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SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
Form 19b-7

File No.* SR - 2014 - * 04

Amendment No. (n/a. for Amendments *)

Proposed Rule Change by * National Futures Association

Pursuant to Rule 19b-7 under the Securities Exchange Act of 1934

Initial *

Amendment *

Withdrawal



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Description

Provide a brief description of the proposed rule change (limit 250 characters, required when Initial is checked *).

Proposed Adoption of the Interpretive Notice to NFA Compliance Rules 2-4 and 2-36: Prohibition on the Use of Certain Electronic Funding Mechanisms

Contact Information

Provide the name, telephone number and e-mail address of the person on the staff of the self-regulatory organization prepared to respond to questions and comments on the proposed rule change.

First Name * Carol Last Name * Wooding

Title * Associate General Counsel

E-mail * cwooding@nfa.futures.org

Telephone * (312) 781-1409 Fax (312) 559-3476

SRO Governing Body Action

Describe action on the proposed rule change taken by the members or board of directors or other governing body of the SRO (limit 250 characters, required *).

NFA's Board of Directors approved the proposed rule change on May 15, 2014

Signature

Pursuant to the requirements of the Securities Exchange Act of 1934,

has duly caused this filing to be signed on its behalf by the undersigned thereunto duly authorized officer.

Date 06/18/2014

Senior Vice-President, General Counsel and Secretary

By Thomas W. Sexton III

(Name *)

(Title *)

NOTE: Clicking the button at right will digitally sign and lock this form. A digital signature is as legally binding as a physical signature, and once signed, this form cannot be changed.

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SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

For complete Form 19b-7 instructions please refer to the EFFS website.

Exhibit 1 - Notice of Proposed Rule Change (required when Initial)

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The self-regulatory organization must provide all required information, presented in a clear and comprehensible manner, to enable the public to provide meaningful comment on the proposal.

The Notice section of this Form 19b-7 must comply with the guidelines for publication in the Federal Register, as well as any requirements for electronic filing as published by the Commission (if applicable). The Office of the Federal Register (OFR) offers guidance on Federal Register publication requirements in the Federal Register Document Drafting Handbook, October 1998 Revision. For example, all references to the federal securities laws must include the corresponding cite to the United States Code in a footnote. All references to SEC and CFTC rules must include the corresponding cite to the Code of Federal Regulations in a footnote. All references to Securities Exchange Act Releases and Commodities Exchange Act Releases must include the release number, release date, Federal Register cite, Federal Register date, and corresponding file number (e.g., SR-[SRO]-xx-xx). A material failure to comply with these guidelines will result in the proposed rule change being deemed not properly filed. See also Rule 0-3 under the Act (17 CFR 240.0-3)

Exhibit 2 - Notices, Written Comments, Transcripts, Other Communications

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Copies of notices, written comments, transcripts, other communications. If such documents cannot be filed electronically in accordance with Instruction E, they shall be filed in accordance with Instruction F.

Exhibit Sent As Paper Document

Exhibit 3 - Form, Report, or Questionnaire

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Copies of any form, report, or questionnaire that the self-regulatory organization proposes to use to help implement or operate the proposed rule change, or that is referred to by the proposed rule change. If such documents cannot be filed electronically in accordance with Instruction E, they shall be filed in accordance with Instruction F.

Exhibit Sent As Paper Document

Exhibit 4 - Proposed Rule Text

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The self-regulatory organization must attach as Exhibit 4 proposed changes to rule text. Exhibit 4 shall be considered part of the proposed rule change.

Exhibit 5 - Date of Effectiveness of Proposed Rule Change (required when Initial)

The self-regulatory organization must attach one of the following:

- CFTC Certification
- CFTC Request that Review of Proposed Rule Change is not Necessary
- Request for CFTC Approval of Proposed Rule Change
- CFTC Determination that Review of Proposed Rule Change is not Necessary
- Indication of CFTC Approval of Proposed Rule Change

Request for CFTC Approval of Proposed Rule Change: Attach a copy of any request submitted to the CFTC for approval of the proposed rule change.

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Exhibit Sent As Paper Document

Partial Amendment

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If the self-regulatory organization is amending only part of the text of a lengthy proposed rule change, it may, with the Commission staff's permission, file only those portions of the text of the proposed rule change in which changes are being made if the filing (i.e. partial amendment) is clearly understandable on its face. Such partial amendment shall be clearly identified and marked to show deletions and additions.

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-_____; File No. SR-NFA-2014-04)

Self-Regulatory Organizations; National Futures Association; Notice of Filing and Immediate Effectiveness of Proposed Adoption of the Interpretive Notice to NFA Compliance Rules 2-4 and 2-36: Prohibition on the Use of Certain Electronic Funding Mechanisms

Pursuant to Section 19(b)(7) of the Securities Exchange Act of 1934 (Exchange Act),¹ and Rule 19b-7 under the Exchange Act,² notice is hereby given that on June 18, 2014, National Futures Association (NFA) filed with the Securities and Exchange Commission (SEC or Commission) the proposed rule change described in Items I, II, and III below, which Items have been substantially prepared by the NFA. The Commission is publishing this notice to solicit comments on the proposed rule from interested persons.

On June 18, 2014, NFA submitted the proposed rule change to the CFTC for approval. The CFTC has not yet approved the proposed rule change.

