August 28, 2008

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: Definition of a Forex Dealer Member: Proposed Amendments to NFA Bylaw 306, NFA Financial Requirements Section 11(a), and the Interpretive Notice Regarding Forex Transactions

Dear Mr. Stawick:

Pursuant to Section 17(j) of the Commodity Exchange Act ("Act"), as amended, National Futures Association ("NFA") hereby submits to the Commodity Futures Trading Commission ("CFTC" or "Commission") proposed amendments to NFA Bylaw 306, NFA Financial Requirements Section 11(a), and the Interpretive Notice regarding Forex Transactions. 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~~)

BYLAWS

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CHAPTER 3
MEMBERSHIP AND ASSOCIATION WITH A MEMBER

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BYLAW 306. FOREX DEALER MEMBERS.

(a) Except as provided in section (b), Members of NFA are Forex Dealer Members if they are registered with the CFTC as retail foreign exchange dealers

(RFEDs) or if they are the counterparty or offer to be the counterparty to forex transactions (as defined in Bylaw 1507(b)).

(b) Unless they are RFEDs, t~~T~~he following Members are not Forex Dealer Members:

(i) Entities described in subsection ~~(I)~~(aa) and subsections ~~(IV)~~(dd) through ~~(VI)~~(ff) of Section 2(c)(2)(B)~~(ii)~~(i)(II) of the Act;

(ii) Entities described in ~~subsection (II) of Section 2(c)(2)(B)(ii)~~ Section 2(c)(2)(B)(i)(II)(bb)(AA) of the Act that are members of ~~another futures association registered under Section 17 of the Act or of~~ a national securities association registered under Section 15A(b) of the Securities Exchange Act of 1934; and

(iii) Entities described in ~~subsection (III) of Section 2(c)(2)(B)(ii) of the Act based on their affiliation with an entity described in subsection (II) of Section 2(c)(2)(B)(ii) of the Act that~~ Section 2(c)(2)(B)(i)(II)(bb)(BB) of the Act that are not primarily or substantially engaged in forex activities, as forex is defined in Bylaw 1507(b), if the affiliated broker or dealer is a member of ~~another futures association registered under Section 17 of the Act or of~~ a national securities association registered under Section 15A(b) of the Securities Exchange Act of 1934).

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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:

* * *

Provided, however, that a Forex Dealer Member that is an entity described in Section 2(c)(2)(B)(i)(II)(bb)(BB) of the Act and is not an RFED does not have to comply with

subsection (a)(i) of this rule if it maintains adjusted net capital equal to or in excess of the greatest of $5,000,000 or the amount required by subsection (a)(ii) or (iii) and it is under common control with and its obligations are guaranteed by an FCM Member of NFA or a registered broker-dealer that is a member of FINRA if the guarantor maintains at least $20,000,000 in adjusted net capital.

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INTERPRETIVE NOTICES

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[¶ 9053] FOREX TRANSACTIONS

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A. BYLAW 306

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Bylaw 306(b) excludes Members that are otherwise subject to regulatory oversight for their forex activities, which means that these Members are not Forex Dealer Members and do not have to comply with Compliance Rule 2-36.[2] The exclusions mostly follow Section 2(c)(2)(B)~~(ii)~~(i)(II) of the CEA, although the exclusions for broker-dealers and their affiliates ~~are conditioned on Financial Industry Regulatory Authority ("FINRA") membership~~ are not identical to those in the CEA. In particular, the following entities are not Forex Dealer Members unless they are registered as RFEDs:

- financial institutions (e.g., banks and savings associations);
- certain insurance companies and their regulated subsidiaries or affiliates;
- financial holding companies;
- investment bank holding companies;
- registered broker-dealers that are members of FINRA;[3] and
- Material Associated Persons of registered broker-dealers that are members of FINRA, except that this exclusion does not apply if the entity is primarily or substantially engaged in forex activities.[4]

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[3] Bylaw 306(b)(ii) and (iii) excludes broker-dealers that are members of any fully-registered national securities association ~~and FCMs that are members of another registered futures association~~. At this time, however, FINRA is the only fully-registered national securities association ~~and NFA is the only registered futures association~~.

