From: Klejna, Dennis (NY Int) <dklejna@mfglobal.com>
Sent: Monday, March 22, 2010 4:24 PM
To: secretary <secretary@CFTC.gov>
Subject: FW: Regulation of Off-Exchange Retail Foreign Exchange Transactions and Intermediaries, 75 Fed.Reg. 3282 (January 26, 2010)
Attach: CFTC - Retail Foreign Currency Rules Comment letter.DOC

Mr. David A. Stawick
Secretary to the Commission
Commodity Futures Trading Commission
Three Lafayette Center
1155 21st Street, N.W.
Washington D.C. 20581
secretary@cftc.gov

Re: Regulation of Off-Exchange Retail Foreign Exchange Transactions and Intermediaries, 75 Fed.Reg. 3282 (January 26, 2010)

Dear Mr. Stawick:

Please see the attached comment letter of MF Global Inc. regarding the Commission's proposed regulatory scheme to implement the CFTC Reauthorization Act of 2008 with respect to Off Exchange Retail Foreign Exchange Transactions.

Kind regards,

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March 22, 2010

Mr. David A. Stawick
Secretary
Commodity Futures Trading Commission
1155 21st Street NW
Washington DC 20581

Re: Regulation of Off-Exchange Retail Foreign Exchange Transactions and Intermediaries, 75 Fed.Reg. 3282 (January 26, 2010)

Dear Mr. Stawick:

MF Global, Inc. ("MFG")[1] is pleased to submit this letter in response to the Commodity Futures Trading Commission's ("Commission's") request for comments on the Commission's proposed rules governing the offer and sale of over the counter foreign exchange transactions to retail customers[2] through intermediaries subject to the Commission's jurisdiction. The proposed rules are proposed to implement the provisions of section 2(c)(2)(B) and (C) of the Commodity Exchange Act ("Act"), which authorize the Commission to "make, promulgate, and enforce such rules and regulations as, in the judgment of the Commission, are reasonably necessary to effectuate any of the provisions of or to accomplish any of the purposes of this chapter in connection with agreements, contracts, or transactions" in foreign exchange as further described in this section of the Act."

MFG strongly supports, as it always has, a comprehensive regulatory regime that will protect retail foreign exchange customers from fraud and other misconduct that may be perpetrated by intermediaries subject to the Commission's jurisdiction, and we welcome most of the proposed regulations. Like many others, however, we believe that certain of the Commission's proposals go too far and may well have the contrary effect, causing intermediaries to avoid Commission regulation entirely by conducting business through other

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[1] MFG is registered with the Commission as a futures commission merchant ("FCM") and with the Securities and Exchange Commission as a broker-dealer. MFG is a wholly owned subsidiary of MF Global Holdings Ltd. which, through its various affiliates (collectively, "MF Global"), is a leading broker of exchange-listed futures and options with offices in Bermuda, New York, London, Chicago, Paris, Mumbai, Singapore, Sydney, Toronto, Tokyo, Hong Kong, Taipei and Dubai. We provide execution and clearing services for exchange-traded and over-the-counter derivative products as well as for non-derivative foreign exchange products and securities in the cash market. MF Global operates across a broad range of trading markets, including interest rates, equities, currencies, energy, metals, agricultural and other commodities. MFG and its affiliates conduct business in 12 countries on more than 70 exchanges, providing access to the world's largest and fastest growing financial markets.

[2] The term "retail customers" means customers that do not fall within the definition of "eligible contract participants," as set forth in section 1a(12) of the Commodity Exchange Act.

permitted counterparties - banks and other financial institutions - authorized under section 2(c)(2)(B) and (C) of the Act. These other permitted counterparties may be subject to sales practice and related rules that are less stringent than the Commission's proposed rules. Moreover, these provisions of the proposed rules place Commission registrants at such a severe competitive disadvantage that they may be effectively prohibited from engaging in this otherwise lawful activity.

