**Futures Industry Association**
2001 Pennsylvania Ave. NW
Suite 600
Washington, DC 20006-1823
202.466.5460
202.296.3184 fax
www.futuresindustry.org

**By Electronic Mail**

**February 20, 2009**

Ms. Marcia E. Asquith
Office of the Corporate Secretary
Financial Industry Regulatory Authority
1735 K Street, NW
Washington, DC 20006-1506

**Re: Proposed Rule to Establish a Leverage Limitation for Retail Forex Regulatory Notice 09-06**

Dear Ms. Asquith:

The Futures Industry Association ("FIA") welcomes the opportunity to submit these comments on the Financial Industry Regulatory Authority's ("FINRA's") proposed Rule 2380, which would establish a leverage limitation on over the counter ("OTC") foreign currency transactions "initiated" by a FINRA member for a retail customer.[1] FIA is a principal spokesman for the commodity futures and options industry. FIA's regular membership is comprised of approximately 30 of the largest futures commission merchants ("FCMs") in the United States, the majority of which are either registered with the Securities and Exchange Commission as broker-dealers or are affiliates of registered broker-dealers.[2] These broker-dealers are members of FINRA and, therefore, may be affected by the proposed rule.

FIA shares FINRA's interest in ensuring adequate protection for retail customers that engage on OTC foreign currency transactions. Nonetheless, we respectfully oppose adoption of the proposed rule. By proposing to set a leverage limitation far lower than market convention and, as important, far lower than the amount necessary to assure the financial integrity of the transaction, the proposed rule appears to have been designed for the sole purpose of

---

[1] For purposes of this proposal, a "retail customer" is a customer that does not meet the definition of an "eligible contract participant" ("ECP") as set forth in section 1a(12) of the Commodity Exchange Act, as amended ("CEA").

[2] Among FIA's associate members are representatives from virtually all other segments of the futures industry, both national and international. Reflecting the scope and diversity of its membership, FIA estimates that its members effect more than eighty percent of all customer transactions executed on United States contract markets.

prohibiting registered broker-dealers and, perhaps their affiliates, from entering into OTC foreign currency transactions with any person that is not an eligible contract participant ("ECP"), as defined in section 1a(12) of the Commodity Exchange Act, as amended ("CEA").[3]

Permitted leverage in connection with OTC foreign currency transactions involving non-ECP customers generally ranges from approximately 10:1 to 100:1, but could be higher or lower.[4] These ratios are established by the relevant foreign currency dealer based on the dealer's assessment of the credit worthiness of the customer and the expected volatility of the subject currency, among other factors.[5] By proposing to set a leverage limitation that is so much lower than market convention, FINRA must know that the proposed rule effectively prohibits broker-dealers from offering OTC foreign currency transactions to their customers by denying them the ability to offer a product that is competitive with the products offered by other permitted counterparties.

By proposing this rule, therefore, FINRA would substitute its judgment for the judgment of the US Congress, which twice determined that, subject to the provisions of section 2(c)(2)(B) of the CEA, non-ECP customers may effect OTC foreign currency transactions. In this regard, we emphasize that, in enacting the Commodity Futures Modernization Act of 2000, Congress specifically determined that broker-dealers and certain of their associated persons could be permitted counterparties in OTC foreign currency transactions with non-ECP customers. In further amending section 2(c) of the CEA in 2008, Congress made no substantive change in the provisions relating to broker-dealers and their associated persons.[6] Where Congress has made its position clear, we submit that FINRA should not be using regulatory action to supersede Congressional clarity.

FIA strongly supported the amendments to section 2(c) of the CEA adopted in 2008, which closed certain regulatory gaps that became evident after the enactment of the Commodity Futures Modernization Act of 2000 and strengthened the Commodity Futures Trading Commission's ("CFTC's") regulatory authority over the offer and sale of OTC foreign

---

[3] As proposed, a FINRA member would be prohibited from permitting a customer to "initiate" any foreign currency transaction with a leverage ratio greater than 1.5:1. The term is vague and could, for example, be interpreted to prevent a broker-dealer from referring a customer to an affiliated bank for purposes of executing an OTC foreign currency transaction. If FINRA elects to go forward with the proposed rule, it should clarify the rule's expected reach.

[4] As FINRA is also aware, the National Futures Association requires its forex dealer members to collect a security deposit from its retail foreign currency customers in an amount equal to at least one percent of the notional value of the transaction in the case of major currencies and four percent in the case of non-major currencies. It is not our position that FINRA must adopt the identical leverage requirements as NFA, although we would encourage FINRA to coordinate with NFA.

[5] We also want to emphasize our belief that the primary purpose of leverage requirements should be to assure the financial integrity of the transaction and, secondarily, to protect customers. FINRA's conduct rules, discussed below, should be the primary vehicle through which customers are protected.

