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GENERAL COUNSEL'S OFFICE

- 1.) Respondent admits the allegations of Paragraph 1 in their entirety.
- 2.) Respondent admits that it registered as an FCM and NFA Member in July 2004, and initially did not do any forex business; however the remaining allegations of Paragraph 2 are denied in their entirety.
- 3.) Respondent neither admits nor denies the allegations of Paragraph 3 as they pertain to what or when NFA learned about GCG, but admits the remaining allegations of Paragraph 3.
- 4.) Respondent neither admits nor denies the allegations of Paragraph 4, as it lacks sufficient information upon which to form a belief as to their truth or falsity.
- 5.) Respondent neither admits nor denies the allegations of Paragraph 5, as it lacks sufficient information upon which to form a belief as to their truth or falsity.

APPLICABLE RULES

6.) Respondent neither admits nor denies the allegations of Paragraph 6, as they contain a non-factual, legal conclusion.

7.) Respondent neither admits nor denies the allegations of Paragraph 7, as they contain a non-factual, legal conclusion.

8.) Respondent neither admits nor denies the allegations of Paragraph 8, as they contain a non-factual, legal conclusion.

9.) Respondent neither admits nor denies the allegations of Paragraph 9, as they contain a non-factual, legal conclusion.

10.) Respondent neither admits nor denies the allegations of Paragraph 10, as they contain a non-factual, legal conclusion.

COUNT I

ALLEGED VIOLATION OF NFA COMPLIANCE RULES 2-36(b) (1) AND 2-36(c): USING DEFICIENT PROMOTIONAL MATERIAL AND FAILING TO UPHOLD HIGH STANDARDS OF COMMERCIAL HONOR AND JUST AND EQUITABLE PRINCIPLES OF TRADE.

11.) Respondent neither admits nor denies the allegations of Paragraph 11, as it is merely a bridge paragraph and not capable of being admitted or denied.

12.) Respondent Gain Capital Group LLC ("GCG") admits the allegations of Paragraph 12 in their entirety.

13.) Respondent neither admits nor denies the allegation of the first sentence of Paragraph 13, as it contains a non-factual, legal conclusion. Respondent denies the remaining allegations of Paragraph 13 to the extent they charge or imply that GCG intended to mislead any prospective or current customer.

14.) Respondent neither admits nor denies the allegation of the first sentence of Paragraph 14, as it contains a non-factual, legal conclusion. Respondent denies the remaining allegations of Paragraph 14 to the extent they charge or imply that GCG intended to mislead any prospective or current customer.

15.) Respondent denies the allegations of Paragraph 15 to the extent that it alleges "the price originally quoted to the customer is not the price that the customer actually receives"; that

“its customers occasionally experience a “rate change,” which occurs when GCG updates prices on its trading platform at the same time that a customer enters an order”; or that it misleads its customers concerning “slippage”. Respondent admits the remaining allegations of Paragraph 15.

16.) Respondent admits the first two sentences of Paragraph 16, but denies the remaining allegations of Paragraph 16 in their entirety.

17.) Respondent admits the allegations of Paragraph 17 in their entirety.

18.) Respondent admits the allegations of the first sentence of Paragraph 18 in its entirety. Respondent neither admits nor denies the allegations of the second sentence of Paragraph 18 as they are unknown to Respondent in their entirety as Respondent lacks sufficient information upon which to form a belief as to their truth or falsity.

19.) Respondent neither admits nor denies the allegations of Paragraph 19, as they are unknown to Respondent in their entirety and Respondent lacks sufficient information upon which to form a belief as to their truth or falsity.

20.) Respondent admits the first sentence of Paragraph 20, but denies the second sentence in its entirety.

21.) Respondent neither admits nor denies the allegations of Paragraph 21 as it is a charging paragraph.

COUNT III

ALLEGED VIOLATION OF NFA COMPLIANCE RULE 2-9(c): FAILING TO ESTABLISH AND IMPLEMENT AN ADEQUATE ANTI-MONEY LAUNDERING PROGRAM.

22.) Respondent neither admits nor denies the allegations of Paragraph 22, as it is merely a bridge paragraph and not capable of being admitted or denied.

