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2021 CPO/CTA HIGHLIGHTS FROM NFA

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INTRODUCTION AND OVERVIEW

After a historically productive 2020 at the Commodity Futures Trading Commission ("CFTC" or "Commission"), notable in particular for a historically uncharacteristic focus on the Commission's regulation of commodity pool operators ("CPOs") and commodity trading advisors ("CTAs") and culminating in a series of watershed regulatory achievements in this area,[1] 2021 was relatively quiet at the CFTC on the CPO and CTA front.[2] By contrast, the National Futures Association ("NFA") picked up the regulatory pace.

This article will focus on three NFA highlights from 2021 focused on CPOs and CTAs:

1. NFA Branch Office Interpretation—Home/Remote Offices
2. NFA Interpretation on Third-Party Supervision
3. NFA Rule 2-50—CPO Market Event Reporting

This article includes a separate section on each of the developments, in the order set forth above. Each section is intended to summarize the development, explain its purpose, and provide suggestions for compliance.

1. NFA BRANCH OFFICE DEFINITION—HOME/REMOTE OFFICES

I. INTRODUCTION AND EXECUTIVE SUMMARY

Effective September 16, 2021, NFA has amended its definition of branch office to exclude any remote working location or flexible shared workspace where one or more associated persons ("APs") from the same household live or rent/lease, provided:

- Each such AP does not hold the location out publicly as the Member's office;
- Each such AP does not meet with

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customers or physically handle customer funds at the location; and

- Any CFTC or NFA-required records created at the remote location are accessible at the firm's main or applicable branch office(s) as required under CFTC and NFA requirements.[3]

The new carve-out for remote working locations reflects the experience gained during the remote working conditions required as a result of the COVID-19 pandemic, during which NFA Members relied on temporary branch office relief provided by NFA. The revised definition is designed to capture both work from home arrangements and flexible shared workspace arrangements, where the arrangements meet the conditions.[4] This includes the condition that APs from a particular firm that work in a shared workspace (such as a "WeWork" space) must be "from the same household." That is a shared workspace where two or more of a firm's APs that are not from the same household conduct the relevant activities would not meet the conditions of the branch office exclusion.

The Branch Office Interpretation notes that pursuant to NFA Compliance Rules 2-9(a) and 2-36(e)(1), all NFA Members are required to diligently supervise their employees and agents in all aspects of their commodity interest and forex activities. Therefore, NFA Members must ensure that they have implemented an appropriate supervisory framework to adequately supervise APs working remotely.

While not directly related to the new definition, NFA has also provided COVID-19 relief from the branch office on-site inspection requirements. This relief is described in Section IV below.

II. BACKGROUND OF THE CHANGE

A. The Original Branch Office Definition

NFA requires each CPO and CTA Member (among Members in other registration categories) to list its branch offices on the Member's Form 7-R. Each branch office must have a branch office manager who has successfully completed the Branch Manager Examination (Series 30), and the Member is required to conduct an annual inspection of each branch office.

Prior to the recent amendment, NFA Interpretive Notice 9002 defined the term branch office as follows: "any location, other than the main business address at which [a CPO or CTA] employs persons engaged in activities requiring registration as an AP, is a branch office. This is true even if there is only one person at the location."[5] Thus, under the prior definition, APs working from home were viewed as creating branch offices, which meant that (1) the AP's home would be listed on the firm's Form 7-R; (2) the AP would be considered a branch manager and thus required to (a) pass the Series 30 exam and (b) list the branch manager status on the AP's Form 8-R; and (3) the home office was subject to annual branch office inspections.

B. Impact of the Pandemic—Temporary Relief for Home and Other Remote Offices

While the treatment of home offices as branch offices had raised compliance issues for years, the practical difficulties resulting from such treatment were brought to a head by the work-from-

home conditions necessitated by the pandemic. NFA quickly recognized the widespread branch office compliance concerns raised by these conditions—multitudes of registered APs would, by necessity, be working from locations that were not listed as branch offices and where the AP was not designated or qualified as a branch manager—and responded promptly by issuing temporary relief. In a March 2020 Notice to Members ("COVID Relief Notice"), NFA stated that, in recognition that the current situation may necessitate alternative work arrangements, NFA would not pursue disciplinary action against a Member that permits APs to temporarily work from locations not listed as a branch office and without a branch manager, provided that the Member implements alternative supervisory methods to adequately supervise the APs' activities, meets its recordkeeping requirements, and ensures that the alternative supervisory procedures are documented.[6]

III. EXPLANATION OF THE CHANGE

The COVID Relief Notice itself did not appear to reflect a rethinking of NFA's historical approach to home offices. Rather, the Notice was in the form of "no-action" relief on a temporary basis, with the explicit expectation that APs working from home or remotely during the pandemic would return to the Member's main office or listed branch office location once the Member firm was no longer operating under contingencies pursuant to its business continuity plan.

However, as work-from-home conditions persisted and both Members and NFA gained experience with the supervisory methods that could be used in these conditions, NFA considered, and in August of 2021 adopted, a change to the branch definition providing permanent relief for remote work situations under appropriate safeguards. As explained in NFA's submission of the proposed change to the CFTC:

> NFA understands that Member firms, similar to other businesses, may adopt hybrid work environments that will permit employees, including registered APs, to work from their homes or other remote locations. NFA's Board does not believe that, under appropriate circumstances, there is a sufficient regulatory benefit to require Members to list these types of locations as branch offices and impose the branch office requirements upon a firm for each of these locations.
>
> Therefore, the Board amended the definition of branch office in the Interpretive Notice to specifically exclude locations where one or more APs from the same household work or rent/lease the location, provided:
>
> - The AP(s) does not hold the location out to the public as the Member's office;
> - The AP(s) does not meet with customers or physically handle customer funds at the location; and
> - Any CFTC or NFA required records created at the remote location are accessible at the firm's main or applicable listed branch office as required under CFTC Regulation 1.31 and NFA Compliance Rule 2-10.
>
> This definition is designed to capture both work from home arrangements as well as flexible shared workspace arrangements. Firms may delist locations that are currently identified as branch offices if those locations fall outside the amended definition.[7]

In notifying Members of the change, NFA reminded Members that they are required to diligently supervise their employees and agents in all aspects of their commodity interest and forex activities. Therefore, Members must ensure that they have implemented an appropriate supervisory framework to adequately supervise APs working remotely.[8]

IV. DEVELOPMENTS IN ON-SITE BRANCH OFFICE EXAMINATION REQUIREMENTS

A. 2019 Change—Risk-Based Alternate Year Option

Historically, NFA required Members with branch offices to conduct an annual on-site inspection of each branch office. In 2019, NFA adopted a change to the Interpretive Notice setting out the branch office supervision requirements that provided some flexibility for the on-site requirement by permitting Members to use a risk-based approach to identify branch offices for which the Member determines that it would be appropriate to conduct an on-site inspection every other year (with the off year's inspection to be conducted remotely).[9] The risk-based and other factors on which the determination should be based are set forth in the Notice. The alternative year remote inspection option is subject to the Member's capacity (both in terms of information and technology) to conduct a remote offsite exam and documentation of its determination of such appropriateness. In conjunction with this option, NFA added a requirement that Members must promptly perform a branch office inspection if they become aware of any irregularities.

B. COVID-19 On-Site Inspection Relief

On October 1, 2020, NFA issued a Notice to Members providing additional relief from the annual on-site inspection requirement for branch offices available during the COVID-19 pandemic, which relief was further extended in July of 2021 as the pandemic continued.[10] In light of the difficulties in conducting on-site branch office inspections during 2020 due to COVID-19, the 2020 Notice provided the following relief for application of the alternative year remote inspection option:

- Although Members were required to conduct the required annual inspection of each branch office by December 31, 2020, firms were permitted to conduct these inspections remotely.
- For the next calendar year (2021), Members that conducted a remote inspection during 2020 based on the relief would not be required to conduct an on-site inspection to comply with the every-other-year restriction on remote inspections imposed by the 2019 changes.
- Specifically, a Member would be permitted to conduct a remote inspection again in 2021 if its risk assessment (which must factor in that the Member did not conduct an on-site inspection in 2020) indicates that it is appropriate to do so.

Under the 2021 extension of the relief, Members must conduct the required inspection of each branch office by December 31, 2021, but may conduct these inspections remotely. A Member that conducts a remote examination in 2021 based on the relief may still conduct a remote examination in 2022 if its risk assessment indicates it is appropriate to do so, taking into account that the firm conducted the exam remotely for the prior two years.