I. Self-Regulatory Organization's Description and Text of the Proposed Rule Change

Under the proposed Interpretive Notice to NFA Compliance Rules 2-4 and 2-36: Prohibition on the Use of Certain Electronic Funding Mechanisms ("Interpretive Notice"), NFA Members ("Members") are prohibited from allowing customers to fund futures or forex accounts with a credit card or other electronic funding methods tied to a credit card. The proposed Interpretive Notice does not prohibit Members from allowing customers to fund futures or forex accounts with electronic funding mechanisms that are tied to a customer's bank account at a

¹ 15 U.S.C. 78s(b)(7).

² 17 CFR 240.19b-7.

financial institution provided the funds deposited are drawn directly from the customer's bank account. The Interpretive Notice requires, however, that the Member be able to distinguish, prior to accepting funds, between an electronic funding method that draws money from the customer's account at a financial institution and a traditional credit card, and be able to reject the credit card transaction before accepting funds. The Interpretive Notice also requires Members offering this type of electronic funding mechanism to provide adequate risk disclosure in light of the customer's financial circumstances.

The text of the Interpretive Notice is available on NFA's website at www.nfa.futures.org, the Commission's website at www.sec.gov, NFA's office, and at the Commission's Public Reference Room.

II. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for the Proposed Rule Change

In its filing with the Commission, NFA included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. NFA has prepared summaries, set forth in sections A, B, and C below, of the most significant aspects of such statements.

A. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for the Proposed Rule Change

1. Purpose

Section 15A(k) of the Exchange Act³ makes NFA a national securities association for the limited purpose of regulating the activities of NFA Members who are registered as brokers or dealers under Section 15(b)(11) of the Exchange Act.⁴ The proposed Interpretive Notice applies to all NFA Members, including those that are registered as security futures brokers or dealers under Section 15(b)(11) of the Exchange Act.

NFA adopted the Interpretive Notice to NFA Compliance Rules 2-4 and 2-36 prohibiting Members from allowing customers to fund futures or forex accounts with a credit card or other electronic payment methods tied to a credit card after an extensive study and analysis done at the direction of NFA's Compliance and Risk Committee ("CRC"). The CRC's study and analysis found significant customer protection concerns with credit card funding in the retail forex area, and therefore NFA's Board of Directors, upon the recommendation of the CRC, determined the only appropriate action was to adopt this prohibition. The prohibition is entirely consistent with NFA's longstanding position that it is a violation of NFA Compliance Rule 2-4, and inconsistent with just and equitable principles of trade, for Members to encourage customers to borrow money to invest.⁵

Many Forex Dealer Members ("FDMs") offer their retail forex customers the ability to fund their accounts directly using a credit card or via an online

³ 15 U.S.C. 78o-3(k).

⁴ 15 U.S.C. 78o(b)(11).

⁵ See *In the Matter of First Investors Group of Pal Beaches, Inc., et al.*, NFA Case No. 95-BCC-011 (November 12, 1999).

payment facilitator (e.g., PayPal) that is commonly tied to a credit card (Payment Facilitator(s) – Credit). The CRC had several concerns with this practice, including that retail customers may be using credit cards to open accounts with funds that are borrowed and, therefore, not risk capital. The CRC's concern had significant merit since a 2012 review of several FDM websites showed that those FDMs promoted credit funding as the "quickest," "easiest," and "fastest" method of investing.

Given its concern, the CRC began considering whether it would be appropriate for NFA to prohibit its Members from allowing customers to fund their accounts (both forex and futures) via a credit card or a Payment Facilitator – Credit. As part of its consideration, the CRC directed NFA staff to conduct a detailed analysis of FDM account funding practices, customer income levels, and customer account funding origins. The analysis covered approximately 15,500 accounts held at seven FDMs—all of which were registered as retail foreign exchange dealers ("RFED")—during 2012. The results of this analysis revealed:

- Credit card funding restrictions varied among the FDMs. Several permitted the use of a credit card up to \$10,000 per transaction. One firm based its restriction on a customer's income level and a permitted customer with a net income between \$0-\$19,000 to fund an account with as much as \$1,000 through a credit card;
- The average life of a retail forex trading account at an RFED was 4 months regardless of the amount of the initial deposit;
- For the 4th quarter 2013, 72% of the accounts analyzed were unprofitable;
- 78% of all accounts were initially funded via credit card/debit card/online payment facilitator;
- Almost 50% of all account holders reported a net income of \$50,000 or less; and

- Deposits made by credit card/debit card/online payment facilitator were markedly lower than deposits made by wires or checks. For example, for customers with a net income less than \$50,000, the average deposit via credit card/debit card/online payment facilitator was approximately \$1,050 whereas for checks or wires it was approximately \$6,650. This difference was also prevalent at other net income levels, including above \$100,000 where the average deposit via credit card/debit card/online payment facilitator was approximately \$2,450 whereas for checks or wires it was approximately \$28,000.

Given the prevalence of credit card usage by customers to initially fund retail forex accounts and the fact that such a large percentage of those customers had a relatively low income level (\$50,000 or less), the CRC reviewed whether the FDMs provide specific risk disclosures regarding the implications of funding via a credit card or a Payment Facilitator – Credit and learned that none of the FDMs warned customers that they should not use a credit card or Payment Facilitator – Credit to borrow money to invest in retail forex.

