

December 9, 2008

**Via Federal Express**

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

Re: National Futures Association: Forex Requirements – Proposed  
Amendments to Compliance Rules 2-36 and 2-39, Financial Requirements  
Section 13, 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 Compliance Rules 2-36 and 2-39, Financial Requirements Section 13, and the Interpretive Notice regarding Forex Transactions. This proposal was approved by NFA’s Board of Directors (“Board”) on November 20, 2008. NFA respectfully requests Commission review and approval of the proposed amendments.

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

**Part 2 - RULES GOVERNING THE BUSINESS CONDUCT OF MEMBERS  
REGISTERED WITH THE COMMISSION**

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**RULE 2-36. REQUIREMENTS FOR FOREX TRANSACTIONS.**

\* \* \*

(i) Hypothetical Results

Any Member who uses promotional material that includes a measurement or description or makes any reference to hypothetical forex transaction performance results that could have been achieved had a particular trading system of the Member or Associate been employed in the past must comply with Compliance Rule 2-29(c) and the related Interpretive Notice as if the performance results were for transactions in on-exchange futures contracts.

(ij) Scope

This rule governs forex transactions as defined in Bylaw 1507(b).

(jk) Definition of Customer

For purposes of this rule, the term "customer" means a counterparty that is not an eligible contract participant as defined in Section 1a(12) of the Act.

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**RULE 2-39. SOLICITING, INTRODUCING, OR MANAGING FOREX TRANSACTIONS OR ACCOUNTS.**

(a) Except for members who meet the criteria in Bylaw 306(b) and Associates acting on their behalf, Members and Associates who solicit customers, introduce customers to a counterparty, or manage accounts on behalf of customers in connection with forex transactions shall comply with Sections (a),(b),(c),(e), ~~and (h)~~, and (i) of Compliance Rule 2-36.

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## FINANCIAL REQUIREMENTS

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### SECTION 13. FOREX DEALER MEMBER WEEKLY REPORTS.

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(2) Submitting the report certifies that the person filing it is a supervisory employee that is, or is under the ultimate supervision of, a listed principal who is also an NFA Associate; that the person filing it is duly authorized to bind the Forex Dealer Member; and that, to the best of that person's knowledge, all information in the report is true, correct, and complete.

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## INTERPRETIVE NOTICES

\* \* \*

## FOREX TRANSACTIONS

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### B. COMPLIANCE RULE 2-36

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**4. *Recordkeeping* - Members must keep books and records relating to their forex operations for a period of five years from the date thereof and shall keep them readily accessible during the first 2 years of the 5-year period. All such books and records shall be open to inspection by NFA.**

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Forex Dealer Members should adopt and enforce a written policy detailing the procedures it follows to calculate rollover or interest charges and payments. The policy must include the factors that are considered as well as the names of any sources for these factors. The Member should document the underlying factors reviewed in completing the calculation, including any related transactions entered into by the Forex Dealer Member, so it can be replicated.

\* \* \*

**10. Discretion – No Forex Dealer Member, or Associate of a Forex Dealer Member acting in such capacity, may exercise discretionary trading authority over a customer account for which the Forex Dealer Member is, or is offering to be, the counterparty to the transactions in the customer account.**

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#### **EXPLANATION OF PROPOSED AMENDMENTS**

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NFA has identified several unrelated forex issues that NFA believes need to be addressed. These issues include the use of hypothetical performance in promotional materials, the process of obtaining information from Forex Dealer Members ("FDMs"), the lack of consistent procedures for calculating rollover charges and payments, and the potential conflict when FDMs exercise trading authority over customer accounts.

#### **Compliance Rules 2-36(i) and 2-39(a): Hypothetical Results**

In February 2002, NFA adopted Compliance Rule 2-36, which, among other things, provides that affected Members may not engage in conduct that would act as a fraud or deceit. NFA has begun to see an increased use of hypothetical performance results in the forex context. For example, one forex solicitor touted almost 1,200 "consecutive wins" with no losses between May 17, 2007 and June 19, 2007, for

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a profit of over \$800,000. When NFA asked the FDM about this performance, the FDM indicated that it was not achieved through actual trading. Another solicitor claimed that between July 8, 2007 and July 21, 2007, it had made 17 trades that achieved a 550 pip gain against a 77 pip loss. As with the first example, this performance was not the result of actual trades. In both instances, there was nothing that suggested to prospective customers that these results were not actually achieved through trading.

Compliance Rule 2-29(c) and the related Interpretive Notice govern the use of promotional materials containing hypothetical performance results by NFA members for on-exchange transactions. Compliance Rule 2-29 is not applicable to Members' off-exchange foreign currency business, however.

The amendments to Compliance Rule 2-36 clarify that forex hypothetical performance results should be subject to Rule 2-29(c) and the related Interpretive Notice as if the hypothetical results were for on-exchange transactions. This will ensure that FDMs and other Members who solicit or manage forex accounts will not be permitted to use promotional materials that would not be allowed if they were soliciting on-exchange accounts and transactions.

