

September 20, 2018

**Via Federal Express**

Mr. Christopher J. Kirkpatrick  
Secretary  
Office of the Secretariat  
Commodity Futures Trading Commission  
Three Lafayette Centre  
1155 21st Street, N.W.  
Washington, DC 20581

Re: National Futures Association: Proposed Amendments to NFA Financial Requirements Section 11 and Section 12 and the Related Interpretive Notice Entitled: *Forex Transactions*

Dear Mr. Kirkpatrick:

Pursuant to Section 17(j) of the Commodity Exchange Act ("CEA"), as amended, National Futures Association ("NFA") hereby submits to the Commodity Futures Trading Commission ("CFTC" or "Commission") the proposed amendments to NFA Financial Requirements Section 11 and Section 12 and the related Interpretive Notice entitled: *Forex Transactions*. NFA's Board of Directors ("Board") unanimously approved the proposals on August 16, 2018. At this time, 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~~)**

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**FINANCIAL REQUIREMENTS**

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**SECTION 11. FOREX DEALER MEMBER FINANCIAL REQUIREMENTS.**

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(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 Regulation 5.7.

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

- (i) a bank or trust company 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; or
- (v) a bank or trust company regulated in a money center country which has in excess of \$1 billion in regulatory capital; ~~or~~
- ~~(vi) any other entity approved by NFA.~~

(c) A Forex Dealer Member may not ~~offset currency transactions or positions executed with or held by or through use of an affiliate (unless approved by NFA) or an unregulated person, as defined in section (b), for purposes of determining net currency positions and the required capital deductions to cover its currency positions for purposes of~~ under CFTC Regulations 1.17(c)(5) and 5.7(b)(2)(v)(A). As used in this subsection (c), "currency" refers to open foreign currency positions with counterparties regardless of whether those counterparties are eligible contract participants as defined in Section 1a(18) of the Act.

(d) NFA will not accept requests to approve an affiliate or unregulated person under subsections (b) or (c) or CFTC Regulation 5.7.

~~(d)~~ (e) An FDM for which NFA is the DSRO that is required to file any document with or give any notice to its DSRO under CFTC Regulations 5.6 [Maintenance of minimum financial requirements by retail foreign exchange dealers and futures commission merchants offering or engaging in retail forex transactions], 5.7 [Minimum financial requirements for retail foreign exchange dealers and future commission merchants offering or engaging in retail forex transactions] and 5.12 [Financial reports of retail foreign exchange dealers], or is required to file any financial report or statement with any other securities or futures self-regulatory organization of which it is a member shall also file one copy of such document with or give such notice to NFA at its Chicago office no later than the date such document or notice is due to be filed with or given to the CFTC or the self-regulatory organization.

~~(e)~~ (f) For purposes of this rule:

- (1) "Forex" has the same meaning as in Bylaw 1507(b);
- (2) "Forex Dealer Member" has the same meaning as in Bylaw 306;
- ~~(3) As used in section (c), "currency" refers to open foreign currency positions with counterparties regardless of whether those counterparties are eligible contract participants as defined in Section 1a(18) of the Act;~~
- ~~(3)~~(4) "Affiliate" means any person that controls, is controlled by, or is under common control with the Forex Dealer Member; and
- ~~(4)~~(5) "Dealer" means any person that (i) holds itself out as a dealer in forex or in retail commodity transactions as described in 2(c)(2)(D) of the Act; (ii) makes a market in forex or in retail commodity transactions as defined in 2(c)(2)(D) of the Act; (iii) regularly enters into forex or in retail commodity transactions as described in 2(c)(2)(D) of the Act with counterparties as an ordinary course of business for its own account; or (iv) engages in any activity causing the person to be commonly known in the trade as a dealer or market maker in forex or in retail commodity transactions as described in 2(c)(2)(D) of the Act. Dealer includes other FDMs, as well as any entity acting in this manner that is not required to be an FDM. For purposes of (a)(ii)(dd) above, dealer does not include a bank or trust company regulated in a money center country which has in excess of \$1 billion in regulatory capital.

