

CLIENT MEMORANDUM

NFA Proposes Reporting of Financial Ratios for CPOs and CTAs

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AUTHORS

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National Futures Association recently filed with the Commodity Futures Trading Commission a proposed amendment to NFA Rule 2-46 and an accompanying proposed Interpretive Notice.¹ If approved by the CFTC, the proposed amendments would generally require each registered commodity pool operator and commodity trading advisor to report certain financial ratios directed at reflecting the financial condition of the CPO or CTA.

Background

In January 2014, in the wake of a series of events involving shortfalls in certain commodity pools, NFA published a Notice to Members in which it requested comments on ways to provide greater protection for customer funds. At the time, NFA was contemplating, among other things, imposing a minimum capital requirement on CPOs and CTAs.² Rather than introducing a capital requirement, NFA has proposed gathering financial ratios on Forms PQR and PR.

¹ The proposed amendment and proposed Interpretive Notice can be found [here](#).

² For more information, please see our client memorandum entitled [NFA Contemplates Capital Requirements for CPOs and CTAs](#), dated January 24, 2014.

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Proposed Amendments

NFA Rule 2-46 generally requires a registered CPO or CTA with reporting requirements under CFTC Rule 4.27 to file Form PQR or PR, respectively, on a quarterly basis. Forms PQR and PR collect certain general identifying information regarding the CPO or CTA, as well as specific information on the pools operated by the CPO and the assets directed by the CTA.

Financial Ratios

If the proposed amendment is approved, each CPO and CTA generally would have to report two financial ratios: (i) current assets/current liabilities (the “Assets/Liabilities Ratio”) and (ii) total revenue/total expenses (the “Revenue/Expense Ratio”).³ The Assets/Liabilities Ratio is meant to measure a firm’s liquidity, and is computed as of the end of the reporting quarter. The Revenue/Expense Ratio is meant to measure a firm’s operating margin, and is computed based on revenues and expenses during the prior 12 months.

A CPO or CTA that is part of a holding company/subsidiary structure may elect to report the ratios at the parent level. However, the CPO or CTA will have to indicate on its Form PQR or Form PR, as applicable, whether the firm is reporting on the parent/holding company or the subsidiary.

Recordkeeping

Each CPO and CTA would have to maintain records that support the ratio calculations. Such records would be subject to inspection by NFA during an examination or upon request.

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³ The two financial ratios would generally be computed using the accrual basis of accounting and in accordance with U.S. generally accepted accounting principles or another internationally recognized accounting standard, consistently applied.