February 20, 2009

Ms. Marcia E. Asquith
Office of the Corporate Secretary
FINRA
1735 K Street, NW
Washington, DC 20006-1506

Re: Comments on Proposed Rule to Establish a Leverage Limitation for Retail Forex

Dear Ms. Asquith:

The Foreign Exchange Committee respectfully submits this letter in response to the issuance by the Financial Industry Regulatory Authority ("FINRA") of proposed FINRA Rule 2380, which would establish leverage limitation on retail foreign exchange currency transactions (the "Rule"). The proposed Rule was published in Regulatory Notice 09-06 on January 21, 2009 (the "Notice"). This letter addresses certain of the Foreign Exchange Committee's general concerns with the potential adoption of the Rule and, specifically, the leverage limitation that would be imposed on retail foreign exchange transactions to a ratio of no more than 1.5 to 1.

The Foreign Exchange Committee ("FXC") was formed in 1978 under the sponsorship of the Federal Reserve Bank of New York and includes representatives from major domestic and foreign commercial and investment banks and foreign exchange brokers. The FXC represents many of the most significant participants in foreign currency trading in the U.S.1

Overview

During the past decade, the retail foreign exchange currency trading ("retail forex") market has experienced significant growth, due largely to the fact that the forex market is a useful tool that allows investors to hedge their foreign currency exposure and provides risk mitigation and hedging opportunities for highly correlated products that might not trade 24 hours a day. We understand and share the concerns that have been raised by FINRA regarding participation by retail investors, particularly those who are less sophisticated and may engage in more speculative transactions. However, there are sufficient protections in place to address these concerns, and artificial limitations on leverage will serve only to restrict the market and deprive market participants of necessary hedging tools.

Congress recently enacted the CFTC Reauthorization Act ("CRA") as part of the larger Food, Conservation, and Energy Act of 2008. The CRA amended the Commodity Exchange Act ("CEA") to make clear the Commodity Futures Trading Commission's ("the Commission") comprehensive regulatory authority over retail forex transactions, except as

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otherwise provided for in the CEA. This language was intended to eliminate any confusion as to
the Commission’s authority over retail forex transactions, created by the passage of the
Commodity Futures Modernization Act of 2000. The CRA also clarified that the antifraud
provisions of the CEA extended to the offer and sale of all transactions made to retail
customers on a leveraged or margined basis and requires retail forex dealers registered with the
National Futures Association (“NFA”) to maintain at least $20 million in capital. These anti-
fraud provisions and net capital requirements are designed to protect the retail forex customer
trading through an NFA-registered entity from fraud or bad faith actions on the part of the
forex dealer.

Congress’s focus on anti-fraud and net capital requirements for NFA- registered
retail forex dealers underscores its judgment that these are the appropriate tools that should be
applied to retail forex transactions entered into by otherwise regulated entities, such as
registered broker-dealers. There is no indication in the legislation, or elsewhere, that Congress
intended restrictions on leverage to be imposed as a means of protecting retail participants.
While we applaud the laudatory goal of protecting retail forex customers, we believe that the
approach taken in the Notice and the proposed Rule raises several important public policy
concerns.

Comments of the Foreign Exchange Committee

The FXC believes that the protections currently in place with respect to retail
forex transactions are adequate to protect retail market participants and that the proposed Rule
is unnecessary and potentially counterproductive.

The Current Regulatory Regime Provides Adequate Safeguards. In addition to the
regulatory framework developed by CRA for the retail forex market, the current forex industry
operates under a best practices environment that seeks to protect the customer from fraud and
manipulation, as well as the reputation of the financial counterparty. In 2005, the Financial
Markets Lawyers Group (“FMLG”)2 was asked to provide the FXC with its views on the legal
framework underlying the retail-wholesale boundary in the foreign exchange market.3 This
document sets forth guidelines for firms engaged in forex transactions and established that when
firms enter into a transactions, firms must take into account the sophistication of a
counterparty, the nature of their relationship with the retail customer, and the type of
transaction being contemplated or executed. The letter suggests that if the counterparty is
relatively unsophisticated, the firm should take additional steps to adequately disclose the risks
of specific transactions. Finally, the letter noted the importance for firms to take a flexible
approach to working with their customers, to ensure the best possible outcome.

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2 The FMLG advises on legal issues relevant to OTC foreign exchange and other OTC financial
markets and is under the sponsorship of the Federal Reserve Bank of New York. The FMLG is
comprised of lawyers who support foreign exchange and other financial markets trading in
leading worldwide financial institutions.