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EXPLANATION OF PROPOSED AMENDMENTS

NFA Bylaw 306(a) currently defines two types of Futures Commission Merchant ("FCM")-only firms as Forex Dealer Members ("FDMs") — those that are engaged in a traditional on-exchange business but have some retail forex customers and those that are registered as FCMs for the sole purpose of engaging in retail forex. After the CFTC Reauthorization Act of 2008's changes to the Act become effective, the latter group of FCMs will become Retail Foreign Exchange Dealers ("RFEDs"). The amendments to Bylaw 306(a) are designed to maintain the status quo and ensure that both these groups are classified as FDMs and continue to be regulated under the same umbrella.

The changes to Bylaw 306(b) also attempt to close two potential loopholes that involve broker-dealer affiliates. These loopholes and their proposed solutions are both extremely limited.

Recently, other regulators have informed NFA that due to the higher FDM capital requirements imposed over the last couple of years fewer entities are seeking FCM registration to act as retail forex counterparties but are exploring how to use a broker-dealer registration to do so. In structuring these businesses, these entities could set up a nominal broker-dealer that has an unregulated affiliate that offers retail forex. The appeal of this arrangement is that broker-dealer affiliates are exempt from the requirements of the Act.

Under normal circumstances, NFA would leave the regulation of retail forex activities of broker-dealer affiliates to the securities regulators, but theoretically a broker-dealer affiliate could become registered as an RFED to cloak itself with the mantle of CFTC and NFA regulation. Any firm that is registered as an RFED should be regulated as an FDM. The proposed amendments to Bylaw 306(b) make it clear that all RFEDs will be FDMs and regulated by NFA accordingly.

Closing this RFED loophole does not, however, resolve another potential loophole—a forex dealer registering as an FCM. This loophole is best exemplified as described in recent discussions NFA has had with two Members that are contemplating a business combination where a traditional FCM that is not an FDM (because it is a broker-dealer affiliate) would purchase a current FDM. Since the traditional FCM is a broker-dealer affiliate, the current FDM would become a broker-dealer affiliate as well and could drop its FCM registration and conduct its retail forex activities as an affiliate of the broker-dealer. However, in this case, neither party to this transaction desires the current FDM to drop its FCM registration because, although it would be primarily engaged in retail forex activities, it may want to engage in a de minimis amount of on-exchange futures activity.

Although the two Members in this transaction are clearly not attempting to avoid NFA regulation, this arrangement certainly highlights a regulatory loophole. As with RFED registration, NFA does not believe that a broker-dealer affiliate that is principally a retail forex dealer should be able to become an NFA Member and cloak itself with the mantle of NFA regulation when it is not subject to NFA's forex rules. Therefore, the proposed amendments to Bylaw 306(b) will ensure that NFA Members that are broker-dealer affiliates and are primarily or substantially engaged in retail forex are regulated as FDMs.

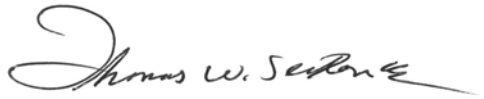
A broker-dealer affiliate registered as an FCM but primarily or substantially engaged in retail forex activities is not subject to the Act and its $20 million capital requirement. Moreover, without the change to Bylaw 306(b) described above, the NFA Member broker-dealer affiliate would also not be an FDM subject to NFA's increased capital requirement. However, the proposed change would make this type of broker-dealer affiliate an FDM subject to NFA's forex rules, including the FDM capital requirement. The Board recognizes that customers of these firms are entitled to the same level of protection as customers of other FDMs. It also recognizes, however, that an alternative capital arrangement can provide comparable protection under the right circumstances. Therefore, it amended Section 11(a) to provide an exemption for these broker-dealer affiliates if certain conditions are met.

In particular, the Board believes customers will be adequately protected if an FDM's obligations are guaranteed by an FCM or broker-dealer and 1) the FDM maintains $5,000,000 in adjusted net capital, 2) the FDM is under common control with the guarantor, 3) the guarantor maintains at least $20,000,000 in adjusted net capital, and 4) the guarantor is a member of either NFA (if an FCM) or FINRA (if a broker-dealer). This alternative will apply to NFA FCM Member broker-dealer affiliates that

become FDMs because they are primarily or substantially engaged in retail forex activities but will not be available to any firm registered as an RFED.

NFA respectfully requests that the Commission review and approve the proposed amendments to NFA Bylaw 306, NFA Financial Requirements Section 11(a), and the Interpretive Notice regarding Forex Transactions.

Respectfully submitted,



Thomas W. Sexton
Vice President and General Counsel