V. DESIGNING PROCEDURES TO INCORPORATE THE NEW BRANCH OFFICE DEFINITION

NFA Member firms that relied on the 2020 temporary branch relief will already have consid-

ered and developed supervisory procedures to address AP activities conducted remotely. In addition, some NFA Member firms may be part of an organization that includes a firm subject to the rules of the Financial Industry Regulatory Authority, Inc. ("FINRA"). FINRA branch office rules have historically included a home office exclusion from the definition of branch office provided by FINRA Rule 3110(f), which imposes restrictions and supervisory requirements that may, to some extent, overlap with the conditions of the NFA exclusion, and thus be useful in developing NFA branch office compliance procedures.[11]

Finally, NFA staff have participated in two webinars that provide guidance for developing procedures designed to ensure compliance with the conditions of the new branch office definition and adoption of appropriate supervisory measures. Recordings of these webinars are publicly available and should be consulted by Members contemplating relying on the exclusion and designing the required policies and procedures.[12] In the course of these webinars, NFA staff further indicated that NFA may be providing additional guidance in the form of further interpretive notices.

While the extent of reliance on the new exclusion and appropriate supervisory policies and procedures will vary based on the size, activities, and characteristics of the firm, as well as factors relating to the APs in question, consideration of the following steps may serve as a starting point for firms that wish to rely on the new exclusion on a permanent basis certain of its APs.

- **Threshold risk analysis**. This initial step contemplates a preliminary risk-based determination of whether reliance on the exclusion is appropriate for the firm and one or more of its APs, based on the firm's specific characteristics, the activities and characteristics of the APs in question, and the firm's supervisory framework and capabilities. This would include identification of the risks and evaluation of available risk mitigation measures and additional supervisory procedures. While risks will vary from firm to firm, and with respect to each individual AP, NFA staff have identified three categories of risk to be considered, at a minimum:

  - Scope and nature of the AP's activities (e.g., solicitation, order taking, or supervision of other APs);
  - The AP's background (including training, experience, disciplinary history, and customer complaints, if any); and
  - Location risk (e.g., locations that lack privacy and thus could expose confidential information, or locations in "high risk" jurisdictions that are more prone to cybersecurity attacks or may prevent access to records by the firm, NFA, or the CFTC).

  Within these categories, NFA staff have emphasized the importance of considering and mitigating, if necessary, risks relating to information security, customer protection (against both misappropriation of funds and misleading sales efforts), recordkeeping integrity and accessibility of records, and business continuity (outage of home phone or internet access) as general risks arising from APs working from remote locations.

- **Identification and vetting of APs wishing**

to work remotely. This would include steps designed to ensure that (1) each such AP is an appropriate candidate for working remotely instead of at the main office or a branch office, and (2) the firm can develop appropriate supervisory procedures. This process may include:

- Outreach to all APs to (1) ensure that they understand the conditions and limitations of the remote location exclusion (including the "from the same household" requirement) and (2) require APs wishing to work remotely to indicate their request to do so and describe the conditions applicable to their situation. This outreach effort could include a questionnaire asking specific questions relating to the risk factors identified in the next bullet;
- Review of the background, experience, location, equipment/technology capabilities, and cybersecurity conditions of each AP requesting permission to work remotely and the applicable location, with attention to each of the risk categories identified above (under "Threshold risk analysis") and the facts and circumstances related to these risks (e.g., the nature of the AP's activities, disciplinary background and/or customer complaints, if any, and location-related risk (such as working from a high-risk location or a location that would impede access to relevant records by the firm, NFA, or the CFTC); and
- A reminder to all APs that the APs themselves have a responsibility to comply with the branch office requirements. This would include an obligation on the part of the AP to notify the firm of any relevant firm activities conducted outside of the main office or a designated branch office.

- **Development of additional written supervisory procedures**. Additional written supervisory procedures required to supervise APs working from a remote location would be tailored to the above analysis and will vary based on the facts, circumstances, and risks involved. General features of such procedures would include:
  - Written procedures and documentation of compliance (both for internal purposes and for demonstration in NFA exams). This could include periodic certifications or attestations by the AP with respect to the AP's activities and compliance with the firm's procedures;
  - Training of and communications with APs with respect to the requirements for remote work and the specific supervisory requirements applicable to the AP's situation (which could include specific emphasis and guidance on the holding out, handling customer funds, and customer meeting prohibitions of the exclusion, as well as the record-keeping requirements);
  - A requirement that APs inform the firm promptly of any change in the relevant facts and circumstances; and
  - Training with respect to the need for

the use of approved firm equipment and applications in remote locations, as well as adequate recordkeeping.

- **Ongoing monitoring by the firm**. Supervisory procedures should include measures for monitoring on an ongoing basis to confirm that remote locations continue to qualify for the exclusion and that the supervisory procedures are effective.
- **Form 7-R and 8-R Amendments**. Delisting locations that are currently identified as branch offices if those locations qualify for the exclusion and making other appropriate updates to the Forms.

2. NFA INTERPRETATION ON THIRD-PARTY SUPERVISION

I. INTRODUCTION AND EXECUTIVE SUMMARY

Effective September 30, 2021, a new NFA Interpretive Notice ("Notice") requires all NFA Members, including CPO and CTA Members, to adopt and implement a written supervisory framework ("outsourcing framework" or "framework") over their outsourcing of regulatory functions to third-party service providers or vendors, including affiliated entities ("Service Providers").[13] The outsourcing framework requirement is designed to mitigate the risks associated with outsourcing regulatory functions and arises from NFA Compliance Rule 2-9, which places a continuing responsibility on Members to diligently supervise their employees and agents in all aspects of their commodity interest activities.

While NFA recognizes that Members need flexibility to design an outsourcing framework that is tailored to their specific needs and business, the Notice requires the framework to address, at a minimum, the following five areas:

- Initial risk assessment;
- Onboarding due diligence;
- Ongoing monitoring;
- Termination; and
- Recordkeeping.

The Notice provides guidance on the types of supervisory provisions that Members should include or consider in each of these areas. In order to further assist Members in drafting their outsourcing frameworks, NFA has published a detailed questionnaire specifically relating to the new outsourcing framework requirement and the guidance provided in the Notice, which is referenced in a new section about the use of Service Providers in the NFA self-examination questionnaire, and has included a segment on the Notice as part of its 2021 Virtual Member Regulatory Workshop (collectively, "Additional Guidance").[14]

The Notice will require NFA Members to review their existing outsourcing policies and procedures and, if appropriate, make adjustments in accordance with the requirements and guidance set forth in the Notice. While CPOs and CTAs, and in particular dual registrants already subject to comprehensive regulation by the SEC under the Investment Company Act of 1940 ("ICA") and the Investment Advisers Act of 1940 ("Advisers Act"), as well as other federal securities laws, will already have substantial outsourcing policies and procedures in place, the guid-

ance in the Notice describes a number of specific measures and considerations that may not necessarily be expressly included in a particular Member's existing outsourcing practices. In addition, the Notice makes clear that Members will be expected to be able to demonstrate, through appropriate records and documentation, that they have addressed, at a minimum, the five required areas identified in the Notice.

This section describes the requirements and guidance set forth in the Notice, as well as the Additional Guidance, and suggests steps for CPO and CTA NFA Members to consider in order to have in place an outsourcing framework consistent with the Notice. To address the practical and interpretive issues that have arisen in the review and implementation process, we have used a "Frequently Asked Questions" ("FAQs") format. Answers to the FAQs are set forth in Section II, below, and are divided into sections by subject matter that address: (1) the purpose and scope of the new requirements; (2) the specific guidance provided for each required section of the framework; and (3) next steps for designing a tailored outsourcing framework that complies with the Notice (including tools provided by NFA for this purpose).

II. ANSWERS TO FREQUENTLY ASKED QUESTIONS

A. Purpose and Scope of the Notice

1. What is the purpose of the new outsourcing framework requirement?

NFA recognizes that Members may fulfill some of their regulatory obligations by having one or more Service Providers perform a regulatory function. However, a Member remains responsible for the performance of such functions in compliance with applicable NFA and CFTC requirements and may be subject to discipline if a Service Provider causes the Member to fail to comply with those requirements. The outsourcing framework requirement is intended to mitigate the risks associated with outsourcing the Member's regulatory functions.

2. Are there specific instances of misconduct or concern that gave rise to the new requirement?

Neither the Notice nor NFA's explanation of the Notice provided in the Rule Submission identifies any particular incident or industry trend that gave rise to the Notice. However, we understand that NFA has seen instances in the past where vendors did not fulfill the responsibilities that had been outsourced to them, which led to deficiencies by Members. For example, some Members have used third parties for performing required calculations, such as of net asset value or net capital, where the calculations were not done correctly, and the errors were not caught by the Member due to the absence of adequate monitoring or verification procedures. In addition, we understand that NFA has seen firms use third-party vendors for recording and maintaining calls with customers where, because of outages or for other reasons, vendor records were lost. NFA also wanted to remind Members that they remain responsible for compliance of the outsourced regulatory functions.

