



Preparing for an NFA Examination: Issues for UK Fund Managers Registered as CPOs or CTAs

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Overview

- **The Process**
- **Exam Preparation**
- **Managing the Examination**
- **Common Deficiencies**

The Process

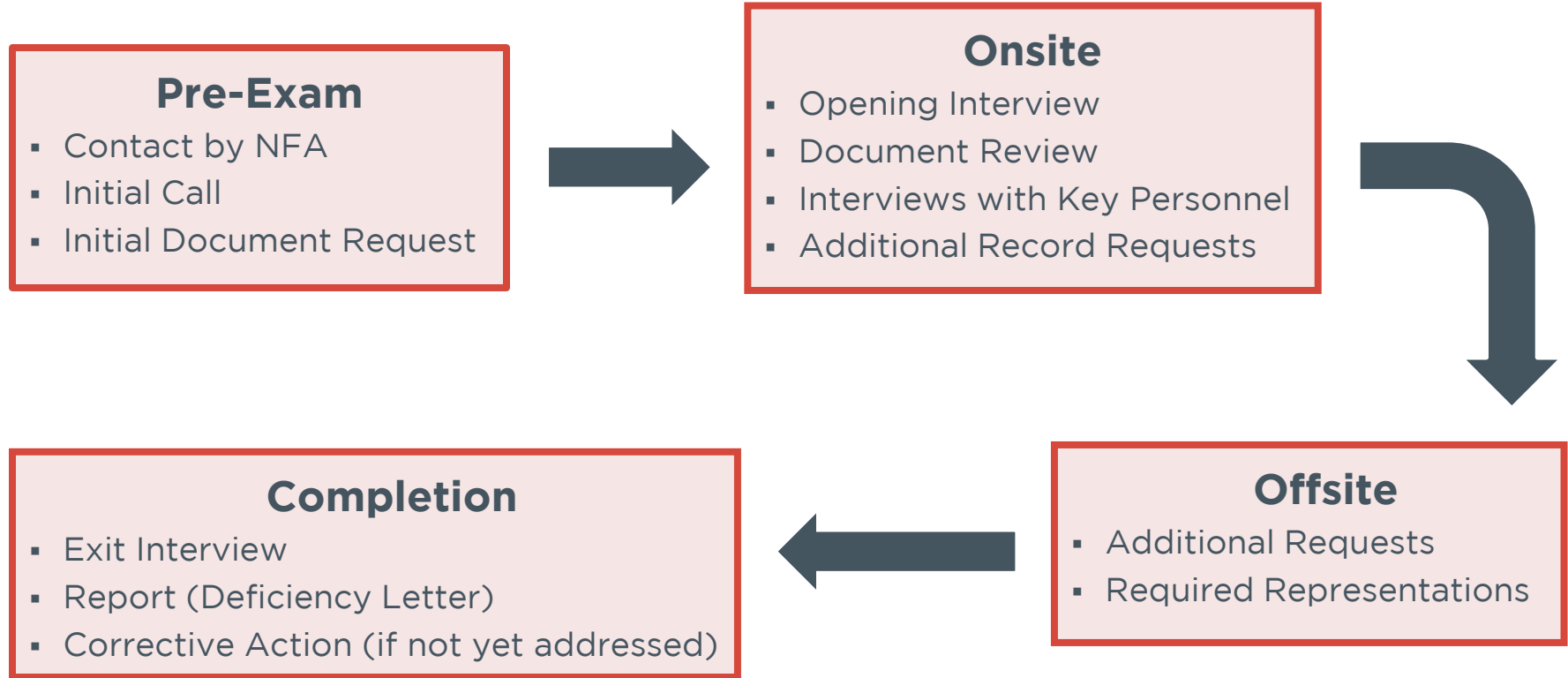
Exam Selection

- **Who Is impacted?**
 - Registered CPOs and CTAs that are NFA Members
 - Generally with at least one non-exempt fund
- **Recent Trends**
 - Influx of new registrants since 2013
 - Expansion of NFA examination staff
 - Increase in examinations in 2015
- **Selecting Members for Exams**
 - NFA attempts to examine CPOs/CTAs every 3-5 years
 - Influx of new registrants who have not been examined yet; using risk factors to determine who to examine and what to focus on

Possible Selection Factors

- **Assets Under Management; Non-Exempt Funds**
- **CPO-PQR and CTA-PR Data**
 - Unusual investments (or loans)
 - Leverage
 - AUM
 - Performance (volatile returns or too consistent)
- **Previous ‘Bad Acts’**
 - Recent actions taken by other agencies
 - Customer complaints
 - Principals/APs with previous history

