of security futures products. NFA believes the proposed rule change

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<sup>6</sup> 15 U.S.C. 78o-3(k)(2)(B).

accomplishes this by requiring Members to request updated information from customers and, where appropriate, provide additional disclosures based on the updated information. The proposed rule change also prohibits making individualized recommendations for certain customers for whom futures trading is too risky.

B. Self-Regulatory Organization's Statement on Burden on Competition

The proposed rule change will require FCMs to request updated information from customers at least annually. The Member Advisory Committees sought to minimize any burden this requirement might have by permitting the request to be made by electronic or any other means reasonably designed to reach the customer. Additionally, if a customer receiving the request for updated information does not indicate to the contrary, the information previously provided is deemed verified. Another burden imposed regards a determination of whether additional disclosure should be provided to a customer that notifies the FCM of any material changes. The rule change places this burden with the Member or Associate that currently solicits and communicates with the customer, and therefore, knows the customer best. The burdens imposed by the rule change are necessary and appropriate to ensure that customers have full and appropriate disclosures of the risks of futures trading.

C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received From Members, Participants, or Others

NFA worked with its Member Advisory Committees in developing the rule change. NFA did not, however, publish the rule change to the membership for comment. NFA did not receive comment letters concerning the rule change.

III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

On June 28, 2010, the CFTC notified NFA that it had approved the rule change, and therefore, NFA is permitted to make the amendments effective as of this date.

At any time within 60 days of the date of effectiveness of the proposed rule change, the Commission, after consultation with the CFTC, may summarily abrogate the proposed rule change and require that the proposed rule change be refiled in accordance with the provisions of Section 19(b)(1) of the Act.

#### IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act. Comments may be submitted by any of the following methods:

##### Electronic Comments

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number SR-NFA-2010-03.

##### Paper Comments

- Send paper comments in triplicate to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number SR-NFA-2010-03. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site

<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for Web site viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10 a.m. and 3 p.m. Copies of such filing also will be available for inspection and copying at the principal office of NFA. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make publicly available. All

submissions should refer to File Number SR-NFA-2010-03 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>7</sup>

Florence E. Harmon  
Deputy Secretary

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<sup>7</sup> 17 CFR 200.30-3(a)(73).