

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-53190; File No. SR-NFA-2005-02)

January 30, 2006

Self-Regulatory Organization; National Futures Association; Notice of Filing and Immediate Effectiveness of a Proposed Amendment to NFA Compliance Rule 2-10 Regarding Recordkeeping

Pursuant to Section 19(b)(7) of the Securities Exchange Act of 1934 (“Act”),¹ and Rule 19b-7 under the Act,² notice is hereby given that on December 6, 2005, 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 prepared by NFA. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons. NFA also has filed the proposed rule change with the Commodity Futures Trading Commission (“CFTC”).

NFA, on December 6, 2005, submitted the proposed rule change to the CFTC for approval. The CFTC approved the proposed rule change on January 5, 2006.³

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

The proposed rule change amends NFA Compliance Rule 2-10 to ensure that NFA has effective access to books and records maintained by foreign firms or in a foreign language.

Section 15A(k) of the Act⁴ makes NFA a national securities association for the limited purpose

¹ 15 U.S.C. 78s(b)(7).

² 17 CFR 240.19b-7.

³ See Letter from Thomas W. Sexton, Vice President and General Counsel, NFA, to Elizabeth King, Associate Director, Division of Market Regulation, Commission, dated January 26, 2006 (enclosing letter from Jean A. Webb, Secretary, CFTC, to Thomas W. Sexton, Vice President and General Counsel, NFA, dated January 5, 2006, confirming approval of the proposal) (“Confirmation of CFTC Approval”).

⁴ 15 U.S.C. 78o-3(k).

of regulating the activities of Members who are registered as brokers or dealers in security futures products under Section 15(b)(11) of the Act.⁵ This rule change will apply to all NFA Members, including Members registered under Section 15(b)(11).

The text of the proposed rule change is below. Proposed new language is underlined.

Text of Proposed Rule Changes

COMPLIANCE RULES

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RULE 2-10. RECORDKEEPING

(a) Each Member shall maintain adequate books and records necessary and appropriate to conduct its business including, without limitation, the records required to be kept under CFTC Regulations 1.18 and 1.32 through 1.37 for the period required under CFTC Regulation 1.31.

(b) Each FCM Member must either:

- (1) Maintain an office in the continental United States, Alaska, Hawaii, or Puerto Rico responsible for preparing and maintaining financial and other records and reports required by CFTC and/or NFA rules; or
- (2) Maintain an office in a jurisdiction that the CFTC has found to have a comparable regulatory scheme for purposes of Part 30 of the CFTC's rules and be subject to that regulatory scheme. This foreign office must be responsible for preparing and maintaining financial and other records and reports required by CFTC and/or NFA rules, and the Member must agree

⁵ 15 U.S.C. 78o(b)(11).

to reimburse NFA for any travel, translation, telephone, and similar expenses incurred in connection with inquiries, examinations and investigations of the Member that exceed the normal expenses incurred by NFA in examining an FCM Member located at the closest point in the continental United States, Alaska, Hawaii, or Puerto Rico.

(c) Each Member subject to minimum capital requirements must:

(1) prepare financial reports required to be filed with the CFTC and/or NFA in English, using U.S. dollars, and according to U.S. accounting standards;

and

(2) maintain a general ledger in English using U.S. dollars.

(d) Each Member must:

(1) file reports, requests for extensions, and other documents required to be filed with the CFTC and/or NFA in English;

(2) maintain English translations of all foreign-language promotional material, including disclosure documents and Web sites, distributed to or intended for viewing by customers located in the United States, its territories, or possessions;

(3) maintain written procedures required by CFTC or NFA rules in English (as well as in any other language if necessary for them to be understood by the Member's employees and agents);

(4) provide English translations of other foreign-language documents and records and file financial information in U.S. dollars when requested by NFA; and

(5) make available to NFA (during an examination or to respond to other inquiries) an individual who is authorized to act on the Member's behalf is fluent in English, and is knowledgeable about the Member's business and about financial matters.

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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 has prepared statements concerning the purpose of, and basis for, the proposed rule change, burdens on competition, and comments received from members, participants, and others. 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

NFA has seen a marked increase in the number of foreign firms applying for Futures Commission Merchant ("FCM")⁶ registration and NFA membership. NFA Compliance Rule 2-10 requires all Members to maintain books and records necessary to conduct their business, but that requirement is useless if NFA staff cannot audit or understand those books and records.

NFA is concerned about its ability to audit and obtain information from foreign FCMs located in countries without regulatory systems comparable to that in the U.S. Furthermore,

⁶ "Futures Commission Merchant" means a person who is required to register or is registered as a futures commission merchant under the Commodities Exchange Act ("CEA") and CFTC rules. NFA Compliance Rule 1-1(o).

there have been instances where promotional materials and other documents prepared by U.S. Members were in a foreign language and it fell on NFA to get them translated. Amending NFA Compliance Rule 2-10 ensures that NFA has effective access to books and records maintained by foreign firms or in a foreign language.