23.) Respondent admits the allegations of Paragraph 23.

24.) Respondent admits the allegations of Paragraph 24.

25.) Respondent neither admits nor denies the allegations of Paragraph 25 as it is a charging paragraph and not capable of being admitted or denied.

COUNT III

VIOLATION OF NFA COMPLIANCE RULES 2-11 AND 2-36(c): FAILURE TO NOTIFY NFA THAT GCG WAS CARRYING CUSTOMER ACCOUNTS.

26.) Respondent neither admits nor denies the allegations of Paragraph 26, as it merely is a bridge paragraph and not capable of being admitted or denied.

27.) Respondent admits the allegations of the first sentence of Paragraph 27, but denies the remaining allegations of the paragraph in their entirety.

28.) Respondent neither admits nor denies the allegations of Paragraph 28 as it is a charging paragraph and not capable of being admitted or denied

STATEMENT OF DEFENSE

A. GAIN'S CORPORATE STRUCTURE

29.) Gain Capital Inc. (GCI); the corporate entity which preceded GCG, had been registered as an FCM and member of the NFA since 2001. GCI initiated its regulatory status as an FCM before it was mandated to do so by the Commodity Futures Modernization Act of 2001. GCI was formed to service professional traders, high net worth individuals, hedge funds and money managers. Thereafter, in or about July 2004, and solely in response to a capital infusion by a private equity firm purchasing a part of GCI's equity, a corporate reorganization occurred, GCG was formed and it was then registered as an FCM commencing July 2004. GCG thereupon became the parent corporation to GCI, and to another subsidiary, Forex.com Inc. (FCI), formed to service the trading needs of retail forex customers.

30.) During the entire period of 2001 to 2006, GCI and later GCG sent consolidated 1-FR's to the NFA on a monthly basis, showing all customer obligations and related net income. Furthermore, GCI and later GCG, submitted annually to the NFA, consolidated financial statements audited by a nationally-recognized (big 4) accounting firm. Thus the NFA was continuously apprised of all of GCI's and GCG's trading activity, customer obligations and net income.

31.) In 2006, in advance of a second corporate recapitalization and concurrent with a new private equity firm desiring to purchase an ownership interest in GCG, management decided to merge GCI and FCI in to GCG. In late February 2006, FCI was merged in to GCG. In April 2006, GCI was merged in to GCG. As a result, FCI and GCI now operate as divisions of GCG, though the divisions target different customer segments and therefore continue to maintain separate websites, trading platforms and marketing campaigns. During this entire time period (before and after the changes), the customer experience remained completely unchanged as they entered the exact same sites (with the same wording) they did previously. The reporting done for the NFA and CFTC also remained unchanged as GAIN had always reported its financial position on a combined basis and never tried to take advantage of the potential loophole that other FDM's did.

32.) It is GCG's position that the changes to its corporate structure have been the natural result of its growth over the past seven years of business. GCG vehemently rejects the NFA's assertion that it at any time intended to avoid regulatory oversight by these corporate reorganizations, as implied in the Complaint by the NFA's use of the term "shell".

B. GAIN'S ALLEGED USE OF MISLEADING PROMOTIONAL MATERIAL

33.) GCG concedes that the statements set out in Paragraph 12 of the Complaint either resided briefly on its website, or were made by an employee during a chat-room session. However, GCG's intent in each of the cited representations was not to mislead, but rather to explain GCG's unique customer-friendly offerings. GCG offers the following factual support for its lack of intent:

a.) "All customer funds are strictly segregated from Forex.com's operating funds in separate bank accounts." This statement was intended to inform customers that that GCG does not commingle the assets of its customers with its own operating funds. The comment was not intended to imply that client funds receive any special protection in the unlikely event of GCG's bankruptcy. Upon notification from NFA of its concern, the comment was immediately removed from the website.