3. What is a regulatory function?

The Notice does not define the term "regulatory function," but generally refers to functions that would otherwise (if not outsourced) be undertaken by the Member itself to comply with NFA and CFTC requirements. The Notice further

describes a Member's regulatory functions as those for which a compliance failure, whether by the Member or by a Service Provider to which the function has been outsourced, may expose the Member to disciplinary action. The Notice does not outline which regulatory functions may or may not be outsourced, noting that this determination rests with the Member. [15]

As a general matter, the Notice refers to regulatory functions such as keeping and maintaining required records, data security, protection of customer assets, and preparation of financial and other information for regulatory and customer reporting. In addition, the Notice provides a number of specific examples of regulatory functions, including conducting annual branch office reviews, conducting initial due diligence on a potential branch office, collecting long-term outstanding debit balances, monitoring outstanding daily margin calls, issuing swaps confirmations, calculating and issuing margin calls, and reporting swaps data to a swap data repository.

Note that the Notice is directed to all NFA Member categories, not specifically to CPOs and CTAs, and that not all of the specific examples of regulatory functions provided in the Notice are directly relevant to the operations or regulatory functions of CPOs and CTAs. While these examples may provide guidance by way of analogy, in order to identify regulatory functions for CPOs and CTAs in particular, one method would be to review general areas covered by CFTC and NFA rules applicable to CPOs and CTAs, such as Part 4 of the CFTC's regulations and NFA rules and notices that specifically mention CPOs and CTAs.

4. What types of Service Providers perform a regulatory function and thus must be covered by the framework?

The first step in complying with the Notice is to identify Service Providers that perform outsourced regulatory functions for the Member CPO or CTA. The Notice clearly states that compliance with the Notice is required **only** with respect to Service Providers that perform functions to assist the Member in fulfilling its regulatory obligations that address NFA and/or CFTC requirements.[16]

Some types of Service Providers will be common to most if not all NFA Members, such as providers of information security and data storage services. Other examples NFA has provided, either in the Notice or the Additional Guidance, include accountants that compute performance or net capital calculations and vendors that maintain voice records of conversations with customers, conduct anti-money laundering or cybersecurity audits, or conduct background checks on employees.

The types of Service Providers that are retained to perform regulatory functions for CPOs and CTAs, however, in particular for dual registrants, are likely to vary significantly from those retained by Members in other categories, such as FCMs, SDs, and IBs. Based on the guidance and examples in the Notice, relevant Service Providers for CPOs and CTAs would likely include, among others, custodians, transfer agents, and fund administrators with responsibility for financial statements, shareholder reports and account statements, net asset value calculations, and regulatory reporting. [17] Arrangements with some types of vendors, for example, pricing vendors that

provide input for valuation of portfolio holdings, may require further analysis to determine whether they involve outsourcing to Service Providers as contemplated by the Notice. There may also be vendors or other parties providing services to a CPO or CTA that are not clearly contemplated as Service Providers in the Notice, but that the Member may wish to include in the framework for other reasons, such as organizational efficiency, consistency, or general risk management.

5. Are affiliated Service Providers included?

While the Notice refers to "third-party" Service Providers, the Notice also states that Members should comply with the Notice's requirements "even if a Member outsources a regulatory obligation to an affiliate."[18] However, as described in Section II.C below, it may be reasonable for some of the requirements of the Notice, such as specific due diligence measures, to be applied differently when the Service Provider in question is an affiliate.

6. Does the Notice apply to existing as well as new Service Provider relationships?

The Notice makes clear that the outsourcing framework should address outsourcing relationships in place prior to the September 30, 2021, effective date, as well as new relationships. While two of the required areas—initial risk assessment and onboarding due diligence—are directed to the initial phases of the arrangement, the remaining three areas—ongoing risk monitoring, termination, and recordkeeping—apply throughout the term of the relationship. Moreover, while recommending that the guidance be considered in connection with renewing or renegotiating existing agreements, NFA acknowledges that some of the guidance in the Notice, in particular guidance relating to written agreements, may need to be adapted for agreements that are already in place.[19]

7. How does the outsourcing framework apply to CPO and CTA Members that are part of a holding company or other large organization?

NFA recognizes that a Member may be part of a larger holding company that has a dedicated procurement or vendor management department responsible for onboarding and maintaining Service Provider relationships for the Member. The Notice states that a Member may meet its obligations under the Notice through this centralized department as long as the areas described in the Notice are addressed with respect to the Member. In addition, in these situations, Members should ensure that all employees involved in the process, including those of other entities in the organization, are aware of the Notice's requirements. [20]

8. What additional guidance or tools has NFA provided for designing an appropriate outsourcing framework?

For assistance to Members in drafting their outsourcing frameworks, NFA has published a questionnaire entitled "Use of Third-Party Service Providers Questionnaire" ("NFA Service Provider Questionnaire"), which sets forth a series of questions in each required area (other than recordkeeping), which are based on the guidance that the Notice provides in that area.[21] The Questionnaire includes both general and specific questions for each required area. For example, under "Initial Risk Assessment," the questions include, among others:

- "How does the firm determine whether a

regulatory function is appropriate to outsource?"

- "What risks does the firm evaluate when considering whether to outsource a function?"
- "How are employees that are involved in the risk assessment process made aware of [the Notice]?"

Similarly, under "Onboarding Due Diligence," the questions include, among others:

- "What is the firm's process for conducting due diligence on prospective third-party service providers?"
- "What is the firm's process to ensure compliance with Bylaw 1101 when selecting a third-party service provider?"
- "How does the firm identify whether a third-party service provider subcontracts any outsourced regulatory functions?" [22]

The NFA Service Provider Questionnaire states that the Member's outsourcing framework should answer all of the questions as completely as possible. Although a Member may answer "not applicable" to certain questions, the Member should carefully consider the firm's operations before doing so and maintain records to demonstrate that it has addressed the area.

NFA has also provided an online educational program on the Notice as part of its most recent virtual regulatory workshop, which includes both a video presentation and slides ("Workshop").[23] The Workshop includes background information on the Notice, as well as specific examples of regulatory functions to be addressed and practical guidance on questions raised by the Notice.

9. Must a Member CPO's or CTA's outsourcing framework expressly cover everything described in the Notice?

The Notice requires every Member CPO and CTA that outsources any regulatory function to a Service Provider to have a written supervisory framework over its outsourcing function that, at a minimum, addresses each of the five areas specified in the Notice—initial risk assessment, onboarding due diligence, ongoing monitoring, termination, and recordkeeping—which are referred to as the "general requirements" for the framework.

The Notice also provides more detailed guidance relating to each of these required areas.

While Members must comply with the general requirements in determining which specific elements of the guidance in each area a particular Member's outsourcing framework should include, the following considerations should be kept in mind.

- Members have flexibility to adopt a framework that is tailored to a Member's specific needs and business. As a general matter, the specific guidance for each required area should be interpreted in light of its purpose, which is to mitigate outsourcing risk. For dual registrants, this will include recognition of outsourcing requirements already in place in compliance with SEC regulatory requirements.
- As part of the recordkeeping requirement of the Notice, Members must maintain documentation sufficient to demonstrate that they have addressed all five of the required areas.

- In the event a Service Provider does fail to perform in a manner that meets the Member's regulatory requirements, the Member is ultimately responsible for this failure and, based on the facts and circumstances, may be subject to discipline. It can be expected that the thoroughness (or lack thereof) of a Member's outsourcing framework relative to the guidance will be part of the facts and circumstances considered in any determination of the Member's responsibility for a compliance failure by a Service Provider.

- As indicated in the NFA Service Provider Questionnaire, Members may determine that some components of the guidance addressed in the Questionnaire are not applicable to their organization. However, they should carefully consider the firms' operations before doing so.

- The guidance relating to several areas may overlap, and an outsourcing framework need not address each of the five areas in isolation, provided the issues and risks associated with each area are addressed in the Member's initiation and management of its outsourced relationships. [24] It should also not be necessary to restate policies and procedures that are found in different places. Nonetheless, given the need for Members to demonstrate that they have addressed all of the required areas, as a practical matter it may be helpful to create and maintain an "umbrella" framework that includes a section for each of the five required areas that, where appropriate, refers to other policies and procedures in place that implement the required area.

- While the Notice states that Members must address the five areas, guidance on each specific area is expressed in terms of specific measures, some of which Members should take, and others which Members should consider taking, should use reasonable efforts to take, or may take. In describing each section of the guidance in Section II.B, below, we have attempted to preserve these differences in order to accurately convey the flexibility embedded in the guidance.

10. Will NFA ask to see a Member's regulatory framework in routine NFA exams?

Members should expect that a request for documentation demonstrating that the Member has addressed the five required areas will be a routine requirement in NFA exams, independent of any actual compliance failure on the part of a Service Provider. In the Workshop presentation, NFA staff have indicated that such requests may include not only the policies and procedures relating to outsourcing but also supporting materials showing that the Member has followed the policies and procedures. For example, if the framework calls for the use of a due diligence questionnaire, NFA may ask to see a sample Service Provider response. NFA guidance on what it expects in exams can be useful in drafting an outsourcing framework, as discussed below in Section II.C.3 ("Designing an Outsourcing Framework—What will NFA look for in exams?").