The CRC found the data very disturbing from a customer protection perspective because it reveals that lower income individuals predominantly use credit cards or Payment Facilitators – Credit to fund their accounts and the vast majority of these individuals lose their funds trading forex. Although the CRC recognized that it is possible that all lower income individuals pay off their credit card balances each month and are not borrowing funds to invest beyond the payment due date, the CRC concluded that this possibility is simply implausible given the low income levels.

NFA Compliance Rule 2-4 requires Members and their Associates to observe high standards of commercial honor and just and equitable principles of trade in the conduct of their commodity futures business. Similarly, NFA

Compliance Rule 2-36(c) requires Members and their Associates to observe high standards of commercial honor and just and equitable principles of trade in the conduct of their forex business. The CRC concluded that permitting customers to utilize funding mechanisms that by their very nature allow retail customers to borrow funds to invest in markets where the risk of loss can be substantial and a total loss may occur simply is not consistent with a Member's obligation to observe high standards of commercial honor and just and equitable principles of trade. Given NFA's analysis of the FDMs' customers' usage of credit cards and Payment Facilitator – Credit, and the fact that credit cards and Payment Facilitators – Credit readily allow individuals to borrow funds to purchase goods and services, the CRC concluded that without adequate mechanisms in place to ensure that customers are not borrowing funds to invest in the highly volatile futures and forex markets, Members should not be permitted to allow their customers to invest via electronic funding mechanisms.

The Interpretive Notice does not ban forms of electronic funding mechanisms that are tied to a customer's bank account at a financial institution, such as a debit card or a PayPal account tied to a bank account. The CRC found that these funding mechanism are acceptable and appear consistent with a Member's obligation to observe high standards of commercial honor and just and equitable principles of trade because when a customer uses an electronic funding mechanism directly tied to an account at a financial institution, the customer has funds on hand that are immediately transferred from the customer's bank account to the Member, which significantly reduces the

likelihood that funds are being borrowed to invest. However, in order for a Member to allow customers to use electronic funding mechanisms, the Member must be able to distinguish between those electronic funding mechanisms tied to a credit card and those tied to a bank account and reject the ones tied to a credit card.⁶

Under the Interpretive Notice, if a Member offers customers the ability to use an electronic funding mechanism, then the Member must utilize a processing system or some other electronic mechanism that can ensure the funding device is a debit card or some other payment facilitator that is tied directly to the customer's bank account at a financial institution. Moreover, any Member offering this type of funding mechanism, must also ensure that adequate risk disclosure is provided to customers in light of the customers' financial circumstances.

2. Statutory Basis

NFA believes that the proposed rule change is authorized by, and consistent with, Section 15A(k)(2)(B) of the Exchange Act.⁷ That section sets out requirements for rules of a futures association, registered under Section 17 of the

⁶ One FDM indicated that it currently uses a third-party provider to process credit and debit card transactions when they are initiated by the customer. Accordingly, the third-party provider uses a programming code, which allows its front-end processor to identify whether a card is a credit or debit card based on the digits listed on the card. This front-end processing system has the ability to identify the card as a debit card even if the customer elected to process the card as a credit transaction. In other words, the system programming can distinguish between a debit card issued by a bank with monies drawn from a checking or savings account, or a traditional credit card. The third party provider is able to automatically reject transactions that are credit card transactions.

⁷ 15 U.S.C. 78o-3(k)(2)(B).

Commodity Exchange Act, that are a registered national securities association for the limited purpose of regulating the activities of members who are registered as brokers or dealers in security futures products pursuant to Section 15(b)(11) of the Exchange Act. Under Section 15A(k)(2)(B), the rules of such a limited purpose national securities association must be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest in connection with security futures products in a manner reasonably comparable to the rules of a registered national securities association applicable to securities futures products. NFA believes the proposed rule change meets these requirements because NFA determined that permitting customers to use credit cards to fund futures and forex accounts was inconsistent with just and equitable principles of trade and the proposed Interpretive Notice prohibits Members from permitting customers to use credit cards to fund accounts.

B. Self-Regulatory Organization's Statement on Burden on Competition

NFA recognizes that the proposed rule change may impose a minor burden on competition with respect to foreign customers that might be able to use credit cards to fund accounts with foreign intermediaries that are not Members of NFA. NFA concluded, however, that any burden was outweighed by the need to adopt appropriate customer protection measures. NFA also concluded that the burden was minimized by the fact that the Interpretive Notice permits Members to offer customers the ability to use an electronic funding mechanism that draws funds directly from the

customer's account at a financial institution, provided the Member is able to distinguish between those electronic funding mechanisms drawing funds directly from the customer's account at a financial institution and those tied to a credit card and reject those transactions tied to a credit card.

C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received From Members, Participants, or Others

The CRC requested feedback on the concept of prohibiting Members from allowing customers to fund their forex or futures accounts with a credit card or Payment Facilitator – Credit from NFA's Futures Commission Merchant ("FCM"), Introducing Broker ("IB"), Commodity Pool Operator ("CPO") and Commodity Trading Advisor ("CTA") Advisory Committees. Each of these Committees fully supported a ban of this practice for both futures and forex accounts. Given the importance of this issue, the CRC did not obtain the views of NFA's FDM Advisory Committee—which had recently lost most of its representatives due to FDM withdrawals and consolidations—but rather obtained the FDMs' views by issuing a Notice to all FDMs requesting their comments. The CRC also met with affected members of the FDM community to further discuss their comments.

