September 2, 2011

Via Federal Express

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

Re: National Futures Association: Forex Price Changes – Proposed Adoption of the Interpretive Notice to NFA Compliance Rule 2-36*

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 adoption of the Interpretive Notice to NFA Compliance Rule 2-36 regarding Forex price changes. NFA's Board of Directors ("Board") approved the proposal on August 18, 2011. NFA respectfully requests Commission review and approval of the proposed amendments.

PROPOSED AMENDMENTS
(additions are underscored)

INTERPRETIVE NOTICES

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NFA COMPLIANCE RULE-2-36: REQUIREMENTS FOR FOREX TRANSACTIONS

NFA Compliance Rule 2-36 imposes a number of obligations on a Forex Dealer Member (FDM) regarding the manner in which it handles customer forex transactions. Compliance Rule 2-36(b)(1) prohibits an FDM engaging in a forex transaction from cheating, defrauding, or deceiving or attempting to cheat, defraud or deceive any other person. NFA Compliance Rule 2-36(b)(4) prohibits an FDM from engaging in any manipulative acts or practices regarding the price of any foreign currency or forex transaction. Also, NFA Compliance Rule 2-36(c) requires an FDM to observe high standards of commercial honor and just and equitable principles of trade in the conduct of its forex business. NFA's Board of Directors (Board) adopted these provisions to ensure that an FDM acts honestly, fairly and in the best interests of its customers.

NFA's Business Conduct Committee (BCC) recently issued several disciplinary Complaints for violations of these rule provisions based on strikingly similar conduct. As described more fully below, in each of these disciplinary matters, the FDM dealt with price changes that occurred from the time the customer entered an order until the time it reached the FDM's system in an asymmetrical manner that benefited the FDM to the detriment of the customer. Given the severity of the conduct at issue in these disciplinary matters, NFA's Board of Directors is issuing this Notice to provide further guidance.

When a customer's order reaches an FDM's trading system, the price being offered on the system may be different than the price offered at the time the customer first submitted the order.[1] The difference between these two prices is commonly referred to as slippage. If the customer's order is executed at the price quoted at the time the customer entered the order, the slippage will result in an immediate unrealized gain or loss to the customer based on the direction of the market's movement. Since the FDM takes the other side of the customer's order, if the market movement is unfavorable to the customer, it will be favorable to the FDM and vice versa.

When slippage occurs, some FDMs immediately requote the customer the current price and require the customer to confirm that it still wants to place the order at the requoted price. In order to prevent excessive requoting in a fast moving market and to ensure timelier fills, some FDMs have built in and clearly disclosed slippage parameters to customers that permit the execution of the order if the slippage is within the established slippage parameters.[2] In each of the recent disciplinary matters, the FDM used asymmetrical slippage settings that benefited the FDM to the detriment of the customer because the slippage settings made it much more likely that a customer order that moved against the customer (and therefore in the FDM's favor) would be filled than one that moved in the customer's favor (and therefore against the FDM). In particular, the FDMs named in the BCC Complaints employed one or more of the following practices:

[1] Although this difference could be the result of an FDM manipulating the prices, the difference may also occur for a number of legitimate reasons including a fast moving market and/or delays in transmitting the order.

[2] These slippage parameters dictate the number of pips the market may move without affecting the execution of the customer's order at the price at the time the customer entered the order. If the order is outside the slippage parameters, the FDM will requote the customer and obtain confirmation of the new price.

- The FDM set the maximum losing slippage (i.e., slippage that was unfavorable to the customer and favorable to the FDM) at a much wider range of pips than the maximum profit slippage (i.e., slippage that was favorable to the customer and unfavorable to the FDM). As a result, a customer was much more likely to have an order filled when the market move was unfavorable to it than when the movement was favorable to the customer.

- The FDM set the limit on the number of contracts in an order that could be executed that experienced losing slippage for the customer at a much higher number than the limit on the number of contracts in an order that could be executed that experienced profitable slippage for the customer. As a result, a larger sized order that moved against the customer was much more likely to be executed than a smaller sized order that moved in the customer's favor.

- The FDM only passed negative slippage on to the customer. If the FDM was able to offset the customer's order at a better price than the price at the time the customer submitted its order, the FDM did not give the customer the better price. However, if the FDM offset the customer's order at a price that had negative slippage and was unfavorable to the customer, the FDM would thereby benefit from the slippage and fill the customer's order at the offset price.

In each of the above instances, the FDM's asymmetrical slippage settings allowed it to manipulate the prices that the forex customer received and allowed the FDM to benefit from the order slippage to the detriment of the customers, which clearly violates Compliance Rule 2-36(b)(1) and (b)(4) and Compliance Rule 2-36(c). The above practices are examples of the type of conduct that would violate these rule provisions, but is not an all encompassing list. Any asymmetrical slippage settings or requoting practices, or any other manipulative practices, that provide an advantage to the FDM to the detriment of the forex customer would violate these rule provisions.[3]

The Board is not prohibiting an FDM from setting symmetrical slippage parameters or requoting prices in appropriate circumstances. An FDM should not be held responsible for order transmission delays that are beyond its control that result in the FDM's trading system reflecting a price at the time a customer order reaches the platform that is

[3] These practices apply to FDM proprietary systems where these parameters are internally and inherently programmed into the system as well as for FDM systems that are enhanced by add-ons that are purchased or leased from third parties. An FDM is responsible for ensuring that its trading system, whether proprietary, purchased or leased, is in compliance with this Interpretive Notice.

different from the price at the time the customer placed the order.[4] However, in order for an FDM to avoid violating these rule provisions, the FDM must apply the slippage settings uniformly regardless of the direction in which the market has moved. Similarly, if the FDM requotes prices based on slippage parameters when the market has moved against it, then it must also requote prices when the market has moved in its favor. An FDM must also ensure that the customer is aware of how the FDM handles such circumstances prior to trading with the FDM. Accordingly, prior to entering into the first forex transaction with a customer, an FDM must disclose its policy with regard to orders that are received for a price that is no longer reflected on the platform. For example, the FDM must disclose whether the order will automatically be executed or filled at the price reflected on the platform or if the customer will be notified of the price reflected on the platform and provided with an opportunity to accept or reject this new price. Similarly, if the FDM utilizes slippage parameters, it must disclose these parameters. In particular, the FDM must fully disclose how slippage parameters will be used with respect to limit orders. If the FDM applies different slippage settings and requoting practices depending on the customer, the FDM must also disclose this fact. and indicate the guidelines it uses to determine the appropriate settings and practices for a particular customer.

