

January 21, 2015 -- [Peter Rawlings](#)

NFA Eyes Firms' Compliance Cultures [UPDATED]

National Futures Association staffers will be paying special attention to firms' cultures of compliance—as well as issues related to valuation, liquidity and cyber security—when they examine members in the coming months.

A primary aim of the self-regulatory organization's examiners is to understand the controls at a given firm and how that firm goes about managing the risks specific to it, **Regina Thoele**, NFA's senior v.p. for compliance, told attendees at a recent **Practising Law Institute** event in New York. Inspectors will seek to do this by looking at a firm's governance structure and assessing how seriously its employees take their compliance obligations, she said.

One of the key ways that a "culture of compliance is reflected is in who attends the opening interview," Thoele said. The attendance of all of a firm's top executives, as well as those leading its compliance efforts, at the initial meeting with regulators indicates that the firm places a high value on compliance, she added.

In this respect, NFA's approach to exams differs from that of the **Securities and Exchange Commission**, whose inspectors tend to be most interested in speaking with the top compliance person at a given firm, **Schulte Roth & Zabel** Partner **Brian Daly** said on the same panel. By contrast, "NFA tends to very much appreciate having the exact executive who runs each function come into the meeting," he said.

Exam Modules

As NFA examiners try to assess a member's culture of compliance, inspectors will seek "to gain a thorough understanding of the background of key personnel, including education, work experience and disciplinary background," NFA Managing Director of Compliance **John Brand** told *Compliance Reporter* later. "NFA is concerned about any disciplinary and criminal history, not just those occurring in the futures space."

NFA exam modules also ask the SRO official concerned to gain a thorough understanding of a member's governance structure, Brand said. "Good governance can set a framework for ensuring that the firm adheres to accepted ethical standards [and] best practices, promotes a culture of compliance and helps the member navigate industry rules and regulations," he said. "We are also interested in understanding how the firm makes business decisions, where decision-making authority sits and how reporting lines are structured."

Examiners are also "seeking to understand the quality of a firm's internal control environment, which we believe to be a key indicator of a firm's culture of compliance," Brand added. "Our examination programs are designed to evaluate the quality of controls in the many different areas we test."

Early Prep

The ability of firms to demonstrate their culture of compliance has of late become more important than ever, **Ropes & Gray** Partner **Deborah Monson** told *Compliance Reporter*. "They are asking more about internal controls and that sort of thing than they [have] historically."

The key to demonstrating a strong compliance culture to NFA examiners is advanced preparation, Monson advised. Most NFA inspections begin with a phone call roughly two weeks before the start of the exam, followed by questionnaires and document requests the firm needs to complete before officials arrive on site, she explained. The pre-visit questionnaire is a relatively recent development for NFA exams. The follow-up document request letter tends to ask about issues such as ethics training, financial records, due diligence of service providers, promotional materials and risk management, among other topics, she said.

"You have to be able to do very quick turnaround and advanced preparation" to ensure records can be made promptly available, Monson said. "Demonstrating compliance culture is one of those things that can really pay off...[If] you make the right impression it helps put examiners in a more amenable frame of mind."

Thoele echoed this sentiment at the conference, emphasizing that a good way for chief compliance officers to demonstrate their firms' commitment to compliance is ensuring that all the documents requested by examiners are readily available. Many firms keep documents with a third-party administrator and NFA exam teams have had issues in the past with delays in retrieval—to the extent that in some cases the SRO has brought administrative actions against firms it alleged took too long to comply with document requests.

Even if documents are held elsewhere, CCOs should be mindful that it is always the firm's responsibility be able to supply documents in a "timely fashion," she cautioned.

"Another element of demonstrating a culture of compliance, besides having a really robust program that is tested and updated, is [to check if] there have been any findings in the past, and to make sure they have been satisfactorily addressed," Monson said. That includes deficiencies that came up in other regulatory exams, such as those conducted by the SEC, because NFA examiners will often ask to see the agency's findings letter if the firm has been audited recently, she said.

Valuation, Liquidity, Cyber

In addition to focusing on members' compliance-related cultures, NFA has concerns about how firms value their assets, Thoele said. The SRO is "seeing a lot more variety of investments, with things like real estate and structured investments" making up a greater share of members' portfolios, she said. Examiners will be scrutinizing firms' valuations policies and procedures with an eye to ensuring that a consistent method is used from quarter to quarter.

"Liquidity risk is another key area," Thoele said. NFA is keeping close tabs on both pools' quarterly reports and the energy markets for warning signs that firms will run short of liquid assets, she said. In cases where such issues come up, examiners in the field will also want to see how firms would handle redemption requests that could potentially exceed a pool's available liquid assets, she added.

NFA also continues to have a "maniacal focus" on Bylaw 1101, and CCOs need to ensure their firms are in compliance, added Daly. That rule, which has caused headaches for many NFA members, prohibits firms from doing business with non-members that are supposed to be registered with the **Commodity Futures Trading Commission**, but aren't (Complianceintel.com, 2/4/2013). In order to comply, firms need to reach out to their investors to ensure they have either registered or else affirmed their exempt status with regulators.

In addition, NFA will be looking at cyber security in the year ahead, Brand added. "Every regulator is currently thinking about this, and in the coming year we're engaging in our own fact finding effort. That will include a few things, such as seeking an understanding as to what existing cyber security practices are and considering what should be the best practices in this space."