Specifically, NFA received comments from five of NFA's 17 FDMs (one of which was filed by a law firm on behalf of the FDM), the Financial Services Roundtable ("FSR") and a retail forex customer. All but one FDM strongly opposed a ban against FDMs accepting credit cards from customers to fund forex trading accounts. Despite the fact that credit card funding was not "an insignificant portion" of its business, this FDM did not object to the proposed ban

but requested a 60-day implementation period in order to make operational changes to reject credit card transactions while permitting debit card transactions and to educate clients about the ban.

The CRC carefully considered all of the comments received. Below is a summary of the material comments and the CRC's response.

- Forex customers must react to market changes during non-banking hours and credit cards are the only funding method to do so, while checks or wire transfers often take too long to be credited to prevent a margin close-out.
- Credit cards are more economical since FDMs do not charge a fee to use them while banks charge fees for wire transfers and use of ACH.
- Credit card funding is one of the fastest, most convenient, and lowest cost funding vehicle.
- Many FDMs represented to NFA that customers need to use credit cards in order to quickly add funds in order to avoid forced liquidation of their positions.

The CRC recognized that credit cards may provide an efficient and, in some instances, economical method for depositing funds into a trading account. The CRC believed, however, that this benefit is vastly outweighed by the risk associated with a customer borrowing funds to invest in futures or forex. Moreover, the CRC believed that the efficient and economical benefits of credit card funding can be retained by permitting Members to offer customers the ability to use an electronic funding mechanism that draws funds directly from the customer's account at a financial institution, provided the Member is able to distinguish between those electronic funding mechanisms drawing funds directly from the customer's account at a financial institution and those tied to a credit card and reject those transactions tied to a credit card.

Additionally, NFA's analysis revealed that very few forex positions overall are auto-liquidated, customers generally add funds to their account using the same method as their initial funding method, and positions in accounts funded through a credit card are not less likely to be auto-liquidated. In fact, NFA's analysis showed that those accounts funded through a credit card actually had positions auto-liquidated more frequently than those accounts funded through traditional methods, although the percentage of auto-liquidations remained relatively low.

- Funds deposited by traditional methods may ultimately be drawn from credit source.

The CRC acknowledged that the prohibition could be circumvented because accounts funded with deposits using traditional methods may ultimately be drawn from credit sources. The CRC, however, concluded that banning the direct use of credit cards would lessen the likelihood of this occurrence because a customer can make an instantaneous decision to use a credit card, whereas other forms of credit generally take longer to obtain and provide the customer with more time to consider the consequences of borrowing funds to invest. Moreover, the CRC felt that credit cards are funding mechanism that lend themselves to borrowing funds and permitting this type of funding mechanism is directly contrary to NFA's longstanding position that it is a violation of NFA Compliance Rule 2-4, and inconsistent with just and equitable principles of trade, for Members and Associates to encourage customers to borrow money to invest.

- The ban is overly broad since alternative payment facilitators (e.g., PayPal, MoneyBookers and Google Checkout) may be funded through a bank account or other debit sources.

The CRC addressed this comment by providing that the ban did not apply to electronic payment methods that are tied to a bank account at a financial institution provided that the Member is able to distinguish between electronic payment mechanisms that are tied to a bank account and traditional credit card transactions and reject the credit card transactions before accepting funds.

- FDMs have other procedures in place to ensure that customers only use risk capital even if the source is a credit card.
- NFA has other rules that ensure that customers do not invest funds in excess of risk capital (Rule 2-36 "know your customer," risk disclosure requirements, and guidance requiring FCMs to prominently disclose that customers should only fund with risk capital).

The CRC acknowledged that NFA had other rules in place to guard against customers investing in excess of risk capital and that FDMs should have other procedures in place to ensure customers only use risk capital even if the source was a credit card. The CRC concluded, however, that based on the analysis conducted and the fact that credit cards by their nature permit easy access to borrowed funds any disclosure alone is an insufficient customer protection measure to address the issue.

- Banks that issue credit cards consider a customer's credit worthiness in determining the customer's credit limit, which is a built in risk safeguard.

The CRC did not believe this provided a credible rationale to permit credit card funding. Retail customers should not be borrowing funds to invest in futures or forex. Regardless of the credit limit determined by a bank, a customer should

not be using borrowed funds to invest in the volatile futures or forex markets where the risk of loss may be substantial.

- Certain foreign jurisdictions permit credit card funding.
- Credit cards are permitted in numerous industries in which "customer funds are put at risk with far fewer safeguards than retail forex trading," including the New York State Lottery provides customers the option of signing up for subscriptions to certain lottery games using credit cards, and the Nassau County New York OTB permits individuals to make deposits via credit card to their permanent wagering account.

The CRC was not persuaded by the comment that many foreign jurisdictions permit customers to use credit cards to fund forex accounts. The CRC felt that the customer protection concerns raised by this practice were far too disturbing and the fact that foreign jurisdictions may permit this practice did not outweigh these concerns. The CRC also found entirely unpersuasive the fact that other industries, particularly off-track betting parlors or lottery related agencies, permitted customers to use credit cards.

- The FDMs opposing a ban on funding via a credit card recommended that NFA address this issue short of imposing a prohibition. For example, these FDMs believe that NFA should do one or more of the following—prohibit heavy promotion of credit card funding, require account withdrawals to go back to the original funding credit card, establish a monthly deposit cap for credit card funding, enhance disclosures regarding risk capital usage, issue prominent warnings regarding credit card usage to underscore the risks of using this funding means if a customer does not have sufficient bank funds to cover the deposit, and recommending that customers pay off credit card balances monthly by the due date.

