

From: IBcoalition.org <info@ibcoalition.org>
Sent: Wednesday, March 10, 2010 3:49 PM
To: secretary <secretary@CFTC.gov>
Subject: Regulation of Retail Forex RIN 3038-AC61
Attach: Joint Comment Letter on CFTC 1-signed.pdf

Mr. David Stawick
Secretary
Commodity Futures Trading Commission
1155 21st Street, N.W.
Washington, DC 20581

Re: RIN 3038-AC61

Dear Mr. Stawick:

The undersigned firms appreciate the opportunity to provide our joint comments to the Commodity Futures Trading Commission (**CFTC** or **Commission**) on its proposed rules for Regulation of Off-Exchange Retail Foreign Exchange Transactions and Intermediaries, 75 FR 3282 (Jan. 20, 2010). Each of the undersigned firms is in the business of providing intermediation services as introducing brokers to a growing class of active, sophisticated traders many of whom consider themselves professionals who trade foreign exchange (forex) on an over-the-counter basis with forex dealers. We provide traders with valuable trading support products to assist them in developing their trading skills, enable them to analyze their trading performance on a real-time basis and promote their understanding of the off-exchange forex markets. Importantly, we assist our trader clients in deciding which dealers suit their needs, helping them evaluate a confusing array of dealer trading platforms, services and fee structures from which to choose. For that part of our businesses, we each have referral relationships with multiple forex dealers.

Please see the attached PDF for the full letter and signatures. Please confirm your receipt of this message. We will follow up with a faxed version.

March 11, 2010

Via E-Mail

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I. OVERVIEW

We support effective, sensible regulation of our forex activities, and of the broader retail forex industry, under an approach that follows the established futures industry model of self-regulation of industry professionals through primary oversight by the National Futures Association (“*NFA*”) backstopped by CFTC oversight. As evidence of our commitment, each of us is registered with the CFTC as an introducing broker (“*IB*”) and is a member of NFA, even though such registration and such membership is not currently required. Thus, we have each voluntarily elected to comply with NFA rules regulating the retail forex activities of its members. We are committed to developing internally strong compliance cultures for complying with requirements under NFA rules and, once adopted, CFTC rules.

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We are, we believe, the types of firms the Commission should be supporting as alternatives to the fraudulent unregistered solicitors the Commission has spent so much time and effort to shut down over the years. Unfortunately, though, in its zeal to curtail fraudulent solicitation practices, the Commission is proposing a set of rules that needlessly restrict legitimate forex activities and will, if adopted, seriously undermine our ability to operate successfully as regulated alternatives, especially against our non-U.S. based competition. Indeed, features of the rulemaking proposal appear to reflect biased Commission views that there are no legitimate segments of the retail forex industry, and that no retail customers should be trading forex. The Commission should not adopt rules predicated upon a distorted perspective derived solely from its enforcement actions against the bad actors, but rather through empirical data providing a better understanding of the legitimate nature of our business.

The proposal to require a forex IB to operate as a guaranteed IB of a single CFTC-regulated forex dealer is in particular detrimental to our business models, where offering our trader clients the freedom to choose among multiple forex dealers is a critical element. The Commission should understand the significant value we provide in matching traders to the right forex dealer. We will work closely with a trader to evaluate different forex dealers on a number of metrics, including trading platforms, spreads, clearing practices, fees and pricing structures, and overall customer service. We are also there as advocates for our trader clients when they have issues or disputes with their forex dealers. Arbitrarily limiting customer choice to a single forex dealer is not in the customers' best interests and will deprive them of services that assist them in making informed choices on where to trade. The Commission should eliminate the guaranteed IB requirement and provide a forex IB with the same choice that a futures IB has to operate either as an independent IB or a guaranteed IB. We see no reason for taking a regulatory approach that is contrary to how futures IBs are regulated. As explained more fully below, applying inconsistent requirements will also create special problems for IBs that introduce both forex and futures customers.

