From: Vizbaras, Andris <Vizbaras@clm.com>
Sent: Tuesday, February 2, 2010 2:56 PM
To: secretary <secretary@CFTC.gov>
Subject: Regulation of Retail Forex
Attach: Letter to CFTC re regulation of retail forex_6560915_1.PDF

Please see the attached letter.

Warm regards.

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February 2, 2010

VIA EMAIL

Commodity Futures Trading Commission
1155 21st Street, N.W.
Washington, D.C. 20581
secretary@cftc.gov

Re: Regulation of Retail Forex

Ladies and Gentlemen:

Carter Ledyard & Milburn LLP appreciates the opportunity to submit these comments in response to the Commission's request for public comment on its proposed rules regarding off-exchange retail foreign exchange transactions and intermediaries.[1]

The many harsh features of the Proposal that would affect futures commission merchants whose sole business is retail foreign exchange ("RFEDs") -- such as the requirement for RFEDs to guarantee their introducing brokers, the requirement that each introducing broker be exclusive to one RFED, the limit of margin to 10 percent, and the requirement to disclose the ratio of unprofitable customer accounts -- already have provoked an outcry from both dealers and customers. They are right. These types of provisions are unprecedented and paternalistic, and as a practical matter would end a lawful business. Congress authorized the Commission to regulate RFEDs -- not to suffocate them.

The focus of this letter, however, is more narrow: Throughout the Proposal are provisions that would restrict not just RFEDs, but also the foreign exchange activities of futures commission merchants that are primarily or substantially engaged in trading futures contracts on registered exchanges ("FCMs") -- even when dealing only in the types of "rollover" contracts that were held by two federal appellate courts not to be futures contracts. Congress did not grant the Commission general jurisdiction to regulate transactions in rollover foreign exchange contracts by FCMs. The portions of the Proposal that purport to do so would exceed the jurisdiction of the Commission.

[1] Regulation of Off-Exchange Retail Foreign Exchange Transactions and Intermediaries, 75 Fed. Reg. 3282 (January 20, 2010) (hereinafter, the "Proposing Release").

1. Congress did not grant the Commission general jurisdiction to regulate "rollover" foreign exchange contracts when the dealer is an FCM.

With the decisions in *CFTC v. Zelener*[2] in 2004 and *CFTC v. Erskine*[3] in early 2008, two federal appeals courts drew a sharp distinction between futures contracts, on one hand, and "rollover" contracts on the other. When Congress considered the amendments to the Commodity Exchange Act (the "CEA") that it enacted with the CFTC Reauthorization Act of 2008, both the Commission and the National Futures Association strenuously appealed to Congress to simply eliminate this distinction with respect to foreign exchange. Congress, however, elected not to do so. The basic grant of jurisdiction over transactions in foreign exchange, in Section 2(c)(2)(B)(i), still is limited to "an agreement, contract, or transaction in foreign currency that . . . is a contract of sale of a commodity for future delivery (or an option on such a contract) or an option." This was the same language that the courts in *Zelener* and *Erskine* considered and held not to include rollover contracts.

Rather, Congress acted in 2008 to grant the Commission jurisdiction over rollover foreign exchange contracts only on a selective basis:

- Where the transaction is speculative[4], and the counterparty is an FCM or an RFED, the antifraud provisions of the CEA apply even to a rollover contract. Section 2(c)(2)(C)(ii)(I).
- Where the transaction is speculative, and the counterparty is an RFED (*but not an FCM*), the Congress authorized the Commission to make rules in its judgment that would apply even to a rollover contract. Section 2(c)(2)(C)(ii)(III).