11. Does the Notice supersede existing NFA guidance in specific areas?

NFA has previously issued interpretive notices

relating to specific regulatory areas (such as use of email and websites and information security), which include guidance on supervising Service Providers in these areas. The Notice is intended to supplement, rather than supersede, the existing guidance in these areas.[25]

B. Guidance for Each Required Component of the Outsourcing Framework

The Notice sets forth the guidance relating to each of the required areas in substantial detail. The FAQs below are intended to capture this detail in a manner that will assist Member CPOs and CTAs in designing their outsourcing framework by serving as a kind of checklist for conducting a comparison with existing policies and procedures and the Member's specific circumstances ("gap analysis"). Note that not all of the specific guidance provided for each area will be relevant for CPOs and CTAs and that, as noted above, some of the guidance is expressly phrased in terms of measures that Members should consider or make reasonable efforts to adopt.

1. What guidance does the Notice provide for addressing "Initial Risk Assessment"?

a. Determination that outsourcing the regulatory function is appropriate

The first component of the outsourcing framework required by the Notice is referred to as "Initial Risk Assessment." This component involves a determination as to whether the regulatory function in question is appropriate to outsource and an evaluation of the risks associated with outsourcing that function.[26] The Notice states that unless a Member determines that it may adequately manage the risks associated with outsourcing a particular regulatory function, the Member generally should not move forward with outsourcing the function.

b. Risk areas to be considered

Although NFA recognizes that the risks associated with outsourcing a particular function or functions may vary, in making the determination that such risks can appropriately be managed and that outsourcing of the function is appropriate, Members should analyze and identify the following primary areas of risk:

- **Information security risk**—the type of confidential, personally identifying information or other valuable information a Service Provider may obtain or have access to and the measures it puts in place to protect such information;
- **Regulatory risk**—the potential impact to the Member, customers, and counterparties if the Service Provider fails to carry out the function properly; and
- **Logistics risk**—the location of the Service Provider and whether it has the resources to meet its contractual obligations and provide the Member with access to required records.

In addition to these primary areas of risk, Members should consider other potential areas of risk applicable to their business and the regulatory function that is being outsourced.

2. What guidance does the Notice provide for addressing "Onboarding Due Diligence?"

This is the longest and most detailed section of the Notice. Note that the discussion, in general, is geared to onboarding new Service Providers

but also provides guidance for adapting these measures for ongoing relationships.

a. Scope and level of due diligence

A Member should perform due diligence on any prospective Service Provider prior to entering into a contractual outsourcing arrangement in order to determine whether the Service Provider is able to successfully carry out the outsourced function in a manner designed to comply with NFA and/or CFTC requirements. The Member should ensure that the Service Provider:

- is aware of relevant NFA and CFTC requirements;
- has sufficient regulatory experience; and
- has the operational capabilities to fully and accurately carry out the outsourced function(s).

The level of due diligence generally should:

- be commensurate with the risks associated with outsourcing the particular regulatory function;
- be tailored to a Member's business needs; and
- provide a Member with an appropriate level of confidence in the Service Provider's ability to properly carry out the outsourced function.

b. Heightened due diligence for confidential data and critical functions

Onboarding due diligence should be heightened for Service Providers that (a) obtain or have access to a Member's critical and/or confidential data or (b) support a Member's critical regulatory-related systems, such as handling customer funds, keeping required records, and preparing or filing financial reports. In these instances, Members should consider assessing the following key areas relating to the Service Provider:

- IT security (e.g., practices regarding data transmission and storage);

  On this point, the Notice specifically states that a Member should avoid using Service Providers that are unable to meet NFA and CFTC standards regarding the confidentiality of customer data, which are set out, for example, in NFA Interpretive Notice 9070.[27]

- financial stability;

  In assessing a Service Provider's financial stability, a Member may want to consider, as appropriate, reviewing a potential Service Provider's financial statements, audit or examination (internal or third-party) results, websites, public filings, insurance coverage, or references.[28]

- background of the Service Provider's key employees;
- regulatory history (e.g., regulatory actions or lawsuits); and
- business continuity and contingency plans (particularly those related to data availability and integrity).

c. Due diligence for subcontracting by the Service Provider

Members should also inquire about whether a

Service Provider subcontracts any of the regulatory functions that the Member outsources to the Service Provider. If so, the Member should:

- request the identity of the subcontractor;
- if possible, assess the risks associated with the Service Provider's subcontracting function;
- require the Service Provider to notify the Member of any change in a subcontractor; and
- retain the ability to terminate the relationship if the Service Provider makes any material changes involving a subcontractor that would have an adverse effect on the performance of the outsourced function.

d. Written agreement

The Member and Service Provider should execute a written agreement that fully describes the scope of services being performed. The agreement should also address any guarantees, indemnifications, limitations of liability, and payment terms.

The Member should make a reasonable effort to ensure that the agreement includes the Service Provider's agreement:

- to comply with all applicable regulatory requirements, including the production of records; and
- to notify the Member immediately of any material failure(s) in performing the outsourced regulatory functions(s).

If applicable, a Member's agreement with the Service Provider should address the process for data management at the termination of the relationship.

In addition, the guidance on due diligence for subcontracting by the Service Provider, discussed above, as well as the guidance on ongoing monitoring and termination, discussed below, note a number of matters that could require inclusion in an agreement.[29]

e. Involvement of principal or CFO

Depending on the criticality of and risk associated with the function being outsourced, a Member should consider whether it is appropriate for a firm principal to either execute the outsourcing agreement or be notified that the Member has entered into an agreement. The Notice provides, as a specific example, that a large CPO Member should consider whether its CFO should execute, or be notified that the CPO has entered into, an agreement for a Service Provider to provide monthly bookkeeping functions or administrative functions for the CPO's pools.

f. Existing relationships and agreements

NFA understands that Members will have existing agreements in place at the time the Notice becomes effective and does not expect a Member to renegotiate these agreements prior to their termination dates. However, NFA does recommend that a Member consider the above guidance when renegotiating, renewing existing agreements, and engaging new Service Providers.

g. Recognition of limits on ability to negotiate

NFA also recognizes that in some cases, a Member, due to its size or otherwise, may have little or no ability to negotiate and secure the

inclusion of specific contractual terms, especially in agreements with industry Service Providers that support critical infrastructure. Each Member, however, should carefully review its Service Provider relationships to ensure to the extent possible that contractual terms are appropriate and reflect the outsourcing relationships as intended.

h. Bylaw 1101 compliance

While not addressed specifically in the onboarding due diligence guidance, the Notice states that when outsourcing to a Service Provider, the Member should ensure, to the extent applicable, compliance with NFA Bylaw 1101.[30]

3. What guidance does the Notice provide for addressing "Ongoing Monitoring"?

a. Ongoing monitoring of risk-based review

Members should conduct ongoing monitoring of the Service Provider's ability to properly carry out the outsourced regulatory function and to meet its contractual obligations. This ongoing monitoring should have two components:

(i) **Ongoing review.** The Member should engage in an ongoing review of a particular outsourced function(s) to ensure it is being performed appropriately (e.g., by reviewing for accuracy reports generated by the Service Provider).

(ii) **Periodic holistic performance and compliance reviews.** These reviews cover more generally the Service Provider's performance and regulatory compliance, as well as, if appropriate, the following specific areas:

- IT security;
- financial stability;
- business continuity and contingency plans;
- audit or examination results;
- websites;
- public filings;
- insurance coverage; and
- references.

b. Notification of material changes

In general, a Member should require a Service Provider to notify it of any material changes to the Service Provider's material systems or processes used to carry out an outsourced regulatory function. While not explicitly stated in the Notice, such changes would logically be part of the Member's ongoing risk-based review of the Service Provider. Note that inclusion of such a requirement in a Service Provider agreement, as the guidance suggests, would be an appropriate consideration as part of onboarding due diligence.

c. Frequency and scope of ongoing reviews

Members should tailor the frequency and scope of ongoing monitoring reviews to the criticality of and risk associated with the outsourced function. For example, a Member may determine to review a Service Provider with access to customer or counterparty data more frequently than a Service Provider that has no access to this type of data.

d. Risk of over-reliance on a Service Provider

The Notice recognizes that there may be constraints on a Member's choice and/or retention of a particular Service Provider. Specifically, (1) a Service Provider may perform multiple functions for a Member or otherwise provide an essential or critical service (e.g., collecting and maintaining customer onboarding data) or (2) there may be only one or few Service Providers available to perform certain functions. To the extent applicable, a Member should evaluate the risk associated with becoming overly reliant on a particular Service Provider and consider the availability of alternatives, including other Service Providers or in-house solutions, in case a viable "exit strategy" is necessary.

e. Senior management involvement

The Notice addresses four items under the rubric of "Senior management involvement."

