

MEMO# 33457

April 14, 2021

New NFA Rule and Interpretive Notices Regarding CPOs and CTAs

[33457]

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TO: ICI Members

Chief Compliance Officer Committee

Investment Advisers Committee

Registered Fund CPO Advisory Committee SUBJECTS: Compliance
CPO/CTA

Derivatives

Intermediary Oversight

Investment Advisers RE: New NFA Rule and Interpretive Notices Regarding CPOs and CTAs

We wanted to update you about recent National Futures Association (NFA) developments relevant to registered fund commodity pool operators (CPOs) and commodity trading advisers (CTAs) that are NFA Members. NFA submitted two rule submissions to the Commodity Futures Trading Commission pursuant to the Commission's "ten-day" automatic effectiveness process.[\[1\]](#) The first rule submission relates to NFA's adoption of an Interpretive Notice on members' use of third-party service providers, which was approved by the CFTC and will go into effect on September 30, 2021.[\[2\]](#) The second rule submission relates to NFA's adoption of Compliance Rule 2-50 and a related interpretive notice, which was approved by the CFTC and will go into effect on June 30, 2021.[\[3\]](#)

Interpretive Notice on Third-Party Service Providers

NFA explains that Compliance Rule 2-9(a) places a continuing responsibility on every Member futures commission merchant (FCM), CTA, CPO, and introducing broker (IB) to diligently supervise its employees and agents in all aspects of their commodity interest activities. NFA recognizes that a member may fulfill its regulatory obligations, in part, by having a third-party service provider or vendor (collectively, "Third-Party Service Provider") perform certain functions that would otherwise be undertaken by the Member itself to comply with NFA and CFTC Requirements.[\[4\]](#) If a Member outsources a regulatory function, however, it remains responsible for complying with that regulatory function and may be subject to discipline if a Third-Party Service Provider's performance causes the Member to fail to be in compliance.

NFA acknowledges that Members that have an existing supervisory framework over their

outsourcing activities are not required to design and implement a new framework. Instead, they should review their current policies and procedures and make any modifications necessary to meet the requirements of the Interpretive Notice.

The Interpretive Notice outlines the minimum areas that should be addressed in the supervisory framework and the types of activities that should be conducted within each:

- Initial risk assessment — Members should analyze, at a minimum, the type of confidential or valuable information the Third-Party Service Provider may obtain and the measures it puts in place to protect the information; the impact of the service provider failing to properly carry out the function; and whether the location and resources available to the service provider allow it to meet its contractual obligations and provide the Member with access to required records.
- Onboarding due diligence — Members should tailor their onboarding due diligence to an appropriate level based on the regulatory functions they are outsourcing and their business needs.[\[5\]](#) If the Third-Party Service Provider has access to confidential data or supports a Member's critical regulatory-related systems, then it should apply a heightened process. A heightened process should include a review of the following areas: IT security, financial stability, background of key employees, regulatory history, and business continuity and contingency plans, particularly those related to data availability and integrity. Further, prior to entering into an agreement, a Member should inquire whether the Third-Party Service Provider subcontracts its regulatory functions, and, if so, request the identity of the subcontractor and notification of any material changes involving a subcontractor that may impact the Member.
- Ongoing monitoring — Members should conduct ongoing reviews of reports generated on the outsourced function and periodic reviews of the Third-Party Service Provider as a whole, including its performance, regulatory compliance and, if appropriate, IT security, financial stability, business continuity and contingency plans, audit or examination results, websites, public filings, insurance coverage, and references. If the Third-Party Service Provider performs multiple functions for the Member, the Member should evaluate the risks of reliance and consider the availability of other alternatives and an "exit strategy," should it become necessary. The Member should ensure that it retains enough employees to perform ongoing monitoring of the Third-Party Service Provider and has procedures in place to escalate matters involving a Third-Party Service Provider to alert senior management when a material change, or a failure, occurs.
- Termination — A Member's Third-Party Service Provider agreements should require sufficient notice prior to termination of the relationship to ensure all capabilities provided by the service provider are maintained. The Member should ensure that it can obtain its records upon termination of the relationship. Upon termination, a Member also should make a reasonable effort to ensure that the Third-Party Service Provider no longer has access to confidential information and data of the Member, and that the service provider returns confidential information and data of the Member.
- Recordkeeping — To demonstrate that a Member's supervisory framework has met the minimum requirements of this Interpretation, the Member must maintain records pursuant to NFA Compliance Rules 2-10 and 2-49.[\[6\]](#)

NFA is developing a supplement to the Self-Examination questionnaire to assist Members in understanding the requirements summarized above and will cover the Interpretive Notice in future educational programs.