The proposed 10:1 leverage restriction is also troubling and should be eliminated, as we explain more fully below. We also address certain other features of the proposal in our comments.

II. THE COMMISSION'S UNDERSTANDING OF THE RETAIL FOREX MARKETS IS BIASED AND INCOMPLETE

The proposed rules and the Commission's explanation reflect hostility towards all retail forex activity. The Commission is clearly of the opinion that all firms providing services to retail forex customers are bad actors intent on committing fraud; all retail customers are naive, unsophisticated and unsuitable to be trading forex; and "relatively few ... trade profitably."¹

¹ 75 FR 3289.

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We understand that the CFTC has brought numerous enforcement actions against forex dealers and solicitors for fraudulent practices. Of course the Commission will have observed practices of "solicitation fraud, a lack of transparency in the pricing and execution of transactions, unresponsiveness to customer complaints and targeting of unsophisticated, elderly, low net worth and other vulnerable individuals"² in the *enforcement* context; after all, it is those very practices that are the grounds for bringing the enforcement actions.

It does not follow, though, that all firms providing retail forex services are bad and predisposed to commit fraud. We are not those firms. We have voluntarily registered and operate under NFA's supervision and rules. We do not engage in abusive sales practices; we do not target "unsophisticated, elderly, low net worth and other vulnerable individuals" to solicit to trade forex. It is unfair to view all forex IBs through the prism of the Commission's enforcement activities.

We should also be honest about the reasons why fraud became wide spread in the retail forex markets. There is nothing inherently wrong or bad about forex trading. The fault lies with the nation's historically irrational, ambiguous and incomplete regulatory approach towards retail forex, which has created opportunities for persons with fraudulent intent, including persons barred or suspended from the securities or futures industries, to operate behind assertions that their activities were not subject to any federal regulation.

The Commission's perception of who trades in the retail forex markets has also been skewed by its enforcement experience. The term "retail" is a misnomer, in that it covers a wide range of customers, including many of our customers who are part of a growing class of experienced, successful traders who do understand and capably manage the risks of their forex trading. The "retail" label is applied to anyone that does not meet the CEA definition of "eligible contract participant." For an individual to meet that definition, he or she must have *total assets in excess of \$10 million* or in excess of \$5 million if trading for risk management purposes.³ That is a very high threshold which captures many individuals on the "retail" side of the dividing line who are experienced forex traders and who in many cases would consider themselves to be professional forex traders. Under that standard, many professional traders on the futures exchanges would be considered "retail." The CFTC has agreed, though, to treat members of a futures exchange as eligible contract participants, and not as retail customers in need of paternalistic protection, to permit them to trade certain off-exchange forex contracts cleared by

² 75 FR 3286.

³ CEA §1a(12)(A)(xi); 7USC §1a(12)(A)(xi).

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the CME Clearing House pursuant to the exclusion under Section 2(d)(1) of the CEA.⁴ The Commission's broad characterization of all retail forex traders as unsophisticated is unwarranted. The forex traders responsible for the overwhelming number of comment letters the Commission has received objecting to the 10:1 leverage proposal would undoubtedly dispute the CFTC's characterization of them.

We recommend that the Commission undertake a study or direct NFA to undertake a study to develop a better factual understanding of the retail forex markets, including the firms that provide services to retail forex customers and the types of services they provide, and who trades retail forex and their trading practices and levels of trading skill and experience. The Commission's rulemaking should be tailored to how the forex industry operates and the varying degrees of trading sophistication captured under the "retail" label, based on an empirical analysis. At a minimum, the Commission should, based on such an empirical study, revise its definition of "retail" to exclude experienced traders who do not meet the CEA's eligible contract participant definition.

We also recommend that the Commission form a Forex Advisory Committee that would serve as a forum for discussion and communication with the forex industry and market participants. The Committee should include representatives of forex dealers, forex IBs and other firms providing retail forex services, as well as forex traders and other interested parties. The Committee's charter should include the authority to conduct public meetings and submit reports and recommendations to the Commission on matters of regulatory concern. In particular, as a matter of highest priority, the Committee should develop recommendations for implementing segregation requirements with respect to funds of retail forex customers held by CFTC-regulated forex dealers, as an important element of customer protection.