(i) **Adequacy of resources.** Members should consider whether they have resources and qualified personnel performing ongoing monitoring. This consideration will depend on the Member's size, operations, and risk tolerance, and the criticality and risk associated with the outsourced function.

(ii) **Escalation to senior management.** Members should have a process of escalation to senior management when a Service Provider fails to perform an outsourced function or its risk profile materially changes (e.g., when the Service Provider is subject to a regulatory fine or experiences a business failure).

(iii) **Internal committee structure.** Some members may maintain internal committees, including risk committees that must be notified about Service Provider relationships and any material changes to them. The definition of a "material change" may differ depending on a Member's size, business, the functions outsourced, and the type of Service Provider(s) utilized (e.g., whether or not the Service Provider is regulated).[31]

(iv) **Independent review.** Members may engage an independent party to review their outsourced relationships.

f. Contractual renewals and proposed changes

The Notice states that, as part of the ongoing monitoring process, Members should consider incorporating "best practices" relating to contractual renewals.[32] In addition, throughout the relationship with a Service Provider, Members should identify and evaluate the risks associated with any proposed changes to its agreements.

4. What guidance does the Notice provide for addressing "Termination"?

a. Advance notice of termination in Service Provider agreements

A Member's agreement with a Service Provider should require the Service Provider to give the Member sufficient notice prior to terminating the relationship in order to ensure that the Member can maintain operational, regulatory or other capabilities supported by the Service Provider.

b. Continuity in general; recordkeeping

Following termination of a Service Provider relationship, Members must be able to meet all NFA and CFTC requirements, including recordkeeping. In order to fulfill their recordkeeping obligations, Members will often need (i) to obtain records from the Service Provider or (ii) to enter into an agreement with the Service Provider to continue acting as a records custodian for an appropriate amount of time.

c. Protection of confidential information

(i) **Cutting off access to information.** Upon termination of a Service Provider, a Member should make a reasonable effort to ensure that the Service Provider no longer has access to confidential information and data of the Member and its customers or counterparties.

(ii) **Return of confidential information and data.** A Member should ensure that a terminated Service Provider does not unnecessarily retain and, in appropriate circumstances, that the Service Provider returns confidential information of the Member and its customers or counterparties. For example, a Service Provider that performs accounting functions may have been granted "read-only" access to certain Member back-office systems and internal reports. A Member should verify that this Service Provider's access is terminated.

(iii) **Terminated employee access to information.** Independently of termination of a Service Provider itself, Members should consider requiring Service Providers to notify them if a key employee with access to the Member's information is terminated and to provide the Member with assurances that the employee's access to this information has been shut off.[33]

5. What guidance does the Notice provide for addressing "Recordkeeping"?

Members that engage a Service Provider to perform a regulatory function must maintain records to demonstrate that they have addressed the areas described in the Notice, in accordance with NFA Compliance Rule 2-10.[34] This requirement may, but need not, be a separate provision of the framework. However, the need to make and retain documentation to demonstrate compliance with the Notice is an important consideration to keep in mind when designing provisions of the framework that address the other four required areas and is expressly noted in the NFA Service Provider Questionnaire.

C. Designing an Outsourcing Framework

1. How would a CPO or CTA Member start to design an outsourcing framework?

While the process will vary depending on the size, operations, and other facts and circumstances relevant to the particular Member, the basic steps are as follows:

a. Review arrangements with all persons or entities that provide services for the Member, including affiliates, and identify those that perform regulatory functions, and thus

should be considered Service Providers covered by the Notice.[35]

b. Conduct a gap analysis of existing policies and procedures relative to the Notice:

   (i) Collect and review existing policies and procedures for each of the five required areas;

   (ii) Review and complete the NFA Service Provider Questionnaire. As noted, the answer to some of the questions may be "not applicable," but such a response requires careful consideration of the firm's operations; and

   (iii) Consider additional elements of the guidance not addressed in the NFA Service Provider Questionnaire (refer to FAQs in Section II).[36]

c. Address specific areas that should be added or adjusted based on the gap analysis.

d. Develop a format and documentation designed to demonstrate that the outsourcing framework addresses the required areas in a manner consistent with the Notice. Keep in mind that this does not require repeating policies included elsewhere. However, demonstration of compliance may be easier and more effective if the Member maintains a centralized document that indicates where each required component of the framework is addressed (such as a table of contents or umbrella policy that cross-references existing policies).[37] Note that the Member's answers to the NFA Service Provider Questionnaire may be a useful tool in designing and documenting the framework.

e. Identify personnel with responsibilities under the framework and develop an appropriate educational or training protocol.

   (i) For example, note that the NFA Service Provider Questionnaire asks specifically how employees that are involved in the risk assessment process will be made aware of the Notice.

   (ii) Note the reminder in the Notice that Members should ensure that all employees involved in the process of outsourcing regulatory functions to Service Providers are aware of the Notice's requirements, including Members that are part of a holding company structure or large organization where outsourcing is conducted in a dedicated organization-wide procurement or vendor management department.[38]

2. How will the process vary for dual registrants?

Dual registrants typically already have policies and procedures addressing oversight of service providers, either as part of their compliance with ICA or Advisers Act rules or as part of their general compliance culture. Both the ICA and the Advisers Act, and SEC rules thereunder, require the adoption of compliance policies and procedures and also impose express oversight obligations over a number of critical functions.

For SEC-registered funds, Rule 38a-1 under the ICA provides for the oversight of compliance by the registered fund's investment adviser, principal underwriter, administrator, and transfer agent. However, not all Service Providers cov-

ered by the Notice will fall into the categories addressed by Rule 38a-1, and the specific oversight requirements of Rule 38a-1 and the Notice differ. In addition, while Rule 38a-1 requires the registered fund to have compliance oversight policies and procedures, it does not, *per se*, require a written outsourcing framework.

For registered investment advisers generally (independent of registered fund obligations), Advisers Act Rule 206(4)-7 requires the adviser to have policies and procedures designed to prevent violations of the Advisers Act. While this would include supervision of outsourced regulatory functions, Rule 206(4)-7 is more narrowly focused on Advisers Act compliance and does not specifically address Service Provider oversight.

Accordingly, although dual registrants will likely have existing policies and procedures that address the purpose of the Notice, in order to demonstrate compliance with the Notice's requirement of a written outsourcing framework that addresses specific areas, dual registrants will still need to conduct the gap analysis and take the other steps described above, albeit in a manner tailored to take into consideration the comprehensive nature of SEC regulation to which they are already subject.

3. What will NFA look for in exams?

Following the effective date, it can be expected that NFA exams will include document requests and questions relating to the Member's outsourcing framework and compliance with the Notice. Accordingly, while many CPOs and CTAs may be confident that they have appropriate outsourcing policies and procedures in place, NFA examiners are likely to require demonstration of an appropriate outsourcing framework in terms of compliance with the Notice, through appropriate documentation of each of the five required components.

As is the case for other areas of CFTC and NFA compliance, it is instructive to consult the NFA Self-Examination Questionnaire, which can serve as a checklist or guide to critical compliance areas.[39] In this connection, NFA has added a new section specifically dedicated to the Notice. The new section asks: (1) whether the Member has a written supervisory framework over its outsourcing of regulatory obligations to Service Providers; (2) whether the framework addresses each of the five required components set forth in the Notice; and (3) whether the Member has maintained records to demonstrate that it has addressed the areas included in the supervisory framework. The NFA Self-Examination Questionnaire also refers Members to the NFA Service Provider Questionnaire for further assistance in drafting policies and procedures for the outsourcing framework.

3. NFA RULE 2-50—CPO MARKET EVENT REPORTING

I. INTRODUCTION AND EXECUTIVE SUMMARY

Effective June 30, 2021, NFA Compliance Rule 2-50 now requires NFA's CPO Members to notify NFA promptly (within one business day) upon the occurrence of any of the following four events with respect to a commodity pool, including an exempt pool, operated by the CPO Member:

- The pool is unable to meet a margin call;
- The pool is unable to satisfy redemption

requests in accordance with its subscription agreement;

- The pool halts redemptions, and the halt is not associated with pre-existing gates, lock-ups or a pre-planned cessation; or
- The CPO Member receives notice from a swap counterparty that the pool is in default.[40]

The purpose of the Rule is to provide NFA with timely notice when critical market or other events raise potential financial issues that may impact a CPO Member's ability to fulfill its obligation to pool participants or that may result in a pool's unplanned liquidation. In order to align the Rule more closely with its purpose, NFA simultaneously issued an Interpretive Notice ("Interpretive Notice") identifying circumstances that technically fall within one of the four specified events but, because of their nature, are NOT required to be reported.[41] For example, a notice filing is not required where a CPO Member is temporarily unable to meet a routine margin call but will be able to do so within the time prescribed by the call, or where a CPO Member decides to liquidate a pool in the ordinary course of business and halts redemptions until a final accounting occurs.

