

MEMO# 31590

February 1, 2019

NFA Adopts Interpretive Notice Regarding CPO Internal Controls

[31590]

February 1, 2019 TO: ICI Members
Investment Company Directors
Accounting/Treasurers Committee
Registered Fund CPO Advisory Committee SUBJECTS: Compliance
Derivatives
Fund Accounting & Financial Reporting
Intermediary Oversight
Investment Advisers
Portfolio Oversight
Risk Oversight RE: NFA Adopts Interpretive Notice Regarding CPO Internal Controls

The National Futures Association (NFA) recently issued a Notice to Members regarding NFA's adoption of an Interpretive Notice on commodity pool operator (CPO) internal control systems under NFA Compliance Rule 2-9.[\[1\]](#) The Interpretive Notice requires CPOs that are NFA members, which have the ability to control customer funds, to implement an internal controls framework. The Interpretive Notice will become effective on April 1, 2019. NFA will provide Member education on these requirements prior to the effective date, including at upcoming Member workshops.[\[2\]](#) The Interpretive Notice is summarized briefly below.

Compliance Rule 2-9 places a continuing responsibility on every NFA Member to diligently supervise its employees and agents in all aspects of their commodity futures and swaps activities.[\[3\]](#) For those Members that have control over customer funds, these supervisory obligations include developing a framework that: (i) deters errors and fraudulent activity by employees, management and third parties in order to safeguard customer funds; (ii) produces financial reports that are timely, accurate and reliable; and (iii) maintains full compliance with all regulatory requirements addressing the control of those funds. NFA believes that it is essential for CPO Members, which handle customer funds, to have an adequate system of internal controls in order to meet their supervisory obligations under Compliance Rule 2-9.

The Interpretive Notice is intended to provide CPO Members with guidance on designing and implementing an adequate internal control system and on the minimum components that must be included. It provides, however, that each CPO Member must conduct its own review to identify any other areas that should be included in the CPO's internal control

system based on the CPO's size, operations, and activities. Importantly, NFA recognizes that some CPO Members are subject to related requirements of other regulators and have designed processes and controls in accordance with those requirements. Compliance with those requirements by a CPO Member, and in some instances the CPO's pool and/or service provider, may satisfy a CPO Member's supervisory obligations under Compliance Rule 2-9 to have an adequate system of internal controls.

NFA states that to implement an adequate internal control system, the CPO must have a strong control environment that includes certain key components: (i) separation of duties, when possible, designed to ensure that no single employee is in a position to carry out fraud, conceal errors, or have control over any two phases of a transaction or operation; and (ii) a risk assessment to identify the CPO's most critical risks, so it can develop and implement appropriate controls. NFA discusses several risk areas and related control activities that would form the basis of an adequate internal control system, including: (i) pool subscriptions, redemptions and transfers; (ii) risk management and investment and valuation of pool funds; and (iii) use of administrators. In addition to establishing an internal control system and developing written policies and procedures that describe it, a CPO must maintain records that support the implementation and effectiveness of its internal control system.

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endnotes

[1] See Notice to Members 1-19-03, *available at* <https://www.nfa.futures.org/news/newsNotice.asp?ArticleID=5088>. The Notice to Members summarizes NFA Interpretive Notice 9074, NFA Compliance Rule 2-9: CPO Internal Controls System, *available at* <https://www.nfa.futures.org/rulebook/rules.aspx?Section=9&RuleID=9074>.

[2] Information about upcoming NFA workshops, which will take place in Chicago on February 25 and in New York on February 27, is *available at* https://www.nfa.futures.org/members/member-resources/workshop-registration/meeting_singnup_2019_member_workshop.aspx.

[3] NFA Compliance Rule 2-9 requires, in relevant part, that each NFA Member diligently supervise its employees and agents in the conduct of their commodity futures activities for or on behalf of the Member. Each Associate who has supervisory duties must diligently exercise such duties in the conduct of that Associate's commodity futures activities on behalf of the Member.

abridged and therefore incomplete. Communications from the Institute do not constitute, and should not be considered a substitute for, legal advice.