#### Financial Requirements Section 13: Responsibility for Weekly Forex Reports

Through on-site examinations of FDMs, NFA found that much of the information provided to NFA regarding price adjustments, as well as information on the weekly forex reports, was incomplete or inaccurate. Many FDMs delegate filing responsibility to employees who are junior employees and do not have a complete understanding of what the information being provided represents.

The Board amended Financial Requirements Section 13 to specifically require that the person submitting weekly reports to NFA be a supervisory employee that is, or is under the ultimate supervision of, a listed principal who is also an NFA Associate. In this way, an individual who is subject to NFA's jurisdiction will be directly responsible for filing this information or for supervising the person who does. NFA believes that this will emphasize the importance of the information being requested and

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will encourage FDMs to be more thorough when collecting, reviewing, and submitting the information to NFA.

#### Forex Interpretive Notice: Rollovers

An additional issue of concern relates to rollover charges. FDMs use different methods of charging customers for rollovers, but the most common is to collect "interest" on short positions that exceed the "interest" paid on long positions. Some FDMs merely pass on the charges or payments they receive from their liquidity provider, but others add a mark-up or mark-down. This amount may vary from day to day.

Currently, FDMs must disclose all costs, fees, and charges incurred by the customer (including rollover charges), but NFA is concerned that some FDMs do not consistently apply the same formula for calculating rollover charges from one day to the next and do not appear to have any underlying basis, such as their own costs or market conditions, for the charges they impose on their customers.

NFA solicited comments from the FDMs on a proposal that would have required FDMs to provide detailed disclosures to customers as to how the FDM calculates rollover charges and payments, including the name of any sources it uses in doing so. While all the FDMs that commented on this proposal generally supported the idea that customers be aware of the rollover charge and how it is generally calculated, some FDMs had concerns regarding the specifics of the proposal. Three FDMs asked that they not be required to disclose the sources they use to calculate the rollover and one of them believed it would have to get the permission of the sources to publicly disseminate their names. Three FDMs expressed concern that the source might change, sometimes on a daily basis depending on market conditions, and disclosure would confuse customers. Similarly, four FDMs noted that the calculations they use to determine rollover charges involve numerous factors, many of which change depending on market conditions outside of their control. Additionally, these FDMs noted that the calculations can be very involved and complicated, and disclosing them might lead to greater confusion for customers.

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Based on the comments received, NFA believes that requiring detailed disclosure to customers is not the best way to meet our objective. NFA's intention was that an FDM be consistent in its calculations of rollover charges and that it have some basis in its own costs and/or the underlying market. Accordingly, the proposed amendments require FDMs to have written procedures in place for calculating the rollover charge. The amendments do not prescribe the calculation that FDMs use or require that the charge, or even the underlying calculation, remain static regardless of market conditions. Rather, the FDM is required to have written procedures that set forth the factors that are taken into consideration when calculating the rollover charge as well as the sources for these factors. Further, the FDM must maintain documentation of the underlying factors it looked at in calculating the charge, including any related transactions, so NFA can replicate the calculation when examining the FDM.

#### Forex Interpretive Notice: Discretionary Trading Authority

Finally, NFA is concerned about the conflict of interest when FDMs exercise discretionary trading authority over customer accounts for which the FDM acts as counterparty. Where FDMs do not automatically offset their positions with customers, they make more money when the customer loses money. Even if they do automatically offset their positions, they still have an incentive to overtrade the account to create more profit for themselves.

NFA also solicited comments regarding this proposal. Two FDMs commenting on this proposal completely opposed it. One of these FDMs indicated that the rule should be the same as that for futures commission merchants ("FCMs") with regard to accounts for on-exchange trading. Permitting an FCM that acts in an agency capacity with regard to its customers orders to exercise discretion over a customer account is vastly different than permitting an FDM who acts as a counterparty to its customer to do so, however, since an FDM has a financial interest in its customer losing money on trades that it enters into with the customer. The second FDM claimed that the conflict of interest present in a counterparty exercising discretion over a customer

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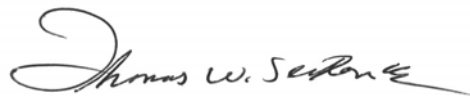
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account is present throughout the financial services industry, but did not offer any examples.

Five FDMs supported this proposal as written. Three additional FDMs supported the proposal for situations where an FDM acts as a market maker but suggested that FDMs that automatically offset the positions should be permitted to have discretion over customer accounts. While this might reduce the economic incentive to place a customer in a bad trade opposite the FDM, it does not eliminate the perceived conflict of interest. Even if an FDM offsets every transaction it enters into with its customers, is still the counterparty to those customer trades. Accordingly, the proposed amendments will prohibit FDMs and their Associates from exercising trading authority over customer accounts for which the FDM acts as counterparty.

NFA respectfully requests that the Commission review and approve the proposed amendments to Compliance Rules 2-36 and 2-39, Financial Requirements Section 13, and the Interpretive Notice regarding Forex Transactions.

Respectfully submitted,



Thomas W. Sexton  
Vice President and General Counsel

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\* The proposed amendments to NFA Compliance Rules 2-36 and 2-39, Financial Requirements Section 13, and the Interpretive Notice regarding Forex Transactions become effective April 1, 2009.