The 10:1 Required Security Deposit

The proposed rules require FCMs and retail foreign exchange dealers ("RFEDs"), as the latter group is defined in proposed rule 5.1(h), to collect security deposits from their retail customers in an amount at least equal to 10 percent of the notional value of the retail foreign exchange transaction. The Commission acknowledges that forex dealers currently offer far greater leverage – anywhere from 400:1 to 25:1. Indeed, NFA rules permit leverage of 100:1 for major currencies. The Commission's primary reason for this ten-fold increase is the threat of significant customer loss caused by even a small move against a customer's position. The Commission explicitly recognizes, however, that "[u]nder current market practices, customer positions are usually closed out once the losses in an account exceed the initial investment."[3] In fact, many retail FX dealers conduct business on platforms that automatically close out customer positions when the customer's positions are at a zero balance, a protection against unlimited loss that exchange traded futures contracts do not provide. The Commission's proposed rule, however, effectively ignores this key feature. As a result, on the same market move against any given position, a customer would lose 10 times the amount currently at risk without ever having to post additional margin. This can hardly be seen as enhancing customer protection. There may be a few platforms that do not provide such automatic (and timely) close-out but, to that extent, they would be no different from any designated contract market.

As further support, the Commission notes that there is no central counterparty for forex transactions and retail foreign exchange customers are thus subject to counterparty risk. The proposed above-market security deposit does nothing to ameliorate this risk. To the contrary, requiring that a customer deposit more of its funds with its counterparty only means that the customer will lose more of its funds in the event of the counterparty's bankruptcy. The Commission also argues that greater customer deposits will "provide some capital to cover customer funds held by a failing firm" and that this is justified by the absence of the bankruptcy preference accorded customer funds held in segregation for exchange-traded contracts. Even without the substantial benefit of the segregation of customer funds, we believe it is inappropriate effectively to require customers to prop-up a failing firm. Counterparty risk is better dealt with by requiring an FCM or retail foreign exchange dealer to maintain sufficient capital to meet its obligations. The $20 million minimum capital

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[3] 75 Fed.Reg. 3282, 3291 (January 26, 2010).

requirement established by Congress, which NFA has adopted and the Commission has proposed, appears to be more than sufficient to address this concern.[4]

The Commission's proposed security deposit amount greatly exceeds the security deposits required in the OTC foreign currency markets generally, including among banks that deal with retail customers. By denying FCMs and retail foreign exchange dealers the ability to offer their customers a product that is financially competitive with that of other permitted counterparties, the proposed amount would effectively prohibit these registrants from engaging in conduct that Congress specifically authorized. Under the Commission's oversight, the NFA's retail forex rules have included security deposit requirements since 2003. The Commission acknowledges that NFA currently requires a minimum security deposit of one percent of the notional value of the transaction in the case of major currencies and four percent in the case of non-major currencies. RFEDs that have lawfully operated for years within these parameters may very well be put out of business as their customers quickly move to the banks that are offering retail foreign exchange. We respectfully submit that this cannot be what Congress intended when it twice explicitly permitted FCMs to engage in the off-exchange retail forex business and when it authorized the Commission to regulate it in 2008.[5] MFG believes that the business disruption and competitive disadvantage to be caused by the Commission's proposed 10:1 rule is unnecessary given the many other elements of the comprehensive regulatory regime the Commission is proposing. We agree with the Futures Industry Association that the Commission should retain the NFA's security deposit levels at least until the Commission has had the opportunity to observe the effectiveness of the many other proposed regulations under consideration that it will surely (and rightly) adopt.

Guaranteed Introducing Brokers

Proposed rule 5.18(h) provides that any introducing broker that solicits or accepts orders for retail forex transactions must be guaranteed by an FCM or retail foreign exchange dealer. This means that the FCM or retail foreign exchange dealer must agree to be jointly and severally liable for all obligations of the introducing broker under the Act or the Commission's rules with respect to the solicitation and acceptance of retail forex transactions entered into after the effective date of the guarantee agreement.

In addition, under the Commission's rules, an introducing broker may enter into a guarantee agreement with only one FCM or retail foreign exchange dealer at any time. Further, proposed Rule 5.24 provides that: "Insofar as it is consistent with the requirements of this part, all other provisions of [the Commission's rules] shall apply to such person as though

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[4] We understand that the increase in the minimum net capital requirement for FCMs and retail foreign exchange dealers to $20 million has caused less well-capitalized dealers to withdraw from registration with the Commission and as members of NFA. This has been accomplished without affecting the ability of better capitalized FCMs to continue to provide appropriate foreign exchange services to their customers.