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

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(g) An FDM is prohibited from acting as a counterparty to an eligible contract participant acting as a dealer (as that term is defined in Financial Requirements Section 11(f) ~~(e)~~) unless that dealer collects and maintains from its customers and eligible contract participant counterparties security deposit amounts for forex equal or greater to the amounts required in subsection(s) (a) and (b).

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## INTERPRETIVE NOTICES

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### 9053 – FOREX TRANSACTIONS

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#### C. OTHER REQUIREMENTS

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#### 3. Financial Requirements Section 11(b)

Section 11(b) prohibits a Forex Dealer Member from including assets held by an affiliate (~~unless approved~~) or an unregulated person in the firm's current assets for purposes of determining its adjusted net capital under CFTC Regulation 5.7(b)(2)(v)(A). This means an FDM may not count any part of those assets for capital purposes.<sup>9</sup>

An unregulated person is any person that is **not**:

- (i) a bank or trust company regulated by a U.S. banking regulator;
- (ii) a broker-dealer registered with the U.S. Securities and Exchange Commission and a member of FINRA;
- (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;
- or
- (v) a bank or trust company regulated in a money center country which has in excess of \$1 billion in regulatory capital; ~~or~~
- ~~(vi) any other entity approved by NFA.~~

NFA will not accept requests to approve an affiliate or unregulated person under NFA Financial Requirements Sections 11(b) or 11(c) or CFTC Regulation 5.7.

~~Any Forex Dealer Member may ask NFA to approve an otherwise unregulated person for purposes of Financial Requirements Sections 11(b) and (c). In~~

determining whether to approve an unregulated person that is not an affiliate, NFA will consider a number of factors, including:

- Whether the person is regulated in another jurisdiction and, if so, the type and extent of regulation; and
- The person's capital.

NFA's approval of a particular person means that all unaffiliated Forex Dealer Members may treat that person as regulated under Sections 11(b) and (c). NFA may also approve categories of counterparties (e.g., banks regulated in a particular jurisdiction).

A Forex Dealer Member may not engage in Section 11(b) or (c) transactions with a regulated affiliate without NFA's approval. The Member may, however, ask NFA to authorize it to cover its positions with specified affiliates (including unregulated affiliates). An affiliate is any entity that controls, is controlled by, or is under common control with the Forex Dealer Member. The standards for approving affiliated persons are significantly higher than those for unaffiliated persons. For example, NFA will also consider:

- The parent company's and affiliated person's capital;
- Whether the parent company and the affiliated person are regulated entities;
- Whether the parent company will guarantee the obligations of the affiliated person (unless the parent company and the affiliated person are the same entity);
- Whether the affiliated person has strong risk-management policies to limit its value-at-risk; and
- For purposes of Section 11(c), whether the affiliated person limits the amount of offsetting transactions it enters into with unregulated counterparties.

#### 4. Financial Requirements Section 11(c)

Section 11(c) prohibits Forex Dealer Members from considering offsetting currency transactions or positions executed with or held by or through an affiliate (unless approved) and or unregulated persons for purposes of determining net currency positions and the required capital deductions to cover their foreign currency positions for purposes of under CFTC Regulations 1.17(c)(5) and 5.7(b)(2)(v)(A).

The rule does not prohibit Forex Dealer Members from entering into positions with an affiliate or unregulated or unapproved counterparties. They may not, however, count positions with those counterparties when calculating their net positions or covered positions for purposes of CFTC Regulations 1.17(c)(5) and 5.7(b)(2)(v)(A).