3 Foreign Exchange Committee 2005 Annual Report, Commenting on the Retail Foreign Exchange
Market. (Appendix 3: Legal Framework for Understanding the Retail-Whole Boundary in Foreign
In addition, FINRA Regulatory Notice 08-66, dated November 4, 2008, has already established appropriate standards and principles to be applied to the retail forex market under NASD Rule 2110, which would apply to all FINRA members. NASD Rule 2110 governs the Standards of Commercial Honor and Principles of Trade and FINRA rightly expects its broker-dealer members to comply with NASD Rule 2110.

The combination of the best practices established by the forex community and the widespread implementation of NASD Rule 2110 will go far to ensure that forex customers are protected from fraudulent transactions and market manipulation in the future. While we appreciate FINRA’s concern for retail forex customers, the current regulatory scheme provides ample protection of these market participants.

**Unnecessary Harm Caused by Proposed Leverage Ratio.** Even if additional regulatory safeguards are warranted for retail forex customers, we believe that imposing a leverage limitation will not be effective in protecting such customers and that it will in fact undermine the existing market and harm market participants by restricting their opportunities. As an initial matter, we would like to note that since foreign currency transactions are not securities and are not subject to the federal securities laws, we therefore question the basis for FINRA’s legal authority to regulate the terms of transactions in this market. While we recognize that FINRA may be able to regulate the sales practices of broker-dealers, even in connection with non-securities, we are not aware of the foundation for FINRA’s authority to control the actual terms of non-securities transactions.

Moreover, we strongly believe that the proposed leverage ratios could effectively preclude broker-dealers from participating in the forex market in its current form. The proposed ratio will prevent even highly capitalized broker-dealers from entering into forex transactions with market participants who are not ECPs, regardless of the capitalization level of the broker-dealer. As a result, these broker-dealers will no longer be able to conduct transactions with well-financed individuals, small businesses or other investment entities that do not qualify as an ECP, but who nonetheless need access to forex transactions, as the cost of such a transaction at the proposed leverage of 1.5 to 1 would essentially price out these market participants. In addition, the proposed ratio could have the effect of significantly limiting the number of dealers with whom a customer may engage in forex transactions and may leave a customer with no alternative but to enter into a forex transaction with other types of dealers that are not subject to this limitation. The proposal will therefore operate to the detriment of retail forex participants by preventing them from trading with regulated, and potentially better capitalized, broker-dealers. Neither alternative is in the best interest of the customer.

Further, while we do not believe that any rigid leverage ratio is appropriate, a level of 1.5 is clearly too low and fails to take into account the fact that volatility in the currency markets is generally lower than that of the equity markets. Volatility and risk in the currency markets also fluctuate fairly rapidly, and it is impossible to establish any single leverage ratio that will be appropriate in all market environments.

Finally, we believe that it is simply not feasible to establish a leverage limit that applies to all transactions because the appropriate degree of leverage will depend on a variety of

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4 FINRA Regulatory Notice 08-66 (Retail Foreign Exchange Currency).
factors, including the needs and objectives of the parties, volatility and other characteristics specific to the transaction.

**FINRA Should Confirm an ECP Carve-Out.** Separately, while ECPs are carved out of the Notice, we urge FINRA to clarify that Regulatory Notice 08-66, which addresses some of the same concerns as the Notice, also does not apply to transactions with ECPs. Moreover, we believe that being classified as an ECP should not be deemed to be the absolute factor in determining whether a customer would be deemed “retail” or not. Therefore, we also urge FINRA to clarify that some participants that are not ECPs may in fact have such institutional resources available to them that they should not be considered retail participants.

To the extent that Regulatory Notice 08-66 is a guideline for FINRA members, we find it helpful as it allows broker-dealers to navigate their relationships with their customers with some flexibility. Given the importance of context in dealing with forex customers, the FXC supports the adoption of policy guidelines over “hard and fast” rules that may do more to harm the market than protect the customer. We appreciate the policy implications of Regulatory Notice 08-66, since we also believe that broker-dealers that engage in retail forex transactions should comply with FINRA rules. This compliance benefits retail forex customers and dealers, by providing clear norms and standards for both parties.

**Conclusion**

The FXC is fully supportive of the requirements on retail forex transactions imposed under the CRA and of the application of FINRA’s standards and industry best practices to broker-dealers engaged in retail forex transactions. We are confident that these provisions will continue to allow the currency markets to operate fairly and transparently. However, the imposition of the proposed leverage limitations will effectively prevent broker-dealers from offering forex transactions to their customers, which will in turn simply result in such customers utilizing NFA-registered forex dealers or unregulated, off-shore firms that are not subject to any capital standards or anti-fraud restrictions. This could not have been the intent of Congress in passing the CRA; and the best interests of customers will not be advanced by the leverage limitations in proposed FINRA Rule 2380.

The FXC appreciates the opportunity to provide these comments. Should you require any further information, please do not hesitate to contact us.

Sincerely yours,

Richard Mahoney
Chair
Foreign Exchange Committee