

August 22, 2008

**Via Federal Express**

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

Re: National Futures Association: Increases to the Forex Dealer Member Capital Requirements: Proposed Amendments to NFA Financial Requirements Sections 1, 11 and 12 and the 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 Sections 1, 11 and 12 and the Interpretive Notice regarding Forex Transactions to increase the Forex Dealer Member (FDM) capital requirements. This proposal was approved by NFA’s Board of Directors (“Board”) on August 21, 2008. NFA respectfully requests Commission review and approval of the proposed amendments.

---

**PROPOSED AMENDMENTS**  
**(additions are underscored and deletions are ~~stricken through~~)**

---

**FINANCIAL REQUIREMENTS**

\* \* \*

**SECTION 1. FUTURES COMMISSION MERCHANT FINANCIAL REQUIREMENTS.**

(a) Each NFA Member that is registered or required to be registered with the Commodity Futures Trading Commission (hereinafter “CFTC”) as a Futures Commission Merchant (hereinafter “Member FCM”) must maintain “Adjusted Net Capital” (as defined in CFTC Regulation 1.17) equal to or in excess of the greatest of:

Mr. David A. Stawick

August 22, 2008

\* \* \*

- (vi) For Member FCMs with an affiliate described in section 2(c)(2)(B)(ii)(III)(i)(II)(cc)(BB) of the Act that engages in forex transactions (as defined in Bylaw 1507(b)) and that is authorized to engage in those transactions solely by virtue of its affiliation with a registered FCM, \$7,500,000; or
- (vii) For Member FCMs that are counterparties to forex options transactions (as forex is defined in Bylaw 1507(b)), \$5,000,000, except that Forex Dealer Members must meet the higher requirement in Financial Requirements Section 11.

\* \* \*

## **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) \$5,000,000 \$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) 5% of all liabilities owed to customers (as customer is defined in Compliance Rule 2-36(i); or
  - (iii) For FCMs, Any other amount required by Section 1 of these Financial Requirements.
- (b) A Forex Dealer Member may not include assets held by an affiliate (unless approved by NFA) or an unregulated person in its current assets for purposes of determining its adjusted net capital under CFTC Rule 1.17. An affiliate is any person that controls, is controlled by, or is under common control with the Forex Dealer Member.

For purposes of this section and section (c), a person is unregulated unless it is:

Mr. David A. Stawick

August 22, 2008

- (i) a financial institution regulated by a U.S. banking regulator;
- (ii) a broker-dealer registered with the U.S. Securities and Exchange Commission and a member of the Financial Industry Regulatory Authority;
- (iii) a futures commission merchant registered with the U.S. Commodity Futures Trading Commission and a Member of NFA;
- (iv) a retail foreign exchange dealer registered with the U.S. Commodity Futures Trading Commission and a Member of NFA;
- (v) an insurance company regulated by any U.S. state;
- (vi) an entity regulated as a foreign equivalent of any of the above if regulated in a money center country as defined in CFTC Regulation 1.49; or
- (vii) any other entity approved by NFA.

\* \* \*

(d) Each RFED must file financial reports with NFA for each month-end, including its fiscal year-end, within 17 business days of the date for which the report is prepared. All financial reports must be filed on the forms required by CFTC regulations, and all financial reports except those required to be certified by a Certified Public Accountant must be filed electronically using an electronic media approved by NFA.

- (e) For purposes of this rule:

\* \* \*

## **SECTION 12. SECURITY DEPOSITS FOR FOREX TRANSACTIONS WITH FOREX DEALER MEMBERS.**

(a) Except as provided in (b) below, each Forex Dealer Member shall collect and maintain the following minimum security deposit for each forex transaction between the Forex Dealer Member and a person that is not an eligible contract participant as defined in Section 1(a)(12) of the Act:

Mr. David A. Stawick

August 22, 2008

\* \* \*

(b) A Forex Dealer Member that consistently maintains adjusted net capital of at least 150% of twice the greater of the amount required by Section 11(a)(i) or (ii) of these Financial Requirements is exempt from (a) above.