b.) "We have segregated accounts which are insured up to \$100,000 by the FDIC." GCG does, in fact, maintain separate customer accounts that are individually insured up to \$100,000 and are titled "segregated" by the custodian bank. GCG's offering of separate customer accounts

and its promotion thereof represented its best efforts to ensure utmost protection of customer funds. Operating under the guidance of GCG's custodian bank at the time, GCG accepted that these individually-named accounts provided additional protection in the unlikely event of any of GCG's general creditors attempting to reach these assets. Upon notification from NFA of its concern, the comment was immediately removed from the website.

c.) "Your funds will be protected in the unlikely case of bankruptcy." GCG does, in fact, maintain separate customer accounts that are individually insured up to \$100,000 and are titled "segregated" by the custodian bank. GCG's offering of separate customer accounts and its promotion thereof represent its best effort to ensure utmost protection of customer funds. Operating under the guidance of GCG's custodian bank at the time, GCG accepted that these individually-named accounts provided additional protection in the unlikely event of any of GCG's general creditors attempting to reach these assets. Upon notification from NFA of its concern, the comment was immediately removed from the website.

d.) "...you can select to have the funds wired to a segregated FDIC insured account to give you peace of mind." GCG's offering of separate customer accounts and its promotion thereof represent its best effort to ensure utmost protection of customer funds. Operating under the guidance of GCG's custodian bank at the time, GCG accepted that these individually-named accounts provided additional protection in the unlikely event of any of GCG's general creditors attempting to reach these assets. Upon notification from NFA of its concern, the comment was immediately removed from the website.

e.) "...if you are worried and want your money to be insured by the FDIC you can open a segregated account with a minimum of \$25k." GCG's offering of separate customer accounts and its promotion thereof represent its best effort to ensure utmost protection of customer funds. Operating under the guidance of GCG's custodian bank at the time, GCG accepted that these individually-named accounts provided additional protection in the unlikely event of any of GCG's general creditors attempting to reach these assets. . Upon notification from NFA of its concern, the comment was immediately removed from the website.

f.) "Forex.com charges no commissions or fees regardless of account balance or trading activity."; "Forex.com charges no commissions or fees whatsoever."; "Gain Capital charges no commissions or fees regardless of account balance or trading activity."; and "Forex.com offers commission free trading across the board – regardless of account type, balance or trading

activity."; GCG maintains that these comments were factual and accurate. GCG is compensated for its services through the bid/ask spread. GCG believes NFA's concerns regarding these comments on the cost of trading is one of "balance of presentation" because how GCG is compensated was not mentioned during the same chat session or immediately thereafter or in near proximity as it related to website(s) and promotional material(s). However, all potential clients are informed repeatedly on the websites, in promotional materials, and throughout the account opening process that GCG is compensated through the bid/ask spread. There is simply no effort on GCG's part to "mask" this fact. This point has always resided on its website and is clearly communicated to the client during client account opening experience.

g.) "No slippage on market orders"; and "...we guarantee your fill at the market price you see. There is no slippage as compared to other companies." These comments were intended to inform the client that GCG's trading platform for market orders operates on a "click and deal" basis. These statements were further intended to distinguish GCG's policy of automated execution for market orders from other business models in the retail FX industry that utilize dealer intervention. Slippage, as defined, is the difference between the customers' intended price and the actual price received. Because GCG does not fill its customers' market orders at any price *other* than the requested price, GCG maintains this statement is factual and accurate. It should also be noted that the system is inherently unbiased, as it simply displays the current market price. This offers equal odds that a rate change will be in the favor of the customer. In the rare instance whereby the trading platform enacts a rate change prior to an order being received and filled, the client will receive a notification that the trade was not filled and will be required to reenter the order. The most common cause of the rate change message is internet latency, which impedes instantaneous trade execution from a real-time rate stream and which is an issue faced by all internet-based trading platforms. That being said, GCG showed its willingness to accommodate the NFA's concerns about this statement by voluntarily adding the following disclosure: "Contingent upon deal request being received prior to a rate change."

34.) GCG has reiterated to staff and incorporated in its training program that when indicating that there is "no slippage on market orders" they must indicate that this is "Contingent upon deal request being received prior to a rate change." It has also reiterated to staff and incorporated in its training program that when indicating that trading has no charges and/or is

commission free that they must state GCG is compensated for its services through the bid/ask spread.