The Commission acknowledges this limit on its jurisdiction in the Proposal: "The Commission . . . retains rulemaking authority with regard to look-alike transactions only where such transactions are offered or entered into by RFEDs."[5]

2. The Proposal would purport to regulate "rollover" foreign exchange contracts even when the dealer is an FCM.

Even though the CEA did not grant the Commission general jurisdiction to make rules regarding rollover foreign exchange contracts when the counterparty is an FCM, and the Proposal acknowledges this restriction, the Proposal goes on to propose precisely that. All of the most onerous provisions of the Proposal would apply both to RFEDs and FCMs:

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[2] 373 F.3d 861 (7th Cir. 2004), reh'g and reh'g en banc denied, 387 F.3d 624 (7th Cir. 2004)

[3] 512 F.3d 309 (6th Cir. 2008)

[4] In this letter, "speculative" is a shorthand reference to the criteria of CEA Section 2(c)(2)(C)(i)(II)(bb)(BB): A contract that neither results in actual delivery within 2 days nor creates an enforceable obligation to deliver between a seller and buyer that have the ability to deliver and accept delivery, respectively, in connection with their line of business.

[5] Proposal at n. 43

- Regulation 1.10(j) would require an FCM (and not just an RFED) to guarantee the obligations of its introducing brokers relating to retail foreign exchange transactions.
- Regulation 1.10(j)(8) would forbid an introducing broker to an FCM (and not just an RFED) to be a party to more than one guarantee agreement relating to retail foreign exchange transactions.
- Regulation 5.9 would require an FCM (and not just an RFED) to collect a minimum security deposit from each retail foreign exchange customer of at least 10 percent.
- Regulation 5.5(a)(1)(ii) would require an FCM (and not just an RFED) to furnish each retail foreign exchange customer with a written disclosure statement that, among other things, states the percentage of the unprofitable retail foreign exchange accounts maintained by the FCM.

The Proposal does not explain this apparent contradiction, other than to refer to a "stated Congressional intent" in the legislative history "that an entity should not be advantaged or disadvantaged as a result of registering as an RFED instead of an FCM," with a footnote reference to the Conference Report for the CFTC Reauthorization Act of 2008.[6] This portion of the Conference Report does not support the proposition for which the Proposal cites it. It immediately follows a discussion of minimum capital requirements and reads,

> In addition, to maintaining a minimum of $20 million in adjusted net capital, the managers expect the Commission to use the rulemaking authority provided under this section to promulgate any other requirements necessary to ensure the financial soundness of RFEDs.
>
> The rules and regulations issued under this section should appropriately address the level of financial risk posed by RFEDs and their operations. To the extent their risk profiles are similar, the managers intend for FCMs and RFEDs to be regulated substantially equivalently in terms of their off-exchange retail foreign currency business. The managers do not intend for the Commission to provide either FCMs or RFEDs with a more favorable regulatory environment over the other or create two significantly different regulatory regimes for similar business models-to the extent the financial risks posed by such operations are similar.[7]

With this context, it is clear that the "stated Congressional intent" is limited to net capital requirements and other requirements relating to the financial soundness of the dealer -- and does not, as the Proposal claims, support the proposition that the Commission has general jurisdiction to regulate FCMs equally with RFEDs in such matters as customer disclosures, minimum deposits or guarantees of introducing brokers. Indeed, it could not, because Congress conspicuously and expressly exempted FCMs from such regulation. Congress expressly exempted any person that is "described in item (aa) through (ff) of subparagraph (B)(i)(II)" from the Commission's general jurisdiction to regulate "rollover" foreign exchange contracts in CEA

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[6] Proposal at n. 72, citing H.R. Rep. No. 110-627, at 980 (2008)(Conf. Rep.)
[7] H.R. Rep. No. 110-627, at 980 (2008)(Conf. Rep.)

Section 2(c)(2)(C)(ii)(III), and that exemption clearly applies to an FCM, as a person described in item (cc) (but not an RFED, as a person described in item (gg)).

We appreciate the opportunity to share our views with the Commission on this important topic. Please contact Andris Vizbaras (by telephone at 212-238-8698, or by email at vizbaras@clm.com) if we may provide any additional information.

Sincerely,

Carter Ledyard & Milburn LLP