III. THE COMMISSION SHOULD DEVELOP A RATIONAL FRAMEWORK FOLLOWING THE FUTURES INDUSTRY MODEL

The Commission should develop a rational regulatory framework that protects U.S. customers, and permits them to make a knowing choice regarding their investments. The alternative is that the forex business will go off-shore, creating new opportunities for the fraudsters who don't care about U.S. regulatory requirements. We endorse following the established futures industry framework which relies upon self-regulation of industry professionals through front-line oversight by NFA, subject to the CFTC's independent enforcement authority.

⁴ CFTC Order, "Determination that Chicago Mercantile Exchange Inc. Floor Brokers and Floor Traders are, Subject to Certain Terms and Conditions, Eligible Contract Participants" (March 14, 2006). Similarly, the Commission has also determined that exchange floor traders and floor brokers should be deemed to meet the even more restrictive definition of exempt commercial entity to permit them to trade on an exempt commercial market. CFTC Order, "In the Matter of the New York Mercantile Exchange, Inc. and the Intercontinental Exchange, Inc., Petitions for Treatment of Floor Brokers and Floor Traders as Eligible Commercial Entities Pursuant to Section 1a(11)(C) of the Commodity Exchange Act," 68 FR 2319 (Jan. 16, 2003).

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The Commission, though, has offered a proposal with the apparent objective to regulate retail forex trading out of business. How else to explain the 10:1 leverage proposal, which marks a drastic departure from NFA's carefully developed leverage requirements? Or a guaranteed IB proposal designed to hold forex dealers liable for fraudulent solicitation practices the Commission assumes will occur even in a regulated environment with NFA's experienced oversight of IB activities?

The demand by "retail" customers to trade forex, in particular experienced traders who rely upon trading for their livelihoods, is very strong and very real and will not disappear simply because the Commission wishes it to. If firms that are willing to operate in a regulated environment are put out of business due to overreaching regulatory requirements, or customers refuse to use their services because regulatory constraints adversely impact their trading, history has shown that customers will find other means to trade retail forex. And it is easy for them to find those alternatives on the internet, without any deliberate intent to circumvent CFTC requirements, including firms willing to operate in disregard of the law to exploit opportunities to meet U.S. customer demands that CFTC-regulated forex firms cannot. CFTC rules that create opportunities for unregistered fraudulent schemes to prey on U.S. customers make no sense.

It is contrary to public policy and protection of customers to create a regulatory framework that pushes retail forex trading underground to the very types of firms that engage in the abusive practices that Congress and the Commission are seeking to curtail. The 2007 amendments to the CEA, although far from perfect, finally provide the CFTC with explicit rulemaking authority to bring long overdue rationality to regulation of retail forex activities. Its proposal misses that opportunity. The Commission needs to seriously rethink its regulatory objectives and recognize the harmful unintended consequences that will follow if U.S. customers are denied rationally regulated alternatives to meet their investment demands.

IV. COMMENTS ON SPECIFIC FEATURES OF THE RULEMAKING PROPOSAL

A. *GUARANTEED IB REQUIREMENT*

The CFTC is proposing that a forex IB must enter into a guarantee agreement with a CFTC-regulated forex dealer, i.e., with a registered futures commission merchant ("*FCM*") that is predominantly engaged in traditional futures activities or a registered Retail Foreign Exchange Dealer ("*RFED*"), along with a requirement that it may be a party to only one guarantee agreement at a time. See proposed Regulation 5.18(h) and proposed revisions to Regulation 1.10(j)(8). The Commission will dictate the terms of the guarantee agreement, to be set out in a form that will be attached to the FCM Form 1-FR. See proposed revisions to Regulation 1.3(nn). The CFTC states that the guarantee agreement it will draft "will provide that FCMs and RFEDs that guarantee performance by an introducing broker that introduces off-exchange retail forex transactions will be jointly and severally liable for *all obligations of the introducing broker* under the Act and Commission regulations with respect to the solicitation of, and transactions involving, *all retail forex customer accounts* of the introducing broker entered into on or after the effective date of the guarantee agreement."⁵ It is our understanding that these provisions, in combination, are intended to require a forex IB to introduce retail forex customers to only one FCM or RFED, and to hold that FCM or RFED liable for all solicitation activities of the IB.