[5] Title XIII, Farm, Conservation and Energy Act of 2008.

such provisions were expressly set forth in this part." Therefore, it would appear that Commission Rule 1.57, which requires an introducing broker to open and carry all accounts that it introduces with its guarantor FCM, would apply. Consequently, each introducing broker would be required to introduce accounts only to its guarantor FCM or RFED.

Each introducing broker, therefore, would effectively become a branch office of its guarantor. Among other responsibilities, under NFA rules, the guarantor FCM or retail foreign exchange dealer would have to conduct an annual compliance audit of the introducing broker, including any branch offices that the introducing broker might have.

We believe the proposed rule imposes an undue burden on introducing brokers that, even if well-capitalized, would be able to introduce its clients to only one FCM or foreign exchange dealer. Many of these introducing brokers may also introduce clients to different FCMs for trading on organized futures exchanges, and the proposed rule might well result in limiting their ability to conduct such business activities. Similarly, the proposed rule would place an undue burden on FCMs and RFEDs, which would be forced to guarantee all introducing brokers or forgo the use of these registrants entirely.

Many FCMs and retail foreign exchange dealers already require introducing brokers to be registered with the Commission and become members of NFA as a sound business practice although they are not currently required to do so. We are not aware of any evidence that these registrants are engaging in fraud or other misconduct to a degree that justifies a requirement that they be guaranteed.

Risk Disclosure

Section 5.5 of the proposed rules sets out a detailed risk disclosure statement that must be provided by each FCM, retail forex dealer and introducing broker before opening an account for a retail customer. As a general matter, we respectfully object to the tone of the disclosure statement, which lacks the objectivity of the futures risk disclosure statement.

More specifically, we object to the proposed disclosure requirements set out in subparagraph (e), which provides that, immediately following the risk disclosure statement, the statement include, for each of the most recent four quarters during which the counterparty maintained retail foreign exchange accounts:

(i) The total number of non discretionary retail foreign exchange accounts maintained by the retail foreign exchange dealer or FCM;

(ii) The percentage of such accounts that was profitable; and

(iii) The percentage of such accounts that was not profitable.

The Commission's Part 4 rules properly require commodity trading advisors and commodity pool operators that exercise discretionary authority over accounts to report the results of their

trading activities to their customers. If FCMs and retail foreign exchange dealers do not exercise discretionary trading authority over their customers' foreign exchange accounts, the percentage of customer accounts that are profitable or unprofitable would appear to be irrelevant to a market participant willing to make his or her own trading decisions. The Commission should not single out off-exchange foreign exchange transactions in this way. It suggests that the Commission truly intends to discourage, if not dissuade, retail investors or traders from participating in this market - even within the sweeping regulatory framework the Commission is now proposing and which MFG largely supports.

Conclusion

The off-exchange foreign exchange experience has been a painful one. For years, firms and individuals sought to position their activities beyond the reach of even the Commission's anti-fraud authority. Courts grappled with the sometimes difficult question of the Commission's jurisdiction and occasionally disagreed. Over time, Congress carefully (even painstakingly) identified the types of regulated entities that may offer off-exchange retail forex contracts and, in 2008, finally granted the Commission badly needed regulatory authority. MF Global applauded this development and we are now very pleased to support most of the regulations the Commission has proposed. We respectfully submit, however, that certain of the Commission's proposals –particularly the required security deposit – are as yet unnecessary, and will make it virtually impossible for FCMs to compete with banks and other financial institutions. Indeed, with a stroke of the regulatory pen, it could ban businesses that have operated for years within the regulatory requirements of NFA as overseen by the Commission.

MF Global Inc. is grateful for this opportunity to comment on the Commission's proposed regulations. If you have any comments or questions you may contact me at 212-589-6235 or lferber@mfglobal.com or Dennis Klejna, Assistant General Counsel, at 212-935-3750 or dklejna@mflgobal.com.

Sincerely,

Laurie R. Ferber
General Counsel