35.) As noted above, GCG has worked closely with NFA to make all required changes and clarifications. GCG has always been an advocate of "Futures Style" segregation rules and at no time was it GCG's intention to imply that customer assets and/or accounts receive special protections under the bankruptcy laws. In fact, GCG sponsored an industry-backed memo sent to NFA and dated September 6, 2006 requesting such changes. The overall intent of the points noted above in Paragraph 33 (a) through (e), was to indicate that GCG does not commingle its own operating funds with customer funds. Furthermore, GAIN attempted in good faith to add an additional level of protection for clients through individually named accounts, above and beyond the industry standard. Additionally, it appears that it is not clear if a client would receive priority in bankruptcy as indicated in the following required NFA disclosure statement that FCM's must provide to a client prior to opening an account:

The transactions you are entering into with [Member] are not traded on an exchange. Therefore, under the U.S. Bankruptcy Code, your funds may not receive the same protections as funds used to margin or guarantee exchange-traded futures and options contracts, which receive a priority in bankruptcy. Since that same priority has not been given to funds used for off-exchange forex trading, if [Member] becomes insolvent and you have a claim for amounts deposited or profits earned on transactions with [Member], your claim may not receive a priority. Without a priority, you are a general creditor and your claim will be paid, along with the claims of other general creditors, from any monies still available after priority claims are paid. Even customer funds that [Member] keeps separate from its own operating funds may not be safe from the claims of other general and priority creditors

36. As noted above, GCG corrected all deficiencies pointed out during its audit as soon as possible. GCG denies it renewed the use of Internet banner advertisements previously deemed deficient. The comment "Just a short time later, however, GCG renewed the use of Internet banner advertisements that touted GCG's commission free trading and the advantages of 200 to 1 leverage" is inaccurate and not based in fact. GCG did not reinstate the usage of advertisements that contained any of NFA's original concerns and/or deficiencies. In reality, during NFA's post audit review, NFA viewed internet banner advertisement(s) that were part of a prepaid, previously-submitted promotional cycle. Such campaigns are often submitted a calendar quarter

in advance. GCG used best efforts to have all such advertisements pulled as soon as possible. With over 400 different ad units running simultaneously on over 30 websites, it is an extremely lengthy task to update existing creative media in multiple sizes with each individual publisher. In fact, the referenced banners were in the process of being replaced with updated, NFA approved banners. It should be further noted that GCG has since purchased a software package that allows GCG to more efficiently add, change or delete banners, as needed.

37.) GCG acknowledges it advertised “commission free” trading on a single display sign at the Forex Expo convention held in September 2006. Due to an administrative oversight, a footnote was not added to the same banner indicating that GCG was compensated through the bid/ask spread. A revised display banner has been created and submitted and approved by NFA. Please note that all other written promotional material at the Expo and website content viewed indicated that GCG is compensated through the bid/ask spread. Again, GCG reiterates that it at no time had any intent to mislead; rather the erroneous banner occurred from inadvertent administrative oversight.

C. GCG’S REVIEW OF ITS PARTNERS’ WEBSITES

38.) GCG acknowledges that several domestic solicitors’ websites included non-compliant claims that inflated profit potential and downplayed risk of loss. As indicated above, GCG has enhanced its Compliance function, website review program and website review cycle in an effort to identify and correct any such deficiencies.

39.) GCG acknowledges while it did indeed conduct both initial and periodic reviews, it was not persistent enough in 2006 in conducting reviews of its solicitors’ websites. However, the assertion that “GCG failed to conduct any review of its solicitors’ websites and, therefore, failed to detect, let alone take any action to correct, the promotional material deficiencies in its solicitors’ websites, including those cited above” is a significant overstatement. All Introducing Broker websites were reviewed by the Partner Services department at inception of the relationship. Further, as indicated above, GCG has enhanced its Compliance function, website review program and website review cycle in an effort to identify and correct any such deficiencies.

