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By Hand Delivery
David A. Stawick
Secretary of the Commission
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street NW
Washington, DC 20581

Re: RIN number 3038-AC96, FCM-IB Conflicts of Interest

Dear Mr. Stawick:

BACKGROUND

I am pleased to submit this comment letter, on behalf of Peregrine Financial Group, Inc. (PFG), regarding the regulations proposed by the Commodity Futures Trading Commission (CFTC) that would establish conflict of interest requirements for futures commission merchants (FCMs) and introducing brokers (IBs).[1] PFG believes that the proposed regulations, although perhaps appropriate in the context of securities trading, are unduly burdensome and unnecessary for FCMs and IBs.

PFG is one of the largest non-clearing U.S. FCMs, with customers, affiliates and offices in more than 80 countries. It is ranked in the annual *Futures Magazine* roundup as one of the nation's Top 50 Brokers. PFG handles customers engaged in the futures, options and currency markets, and also provides full-service brokerage, managed funds, trader education and direct online trading through its BESTDirect platform.

SUMMARY

The proposed regulations appear to suffer from several flawed assumptions regarding the operations of FCMs and IBs. Associated persons (APs) of FCMs and IBs have time and price discretion to enter orders on behalf of customers, so they are necessarily involved in researching and analyzing markets to determine when is the best moment and the best price to enter a customer order. This research and analysis may be presented in a report that the AP distributes to his or her customers, or that forms part of the basis of an FCM's or IB's re-

[1] 75 Fed. Reg. 70152 (November 17, 2010).

search report. Under the proposals, the AP would be deemed to be a "research analyst," and the FCM or IB would be prohibited from compensating the AP based upon commission income. It is untenable to prevent these APs from contributing to research reports that may be published by their firms and earning commissions on handling orders for customers. In addition, it must be recognized that, to enter into a futures, options or currency transaction, there must be two sides to a trade. Unlike securities, where a customer order to buy securities may be executed by purchasing available shares, the futures, options and currency markets require that a party on the other side be willing to enter into a transaction. No research report of an FCM or IB can cause a market to move by itself.

THE PROPOSALS WOULD MISAPPLY A SECURITIES LAW CONCEPT TO FUTURES

As is evident by statements in the preamble of the *Federal Register* notice announcing the proposed regulations, the proposals appear to have their origins in securities law. The CFTC notes that the authority for these proposals is set forth in Section 732 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank), which contains language similar to that of Section 501(a) of the Sarbanes-Oxley Act of 2002, which created a new Section 15D of the Securities Exchange Act of 1934. The CFTC further notes that many elements of the proposals, particularly those provisions relating to potential conflicts of interest surrounding research and analysis, have been adapted from National Association of Securities Dealers Rule 2711. Those provisions were intended to address perceived abuses by securities analysts who recommended particular equity securities. Such recommendations would necessarily focus upon a particular company, and there is concern that such reports could be used to pump up the price of a stock artificially, or perhaps rely upon material, non-public information. These concerns are misplaced in the markets for futures, options and currencies, which have no insider trading prohibitions comparable to that under the securities laws. Any information in a research report in the markets for futures, options and currencies would cover the entire market and not be related to information on a specific company. Further, if a research report on a market for futures, options and currencies helped a retail customer formulate an opinion as to whether he or she should enter an order to buy a particular amount of a particular futures contract, before such a transaction could be executed there would have to be a speculator who thought that it would be profitable to sell that amount of that futures contract, or a hedger on the other side of the trade who would benefit from the market liquidity provider by the potential purchaser.

THE PROPOSALS ARE SUPERFLUOUS

There already exists a regulatory framework sufficient to address the issue of conflicts of interest regarding research reports. CFTC Regulation 1.40, which dates back to the CFTC's predecessor agency, the Commodity Exchange Authority, requires FCMs and IBs to maintain

as a record, and to furnish to the CFTC upon request, a true copy of any report published or given general circulation by those firms that concerns crop or market information or conditions that affect or tend to affect the price of any commodity or exchange rate, and the true source of, or authority for, the information contained therein.[2] Trading standards applicable to FCMs and IBs require that customer orders have priority over orders of the firm or its affiliated persons.[3] As noted above, a transaction is specifically authorized if the customer or his or her designee specifies the precise commodity interest to be purchased or sold and the exact amount thereof, leaving FCMs, IBs and their APs with time and price discretion.[4] These regulations are supplemented by the general supervisory duties of FCMs and IBs,[5] and the antifraud proscription of the Commodity Exchange Act (CEA).[6]