Although NFA has had foreign firms as Members since its inception, they have been concentrated in the Commodity Pool Operator (“CPO”)⁷ and Commodity Trading Advisor (“CTA”)⁸ categories, with a few Introducing Brokers (“IBs”)⁹ sprinkled in. Applications from foreign FCMs were rare, and those firms all had a U.S. office by the time they became Members. This has changed recently, primarily due to membership applications from foreign firms that want to offer retail forex to U.S. customers.

As of October 3, 2005, NFA had six foreign FCM Members. Four of the foreign FCMs are located in London and the other two are located in Ontario, Canada, so they are all subject to established regulatory schemes in their home countries. As of that same date, there were three firms with pending applications for FCM registration and NFA membership and one firm with a pending application for registration only. The four pending firms are located in Columbia (two firms), Cyprus, and Israel. Within the past few years, NFA has also received applications from

⁷ “Commodity Pool Operator” means a person who is required to register or is registered as a commodity pool operator under the CEA and CFTC rules. NFA Compliance Rule 1-1(g).

⁸ “Commodity Trading Advisor” means a person who is required to register or is registered as a commodity trading advisor under the CEA and CFTC rules. NFA Compliance Rule 1-1(h).

⁹ “Introducing Broker” means a person who is required to register or is registered as an introducing broker under the CEA and CFTC rules. NFA Compliance Rule 1-1(q).

firms located in Argentina, Jordan, Pakistan, Romania, Russia, and Singapore, although those firms withdrew their applications before they completed the registration process.

Since December 1987, NFA has required foreign firms to certify that they can and will produce their books and records in the U.S. within 72 hours and that they are not subject to any blocking, privacy, or secrecy laws that would interfere with this inspection. NFA shortened the response time for FCMs to 24 hours in 2003, after more foreign firms started applying for FCM registration.

NFA audits most foreign firms by asking them to provide copies of their books and records, and this procedure has proven workable for auditing CPOs, CTAs, and IBs. For the foreign FCMs, NFA sent auditors to Canada, and each of the London firms either maintains a U.S. office to prepare and maintain the books relating to its U.S.-regulated business or provides those books and records through a U.S. agent. As the number of foreign FCM applicants grows, however, concerns about NFA's ability to conduct efficient and effective audits of these firms increase.

Finally, U.S. firms occasionally provide NFA with documents written in foreign languages without also providing a translation. NFA has taken at least two disciplinary actions involving foreign-language solicitations made to a targeted group within the U.S. In the most recent case, a Forex Dealer Member located in California solicited Chinese-speaking individuals to trade OTC forex. In the other case, a CTA Member located in New York solicited Chinese-speaking individuals to trade products on U.S. exchanges. In both cases, NFA bore the onus of translating the materials into English. We believe this onus should be on the Member rather than on NFA, although NFA would check the accuracy of the translations in appropriate circumstances.

The amendments to NFA Compliance Rule 2-10 add three new sections, with the current text becoming section (a).¹⁰ Section (b) requires FCMs to maintain their books and records in an office located in the U.S. or a Part 30 jurisdiction (e.g., Great Britain, Canada).¹¹ Section (b) also requires FCMs that do not maintain their books and records in the U.S. to reimburse NFA for travel and related expenses if travel to a foreign jurisdiction is necessary.

Section (c) applies to all Members subject to minimum capital requirements (i.e., FCMs and independent IBs). It requires them to prepare financial and other required reports in English, using U.S. dollars and U.S. accounting standards, and to maintain a general ledger in English using U.S. dollars. Section (d) applies to all Members. That section requires them to:

- file documents with NFA in English;
- maintain English translations of foreign-language promotional material;
- maintain required procedures in English;
- provide English translations of other documents when requested by NFA; and
- ensure that an English-speaking individual who is knowledgeable about the firm's business is available to assist NFA during an audit.

2. Statutory Basis

The rule change is authorized by, and consistent with, Section 15A(k) of the Act.¹²

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

¹⁰ Many of these requirements are taken from NASD Rule 1090 or CBOE Rule 3.4 regarding foreign members.

¹¹ See CFTC Rule 30.10 (17 CFR 30.10) and Appendix C to that rule. A list of the Part 30 jurisdictions can be found on the CFTC's website at <http://www.cftc.gov>.

¹² 15 U.S.C. 78o-3(k).

The rule change will not impose any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act and the CEA.¹³

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

NFA did not 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

The proposed rule change became effective on January 5, 2006, upon approval by the CFTC.¹⁴ 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.¹⁵

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. Please include Filed No. SR-NFA-2005-02 on the subject line.

¹³ 7 U.S.C. 1

¹⁴ See Confirmation of CFTC Approval, supra note 3.

¹⁵ 15 U.S.C. 78s(b)(1).

Paper Comments:

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

All submissions should refer to File No. SR-NFA-2005-02. 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 inspection and copying in the Commission's Public Reference Room. Copies of such filing will also be available for inspection and copying at the principal office of the 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 available publicly. All submissions should refer to File No. SR-NFA-2005-02 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.¹⁶

Nancy M. Morris
Secretary

¹⁶ 17 CFR 200.30-3(a)(73).