An FDM must also have written procedures in place regarding its handling of instances where the price at the time a customer's order reaches the FDM's trading system is different from the price that was reflected at the time the customer placed the order. For those FDMs that utilize different slippage parameters and requoting practices depending on the customer, the FDM's procedures should indicate the guidelines it uses to determine the appropriate settings and practices for a particular customer. A listed principal that is also an NFA associate must have reviewed and approved these procedures.

Finally, an FDM must ensure that any of its promotional material that discusses the mechanics of its trading system does not provide information that misrepresents or is misleading with respect to how it deals with price slippage and requoting. This includes ensuring that if the FDM uses promotional material that discusses the performance in a demo account, that demo account is subject to the same slippage parameters as actual customer accounts and those parameters are disclosed. Moreover, if the FDM advertises that its electronic trading platform ensures "no slippage," the electronic trading platform must be designed to execute a market order at the price displayed to the customer when the order is entered by the customer.

[4] An FDM is, however, responsible for taking steps to ensure that its trading system has sufficient capacity and integrity to handle the timely and efficient transmission and execution of customer orders.

EXPLANATION OF PROPOSED AMENDMENTS

NFA Compliance Rule 2-36 contains a number of provisions designed to ensure that a Forex Dealer Member (FDM) acts honestly, fairly and in the best interests of its customers, including with respect to the manner in which it handles its customers' Forex transactions. Among other things, the Rule prohibits an FDM engaging in a Forex transaction from or attempting to cheat, defraud, or deceive any person (2-36(b)(1)) or from engaging in any manipulative acts or practices regarding the price of any foreign currency or Forex transaction (2-36(b)(4)). The Rule also requires FDMs to observe high standards of commercial honor and just and equitable principles of trade in the conduct of their Forex business.

Over the last year, NFA's Business Conduct Committee (BCC) has issued several Complaints, each of which charged an FDM with violating provisions of Compliance Rule 2-36 based on the manner in which the FDM dealt with price changes that occurred from the time a customer entered an order until the time it reached the FDM's system. Although the BCC found that the conduct at issue in these matters clearly violated Compliance Rule 2-36, NFA adopted this Interpretive Notice to provide additional guidance on the issue.

In the context of FDM trading systems, price slippage sometimes occurs between the time a customer first submits an order until the time the order reaches the FDM's system. If price slippage occurs but the customer's order is filled at the price quoted at the time the customer entered the order, then the slippage creates an immediate unrealized gain or loss to the customer. When slippage occurs, some FDMs immediately requote the customer the current price and require the customer to confirm that it still wants to place the order at the requoted price. Other FDMs have built in and clearly disclosed slippage parameters to their customers that permit the execution of an order if the slippage is within the established parameters. Although there is nothing inherently wrong with using slippage parameters, FDMs must ensure that the parameters are not implemented in an asymmetrical manner so that it is more likely that a customer order that had moved against the customer (and therefore in the FDM's favor) would be filled than one that moved in the customer's favor (and therefore against the FDM). Similarly, an FDM must ensure that its policy for requoting prices is the same regardless of whether the order has moved for or against the customer.

The Interpretive Notice describes the specific conduct that was at issue in the BCC matters. The Notice makes clear, however, that these are only examples of practices that would violate Compliance Rule 2-36, and that any practice that provides an advantage to the FDM to the detriment of a Forex customer would violate the Rule 2-36.

The Notice also clarifies that an FDM must provide its customers with complete information on how it handles price slippage and price requoting, including how slippage parameters will be used with respect to limit orders. This information must be provided to an FDM's customers prior to entering into the first trade.

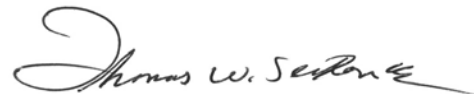
The Notice also requires an FDM to have written supervisory procedures in place that describe how the FDM handles price slippage situations. Also, if the FDM utilizes different slippage parameters and requoting practices depending on the customer, the FDM's procedures must indicate the guidelines it uses to determine the various settings and practices for a particular customer.

Finally, the Notice discusses promotional material that includes information on the FDM's trading system. The Notice requires the FDM to ensure that any material that discusses the mechanics of the FDM's trading system does not provide misleading or inaccurate information regarding how the system deals with price slippage and requoting. In addition, if the FDM's promotional material discusses demo account performance, those demo accounts must be subject to the same slippage parameters as actual customer accounts and the parameters must be disclosed. Moreover, any FDM that advertises "no slippage" must ensure that its system is designed to execute a market order at the price displayed when the order is entered by the customer.

NFA's FDM Advisory Committee supported the Interpretive Notice.

NFA respectfully requests that the Commission review and approve the proposed Interpretive Notice to NFA Compliance Rule 2-36 Forex price changes.

Respectfully submitted,



Thomas W. Sexton
Senior Vice President and
General Counsel

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*The proposed adoption of the Interpretive Notice to NFA Compliance Rule 2-36 becomes effective March 26, 2012.