D. CGC'S AML PROCEDURES

40.) GCG acknowledges that its written "AML Procedures" failed to include all of the requirements of NFA Compliance Rule 2-9(c). In general the written procedures covered the "Know-Your-Customer" guidelines, but failed to be updated in writing for the new "Customer Identification Program" guidelines. That being said, GCG's practices did incorporate all the requirements of NFA Compliance Rule 2-9(c) at all times. There were no deficiencies in practice in this area – which was noted during the NFA audit process. Although GCG views this as a documentation issue, GCG takes such matters seriously and worked diligently with NFA to update its written procedures.

E. CGC'S ALLEGED FAILURE TO NOTIFY NFA OF THE CARRYING OF CUSTOMER ACCOUNTS

41.) GCG did not fail to notify the NFA regarding its handling of customer accounts. Among other things, Gain complied with the spirit as well as the letter of the law under Rule 2-11, as it modified its BASIC filing on line on or about February, 2006 to show that GCG was now "carrying" all customer accounts formerly carried by Forex.com. Rule 2-11 does not require any specific form of confirmation to, or approval by the NFA, nor does the rule specify any particular form of notice. The rule is arguably complied with when notice that is reasonably calculated to reach the NFA is sent. GCG sent gave the NFA such a reasonable notice in February 2006.

42.) GCG previously GCI also sent monthly consolidated 1-FR's to the NFA consistently since 2001. It also filed annual consolidated financial statements audited by its accounting firm during the same time period. Thus, it is hard to imagine how the NFA could claim that it was not continuously appraised of GCG's, GCI's and/or FCI's trading activity, customer obligations and net income during the relevant time period.

43.) As a result of the forgoing, GCG does not believe that its overall conduct merits any monetary or registration sanction by the Business Conduct Committee. GCG lacked the corporate state of mind to mislead its customers and counterparties and responded rapidly to any NFA suggestions of non-compliance. GCG's responsiveness and cooperation with the NFA (almost every issue was rectified immediately and more than six months prior to the complaint) should be taken into account in assessing the charges and any sanction deemed necessary for

those small violations to which it admitted above. Lastly, GCG would call to the attention of the Business Conduct Committee its stellar compliance record since it (and its predecessor GCI) began business, having been charged with no violations of either the CFTC or NFA rules and regulations.

Dated: January 29, 2007

JOHN W. COTTON
COTTON & GUNDZIK LLP



John W. Cotton

Attorneys for Respondent Gain Capital
Group LLC

PROOF OF SERVICE

I declare that I am employed in the County of Los Angeles, California. I am over the age of eighteen years and not a party to the within case; my business address is: Cotton & Gundzik LLP, 801 South Figueroa Street, Suite 1200, Los Angeles, California 90017.

On January 29, 2007, I served the foregoing document described as:

GAIN CAPITAL'S ANSWER TO COMPLAINT

on the following parties:

Legal Dept. – Docketing (one Original, Four Copies and one conform copy)
National Futures Association
200 West Madison, Suite 1600
Chicago, IL 60606

Ronald Hirst
National Futures Association
200 West Madison, Suite 1600
Chicago, IL 60606

- ☐ (BY MAIL) ☐ (BY CERTIFIED MAIL) by placing a true copy thereof in a sealed envelope with postage fully prepaid. I am readily familiar with the business practice of Cotton & Gundzik LLP for collection and processing of correspondence for mailing with the United States Postal Service, and the correspondence would be deposited with the United States Postal Service that same day in the ordinary course of business.
- ☐ (BY TELEFACSIMILE TRANSMISSION) at approximately ____ [] AM [] PM, from the telefacsimile transmitting machine at the offices of Cotton & Gundzik LLP, 801 South Figueroa Street, Suite 1200, Los Angeles, California 90017 [facsimile number (213) 623-6699], to the attention of the following interested parties in this action, at addressee's facsimile numbers set forth in the attached facsimile cover sheet.

This transmission was reported as complete and without error.

☒ (BY OVERNIGHT MAIL)
☒ BY FEDERAL EXPRESS DELIVERY

I declare under penalty of perjury under the laws of the State of California that the foregoing is true and correct. Executed on January 29, 2007 at Los Angeles, California.



Diane M. Gotori