

From: Scott Ferber <sferber@cmsfx.com>
Sent: Monday, March 22, 2010 4:37 PM
To: secretary <secretary@CFTC.gov>
Subject: Regulation of Retail Forex - RIN 3038-AC61
Attach: _10-03-22_ Letter to CFTC on FX Regs _final_.pdf

Dear Mr. Stawick:

Attached please find the comment letter for Capital Market Services, LLC which comments on the Regulation of Retail Forex, RIN 3038-AC61.

Best Regards,

Scott

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Staff Attorney

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March 22, 2010

VIA E-Mail

Mr. David A. Stawick
Office of the Secretariat
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, DC 20581

**Re: Comments on Proposed Regulation of Retail Foreign
Exchange Transactions and Intermediaries, RIN 3038-AC 61**

Dear Mr. Stawick:

Capital Market Services LLC (“CMS”) appreciates the opportunity to respond to the Commodity Futures Trading Commission’s (the “CFTC” or “Commission”) request for comments on the proposed rules entitled “Regulation of Off-Exchange Retail Foreign Exchange Transactions and Intermediaries.”

CMS is a CFTC-registered Futures Commission Merchant (“FCM”) and a National Futures Association (“NFA”) regulated Forex Dealer Member (“FDM”). CMS is also a member of the Foreign Exchange Dealers Coalition (“FXDC”), an organization composed of nine FDMs.

CMS supports the Commission’s efforts to provide greater oversight to the forex industry. CMS generally believes that the proposed regulations are beneficial to the forex industry and constructively implement the purpose of the 2008 Farm Bill. However, CMS believes certain changes should be made before the final rules are issued. Therefore, we are hereby submitting comments regarding the following four proposals:

- (a) Proposed Regulation 5.9 (changing the margin requirement to ten percent) – we urge the CFTC to leave the margin levels at one percent in accordance with just recently adopted NFA regulations;
- (b) Proposed Regulation 5.18(h) (requiring all introducing brokers to be guaranteed by an FCM or RFED) – we urge the CFTF to allow the option for introducing brokers to remain independent;

- (c) Proposed Rule 5.18(j) (requiring all FCMs and RFEDs to designate a Chief Compliance Officer) – we believe imposing personal liability on Chief Compliance Officer is unnecessary in view of current stringent regulatory regime for the forex industry; and
- (d) Proposed Regulations 5.5(e) and 5.18(i) (requiring disclosures regarding the number of active trading accounts and the percent of such accounts that were profitable in the four most recent quarters) – we believe requiring such disclosures will not contribute to enhanced transparency and customer protection and would create potential for dissemination of misleading information and data manipulation by industry participants.

For the reasons outlined below, CMS urges the Commission to revise the proposed regulations in order to ensure adequate investor protections as well as maintain competitiveness and sustainability of the forex industry.

A. Proposed Regulation 5.9

CMS strongly believes that current 100:1 NFA leverage requirement for major pairs and 25:1 leverage requirement for minor pairs are fully adequate for the US forex industry in view of the existing regulatory regime and internal procedures in place at member FDMs. Such leverage level ensures oversight over FDMs' insolvency risks and provides proper customer protections while maintaining competitiveness with non-US forex companies and operational efficiency.

Forex brokers worldwide are currently offering their customers a variety of leverage options (including leverage up to 400:1 in regulated jurisdictions such as the UK and even higher leverage in off-shore unregulated countries), which allows these brokers to stay competitive in the global economy. Higher leverage options also allow small investors to have access to and meaningfully participate in the forex market. Pursuant to the NFA regulations adopted in November 2009, US FDMs have already reduced their leverage across the industry to 100:1 despite the anti-competitive impact of such a comparatively lenient reduction. Recent NFA regulations following the enactment of the Farm Bill have also substantially increased the capital requirement for US FDMs to prevent any risk of insolvency and provide greater customer protections. In view of these stringent checks and balances already applicable to the forex industry, requiring FDMs to lower leverage to 10:1 will unduly burden the forex industry in the US to anti-competitive levels by forcing US FDMs to move their operations abroad. The proposed 10:1 leverage levels will also encourage US and foreign retail customers to invest their funds in unregulated jurisdictions outside of the CFTC's reach, thereby creating the exact opportunities for fraud and market abuse that the CFTC is seeking to prevent.

Further, the highly automated nature of the Forex market and operational practices utilized by the FDMs provide adequate customer protections without the necessity to further decrease leverage. Particularly, US FDMs provide 24-hour risk-management and market making functions and, unlike FCMs, have full control over market making, are not subject to time gaps between sessions and have lower risk of deficits, thus warranting much lower margins than even

existing 1% exchange margins for futures. Hence, imposition of margin requirements 10 times higher than exchange margins on FDMs is neither justified by industry practices, nor supported by any evidence that such levels are necessary to protect FDMs and their customers.

Therefore, CMS strongly urges the CFTC to leave the existing NFA-mandated 1% margin requirement in place – it would preserve a US industry bringing over \$1 billion in revenue and would allow to strike a balance between providing adequate customer safeguards and remaining competitive with other forex firms around the globe.