The CRC considered other alternatives and concluded that given the customer protection concerns raised, and the fact that credit cards are any easy source of borrowed funds, the only way to address the issues was to prohibit Members from allowing customers to use credit cards or other electronic methods

unless the Member could distinguish between electronic payments that are tied to a bank account and traditional credit card transactions and reject the credit card transactions.

- The FSR's letter claimed banning credit cards and the use of credit cards through payment facilitators (e.g. Paypal) is a significant regulatory action that has far reaching implications. The FSR urged NFA to consider viable alternatives and seek comments from those outside the forex industry.

The CRC determined that one of NFA's primary responsibilities is the protection of customers in the futures and forex industries and that the prohibition was necessary to achieve this objective. The CRC also observed that NFA's mandate is not to promote the business interests of credit card companies.

D. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

The proposed rule change is not effective because the CFTC has not yet approved the proposed rule change.

Section 19B(7)(C) of the Act provides, inter alia that "[a]ny proposed rule change of a self-regulatory organization that has taken effect pursuant to [Section 19(b)(7)(B) of the Act] may be enforced by such self-regulatory organization to the extent such rule is not inconsistent with the provisions of the title, the rules and regulations thereunder, and applicable Federal law. At any time within 60 days of the date of effectiveness of the proposed rule change, the Commission after consultation with the CFTC, may summarily abrogate the proposed rule change and require that the proposed rule change be refilled in accordance with the provisions of Section 19(b)(1) of the Exchange Act.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Exchange Act. Comments may be submitted by any of the following methods:

Electronic Comments

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number SR-NFA-2014-04 on the subject line.

Paper Comments

- Send paper comments in triplicate to Kevin M. O'Neill, Deputy Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number SR-NFA-2014-04. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's website (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for website viewing and printing in

the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10 a.m. and 3 p.m.

Copies of such filing also will be available for inspection and copying at the principal office of NFA. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions.

You should submit only information that you wish to make publicly available. All submissions should refer to File Number SR-NFA-2014-04 and should be submitted on or before [insert date 21 days from publication in the Federal Register.]

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.⁸

Kevin M. O'Neill
Deputy Secretary

⁸ 17 CFR 200.30-3(a)(73).

Exhibit 2

(Not applicable)

Exhibit 3

(Not applicable)

Exhibit 4

INTERPRETIVE NOTICES

**Interpretive Notice to NFA Compliance Rules 2-4 and 2-36:
Prohibition on the Use of Certain Electronic Funding Mechanisms**

NFA Compliance Rule 2-4 requires Members and Associates to observe high standards of commercial honor and just and equitable principles of trade in the conduct of their commodity futures business. Similarly, NFA Compliance Rule 2-36(c) requires Forex Dealer Members (FDM) and their Associates to observe high standards of commercial honor and just and equitable principles of trade in the conduct of their forex business.

NFA's Board of Directors (Board) recently reviewed information regarding the use of credit cards⁵ by FDM retail customers to fund their forex trading accounts, which indicates that retail forex customers overwhelmingly fund their trading accounts using a credit card. For the reasons described below, the Board believes that permitting customers to invest in the forex or futures markets using a credit card is inconsistent with a Member's obligation to observe high standards of commercial honor and just and equitable principles of trade.

Credit cards, by their very nature, permit easy access to borrowed funds. Given the highly volatile nature of the forex and futures markets, the substantial risk of loss, and the possibility that a total loss may occur in a very short period of time, the Board has concluded that Members should be prohibited from permitting customers to use credit cards to fund forex or futures accounts.

The Board also recognizes that the retail forex and futures businesses are largely Internet based, electronic payments are the acceptable payment method for most Internet based businesses, and that certain electronic funding methods may provide some convenience to customers.

⁵ For purposes of this Interpretive Notice, the term credit card also includes other electronic payment facilitators (e.g., Paypal) that commonly draw funds from a customer's credit card.

Therefore, the Board is not prohibiting all forms of electronic payment mechanisms.

Specifically, the Board believes that certain electronic funding mechanisms are acceptable and appear consistent with a Member's obligation to observe high standards of commercial honor and just and equitable principles of trade. Those electronic funding mechanisms, however, must be tied to a customer's bank account at a financial institution. In particular, the Board is aware that with an electronic payment made through a debit card, the funds are drawn directly from the customer's bank account and therefore this payment method functions in a manner very similar to a check drawn on a customer's account. The Board also understands that certain other electronic payment facilitators may draw funds directly from a customer's bank account.

The key factor differentiating a credit card payment from an electronic funding method that is directly tied to the customer's account at a financial institution is that with the latter method, the customer has funds on hand and those funds are immediately transferred from the customer's bank account to the FDM or FCM, which significantly reduces the likelihood that the customer is borrowing funds to invest. The Board also believes, however, that in order to accept an electronic funding method such as a debit card, the Member must be able to distinguish, prior to accepting funds, between a debit card or other electronic funding method that draws money from the customer's checking or savings account at a financial institution from a traditional credit card, and be able to reject the credit card before accepting funds. For example, in processing electronic payments, Members may utilize a third-party provider that uses technology to differentiate between a credit or debit card transaction.

As always, any Member offering this type of funding mechanism should make sure that adequate risk disclosure is provided to a customer in light of the customer's financial circumstances.