The Commission has suggested that the guarantee requirement is necessary to counter "fraudulent solicitation and sales practices have been commonplace" among "persons who have introduced off-exchange retail forex customers to counterparties."⁶ By "requiring guarantee agreements between all off-exchange retail forex IBs and the FCM/RFED counterparties to which they introduce off-exchange retail forex customers, the counterparties will be forced to more carefully vet the persons who solicit business on their behalf and the practices those persons employ."⁷ In short, the Commission unfairly assumes that all forex IBs are fraudsters when, as explained above, that is not the case.

The remedy to combat fraudulent conduct by unregistered forex solicitors is to require them to register with the CFTC, join NFA and operate in compliance with NFA and CFTC rules enforced through NFA as the front-line for oversight, not to force all forex IBs to be guaranteed. A forex IB will be subject to stringent fitness screening by NFA and required to comply with NFA and CFTC requirements regardless whether it operates as an independent IB or a guaranteed IB. In addition, an independent IB is subject to minimum capital requirements, which the Commission deemed "an important element of customer protection" when it first developed the IB

⁵ 75 FR 3287 (emphasis added).

⁶ *Id.*

⁷ *Id.*

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registration rules in 1983.⁸ Registration and oversight of independent IBs has worked well in the futures industry to “protect the public” against the “sales abuses” committed by unregistered agents soliciting futures customers for FCMs, which led Congress to create the IB registration category in 1982.⁹ There is no reason to assume that approach will not work in the forex industry to protect customers.

If adopted, the guarantee requirement will interfere with the legitimate activities of many forex IBs, including those signing this comment letter, which have introducing relationships with multiple forex dealers and in some cases also with multiple FCMs for referral of futures customers. We fail to see how customer protection interests are served by denying customers access to forex IBs that help them make informed decisions about where to trade forex or by creating circumstances under which every forex IB will face an inherent conflict of interest between representing the best interests of its customers and the commercial interests of the dealer on which it must rely exclusively for its business survival.

The guarantee IB requirement, if adopted, will have other unintended, harmful consequences. Although technically the CFTC is not proposing to prohibit a forex IB from introducing customers to non-CFTC regulated forex dealers that are permissible counterparties, such as banks, that will certainly be the result. It is unrealistic to expect that any FCM or RFED would agree to enter into a guarantee agreement without requiring the IB to refer customers to it exclusively, to avoid liability under the guarantee agreement for customers referred to such other forex dealers. Thus, if adopted, the requirement will deny forex IBs the right to refer customers to banks and others permitted to trade forex with retail customers outside the scope of the CFTC’s rulemaking authority. Notably, it will also force banks and other non-CFTC regulated permissible counterparties to stop using solicitors or to use unregistered solicitors, when they may well prefer to use CFTC-registered IBs with the comfort of knowing that such IBs are subject to NFA and CFTC oversight.

The guarantee requirement will also severely restrict a forex IB’s opportunity to act as an IB for exchange-traded foreign currency products, which for a number of forex IBs would be a natural complement to their forex business. It would be impossible to divorce futures solicitation activities from forex solicitation when providing customers with services to trade in both the futures and forex markets is the value offered. Thus, for liability reasons, the forex dealer that guarantees the IB’s forex activities will likely insist that the IB introduce futures customers to it alone, assuming the dealer is an FCM, or prohibit the IB from engaging in any solicitation of futures customers, if the dealer is an RFED. The guarantee requirement will also serve as a

⁸ CFTC proposed rules on “Introducing Brokers and Associated Persons of Introducing Brokers, Commodity Trading Advisors and Commodity Pool Operators; Registration and Other Regulatory Requirements,” 48 FR 14933, 14942 (April 6, 1983).