[6] Title XIII, Farm, Conservation and Energy Act of 2008.

currency transactions to retail customers. Among other things, these amendments substantially increased the minimum adjusted net capital requirement for FCMs and other foreign currency dealers subject to the CFTC's jurisdiction. The current minimum capital requirement is $15 million, increasing to $20 million in May 2009.

Based on our conversations with NFA senior staff, we understand that the 2008 amendments, in particular, the significant increase in the minimum net capital requirement for FCMs and other OTC foreign currency dealers subject to the CFTC's authority, have been successful in causing less well-capitalized foreign currency dealers to withdraw from registration with the Commission and as members of NFA. This has been accomplished without affecting the ability of better capitalized FCMs and dual-registered FCM/broker-dealers to continue to provide appropriate foreign currency services to their customers.

In Regulatory Notice 09-06 and, earlier, in Regulatory Notice 08-66, issued in November 2008, FINRA made clear its concern that certain of the foreign currency dealers previously registered with the CFTC may choose to apply for registration as a broker-dealer or purchase an existing broker-dealer in order to continue acting as an OTC foreign currency dealer in a seemingly less-regulated environment. FIA appreciates this concern and FINRA's interest in assuring adequate protection of customers that may elect to enter into OTC foreign currency transactions. However, FINRA already has the regulatory tools in place necessary to adequately protect customers.

In Regulatory Notice 08-66, FINRA noted that NASD Rule 2110, which requires member firms to observe high standards of commercial honor and just and equitable principles of trade, would apply to broker-dealers engaging in OTC foreign currency transactions. For more detailed guidance of their obligations to retail foreign currency customers under this rule, FINRA directed member firms to NFA's rules governing its foreign currency dealer members.

Regulatory Notice 08-66 then sets out a litany of actions that would constitute a violation of Rule 2110, including: (i) failing to disclose that the firm is acting as a counterparty to a transaction; (ii) failing to adequately disclose the risks of trading in foreign currency; (iii) failing to disclose to customers the risks and terms of leveraged trading; (iv) soliciting business for and introducing customers to a foreign currency dealer without doing adequate due diligence of the foreign currency dealer, or in a way that misleads the customer about the foreign currency dealer or foreign currency trading, including how customer funds will be held; and (v) failing to conduct due diligence into any solicitors that introduce foreign currency customers to the firm, and failing to supervise any unregistered solicitors or agents of the firm.

As is evident from the above, FINRA's existing regulatory requirements appear to be more than sufficient to protect OTC foreign currency non-ECP customers, without affecting the ability of better capitalized broker-dealers to continue to provide foreign currency services to their customers. In this regard, FINRA's suggestion that trading in foreign currencies is more speculative or more volatile than trading in other products, including, for example, securities

and real estate, is not justified. In each instance, however, it is critical, as FINRA's rules already require, that customers are provided sufficient information regarding the potential risks of the particular transaction and that the customer is not misled in any way about the nature of the transaction and its attendant risks.

We further note that many broker-dealers provide services to high net worth individuals, small businesses and investment entities, many of which may not have the assets necessary to be considered ECPs. These customers may want to enter into foreign currency transactions to hedge or otherwise manage the foreign currency exposure of international securities investments or other business transactions or in connection with a diversified investment portfolio. The proposed leverage of 1.5:1 would make the cost of such transactions prohibitive, causing the customer to forego the transaction entirely or effect such transaction with another permitted counterparty. The rules governing the sales practices and related activities of these permitted counterparties may be more or less stringent than FINRA's existing rules governing the conduct of member firms. In any event, this counterparty may not appreciate the customer's circumstances as fully as the customer's broker-dealer. Neither alternative, therefore, is in the best interest of the customer.

If FINRA nonetheless concludes that more regulation is necessary, we encourage FINRA to coordinate its activities with other affected regulatory bodies. As noted earlier, permitted counterparties in OTC foreign currency transactions with non-ECP customers include financial institutions and FCMs, as well as the material associated persons of broker-dealers and FCMs, among others. To the extent that any one regulator or self-regulatory organization identifies activities that adversely affect the protection of customers or the financial integrity to transactions, these activities should be addressed on a coordinated basis to protect against regulatory arbitrage and the imposition of conflicting regulatory obligations on dual registrants.

**Conclusion**

For all of the above reasons, FIA respectfully requests that FINRA withdraw proposed Rule 2380. The FIA stands ready to work with you as FINRA continues to consider the appropriate oversight of retail forex transactions.

Sincerely,

John M. Damgard
President

cc: Gary Goldsholle, Vice President and Associate General Counsel
Matthew E. Vitek, Counsel