Exhibit 5

- (a) June 18, 2014 letter from Thomas W. Sexton to Melissa D. Jurgens



June 18, 2014

Via Federal Express

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

Re: National Futures Association: Electronic Funding Mechanisms – Adoption of the Interpretive Notice to NFA Compliance Rules 2-4 and 2-36: Prohibition on the Use of Certain Electronic Funding Mechanisms

Dear Ms. Jurgens:

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 adoption of the Interpretive Notice to NFA Compliance Rules 2-4 and 2-36: Prohibition on the Use of Certain Electronic Funding Mechanisms. NFA’s Board of Directors (“Board”) approved the proposal on May 15, 2014, and NFA respectfully requests Commission review and approval of the proposal.

**PROPOSED AMENDMENTS
(additions are underscored)**

INTERPRETIVE NOTICES

Interpretive Notice to NFA Compliance Rules 2-4 and 2-36: Prohibition on the Use of Certain Electronic Funding Mechanisms

NFA Compliance Rule 2-4 requires Members and Associates to observe high standards of commercial honor and just and equitable principles of trade in the conduct of their commodity futures business. Similarly, NFA Compliance Rule



Ms. Melissa D. Jurgens

June 18, 2014

2-36(c) requires Forex Dealer Members (FDM) and their Associates to observe high standards of commercial honor and just and equitable principles of trade in the conduct of their forex business.

NFA's Board of Directors (Board) recently reviewed information regarding the use of credit cards¹ by FDM retail customers to fund their forex trading accounts, which indicates that retail forex customers overwhelmingly fund their trading accounts using a credit card. For the reasons described below, the Board believes that permitting customers to invest in the forex or futures markets using a credit card is inconsistent with a Member's obligation to observe high standards of commercial honor and just and equitable principles of trade.

Credit cards, by their very nature, permit easy access to borrowed funds. Given the highly volatile nature of the forex and futures markets, the substantial risk of loss, and the possibility that a total loss may occur in a very short period of time, the Board has concluded that Members should be prohibited from permitting customers to use credit cards to fund forex or futures accounts.

The Board also recognizes that the retail forex and futures businesses are largely Internet based, electronic payments are the acceptable payment method for most Internet based businesses, and that certain electronic funding methods may provide some convenience to customers. Therefore, the Board is not prohibiting all forms of electronic payment mechanisms.

Specifically, the Board believes that certain electronic funding mechanisms are acceptable and appear consistent with a Member's obligation to observe high standards of commercial honor and just and equitable principles of trade. Those electronic funding mechanisms, however, must be tied to a customer's bank account at a financial institution. In particular, the Board is aware that with an electronic payment made through a debit card, the funds are drawn directly from the customer's bank account and therefore this payment method functions in a manner very similar to a check drawn on a customer's account. The Board also understands that certain other electronic payment facilitators may draw funds directly from a customer's bank account.

¹ For purposes of this Interpretive Notice, the term credit card also includes other electronic payment facilitators (e.g., Paypal) that commonly draw funds from a customer's credit card.



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The key factor differentiating a credit card payment from an electronic funding method that is directly tied to the customer's account at a financial institution is that with the latter method, the customer has funds on hand and those funds are immediately transferred from the customer's bank account to the FDM or FCM, which significantly reduces the likelihood that the customer is borrowing funds to invest. The Board also believes, however, that in order to accept an electronic funding method such as a debit card, the Member must be able to distinguish, prior to accepting funds, between a debit card or other electronic funding method that draws money from the customer's checking or savings account at a financial institution and a traditional credit card, and be able to reject the credit card before accepting funds. For example, in processing electronic payments, Members may utilize a third-party provider that uses technology to differentiate between a credit or debit card transaction.

As always, any FCM or FDM offering this type of funding mechanism should make sure that adequate risk disclosure is provided to a customer in light of the customer's financial circumstances.

EXPLANATION OF PROPOSED AMENDMENTS

The Board adopted the Interpretive Notice to NFA Compliance Rules 2-4 and 2-36, which prohibits Members from allowing customers to fund futures or forex accounts with a credit card or other electronic methods tied to a credit card. The Board approved this prohibition based on an extensive study and analysis done at the direction of NFA's Compliance and Risk Committee (CRC). As discussed below, the CRC's study and analysis found significant customer protection concerns with credit card funding in the retail forex area, and therefore the Board determined the only appropriate action was to adopt this prohibition. This prohibition is entirely consistent with NFA's longstanding position that it is a violation of NFA Compliance Rule 2-4, and inconsistent with just and equitable principles of trade, for Members and Associates to encourage customers to borrow money to invest.²

While reviewing business practices of NFA's Forex Dealer Members (FDM), the CRC became aware that many FDMs offer their retail forex customers the ability to fund their accounts directly using a credit card or via an online payment facilitator (e.g., PayPal) that is commonly tied to a credit card (Payment Facilitator(s) – Credit). The CRC had several concerns with this practice, including that retail

² See *In the Matter of First Investors Group of Palm Beaches, et. al.*, NFA Case No. 95-BCC-011 (November 12, 1999).



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customers may be using credit cards to open accounts with funds that are borrowed and, therefore, not risk capital. The CRC's concern had significant merit since staff's 2012 review of several FDM websites showed that they promoted credit funding as the "quickest," "easiest," and "fastest" method of investing, and none indicated that retail customers should not be using credit cards to borrow funds to invest.