The following discussion describes the new requirements and suggests additions to CPO Member compliance policies and procedures designed to ensure compliance with the new notice requirements.

II. THE NEW CPO NOTICE FILING REQUIREMENTS

The new requirements are set forth in a new rule, NFA Compliance Rule 2-50, as modified by the Interpretive Notice. The Interpretive Notice effectively narrows the reporting obligations set forth in the Rule, in order to conform to the Rule more closely with its purpose by identifying circumstances that need not be reported. Similar to CFTC and NFA notification requirements regarding financial issues already in place for FCMs and introducing brokers, Rule 2-50 and the related Interpretive Notice are intended to provide NFA with important information regarding CPO Members and their pools during a market or other event.[42]

A. Rule 2-50

1. Terms of the Rule

Rule 2-50 requires that each CPO Member must provide prompt notification to NFA upon the occurrence of one of the following events, in accordance with the Interpretive Notice:

a. CPO Member operates a commodity pool that is unable to meet a margin call(s);

b. CPO Member operates a commodity pool that is unable to satisfy redemption requests in accordance with its subscription agreements;

c. CPO Member operates a commodity pool that has halted redemptions, and the halt on redemptions is not associated with pre-existing gates or lock-ups, or a pre-planned cessation of operations; or

d. CPO Member receives notice from a swap counterparty that a pool the CPO Member operates is in default.

2. Scope—Inclusion of "Exempt Pools"

The term "commodity pool" as used in Rule

2-50 includes "exempt pools," and thus the reporting obligation under Rule 2-50 applies to a CPO Member with respect to circumstances identified in the Rule that occur in such exempt pools, as well as pools for which the Member serves as a registered CPO.[43] Note that the term "exempt pools" refers to pools for which the CPO claims a CPO registration exemption (e.g., under Rule 4.13(a)(3)), but not pools for which the CPO claims an exclusion from the definition of CPO (specifically, Rule 4.5).

3. Timing and Method of Notification

The notification must be filed promptly, which the Rule defines as no later than 5:00 p.m. (CT) of the next business day following the event. The Rule also states that the notice must be provided in the form and manner prescribed by NFA. Notice filings required by the Rule must be made by the CPO by means of NFA's EasyFile system, which can be accessed via NFA's website. The filing made pursuant to the Rule must include a summary of the event as well as all relevant subsection(s) of the Rule and the names of the impacted pool(s). Each CPO must ensure that it is capable of filing a timely notification to the NFA upon the occurrence of the above-listed events.

B. The Interpretive Notice—Guidance on Events That Do NOT Require Reporting

1. Purpose of the Guidance

The Interpretive Notice reflects NFA's recognition that there may be circumstances that technically fall within one of the four events enumerated in the Rule itself ("triggering events") but would not be the type of event that should require a CPO Member to notify NFA ("reporting events"). To that end, the Interpretive Notice provides guidance that more fully clarifies the circumstances that may be triggering events under the literal terms of the Rule but are NOT reporting events that require notice under the Rule. The guidance is intended to ensure that the Rule is "narrowly tailored" to its purpose—to provide timely notification to NFA of potential financial issues that may impact a CPO Member's ability to fulfill its obligations to pool participants or that may result in a pool's unplanned liquidation and assist NFA in readily identifying CPO Members with pools that have been adversely impacted by a market or other event—"without being unduly burdensome."[44]

2. Guidance for Each Triggering Event

The Interpretive Notice provides guidance on each category of triggering event separately.

a. A Commodity Pool is Unable to Meet a Margin Call

(i) Routine Margin Calls

A commodity pool may experience a routine margin call that it may not be able to meet on the day of the call, but that it is able to meet within the time period imposed by its FCM or broker ("prescribed time period") by altering its portfolio or accessing other means to meet the call.[45]

A CPO Member is not required to file a notice if, on the day the pool receives a margin call, the CPO Member reasonably expects to meet the margin call within the prescribed time period.

However, once a CPO Member determines that one of its commodity pools will NOT be able to meet a margin call, including in situations where

the CPO Member disputes the amount or appropriateness of the margin call (other than as described below), the CPO Member must file the Rule 2-50 notice by 5:00 p.m. (CT) the following business day.

(ii) Disputed Margin Calls

Where the CPO Member disputes the amount and appropriateness of a margin call, the CPO Member is not required to file a notice if the commodity pool has sufficient assets to meet the greatest of the disputed amount.[46]

b. A Commodity Pool is Unable to Satisfy Redemption Requests—Redemption Terms of Subscription Agreement

In determining whether it is obligated to file a notice under this provision, a CPO Member should consider the terms of the pool's subscription agreement, including any grace period or other provisions that impact the timing of a redemption payment. Provided a CPO Member is able to meet a redemption request in accordance with the subscription agreement, no notice is required. The mere fact that a pool is unable to meet the request on the day received is not controlling. For example:

Grace Period. A pool may have securities that will mature within the grace period and can be used to satisfy the redemption.

Payment-in-Kind/Side Pockets. In some instances, a CPO Member may also be able to offer a participant a payment-in-kind or provide for the creation of a side pocket when dealing with illiquid investments.

However, once a CPO Member determines that a pool will not be able to meet a redemption request within the terms of the subscription agreement, the CPO Member must file a notice within the required time period, even if the grace period has not expired.

c. A Commodity Pool Halts Redemptions—Expected vs. Unexpected Redemption Halts

This category requires notice of the type of trading halt that is not expected or contemplated based on pool documents or in the ordinary course of business. For example, a CPO Member is not required to file a notice in the following instances:

Pre-determined gates or lock-ups. Trading halts in accordance with pool subscription agreements that identify pre-determined gates or lock-ups dependent on a base level of funding.

Ordinary course liquidation. A halt on redemptions until a final accounting can occur when the CPO Member decides to liquidate a pool in the ordinary course of business (i.e., not due to a market or other unexpected event).

However, a CPO Member is required to file a notice within the required time period when one of its pools unexpectedly halts redemptions, either temporarily or permanently, as a result of a market or other event that impacts the pool's ability to meet redemptions.

d. A Commodity Pool is Declared in Default by Swap Counterparty

(i) Reasonable Belief in Ability to Cure

This category requires a CPO Member to file a notice of a default notification where the CPO Member does not reasonably believe that the default can be cured within the contractual cure period. For example, a CPO Member may receive notification if one of its pools is in default to a

swap counterparty on a margin call, resulting in a deficit that the pool will not be able to cover or address by adding additional funds.

The Interpretive Notice specifies that a CPO Member must file notice within the required time period once the CPO Member is notified that a pool is in default to a swap counterparty and the CPO Member does not reasonably believe the pool can cure the default within the previously agreed to cure period.

(ii) Disregard of Negotiations or Dispute

In determining whether the CPO Member reasonably believes that it can cure the default within the cure period, and thus whether the reporting obligation applies, the CPO Member must disregard negotiations with the swap counterparty to liquidate positions or any dispute of the default notice. That is, the reporting obligation would arise regardless of the existence of such negotiations or dispute.

III. DESIGNING RULE 2-50 COMPLIANCE POLICIES AND PROCEDURES

A. Components of Rule 2-50 Compliance Policies and Procedures

For many (if not most) CPO Members, the occurrence of a triggering event will be rare, and that of a triggering event that constitutes a reporting event is rarer still. In addition, RIAs serving as CPOs for registered funds have SEC obligations with respect to certain events that may overlap with those covered by Rule 2-50 and will have procedures designed to comply with those SEC requirements.[47]

Nevertheless, CPO Members should have in place policies and procedures sufficient to ensure compliance with the Rule 2-50 notice filing requirement, should a triggering event that requires a notice filing occur. Such policies and procedures should be tailored to the particular circumstances of the pool and may take into consideration the likelihood of occurrence of any of the triggering events. They should address the following steps for each pool (including exempt pools) that the CPO Member operates:

Step 1—Identifying triggering events. Design and implement a mechanism for identifying the occurrence of a triggering event.

Step 2—Determination of whether a triggering event is a reporting event. Assign personnel and establish a process for conducting an immediate analysis of the circumstances surrounding the triggering event under the Interpretive Notice to determine whether it is a reporting event, including appropriate escalation procedures.

Step 3—Documentation of Step 2 determinations. Establish parameters and a process for documentation of the analysis performed under Step 2 that provides a reasonable basis for each determination that a triggering event was not a reporting event. Step 3 would be particularly important where the analysis under Step 2 involves subjective factors (e.g., whether there was a "reasonable belief" that the CPO could meet a margin call or cure a default in a timely manner), which may be viewed differently in hindsight and could subject the CPO Member to second-guessing.

Step 4—NFA Notification. Assign person-

nel and develop connectivity necessary to ensure that timely filings are made when required.

Step 5—Responding to NFA inquiries. Assign a contact person for receiving and appropriately escalating NFA inquiries relating to notices filed.

