

November 20, 2012

Via Federal Express

Ms. Sauntia Warfield
Assistant Secretary
Office of the Secretariat
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, DC 20581

Re: National Futures Association: NFA Member FCMs Acting as a Counterparty to Off-Exchange Foreign Currency Transactions With Eligible Contract Participants – Proposed Amendments to NFA Financial Requirements Section 1(a)*

Dear Ms. Warfield:

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") the proposed amendments to NFA Financial Requirements Section 1(a) regarding NFA Member FCMs acting as a counterparty to off-exchange foreign currency transaction with eligible contract participants. NFA's Board of Directors ("Board") approved the proposal on November 15, 2012, and NFA respectfully requests Commission review and approval of the proposal.

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:

(i) \$1,000,000;

(ii) For Member FCMs with less than \$2,000,000 in Adjusted Net Capital, \$6,000 for each remote location operated (i.e., proprietary branch offices, main office of each guaranteed IB and branch offices of each guaranteed IB);

(iii) For Member FCMs with less than \$2,000,000 in Adjusted Net Capital, \$3,000 for each AP sponsored (including APs sponsored by guaranteed IBs);

(iv) For securities brokers and dealers, the amount of net capital specified in Rule 15c3-1(a) of the Regulations of the Securities and Exchange Commission (17 CFR 240.15c3-1(a));

(v) Eight (8) percent of domestic and foreign domiciled customer and non-customer (excluding proprietary) risk maintenance margin/performance bond requirements for all domestic and foreign futures, options on futures contracts and cleared over-the counter derivatives positions excluding the risk margin associated with naked long option positions;

(vi) For a Member FCMs that are acts as counterparties to a forex options transactions-(as forex isn defined in Bylaw 1507(b) but excluding the counterparty limitation contained in Bylaw 1507(b)(2)), \$520,000,000, except that Forex Dealer Members must meet the higher requirements in Financial Requirements Section 11.

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EXPLANATION OF PROPOSED AMENDMENTS

Over the past ten years, NFA has created a regulatory framework and requirements to address issues posed by NFA's Forex Dealer Members (FDMs). Pursuant to NFA Bylaw 306, Members are FDMs if they act as counterparty to forex transactions, as defined in NFA Bylaw 1507(b). Pursuant to NFA Bylaw 1507(b)(2), for a counterparty to be an FDM, the "forex transactions" must be offered to or entered into with persons that are not eligible contract participants (ECPs). In other words, an FDM acts as a counterparty to retail forex transactions. Once a Member firm is an FDM, then NFA Financial Requirements Section 11(a) imposes a minimum adjusted net capital requirement of \$20 million upon the firm.

Over the past year or so, we have observed that several NFA Member FCMs are almost exclusively acting as counterparty in forex transactions with ECPs. Because these FCMs are not FDMs (i.e. they do not act as a counterparty to retail forex transactions), they only must meet the minimum adjusted net capital requirement of \$1 million pursuant to NFA Financial Requirements Section 1. Furthermore, the vast majority of ECPs doing business with these thinly-capitalized FCMs are not typical institutional customers.

Specifically, three FCM Members have ceased acting as FDMs but continue to act as counterparty to forex transactions with ECPs. One firm's ECP forex counterparties include a Hong Kong based bullion investment company, a jewelry company in the United Arab Emirates, an investment company based in Lebanon, and three foreign retail forex affiliates¹ of the FCM. This NFA Member FCM was subject to two NFA enforcement actions while it was an FDM. The second FCM Member introduces retail forex customers to another NFA FDM, and also acts itself as counterparty to two ECPs. One of the ECP counterparties is a foreign retail forex affiliate and the other is a financial institution located in Japan. NFA also brought two enforcement actions against this FCM while it was an FDM. The third FCM Member has approximately 30 ECP counterparties, several of which are omnibus accounts from Korea and other parts of Asia. NFA has also brought an enforcement action against this FCM while it was an FDM.

In addition to these three FCMs, one other current FDM has recently informed NFA that it is in the process of winding down its retail forex business, and plans to only act as counterparty to forex transactions with ECPs. Lastly, NFA recently approved an FCM Member that indicated it plans to act as counterparty to forex transactions with ECPs; however, this firm has not yet commenced business. All of these FCMs will only have to meet the FCM minimum net capital requirement of \$1 million.

Given the counterparty nature of these FCMs' forex activities, NFA is extremely concerned that these firms are currently subject to inadequate capital requirements. Specifically, from a financial safeguard perspective, it makes absolutely no sense that an FDM that acts as counterparty to a single retail forex transaction must maintain at least \$20 million in adjusted net capital; however, an FCM that engages in an identical type transaction with an ECP must only maintain at least \$1 million in capital. Moreover, although other NFA Member FCMs currently act as counterparties to forex transactions with ECPs, all of those FCMs also engage in a substantial exchange

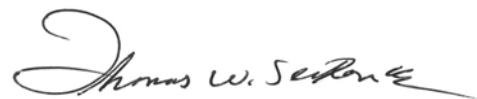
¹ NFA does not believe that these foreign affiliates are subject to requirements similar to NFAs with respect to the type of entities that can be used to offset risk and to deposit customer funds.

traded business and have capital requirements that exceed \$20,000,000. NFA staff confirmed with CME Group staff that none of the FCMs for which it is the DSRO have less than \$20 million in adjusted net capital if they engage in forex activities with ECPs. NFA also discussed this proposal with NFA's FCM Advisory Committee, which supported the proposal.

To address these financial safeguard concerns, the proposed amendments to NFA Financial Requirements Section 1 will include a provision that requires an FCM that acts as counterparty to a forex transaction with an ECP to maintain adjusted net capital of at least \$20,000,000. Certainly, NFA may have to address other rulemaking issues in the future with regard to FCMs engaging in these types of forex transactions but the financial integrity of these firms is paramount and must be addressed first.

NFA respectfully requests that the Commission review and approve the proposed amendments to NFA Financial Requirements Section 1(a) regarding NFA Member FCMs acting as a counterparty to off-exchange foreign currency transactions with ECPs.

Respectfully submitted,



Thomas W. Sexton
Senior Vice President and
General Counsel

*The proposed amendments to Financial Requirements Section 1 become effective June 30, 2013.