Given its concern, the CRC began considering whether it would be appropriate for NFA to prohibit its Members from allowing customers to fund their accounts (both forex and futures) via a credit card or a Payment Facilitator – Credit. The CRC obtained the feedback of NFA's FCM, IB, CPO/CTA Advisory Committees, each of which fully supported a ban of this practice for both futures and forex. Given the importance of this issue, the CRC did not obtain the views of NFA's FDM Advisory Committee—which had recently lost most of its representatives due to FDM withdrawals and consolidations—but rather obtained the FDMs' views by issuing a Notice to all FDMs requesting their views. The CRC also met with affected members of the FDM community to further discuss their comments.

Specifically, NFA received comments from five of NFA's 17 FDMs (one of which was filed by a law firm on behalf of the FDM), the Financial Services Roundtable (FSR)³ and a retail forex customer. All but one FDM strongly opposed a ban against FDMs accepting credit cards from customers to fund forex trading accounts. Despite the fact that credit card funding was not "an insignificant portion" of its business, this FDM did not object to the proposed ban but requested a 60-day implementation period in order to make operational changes to reject credit card transactions while permitting debit card transactions and to educate clients about the ban.

As previously noted, the comments received from the other four FDMs opposed the ban, and contained many of the same themes, including:

- Banks that issue credit cards consider a customer's credit worthiness in determining the customer's credit limit, which is a built in risk safeguard;
- Credit card funding is one of the fastest, most convenient, and lowest cost funding vehicles;

³ The FSR's letter claims banning credit cards and the use of credit cards through payment facilitators (e.g. Paypal) is a significant regulatory action that has far reaching implications. The FSR urged NFA to consider viable alternatives and seek comments from those outside the forex industry.



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- NFA has other rules that ensure that customers do not invest funds in excess of risk capital (Rule 2-36 "know your customer," risk disclosure requirements, and guidance requiring FCMs to prominently disclose that customers should only fund with risk capital);
- Forex customers must react to market changes during non-banking hours and credit cards are the only funding method to do so, while checks or wire transfers often take too long to be credited to prevent a margin close-out;
- Credit cards are more economical since FDMs do not charge a fee to use them while banks charge fees for wire transfers and use of ACH;
- Funds deposited by traditional methods may ultimately be drawn from credit sources;
- The ban is overly broad since alternative payment facilitators (e.g., PayPal, MoneyBookers and Google Checkout) may be funded through a bank account or other debit sources; and
- FDMs have other procedures in place to ensure that customers only use risk capital even if the source is a credit card.

To further support their position, several commenters noted that foreign jurisdictions permit credit card funding—the U.K., Japan, Canada, and Australia—where retail forex "trading is available on a 24-hour basis." Additionally, at least one commenter noted that credit cards are permitted in numerous other industries in which "customer funds are put at risk with far fewer safeguards than retail forex trading." As an example, this commenter offered that the New York State Lottery provides customers the option of signing up for subscriptions to certain lottery games using credit cards, and the Nassau County, New York OTB permits individuals to make deposits via credit card to their permanent wagering account.

The FDMs opposing a ban on funding via a credit card recommended that NFA address this issue short of imposing a prohibition. For example, these FDMs believe that NFA should do one or more of the following—prohibit heavy promotion of credit card funding, require account withdrawals to go back to the original funding credit card, establish a monthly deposit cap for credit card funding, enhance disclosures regarding risk capital usage, issue prominent warnings regarding credit card usage to underscore the risks of using this funding means if a customer does not have sufficient



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bank funds to cover the deposit, and recommending that customers pay off credit card balances monthly by the due date.

The CRC also directed staff to conduct a detailed analysis of FDM account funding practices, customer income levels, and customer account funding origins. The analysis covered approximately 15,500 accounts held at seven FDMs—all of which were registered as retail foreign exchange dealers (RFED)—during 2012. Based on the results of this analysis, the CRC, as well as the Board, found that this practice raised significant customer protection concerns and the only appropriate response was to prohibit Members from allowing customers to fund accounts using a credit card or Payment Facilitator – Credit. Specifically, the analysis revealed:

- Credit card funding restrictions varied among the FDMs. Several permitted the use of a credit card up to \$10,000 per transaction. One firm based its restriction on a customer's income level and a permitted customer with a net income between \$0-\$19,000 to fund an account with as much as \$1,000 through a credit card;
- The average life of a retail forex trading account at an RFED was 4 months regardless of the amount of the initial deposit;
- For the 4th quarter 2013, 72% of the accounts analyzed were unprofitable;
- 78% of all accounts were initially funded via credit card/debit card/online payment facilitator;
- Almost 50% of all account holders reported a net income of \$50,000 or less; and
- Deposits made by credit card/debit card/PayPal were markedly lower than deposits made by wires or checks. For example, for customers with a net income less than \$50,000, the average deposit via credit card/debit card/PayPal was approximately \$1,050 whereas for checks or wires it was approximately \$6,650. This difference was also prevalent at other net income levels, including above \$100,000 where the average deposit via credit card/debit card/PayPal was approximately \$2,450 whereas for checks or wires it was approximately \$28,000.