⁹ H.R. Rep. No. 97-565, pt. 1, at 49 (1982).

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needless obstacle for an independent futures IB to expand its business to include forex, by essentially forcing such a firm to change its status to a guaranteed IB.

The CFTC should eliminate the requirement that an IB must have a guarantee agreement with an FCM or RFED. Instead, it should revise the rules to allow a forex IB to have the same choice that a futures IB has to operate either as an independent IB (subject to the same capital requirements) or a guaranteed IB.

B. 10:1 LEVERAGE REQUIREMENT

The CFTC is proposing to require FCMs and RFEDs to collect security deposits from retail forex customers equal to 10% of the notional value of the retail forex transaction, with obligations to collect additional security deposits as needed to maintain the 10:1 leverage ratio. Proposed Regulation 5.9. The 10:1 leverage ratio marks a sharp departure from current industry practices and NFA requirements. It appears to be an attempt to quash retail demand to trade forex, predicated upon the Commission's misperception that all retail forex traders are unsophisticated and incapable of understanding the risks of leveraged trading. As explained above, customer demand to trade forex will not disappear, and traders who want to trade with higher leverage will seek, and readily find, counterparties to trade with them over the internet. Moreover, contrary to the Commission's characterization, many retail forex customers are skilled traders who do understand the risks of leveraged trading and make prudent decisions on limiting their trading leverage consistent with their financial resources and risk appetite.

In addition, forex dealers (much like the clearing firms that guarantee trading on the futures exchanges) carefully monitor the trading of their customers, because they bear ultimate financial responsibility for any losses a customer is unable to repay. The Commission implicitly recognizes that this dealer self-interest helps keep losses from leveraged trading in check by noting "Under current practices, customer positions are usually closed out once the losses in an account exceed the initial investment."¹⁰ Segregation requirements would reinforce that self-interest.

The Commission notes that it considered NFA's current leverage restrictions of 100:1 for major currencies and 25:1 for other currencies, but offers no explanation for rejecting NFA's approach. NFA has developed considerable expertise in regulating the retail forex activities of its members, and its leverage restrictions are the result of careful deliberation with the input of its member firms. The Commission should permit NFA to establish the appropriate leverage ratios, with current NFA restrictions as a maximum. If the Commission's objective is to protect unsophisticated customers from the magnified risk of loss associated with leveraged trading, then it could consider asking NFA to evaluate the merits of an approach where stricter leverage ratios apply to such customers, while giving experienced traders latitude to trade with higher leverage.

¹⁰ 75 FR 3291.

C. CLARIFICATION OF IB RECORDKEEPING OBLIGATIONS

The operations of forex IBs can vary greatly in terms of the services they provide and the roles they perform in the account opening process or in receiving and transmitting customer orders. When an IB provides referrals solely through means of a link to a forex dealer's website and has no involvement in the account opening process, we believe that the recordkeeping requirements under Regulation 1.37 should be inapplicable. Under the proposed revisions to that regulation, a forex IB would be required to make and retain a permanent record showing for each introduced account the customer's name, address and principal business occupation and the name of any other person guaranteeing or exercising trading discretion over the account. The FCM or RFED would also be required to make and retain such records, though, and we question the need for duplication under the limited circumstances described.

We also believe that certain recordkeeping requirements with respect to trading records should not apply when a forex IB has no role in receiving or sending customer orders. We request confirmation that under those circumstances, the requirements of Regulation 1.35(a) (to keep full, complete and systemic records of the customer's forex transactions); Regulation 1.35(a-1) (to prepare written records of each customer's forex order; and Regulation 1.35(b) (to prepare a daily record or journal showing complete details of all forex trades in the customer's account) would not apply.