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### EXPLANATION OF PROPOSED AMENDMENTS

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NFA Financial Requirements Section 11 requires each FDM to maintain adjusted net capital (as defined by CFTC Regulations 1.17 and 5.7) of at least \$20 million plus additional amounts based on the FDM's liabilities to customers and counterparties less several adjustments set forth in CFTC Regulation 1.17. NFA Financial Requirements Section 11(b) currently provides that an FDM may not include assets held by an affiliate or an unregulated person<sup>1</sup> in its current assets for purposes of determining its adjusted net capital unless such affiliate or unregulated person has been approved by NFA.

As the Commission is aware, in determining adjusted net capital, CFTC Regulations 1.17 and 5.7 require an FDM to take capital deductions of specified percentages of market value for net currency positions. Under NFA Financial Requirements Section 11(c), positions entered into with an affiliate or unregulated person may not be used to reduce an FDM's exposure for purposes of determining

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<sup>1</sup> For purposes of NFA Financial Requirements Section 11(b) and 11(c), a person is unregulated unless it is: (i) a bank or trust company 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) a bank or trust company regulated in a money center country which has in excess of \$1 billion in regulatory capital; or (vi) any other entity approved by NFA.

CFTC capital charges on net currency positions unless such affiliate or unregulated person has been approved by NFA.

NFA added the restrictions on using an affiliate or unregulated person to hold assets or cover positions for purposes of reducing net exposure in 2007. In doing so, NFA identified several factors that would be considered in determining whether to approve an affiliate or unregulated party under Sections 11(b) and 11(c). NFA added these limitations on maintaining assets and covering exposure through affiliates or unregulated parties to replace concentration charges that were previously applied to significant positions with unregulated counterparties.

In recent years, NFA's concerns regarding FDM capital have increased, and NFA does not believe that it is appropriate to grant an exemption under Section 11(b) or 11(c) in any circumstance. In particular, NFA is concerned that an FDM using affiliates and unregulated entities to hold assets may lose those assets if an unanticipated event occurs causing the affiliate financial stress. Additionally, while holding funds in another jurisdiction always poses some bankruptcy risk, NFA is concerned that this risk is heightened when inter-affiliate transactions or those with unregulated entities are involved. Any delay in the recovery of customer funds caused by a foreign bankruptcy regime is problematic and recovery may lead to increased administrative fees. Moreover, NFA's experience over the years has shown that NFA generally has little to no visibility into the books and records of non-Member affiliates and unregulated persons, which limits our ability to track the financial condition of these firms.

Given these concerns, NFA has not granted any requests pursuant to Sections 11(b) and 11(c) since 2014. Currently, no FDM uses an affiliate or unregulated entity based on an approval by NFA to either include assets held by an affiliate or unregulated person in its current assets or to reduce an FDM's retail forex exposure for purposes of determining CFTC capital charges on net forex positions.

For the reasons discussed above, NFA is proposing to eliminate the approval request process for affiliates and unregulated persons under NFA Financial Requirements Sections 11(b) and 11(c). Additionally, since CFTC Regulations 5.7(b) and (c) contain references prohibiting an RFED from using an affiliate or an unregulated person for certain activities in the context of determining net capital unless the entity is approved by the firm's DSRO, NFA is also proposing to amend Section 11 to clarify that NFA will not accept requests to approve an affiliate or unregulated person under CFTC Regulation 5.7. Finally, NFA is proposing to update a cross-reference in NFA Financial Requirements Section 12 and to make corresponding changes to NFA Interpretive Notice 9053 entitled *Forex Transactions*.

Mr. Christopher J. Kirkpatrick

September 20, 2018

As mentioned earlier, NFA's Board of Directors unanimously approved the proposed amendments on August 16, 2018. NFA respectfully requests that the Commission review and approve the proposed amendments to NFA Financial Requirements Section 11 and Section 12 and the related Interpretive Notice entitled: *Forex Transactions*.

Respectfully submitted,

A handwritten signature in black ink that reads "Carol A. Wooding". The signature is written in a cursive, flowing style.

Carol A. Wooding  
Vice President  
General Counsel and Secretary