B. General Considerations

The components of a Rule 2-50 compliance program that are likely to be the most important, time-sensitive, and labor-intensive are Steps 2 and 3, described above. Once a triggering event has been identified, the CPO Member must garner and analyze the relevant facts, make the determination, and, if necessary, be prepared to file the Notice (with whatever information NFA requires) within a short period of time (one business day). Note that triggering events, if they occur at all, may be most likely to occur in times of general market stress when resources may be needed across a range of functions. In order to be most effective, documentation of this analysis should be completed as contemporaneously as possible, especially for any determination that a notice filing is not required.

To ensure that these components are both efficient and effective, firms may wish to consider the following suggestions.

1. Establishing Triage Parameters and Escalation Procedures

As indicated in the Interpretive Notice, some events that qualify as triggering events are clearly not reporting events based on objective criteria set forth in the Notice, while others require further analysis and subjective determinations. One approach to streamlining the process could involve creating a list of circumstances that, based on the Interpretive Notice, meet the objective criteria for not qualifying as reporting events, with an escalation process for those that require additional analysis.

In addition, different types of triggering events may require analysis by personnel from different functional groups. For example, for a triggering event that relates to a redemption halt where the issue is whether the halt is contemplated by subscription documents, personnel from legal may be appropriate. By contrast, where the triggering event relates to a margin call or default notice, and the determination rests on the CPO Member's financial ability to meet the call or cure the default, business and finance personnel are likely to have the relevant information. In order to ensure the appropriate determination and filing within the one business day timeframe, it may be helpful for compliance policies to identify the specific personnel or functional group responsible for each category of triggering events.

2. General Principles

As indicated above, the Interpretive Notice is intended to help identify triggering events that are not reporting events based on the purpose of the Rule. While the Interpretive Notice identifies some of these circumstances specifically, there may be others that fall within the purpose of the Interpretive Notice. In all cases, it may be helpful for compliance policies and procedures to include a section that sets out the purposes of the Rule as guidance for making and documenting the Step 2 determinations.

3. Further NFA Guidance

NFA has announced that it intends to conduct educational programs on the new Rule, and these

are likely to provide additional guidance on both the mechanics of the notice filing and the type of events that must be reported. These programs are likely to provide helpful information on how compliance programs can be efficiently and effectively developed.

CONCLUSION

The three developments covered are a mixed bag with respect to adding vs. reducing regulatory burdens. The first effectively reduces compliance burdens by providing clarity and alignment with practical developments. The second and third introduce new regulatory requirements. They all, to varying degrees, can be expected to have significant practical compliance implications for CPOs and CTAs, and merit careful attention to ensure that CPO and CTA policies and procedures match the underlying regulatory goals.

ENDNOTES:

[1]*See, e.g.,* Compliance Requirements for Commodity Pool Operators on Form CPO-PQR, 85 Fed. Reg. 71,772 (Nov. 10, 2020), https://www.federalregister.gov/d/2020-22874; Exemption from Registration for Certain Foreign Intermediaries, 85 Fed. Reg. 78,718 (Dec. 7, 2020), https://www.federalregister.gov/d/2020-23810; Registration and Compliance Requirements for Commodity Pool Operators and Commodity Trading Advisors: Prohibiting Exemptions Under Regulation 4.13 on Behalf of Persons Subject to Certain Statutory Disqualifications, 85 Fed. Reg. 40,877 (July 8, 2020), https://www.federalregister.gov/d/2020-12607.

[2]*But see CFTC's Market Participants Division Issues Updated Responses to Form CPO-PQR FAQs: What's New in the New FAQs?*, Stradley Ronon Client Alert (Aug. 18, 2021), available at https://www.stradley.com/insights/publications/2021/08/im-alert-august-18-2021.

[3]Notice to Members I-21-28 (Sept. 16, 2021), https://www.nfa.futures.org/news/newsNotice.asp?ArticleID=5403, advising Members of the amendment of NFA Interpretive Notice 9002—Registration Requirements: Branch Offices ("Branch Office Interpretation").

[4]Proposed Amendments to NFA's Interpretive Notice: Registration Requirements: Branch Offices (Aug. 23, 2021), https://www.nfa.futures.org/news/PDF/CFTC/082321-Proposed-Amendments-NFA-Interpretive-Notice-Registration-Requirements-Branch-Offices.pdf ("Branch Office Rule Submission Letter").

[5]*See id.*

[6]Notice to Members I-20-12 (Mar. 13, 2020), https://www.nfa.futures.org/news/newsNotice.asp?ArticleID=5214.

[7]*See* Branch Office Rule Submission Letter, *supra* note 4.

[8]*See* Branch Office Interpretation, *supra* note 3.

[9]*See* Notice to Members I-19-19 (Oct. 8, 2019); NFA Interpretive Notice 9019—Compliance Rule 2-9: Supervision of Branch Offices and Guaranteed (Jan. 1, 2020), https://www.nfa.futures.org/rulebook/rules.aspx?Section=9&RuleID=9019. The effective date of the change was January 1, 2020, but Members were permitted to rely on the change upon issue of the October 2019 Notice.

[10]NFA Notice to Members I-20-35 (Oct. 1, 2020), https://www.nfa.futures.org/news/newsNotice.asp?ArticleID=5287; NFA Notice to Members I-21-25 (July 19, 2021), https://www.nfa.futures.org/news/newsNotice.asp?ArticleID=5386 (extension of relief from the on-site annual inspection of branch offices and guaranteed IBs).

[11]Currently, FINRA Rule 3110(f) expressly excludes from the definition of branch office, an associated person's primary residence, provided the requirements of the rule are met. In March 2020, FINRA issued a Regulatory Notice to its member firms providing pandemic-related business continuity planning guidance and regulatory

relief, which addressed remote offices and telework arrangements, among other matters, and sounded regulatory themes similar to those recognized by NFA. The Notice stated that FINRA expects a member firm to establish and maintain a supervisory system that is reasonably designed to supervise the activities of each associated person while working from an alternative or remote location during the pandemic. The Notice also recognized that, with respect to oversight obligations, a member firm's scheduled on-site inspections of branch offices might need to be temporarily postponed during the pandemic. In addition, the Notice stated that member firms may find it helpful to test broad use of remote offices or telework arrangements by associated persons prior to activating their business continuity plans, in order to confirm connectivity with critical firm systems and assess the potential need for additional connectivity measures. FINRA also provided pandemic-related relief to FINRA member firms with respect to branch office compliance matters, including (1) temporarily suspending the need to update Form U4 information regarding office address for registered persons that temporarily relocated due to the pandemic and (2) granting relief from the need to file a branch office application on Form BR for newly opened temporary office locations established as a result of the pandemic. *See* FINRA Regulatory Notice 20-08 (March 9, 2020), https://www.finra.org/rules-guidance/notices/20-08.

[12]NFA and the NIBA Joint Webinar: Supervision in a Hybrid Environment, December 7, 2021, https://www.nfa.futures.org/members/member-resources/files/supervision-hybrid-environment.html; NFA and the NIBA Joint Webinar: Navigating Regulatory Requirements in a Hybrid Environment, September 23, 2021, https://www.nfa.futures.org/members/member-resources/files/webinar-nav-reg-req-hybrid-environment.html.

[13]*See* NFA Interpretive Notice 9079, NFA Compliance Rules 2-9 and 2-36: Members' Use of Third-Party Service Providers (effective Sept. 30, 2021), https://www.nfa.futures.org/rulebook/rules.aspx?Section=9&RuleID=9079 ("Notice"). *See also* NFA Notice to Members I-21-13, Effective Date for Interpretive Notice regarding Members' Use of Third-Party Service Providers (Mar. 24, 2021), https://www.nfa.futures.org/news/newsNotice.asp?ArticleID=5342; Rule Submission to the CFTC, Proposed Interpretive Notice entitled NFA Compliance Rules 2-9 and 2-36: Members' Use of Third-Party Service Providers (Feb. 26, 2021), https://www.nfa.futures.org/news/PDF/CFTC/022621-ProposedInterpNoticeCRs2-9and2-36-MembersUse3rdPartyServiceProviders.pdf ("Rule Submission").

The Notice also applies to other NFA Member categories, i.e., FCMs, introducing broker ("IBs"), swap dealers ("SDs"), major swap participants ("MSPs") and forex dealers. However, for purposes of this article, we have focused on application of the Notice to CPOs and CTAs.

[14]All of these materials are available on NFA's website. *See* NFA Self-Examination Questionnaire—Use of Third-Party Service Providers, https://www.nfa.futures.org/members/member-resources/files/self-exam-files/self-exam-questionnaire.pdf; Appendix E—Use of Third-Party Service Providers Questionnaire, https://www.nfa.futures.org/members/member-resources/files/self-exam-files/self-exam-questionnaire-appendix-e.pdf; NFA 2021 Virtual Member Regulatory Workshops, Segment: "Member Outsourcing to Third Parties," https://www.nfa.futures.org/members/member-resources/files/2021-regulatory-workshop.html.