Indeed, the proposed regulations appear to be chasing a non-existent problem. The CFTC cites no evidence that any research reports of FCMs and IBs triggered any part of the crisis in financial markets of recent years that gave impetus to the enactment of Dodd-Frank, because there is none. Similarly, FCM and IB research reports have not been the subject of CFTC enforcement actions. The CFTC is seeking to take a concept that may have relevance in the securities markets, where research reports tend to focus upon the characteristics of individual companies and their equity securities, and transplant it to the futures, options and currency markets, where this concept does not fit and has no relevance. As an example of this square-peg-in-a-round-hole approach, proposed Regulation 1.71(b)(4) would prohibit promises of favorable research, that is, an FCM or IB could not directly or indirectly offer favorable research, or threaten to change research, to an existing or prospective customer as consideration or inducement for the receipt of business or compensation. Perhaps such a prohibition makes sense in the context of a particular company; it has no relevance in terms of a report on soybeans or the Euro.

THE PROPOSALS ARE UNDULY BURDENSOME AND COSTLY

Despite the fact that the CFTC cannot point to any recent or historical problems involving FCM and IB research reports, the proposed regulations would establish elaborate policies and

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[2] 17 C.F.R. § 1.40.

[3] *See* CFTC Regulations 155.3 and 155.4, 17 C.F.R. §§ 155.3 and 155.4.

[4] CFTC Regulation 166.2, 17 C.F.R. § 166.2.

[5] CFTC Regulation 166.3, 17 C.F.R. § 166.3.

[6] CEA Section 4b, 7 U.S.C. § 6b.

procedures that would be required to be implemented to address supposed conflicts of interest between research analysts and other personnel at the firms. Such requirements would cause great upheaval at firms like PFG, where APs routinely contribute to research developed by the firm. The proposals could require a firm like PFG to hire additional staff and to implement costly new procedures without any apparent customer benefit. Customers come to a firm like PFG for full-service brokerage and trader education services. If PFG has to be constantly looking over its shoulder to make sure that someone involved in trade execution did not contribute to a research report, and be concerned about how it may compensate such a person, the incentive would be to withdraw from providing these services to customers to eliminate the expense involved and the potential liability. This could push out the research function from FCMs and IBs to independent advisors, who may not be required to register[7] and would not be subject to FCM or IB supervision.

Pushing analysts out of FCMs and IBs or altering the compensation of APs would not be the end of disruptions caused by the proposed regulations. The policies and procedures that would be required would restrict how communications could be made within a firm and who may review research reports and supervise research analysts. FCMs and IBs may find it necessary to establish different affiliates to conduct business internationally, or for particular asset classes, yet the proposed regulations would restrict communications with research analysts employed by affiliates. Various additional disclosures would also be required, which could include futures positions of research analysts, as well as records of public appearances. It would not only be difficult for firms to keep up-to-date with analysts' positions in fast-moving futures markets, but disclosure of these positions would appear to be antithetical to the general prohibition on disclosing the positions of any customer. The penultimate paragraph of the proposed regulations, which appears under the heading "*Undue Influence on Customers*," is described in the preamble of the Federal Register release as "an additional safeguard," and would "mandate the disclosure to . . . customers of any material conflicts of interest regarding the decision of a customer as to the trade execution and/or clearing of the derivatives transaction." No further explanation or standards are provided in the regulatory text or the preamble as to what this disclosure should consist of. This is yet another example of a regulation that is vague, unnecessary, arguably in conflict with the existing regulatory framework (CFTC Regulations 1.55 and 33.7 provide the basic risk disclosure requirements for futures and options, respectively), and would apply a securities market concept where it does not belong.

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[7] CFTC Regulation 4.14(a)(9) provides that a person is not required to register under the CEA as a commodity trading advisor if the person does not direct client accounts or provide commodity trading advice based upon, or tailored to, the commodity interest or cash market positions or other circumstances or characteristics of particular clients.

CONCLUSION

The forced implementation of conflicts of interest policies and procedures by FCMs and IBs, which would be required if the proposals are adopted, attempt to take a concept that may have relevance in the securities markets and apply it to the futures, options and currency markets where it has no relevance. The existing regulatory framework is more than adequate to deal with any perceived problems from research reports, which have not been the subject of CFTC enforcement actions. For a firm like PFG, which operates a full-service brokerage and provides trader education that caters to retail clients, imposition of these proposals would be costly, disruptive to the operation of its business, and likely cause fewer services to be provided to clients as a result. PFG respectfully requests that the CFTC withdraw the proposed FCM-IB conflicts of interest regulations.

PFG appreciates the opportunity to comment upon the proposed regulations that would require implementation of conflicts of interest policies and procedures by FCMs and IBs. We would be happy to discuss our comments upon these proposals at greater length with Commissioners and/or CFTC staff at their convenience. Please feel free to contact the undersigned at 202-778-9219 or Rebecca J. Wing, PFG's General Counsel, at 312-775-3464, if you have any questions.

Very truly yours,

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