B. Proposed Regulation 5.18(h)

Although CMS supports implementing CFTC registration and monitoring criteria for Introducing Brokers (“IBs”), we believe that the new requirement for IBs to register as guaranteed IBs with the Forex dealer to which they introduce accounts is misguided. Effectively, such new regulation will impose exclusivity in IB relationships and will provide a disservice to retail customers by restricting the IBs from offering their clients a variety of options particularly suitable to them.

CMS understands the CFTC’s concern regarding fraudulent and deceptive sales practices by IBs and supports all additional regulations which would provide better oversight of IBs. Curbing the fraudulent and deceptive sales practices which are conducted by a small minority of unethical IBs is an important regulatory objective. However, this proposed rule is misguided and sets exclusivity standards for the forex industry that do not exist in the futures and securities industries, where IBs have the option of being either independent or guaranteed.

Requiring the guaranteeing of all IBs would force IBs to conduct business for only one forex dealer. Hence, the IBs will not be able to offer customers the benefits that different forex dealers may offer, including different liquidity provider banks, different platforms and different products. Therefore, the proposed regulation drastically limits the ability of IBs to not only offer suitable options to their clients but also for their clients to make competitive economic decisions regarding their relationship with forex dealers. CMS believes that IBs should be allowed the same flexibility that is available in the futures market since there is no rational justification for differentiating between the two marketplaces and placing the forex market at a disadvantage.

CMS believes that a more effective solution is to require all IBs and any third party that performs services similar to an IB (such as a third party provider of trading algorithms that recommends its customers to use certain forex dealers) to register with the CFTC. Registration would subject these third parties to regulatory audits and oversight by the CFTC. Third parties who attract clients to the industry will then become accountable to a regulator for their solicitation and sales practices. At the same time, individual IBs would maintain control of the decision of whether to affiliate with a forex dealer or to maintain their independence.

C. Proposed Regulation 5.18(j)

This proposed regulation would require that all forex dealers designate a Chief Compliance Officer (“CCO”). The CCO would be required to certify each year that the forex dealer had policies and procedures in place reasonably designed to achieve compliance with the Commodity Exchange Act and the Commission’s regulations.

CMS agrees with the CFTC that compliance should be taken seriously and in accordance with the highest professional standards. However, holding the CCO accountable for a firm’s oversight is misguided as the CCO is generally not a decision-maker for a firm. In effect, the CCO could potentially be held personally responsible for conduct that is outside of his/her control.

This regulation creates an unnecessary strain on forex dealers and will discourage individuals from taking on the role of CCO due to high risk of personal liability. The CCO is not held personally liable in other related industries and we do not believe the forex industry should be held to a different standard. Effective compliance is of the utmost importance in the financial services industry but personal liability is not an effective solution. CMS believes that promulgating additional compliance and risk management procedures would be a less drastic, yet equally effective method of implementing the CFTC’s compliance objectives.

D. Proposed Regulation 5.5(e) and 5.18(i)

Proposed Regulation 5.5(e) would require that FCMs and RFEDs disclose the number of active accounts traded and the percent of such accounts that are profitable. Further, proposed Regulation 5.18(i) would require forex dealers to keep records of unprofitable accounts in order to make the disclosure under Regulation 5.5(e). CMS believes that the disclosure of the number of active accounts and the percent of such accounts that are profitable is not only unnecessary but, in fact, counterproductive for customer protection since this data can be easily manipulated and gives limited insight into a firm’s economic strength or the risks present in forex trading.

CMS supports educating clients and providing proper disclosures. However, CMS believes that these proposed Regulations are misguided. Requiring the disclosure of the percent of profitable accounts will have an unintended consequence of increasing confusion and unbalanced customer perceptions of the market. For instance, the number of profitable traders could differ significantly depending on when the report was generated. Investors could also be misled into thinking that they will profit if there is a large number of profitable trades during a given time period or for a specific forex dealer. In reality, however, the success of one trader has absolutely no bearing on the success of another.

Further, since the proposed regulation does not specify the method for calculating profitable accounts or the time frame for determining profitability, each FCMs and RFEDs could skew the data in order to make it appear that more accounts are profitable. Without defining a uniform method of analysis, the profitability reports have a high potential to be misleading and detrimental to retail customers.

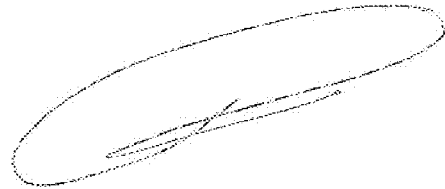
CMS believes that current regulatory requirements regarding risk disclosures sufficiently allow retail customers to evaluate the risks inherent in forex trading. Such risk disclosures are much more pertinent to trading decisions than arbitrary information about other traders' successes or failures.

Conclusion

CMS strongly believes that the Commission's proposed rules should be revised as outlined above. CMS's suggested changes will help strengthen the forex market while protecting retail clients.

We look forward to working with the Commission in order to better protect investors.

Sincerely,

A handwritten signature in black ink, enclosed within a hand-drawn oval border. The signature is cursive and appears to read 'Felix Shipkevich'.

Felix Shipkevich
General Counsel