Under proposed Regulation 5.20, an IB would be required to provide information to the Commission upon special call regarding account indentifying information for, and trading activity in, retail customer forex accounts. Consistent with the above comments, we ask the Commission to modify the regulation to clarify that the IB will provide such information only to the extent it is required to have such information or otherwise has such information.

D. SELF-REPORTING TO CFTC ENFORCEMENT DIVISION

The Commission is proposing to require forex firms that register under the rules to send copies of communications relating to customer complaints to the CFTC Division of Enforcement. Proposed Regulation 5.18(g). The obligation attaches if the firm makes the subjective determination that the customer's factual allegations "[give] rise to possible violations of the Act, rules, regulations or orders thereunder, related to their retail forex business." *Id.* The firm would also have to determine if the allegations "[give] rise to possible fraud under the Act or Commission regulations," in which case the deadline for submitting the complaint to the Enforcement Division is 3 business days instead of 30 calendar days. *Id.* Presumably, the filing is required regardless of the merits of the customer's complaint. Again, the Commission is unfairly treating all retail forex firms with suspicion.

The existing oversight framework is sufficient and does not need to be supplemented. As CFTC registrants and NFA members, we have written policies for handling customer complaints that

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we follow, including obligations to maintain records of any customer complaints we receive and how we resolve them. Our policies and complaint files are subject to NFA review during audits and at other times as NFA may request. They are also available to the CFTC and Justice Department for review.

The Commission should eliminate the self-reporting requirement. If any CFTC-registered firm engages in a pattern of ignoring customer complaints or committing customer abuses, NFA should be trusted to take appropriate disciplinary action and, when warranted, to impose restrictions on the firm's operations, including potentially an obligation to report customer complaints to NFA.

CONCLUSION

For the reasons explained above, we urge the Commission to:

1. Undertake, or direct NFA to undertake, a study of the retail forex markets to assure that the rules the Commission ultimately adopts are based on a solid factual understanding of the markets, including the firms providing services to customers and the customers trading forex, and are tailored accordingly.
2. Form a Forex Advisory Committee, with the authority under its charter to conduct public meetings and submit reports and recommendations to the Commission on matters of regulatory concern, including developing recommendations to implement segregation requirements with respect to funds of retail forex customers held by CFTC-regulated forex dealers, as an important element of customer protection.
3. Revise the proposed rules to permit a forex IB to operate either as an independent IB subject to the same minimum capital requirements that apply to a futures IB or as a guaranteed IB.
4. Defer to NFA to set appropriate leverage restrictions. An onerous leverage restriction that creates opportunities for unregistered fraudulent schemes to exploit U.S. customers is contrary to the public interest.
5. Clarify the recordkeeping obligations of forex IBs under the proposed revisions to Regulations 1.37, 1.35(a), 1.35(a-1) and 1.35(b), and revise proposed Regulation 5.20 with respect to an IB's reporting obligations, as recommended in Section IV.C.
6. Eliminate the requirement under proposed Regulation 5.18(g) that firms registered under the rules must report customer complaints to the CFTC Division of Enforcement, in deference to the existing framework.

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We are happy to answer any questions CFTC staff may have. We would also welcome the opportunity to meet with any of the Commissioners and Commission staff to discuss our comments.

Respectfully submitted,



David Lemont, CEO
Currensee, Inc.
NFA # 0403251

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David Manoukian.
David Manoukian ATC Brokers

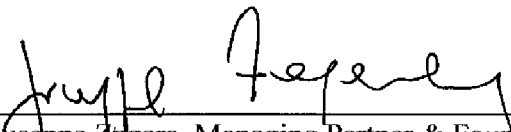
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Stephen Leaby CEO BackBayFX

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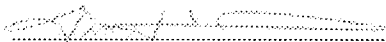


Giuseppe Zagara, Managing Partner & Founder
Fast Trading Services, LLC d/b/a FastBrokers.com
NFA #0342002

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Todd Hendricks, President

Gecko Financial Services, Inc

NFA #0402367