\* \* \*

## **INTERPRETIVE NOTICES**

\* \* \*

### **[¶ 9053] FOREX TRANSACTIONS**

\* \* \*

#### **4. Financial Requirements Section 12**

\* \* \*

This requirement does not apply to any Forex Dealer Member that consistently maintains adjusted net capital equal to or in excess of two-times 150% of the greater of the amount required by Section 11(a)(i) or (ii) of the Financial Requirements. A Forex Dealer Member claiming the exemption must file advance written notice with NFA. If a firm that claims the exemption falls below double 150% of its capital requirement under Section 11(a)(i) and (ii), it must immediately notify NFA. If the firm does not come back into compliance within 48 hours, it must collect the required security deposits on all customer positions and may not claim the exemption for six months. A firm that claims the exemption but falls below the required capital amount three times within 90 days may not claim the exemption for six months.<sup>18</sup>

---

## **EXPLANATION OF PROPOSED AMENDMENTS**

---

The CFTC Reauthorization Act of 2008 imposes a \$20,000,000 capital requirement on retail forex counterparties that are retail foreign exchange dealers (RFEDs) or that are FCM-only firms primarily or substantially engaged in on-exchange futures activities. Under the legislation, the requirement is to be phased in starting 120

Mr. David A. Stawick

August 22, 2008

days after the Act became law (which would put the effective date of the first increase at September 19, 2008) or such later date as determined by the Commission. Based on conversations with CFTC staff, it appears that the Commission will extend the effective date of these provisions to give it sufficient time to formulate its own rules governing forex capital.

Given that Congress recognized the importance of the \$20,000,000 capital requirement, however, the Board believes that it should not wait until the Commission has revised its rules. Therefore, the Board amended Section 11 of NFA's Financial Requirements to implement all but the first increase on the schedule set forth in the legislation. NFA will postpone the first increase until the CFTC has approved the rule change and FDMs have had sufficient notice and an opportunity to meet the increased requirement. We anticipate raising the capital requirement to \$10,000,000 on October 31, 2008.

Separately, a new Financial Section 11(d) will require RFEDs to file monthly financial reports. Currently, all FDMs are FCMs, and they are required to file these reports under NFA Financial Section 1. However, RFEDs will not be subject to Section 1 unless they are also registered as FCMs.

NFA Financial Requirements Section 12 requires FDMs to collect security deposits from customers but currently exempts FDMs that maintain twice their minimum net capital requirement. Similar to exchange margin, NFA adopted the security deposit to protect FDMs and their non-defaulting customers from customer defaults. The exemption was added later—when the minimum net capital requirement for FDMs was \$250,000—and NFA concluded that double capital provided an adequate buffer against those defaults. Given the substantial increase in the FDM capital requirements, the Board believes that twice capital is a greater buffer than necessary and has provided relief by lowering the requirement to 150%, which is the current early warning requirement for most of these firms.

NFA issued a Notice to Members on July 23 to give FDMs advance notice of the proposed changes to Financial Requirements Sections 11 and 12 and the need to have additional capital by October 31, 2008. In response, NFA received a letter from an attorney for an FDM that objects to the proposed changes.

The letter does not object to the capital increases themselves. Rather, it objects to the need for an FDM to maintain 150% of its capital requirement in order to

Mr. David A. Stawick

August 22, 2008

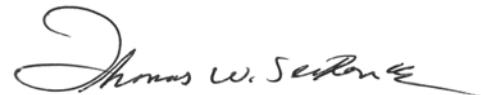
be exempt from collecting the minimum security deposit. NFA notes, however, that the amendments actually provide relief from the current rule, which requires 200%. Furthermore, an FDM is not forced to maintain the extra capital—it need do so only if it chooses to charge lower security deposits than those set by the rule.

In his letter, the attorney claims that this requirement is discriminatory because it does not apply to all Members who offer retail forex, and he cites language in the legislative history of the reauthorization act stating that Congress intends “FCMs and RFEDs to be regulated substantially equivalently in terms of their off-exchange retail foreign currency business.” However, the legislation clearly provides different treatment for broker-dealers and broker-dealer affiliates—even if they are also FCMs—than for FCM-only firms and RFEDs. Because of how NFA defines an FDM, the security deposit requirement and the capital percentage needed for an exemption apply (and will continue to apply) to both FCM-only firms (those who are primarily or substantially engaged in a traditional, on-exchange business) and those who are primarily forex dealers (and will be required to register as RFEDs). Therefore, NFA contends that its requirements are consistent with Congressional intent in stating that FCMs and RFEDs should be treated similarly.

The amendments to Financial Requirements Section 1 and to the Interpretive Notice regarding Forex Transactions are technical changes that conform those requirements to the amendments to Financial Requirements Sections 11 and 12.

NFA respectfully requests that the Commission review and approve the proposed amendments to NFA Financial Requirements Sections 1, 11 and 12 and to the Interpretive Notice regarding Forex Transactions to increase the Forex Dealer Member (FDM) capital requirements.

Respectfully submitted,



Thomas W. Sexton  
Vice President and General Counsel

---

\* The proposed amendments to NFA Financial Requirements Sections 1, 11 and 12 and the Interpretive Notice Regarding Forex Transactions become effective October 31, 2008.