NFA Exam Process



Exam Preparation

The 'First Day Presentation'

- **Investment Program/Business Strategy Overview**
 - Focus on "narrowing" the scope of investments and activity
- **Firm and Individual Registrations and Exemptions**
- **Organizational Charts**
 - Entities and personnel/departments/functions
 - Break out marketing functions for NFA exams
- **Address key Controls /Identify Key Personnel**
 - CFTC/NFA policy compliance
 - Financial controls
 - Risk management
- **Arrange for Key People to Participate**
- **Keep Brief (Under an Hour) and High-Level**

Self-Assessments

- **Mock Audits/Self-Examination Checklist**
 - NFA Compliance Rule 2-9
 - Confirm answers to relevant questions
 - Keep records of signed attestations for each year (must review checklist for each entity that is registered; keep multiple copies)
 - Written responses to questions
 - Be prepared to discuss responses
 - Rectify deficiencies

Self-Assessments (2)

- **Review of Firm CFTC Compliance Manual**
 - Confirm compliance with stated policies
 - Review for “missing” policies

Managing the Exam

Nuts and Bolts

- **Physical Environment**
- **Facility Access**
- **Instructions to Employees**
- **Presence of Key Personnel**
- **Support Services (Copying, Telecom, etc.)**
- **Having Documents Readily Available and Preparing to Respond to Document Requests**

Document Production

- **Handling Confidentiality Requests**
 - FOIA requests (SEC vs NFA)
- **Redact PII (Personally Identifiable Information) Unless Otherwise Requested**
- **Timely Responses/Fast Turnaround**
 - Open communication if delays anticipated
- **Tracking Produced Documentation**
 - Bates stamping? (likely all electronic today)
- **Creation of New Documents?**
 - If it will streamline process, discuss with examiners
- **Negotiation of Certain Requests**

The Exam and Common Deficiencies

Areas of Focus

- **Risk Management**
- **Ledger and Cash Management**
- **Policies and Procedures; Compliance Program**
- **Investor Information (Subscription Documents)**

Areas of Focus (2)

- **Registration of Associated Persons**
 - All individuals who solicit
 - Up the chain
 - Branch offices
- **Listing Principals**
 - Looking through complex ownership structures
- **Promotional Material**
 - Review and approval process
 - Appropriate disclosures and balanced presentation
- **Supervision**
 - Supervising traders, solicitors
 - Branch office supervision

Areas of Focus (3)

- **Disclosures and Performance**
 - PPM disclosures
 - Performance reporting (PQR/PR, quarterly statements)
 - Financial reporting and valuation of assets
- **Trading**
 - CTAs quarterly review of bunched orders procedures
 - Trade errors

Areas of Focus (4)

- **Bylaw 1101**

- Who

- Futures relationships (i.e., FCMs, prime brokers)
 - Investors

- What

- Does the account appear to require registration?
 - If not, why not (exemption, offshore)?
 - If yes, why, and is it registered?
 - Annually, review exempt entities (exemption affirmation); copy of no-action submission
 - Necessary steps to take

Areas of Focus (5)

- **NFA Rule 2-45: Prohibition on Pools Loaning Money to the CPO or an Affiliate**
 - Permissible transactions
 - Securities borrowings
 - Securities loans for cash financing
 - Guarantee obligations
 - Wholly-owned subsidiaries
 - Repos and reverse repos
 - Tax-related distributions
 - Increased interest in any loans
 - Advances to investment manager

Common Deficiencies

- **Registration**

- Unlisted principals and branch offices; unregistered APs; APs not terminated
- Failing to update registration records

- **Reporting**

- Incomplete quarterly statements; statements not sent

- **Supervision**

- Failure to review promotional materials
- Failure to appropriately supervise branch office
- Handling pool funds

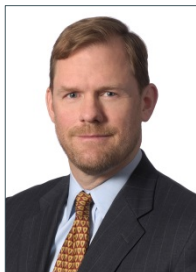
Common Deficiencies (2)

- **Operations Inconsistent with Disclosure**
 - Fees
 - Redemptions
 - Trading strategy
 - Conflicts of interest
- **Performance Recordkeeping**
 - Verifying performance information sent to investors
 - Verifying performance information in promotional materials

Possible Enforcement Referral Topics

- **Financial Integrity**
 - Account statement issues
 - Pool loans and advances
- **Manipulation**
 - Spoofing
 - Wash trades
 - EFRPs
 - Position limits
- **Late Filings**
 - Required filings
 - Claims for exemption

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