Compliance Rule 2-50 and Related Interpretive Notice

Compliance Rule 2-50^[1] requires that a CPO Member must promptly notify NFA, by no later than 5:00 p.m. (CT) of the next business day, if any of the following events occurs:

- CPO Member operates a commodity pool that is unable to meet a margin call;
- CPO Member operates a commodity pool that is unable to satisfy redemption requests in accordance with its subscription agreements;
- CPO Member operates a commodity pool that has halted redemptions and the halt on redemptions is not associated with pre-existing gates or lockups, or a pre-planned cessation of operations; or
- CPO Member receives notice from a swap counterparty that a pool the CPO Member operates is in default.

NFA's related interpretive notice provides further guidance on when a Member is required to file a notice under Compliance Rule 2-50, clarifying that:

- A commodity pool is unable to meet a margin call — Members are required to file notice with NFA when they determine that one of their commodity pools will be unable to meet a margin call, unless the Member reasonably expects to meet the margin call within the time period imposed by its FCM or broker.
- A commodity pool is unable to satisfy redemption requests — Members are required to file notice with NFA when they cannot meet a redemption request in accordance with the pool's subscription agreement. Notice is not required if a pool is unable to meet a redemption request on the day it is received, so long as it is met within the period specified in the pool's subscription agreement.
- A commodity pool halts redemptions — Members are required to file notice with NFA when one of their pools unexpectedly halts redemptions, either temporarily or permanently, as a result of market or other events that impact the pool's ability to meet redemptions. Members are not required to file a notice, however, if they are liquidating a pool in the ordinary course of business.
- A commodity pool is declared in default by swap counterparty — Members must file notice with NFA if they are notified that a pool is in default to a swap counterparty and the Member does not reasonably believe the pool can cure the default within the agreed cure period. Members are required to notify NFA regardless of whether the pool is in negotiations with the swap counterparty to liquidate positions or dispute the default notice.

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endnotes

^[1] See Section 17(j) of the Commodity Exchange Act.

^[2] National Futures Association: Proposed Interpretive Notice entitled NFA Compliance Rules 2-9 and 2-36: Members' Use of Third-Party Service Providers (February 26, 2021),

available at

https://www.nfa.futures.org/news/PDF/CFTC/022621-ProposedInterpNoticeCRs2-9and2-36-MembersUse3rdPartyServiceProviders.pdf?j=131994&sfmc_sub=51539440&l=16766_HTML&u=2859812&mid=100026896&jb=0; see also National Futures Association: Effective date for Interpretive Notice regarding Members' use of third-party service providers, Notice I-21-13 (March 24, 2021), available at <https://www.nfa.futures.org/news/newsNotice.asp?ArticleID=5342>.

[3] National Futures Association: Proposed NFA Compliance Rule 2-50 and related Interpretive Notice entitled NFA Compliance Rule 2-50: CPO Notice Filing Requirements (March 5, 2021), available at https://www.nfa.futures.org/news/PDF/CFTC/Proposed-CR-2-50-and-Interp-Notc-CPO-Notice-Filing-Requirements.pdf?j=132936&sfmc_sub=51539440&l=16770_HTML&u=2875288&mid=100026896&jb=0; see also National Futures Association: Effective date for NFA rules establishing CPO notice filing requirements, Notice I-21-15 (April 13, 2021), available at <https://www.nfa.futures.org/news/newsNotice.asp?ArticleID=5346>.

[4] NFA notes that, when outsourcing to a Third-Party Service Provider, a Member should ensure, to the extent applicable, compliance with NFA Bylaw 1101.

[5] NFA expects a Member and its Third-Party Service Provider to enter into a written agreement that describes the scope of services to be performed and addresses any guarantees and indemnifications, limitations of liability, and payment terms. Each Member should review its Third-Party Service Provider agreements to make certain, to the extent possible, that the service provider has agreed to comply with all applicable regulatory requirements and outlines the outsourcing relationship(s) through termination.

[6] NFA Rule 2-10 provides the recordkeeping requirements for Members, and is *available at* <https://www.nfa.futures.org/rulebook/rules.aspx?Section=4&RuleID=RULE%202-10>; NFA Rule 2-49 defines additional regulatory rules for swap dealers and participants and is available at <https://www.nfa.futures.org/rulebook/rules.aspx?Section=4&RuleID=RULE%202-49>.

[7] NFA notes that Compliance Rule 2-50 also applies to exempt pools operated by an NFA Member CPO.