Given the prevalence of credit card usage by customers to initially fund retail forex accounts and the fact that such a large percentage of those customers have a



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relatively low income level (\$50,000 or less), NFA reviewed whether the FDMs provide specific risk disclosures regarding the implications of funding via a credit card or Payment Facilitator-Credit. NFA learned that none of the FDMs warned customers that they should not use a credit card or Payment Facilitator – Credit to borrow money to invest in retail forex.

Many FDMs had represented to NFA that customers need to use credit cards in order to quickly add funds in order to avoid forced liquidation of their positions. NFA's analysis, however, revealed that very few positions overall are auto-liquidated, customers generally add funds to their account using the same method as their initial funding method, and positions in accounts funded through a credit card are not less likely to be auto-liquidated. In fact, those accounts funded through a credit card actually had positions auto-liquidated more frequently than those accounts funded through traditional methods, although still at a relatively low percentage.

Average Percent of Open Positions Auto-Liquidated

Initial Account Size	Initial Funding Source	
	Credit/Debit/Paypal	Wires, Checks, etc.
\$0-\$250	3.6%	2.3%
\$251-\$500	2.2%	1.2%
\$501-\$1,000	2.0%	1.8%
\$1,001-\$5,000	2.7%	1.1%
\$5,001-\$10,000	4.2%	0.8%
\$10,001+	2.7%	1.2%

The Board concluded that the data was very disturbing from a customer protection perspective because it revealed that lower income individuals predominantly use credit cards or Payment Facilitator – Credit to fund their accounts and the majority of these individuals lost their funds trading forex. Although the Board acknowledged the possibility that all lower income individuals may pay off their credit card balances each month and not be borrowing funds beyond the payment due date to invest, the Board also believes that this possibility is simply implausible given the low income levels.

NFA Compliance Rule 2-4 requires Members and their Associates to observe high standards of commercial honor and just and equitable principles of trade in the conduct of their commodity futures business. Similarly, NFA Compliance Rule



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2-36(c) requires Members and their Associates to observe high standards of commercial honor and just and equitable principles of trade in the conduct of their forex business.

In considering this issue, the Board noted that permitting customers to utilize funding mechanisms that by their very nature permit retail customers to borrow funds to invest in markets where the risk of loss can be substantial and a total loss may occur simply is not consistent with a Member's obligation to observe high standards of commercial honor and just and equitable principles of trade. Given NFA's analysis of the FDMs' customers' usage of credit cards and Payment Facilitator – Credit, and the fact that credit cards and Payment Facilitators – Credit readily allow individuals to borrow funds to purchase goods and services, the Board concluded that without adequate mechanisms in place to ensure that customers are not borrowing funds to invest in the highly volatile futures and forex markets, Members should not be permitted to allow their customers to invest via electronic funding mechanisms.

The Interpretive Notice adopted by the Board does not ban forms of electronic funding mechanisms that are tied to a customer's bank account at a financial institution, such as a debit card or a PayPal account tied to a bank account. These funding mechanism are acceptable and appear consistent with a Member's obligation to observe high standards of commercial honor and just and equitable principles of trade because customers by using electronic funding mechanisms directly tied to an account at a financial institution have funds on hand that are immediately transferred from the customer's bank account to the FDM or FCM, which significantly reduces the likelihood that funds are being borrowed to invest.

However, in order for a Member to allow customers to use electronic funding mechanisms, the Member must be able to distinguish between those electronic funding mechanisms tied to a credit card and those tied to a bank account and reject the ones tied to a credit card. One FDM indicated that it currently uses a third-party provider to process credit and debit card transactions when they are initiated by the customer. Accordingly, the third-party provider uses a programming code, which allows its front-end processor to identify whether a card is a credit or debit card based on the digits listed on the card. This front-end processing system has the ability to identify the card as a debit card even if the customer elected to process the card as a credit transaction.⁴ In other words, the system programming can distinguish between a debit

⁴ Many debit cards permit the user to elect to process the transaction as a "debit" or a "credit." When the user selects credit, the transaction amount is still deducted from



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card issued by a bank with monies drawn from a checking or savings account, or a traditional credit card. The third party provider is able to automatically reject transactions that are credit card transactions.

Under the Interpretive Notice, if an FCM or FDM Member offers customers the ability to use an electronic funding mechanism, then the FCM or FDM must utilize a processing system or some other electronic mechanism that can ensure the funding device is a debit card or some other payment facilitator that is tied directly to the customer's bank account at a financial institution. Moreover, if FCMs and FDMs offer this type of funding mechanism, then they should also ensure that adequate risk disclosure is provided to customers in light of the customers' financial circumstances.

NFA strongly believes that the Interpretive Notice to NFA Compliance Rules 2-4 and 2-36, which prohibits Members from allowing customers to fund futures or forex accounts with a credit card or other electronic methods tied to a credit card is a necessary customer protection measure. NFA respectfully requests that the Commission review and approve the proposed adoption of the Interpretive Notice to NFA Compliance Rules 2-4 and 2-36: Prohibition on the Use of Certain Electronic Funding Mechanisms.

Respectfully submitted,

A handwritten signature in black ink, consisting of several loops and a long horizontal stroke extending to the right.

Thomas W. Sexton
Senior Vice President and
General Counsel

cc: Gary Barnett
Frank Fisanich
Tom Smith

TWS:jac(m./jac/SubmissionLtrsInterpNotc CR2-4_2-36_ProhibitUseOfCertainFundingMechanisms 051514)

the user's checking or savings account. The primary difference is that by selecting "credit" the user receives some of the protections provided by a credit transaction.