

February 23, 2009

Via Federal Express

Mr. David A. Stawick
Office of the Secretariat
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, DC 20581

Re: National Futures Association: Alternative Net Capital Requirement for
Forex Dealer Members - Proposed Amendments to NFA Financial
Requirements Section 11 and Interpretive Notice Regarding Forex
Transactions*

Dear Mr. Stawick:

Pursuant to Section 17(j) of the Commodity Exchange Act, as amended, National Futures Association ("NFA") hereby submits to the Commodity Futures Trading Commission ("CFTC" or "Commission") proposed amendments to NFA Financial Requirements Section 11 and the Interpretive Notice regarding Forex Transactions. This proposal was approved by NFA's Board of Directors ("Board") on February 19, 2009. NFA respectfully requests Commission review and approval of the proposed amendments.

PROPOSED AMENDMENTS

(additions are underscored and deletions are ~~stricken through~~)

FINANCIAL REQUIREMENTS

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SECTION 11. FOREX DEALER MEMBER FINANCIAL REQUIREMENTS.

(a) Each Forex Dealer Member must maintain "Adjusted Net Capital" (as defined in CFTC Regulation 1.17) equal to or in excess of the greatest of:

- (i) \$10,000,000 through January 16, 2009, \$15,000,000 from January 17, 2009 through May 15, 2009, and \$20,000,000 from May 16, 2009 forward;
- (ii) the amount required by subsection (a)(i) above plus 5% of all liabilities owed to customers (as defined in Compliance Rule 2-36(i)) exceeding \$10,000,000, except that any Forex Dealer Member that uses straight-through-processing for all customer transactions is not subject to this requirement; or
- (iii) For FCMs, any other amount required by Section 1 of these Financial Requirements.

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INTERPRETIVE NOTICES

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FOREX TRANSACTIONS

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C. OTHER REQUIREMENTS

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2. Financial Requirements Section 11(a)

Forex Dealer Members must maintain adjusted net capital equal to or in excess of the greatest amount specified in subsections (a)(i), (a)(ii), and (a)(iii) (if applicable). Subsection (a)(ii) applies to Forex Dealer Members that execute any customer transactions other than by using straight-through-processing and that also have liabilities to customers of more than \$10 million. Where it applies, the Member's capital requirement is the minimum capital required by subsection (a)(i) plus 5% of the liabilities over \$10 million. The formula is:

Amount required by (a)(i) + .05(customer liabilities - \$10,000,000)

For example, if the minimum capital requirement is \$20 million, a Forex Dealer Member that operates a dealing desk and has \$208 million in liabilities to customers would be required to maintain adjusted net capital equal to or in excess of \$29.9 million.

Forex Dealer Members with over \$10 million in customer liabilities are subject to this alternative requirement unless they execute all customer transactions using straight-through-processing. Straight-through-processing refers to platforms that automatically (without human intervention and without exception) enter into an identical but opposite transaction with another counterparty, creating an offsetting position in the Forex Dealer Member's own name. A Forex Dealer Member that offers several platforms will be exempt from this requirement only if each platform executes all customer orders using straight-through-processing.

This requirement that all customer trades be executed by straight-through-processing is not, however, meant to limit a firm's ability to provide for other methods in its disaster recovery procedures. As long as those other methods are used only when dictated by those procedures and both the procedures and the firm's trading platform are designed to ensure that the need will rarely arise, the FDM will not lose its exemption by implementing other execution methods in disaster recovery situations.

3. Financial Requirements Section 11(b)

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34. Financial Requirements Section 11(c)

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45. Financial Requirements Section 12

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EXPLANATION OF PROPOSED AMENDMENTS

The CFTC Reauthorization Act of 2008 imposed a \$20 million capital requirement on those firms that are classified as Forex Dealer Members under NFA

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rules, and this requirement is currently being phased in through rule changes NFA's Board adopted in August 2008.¹ The requirement in the legislation does not, however, take into account the size of the firm's retail business or whether it automatically offsets its risk.

Section 11 of NFA's Financial Requirements currently contains an alternative net capital requirement equal to 5% of the firm's liabilities to customers. The advantages of this alternative are that it correlates to the size of an FDM's business and is easy to calculate. NFA has become increasingly concerned, however, that the alternative does not provide enough of a cushion against insolvency where an FDM does not immediately offset its customer risk. Furthermore, with the increases in the Reauthorization Act, the current alternative is effectively obsolete.²

NFA believes that \$20 million is sufficient for smaller FDMs and for those that automatically hedge their exposure on every trade. Therefore, when studying potential alternatives, we looked for one that will distinguish firms with either of these characteristics from those that carry the greater financial risk.

The proposed amendments revise the alternative requirement to equal \$20 million plus 5% of liabilities to customers that exceed \$10 million. Under the proposed amendments, the capital requirement for an FDM with \$8 million in liabilities to customers would stay at \$20 million, while the capital requirement for an FDM with \$208 million in liabilities to customers would rise to \$29.9 million.

Firms that exclusively use a straight-through-processing model will not be subject to the alternative requirement. Since these firms automatically enter into an opposite transaction on every trade, as opposed to aggregating trades at various points during the day before entering into hedging transactions (or not hedging at all), their exposure to market movements is minimal.

NFA sent this proposal to the FDMs for comment and received seven responses. One supported the proposal as long as it includes the exemption for straight-through-processing. Another generally supported it but believes that it is too

¹ The current requirement of \$15 million will increase to \$20 million as of May 15, 2009.

² With the minimum at \$15 million, the alternative requirement does not capture even one firm.

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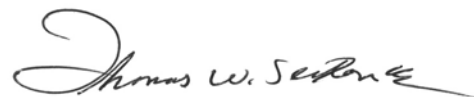
low for larger FDMs. Four FDMs stated that the proposed alternative is unnecessary, and two of these asked NFA to give the \$20 million requirement time to prove itself.

The other letter did not address the alternative capital requirement itself but did discuss the proposed exemption for straight-through-processing. On this issue, the letter stated that the exemption gives an unfair advantage to firms that use straight-through-processing without recognizing that other firms may also manage their risks effectively. Another commenter opposed the exemption on the grounds that these firms already benefit by avoiding the haircut on uncovered positions. A third FDM felt the exemption should be broadened to include firms that use straight-through-processing for less than 100% of their accounts, proposing that the exemption be pro-rated so that only those accounts that do not use straight-through-processing be included in the customer liabilities subject to the 5% alternative.

After considering the comments, NFA believes that larger FDMs should be subject to a different capital requirement than smaller FDMs and that this requirement should be related to risk, which is affected both by customer liabilities and by how the firm covers its positions. We also believe—as one commenter who opposed the exemption recognized—that the formula should be relatively simple. NFA feels that the proposed alternative requirement, including the exemption for firms that exclusively use straight-through-processing, is the best way to accomplish these goals.

NFA respectfully requests that the Commission review and approve the proposed amendments to NFA Financial Requirements Section 11 and the Interpretive Notice regarding Forex Transactions.

Respectfully submitted,



Thomas W. Sexton
Vice President and General Counsel

* The proposed amendments to NFA Financial Requirements Section 11 and the Interpretive Notice regarding Forex Transactions become effective November 30, 2009.