[15]*See* Notice, *supra* note 13, at n.8.

[16]*See id.*, text accompanying n.6.

[17]*See* "Use of Administrators" section of NFA Interpretive Notice 9074, NFA Compliance Rule 2-9: CPO Internal Controls System (effective Apr. 1, 2019), https://www.nfa.futures.org/rulebook/rules.aspx?RuleID=9074&Section=9.

[18]*See* Notice, *supra* note 13, at n. 1.

[19]*See infra* Section II.B.2.f.

[20]The fact that a Member's outsourcing of a function is implemented through a contract between the Service Provider and another entity in the Member's organization does not take the relationship outside of the Notice's requirements. The Notice states that a Member should comply with the Notice's requirements "even if a Mem-

ber outsources a regulatory obligation to . . . a Third-Party Service Provider with an existing contractual relationship with the Member's parent entity." Notice, *supra* note 13, at n. 1.

[21]*See supra* note 14, Appendix E—Use of Third-Party Service Providers Questionnaire.

[22]In the same vein, the questions under "Ongoing Monitoring" include, among others: "What and how often does the firm review to ensure the [Service Provider] is adequately performing the outsourced function?" and "Does the firm require the third party to provide notice if a key employee with access to the Member's information is terminated and ensure the individual's access to this information has been removed?"; the questions under "Termination" include, among others: "Does the written agreement with the [Service Provider] require they give sufficient notice prior to terminating its relationship with the Member?"

[23]*See supra* note 14, NFA 2021 Virtual Member Regulatory Workshops.

[24]*See* Notice, *supra* note 13, at n.5.

[25]*See id.* at n.2. NFA cites several examples of such previous notices. *See, e.g.*, NFA Interpretive Notice 9037, NFA Compliance Rules 2-9, 2-10, 2-29 and 2-39: Guidance on the Use and Supervision of Websites, Social Media and Other Electronic Communications (Aug. 19, 1999; rev'd, Jan. 1, 2020), https://www.nfa.futures.org/rulebook/rules.aspx?Section=9&RuleID=9037; NFA Interpretive Notice 9046, Compliance Rule 2-9: Supervision of the Use of Automated Order-Routing Systems (June 21, 2002; rev'd, Dec. 12, 2006), https://www.nfa.futures.org/rulebook/rules.aspx?Section=9&RuleID=9046; Interpretive Notice 9055, NFA Bylaw 1101, Compliance Rules 2-9 and 2-29: Guidelines Relating to the Registration of Third-Party Trading System Developers and the Responsibility of NFA Members for Promotional Material That Promotes Third-Party Trading System Developers and Their Trading Systems (effective Jan. 10, 2005), https://www.nfa.futures.org/rulebook/rules.aspx?Section=9&RuleID=9055; NFA Interpretive Notice 9070, NFA Compliance Rules 2-9, 2-36 and 2-49: Information Systems Security Programs (effective Mar. 1, 2016), https://www.nfa.futures.org/rulebook/rules.aspx?Section=9&RuleID=9070.

[26]*See* Notice at n.8.

[27]*See* NFA Interpretive Notice 9070, *supra* note 25; Notice, *supra* note 13, at n.9.

[28]*See* Notice, *supra* note 13, at n.10.

[29]*See supra* Section II.B.2.c; *infra* Sections II.B.3.b, II.B.4.a.

[30]*See* Notice, *supra* note 13, at n.1. Bylaw 1101 generally prohibits Members from doing business with persons that are not registered with the CFTC, if the person's activities require such registration.

[31]*See* Notice, *supra* note 13, at n.14.

[32]The Notice does not explain what "best practices" means in this context, and this particular guidance is phrased as something that Members should consider. Note, however, that the NFA Service Provider Questionnaire specifically asks whether the firm incorporates best practices with respect to contract renewals.

[33]*See* Notice, *supra* note 13, at n.15. Note that such a notification provision would be appropriate for consideration in connection with the guidance on written agreements. *See supra* Section II.B.2.d. In addition, the NFA Service Provider Questionnaire includes a question about terminated employees in the "Ongoing Monitoring" section of the Questionnaire.

[34]NFA Compliance Rule 2-10 generally requires Members (a) to maintain adequate books and records necessary and appropriate to conduct their business including, without limitation, the records required to be kept under CFTC Regulations 1.18, 1.32 through 1.37, and 1.71 for the period required under CFTC Regulation 1.31 and (b) to 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. The Notice also refers to NFA Compliance Rule 2-49, which is specific to SDs and MSPs.

[35]*See supra* Sections II.A.3, II.A.4.

[36]The Notice also recommends as additional guidance that Members may want to consider incorporating relevant standards and guidelines, including, but not limited to, those set out in the National Institute of Standards and Technology ("NIST") SP-800 series of publications, https://csrc.nist.gov/publications/sp800; the International Organization of Securities Commissions' ("IOSCO") 2005 report Principles on Outsourcing of Financial Services for Market Intermediaries, https://www.iosco.org/library/pubdocs/pdf/IOSCOPD187.pdf; and the Federal Financial Institutions Examination Council ("FFIEC") IT Examination Handbook sections on outsourcing, https://ithandbook.ffiec.gov/it-booklets/outsourcing-technology-services.aspx.

[37]*See supra* Section II.A.9.

[38]*See* Notice at n.3, 7.

[39]*See* "Use of Third-Party Service Providers" section of NFA Self-Examination Questionnaire; *supra* note 14.

[40]*See* NFA Compliance Rule 2-50: CPO Notice Filing Requirements; NFA Notice to Members I-21-15, Effective date for NFA rules establishing CPO notice filing requirements (April 13, 2021), https://www.nfa.futures.org/news/newsNotice.asp?ArticleID=5346; Proposed NFA Compliance Rule 2-50 and related Interpretive Notice entitled NFA Compliance Rule 2-50: CPO Notice Filing Requirement (March 8, 2021) ("Rule Submission Letter"), https://www.nfa.futures.org/news/PDF/CFTC/Proposed-CR-2-50-and-Interp-Notc-CPO-Notice-Filing-Requirements.pdf.

[41]*See* NFA Interpretive Notice 9080—NFA Compliance Rule 2-50: CPO Notice Filing Requirements, https://www.nfa.futures.org/rulebook/rules.aspx?Section=9&RuleID=9080 ("Interpretive Notice"); Rule Submission Letter, *supra* note 40.

[42]*See* Rule Submission Letter, *supra* note 40, at 4. NFA recognizes that CPO Members are currently required to report some of these events to NFA in a PQR filing or pool annual report. However, those reports would not cover all the events and do not provide NFA with information on a current basis. *See* Interpretive Notice, supra note 41, at n.1.

[43]While exempt pools are not mentioned in either the Rule itself or the Interpretive Notice, the Rule Submission Letter makes clear that the scope of the Rule includes events occurring in exempt pools operated by CPO Members:

> Compliance Rule 2-50 applies to circumstances that occur in an exempt pool operated by an NFA Member CPO, which is consistent with the application of NFA Compliance Rule 2-45. NFA's Board determined this application was appropriate given that the regulatory policy of the rule is to assist NFA with its oversight of CPO Members and their pools during times of extreme market stress. In particular, the Board determined that this information would be useful especially in situations where an exempt pool was unable to meet a margin call issued by an NFA Member FCM or was defaulting on a swap with another NFA Member.

Rule Submission Letter, *supra* note 40, at 5. Note however that Rule 2-50 applies only to CPOs that are NFA Members, so that fully exempt Non-NFA Member CPOs and their exempt pools are not subject to the Rule.

[44]*See* Rule Submission Letter, *supra* note 40, at 5. While the Interpretive Notice gives a number of specific examples of triggering events in each category that will not require a notice filing, the Notice also describes the principles underlying these examples, indicating that there may be additional circumstances not specifically identified that would not require reporting based on appropriate application of these principles.

[45]Note that the Interpretive Notice does not define the term "routine" margin call, other than to refer to margin calls that the CPO is able to meet on a timely basis, within the prescribed time period.

[46]*See* Interpretive Notice at n.2.

[47]Under Section 22(e) of the ICA, registered funds that offer redeemable securities generally must honor redemption requests within seven calendar days, except (1) when the New York Stock Exchange is closed or has restricted trading (other than customary weekend and holiday closings), (2) for any period during which an emergency exists as a result of which disposal by

the fund of securities owned by it is not reasonably practicable, or it is not reasonably practicable for the fund fairly to determine the value of its net assets, or (3) for such other periods as the SEC may by order permit for the protection of the fund's security holders. Thus, a registered fund that cannot timely satisfy redemption requests may have to contact the SEC to seek an appropriate order. In addition, a registered fund must file a report to the SEC on Form N-RN within one business day if more than 15% of its net assets are illiquid, as determined under SEC Rule 22e-4.