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Office of the Corporate Secretary-Admin.

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FINRA
Notice to Members

David M. Battan
Vice President & General Counsel

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 (Regulatory Notice 09-06)

Dear Ms. Asquith,

Interactive Brokers LLC ("IBKR") respectfully submits these comments regarding FINRA's proposal to impose a leverage ratio of 1.5-to-1 (equivalent to a 67% initial and maintenance margin requirement) on foreign exchange transactions between a FINRA member and any "retail" customer, defined as a customer that is not an Eligible Contract Participant under Section 1a(12) of the Commodity Exchange Act.

While we understand and support FINRA's desire to protect true retail investors from thinly capitalized or unscrupulous foreign exchange dealers, we do not believe that the proposed 67% margin requirement will accomplish this objective. To the contrary, the leverage limitation proposal will both: a) force many investors to conduct their foreign exchange transactions through *less* regulated or largely *unregulated* institutions overseas or under the jurisdiction of other U.S. regulators; and b) effectively ban well-capitalized and well-regulated FINRA members such as Interactive Brokers from competing in this legitimate and growing market.

Despite repeated consideration, neither Congress nor the Federal Reserve has ever enacted specific margin requirements on foreign exchange transactions, and federal laws explicitly contemplate that banks, broker-dealers, futures commission merchants, NFA forex dealer members and exchanges all may offer foreign exchange instruments. It would not be appropriate for FINRA or any single private self-regulatory organization to usurp the authority of Congress and federal regulators by imposing margin requirements on foreign exchange trading that are economically prohibitive and that disadvantage only one class of federal financial institutions (broker-dealers) to the benefit of all others. We discuss these matters in more detail, below.

Background

IBKR has over $ 600 MM in net capital and is dually-registered as a broker-dealer and a futures commission merchant. IBKR does not recommend or solicit trades and does not employ human brokers that sell to or manage customer accounts. Rather, IBKR offers to its customers an integrated online platform on which they may engage in self-directed investing in U.S (and many foreign) stocks, bonds, mutual funds, options, futures and foreign currencies – all through a single platform that shows the risk and margin requirements of the customer's entire portfolio in real-time.

On its integrated platform, IBKR offers trading in 13 currencies with market spreads as small as 1/2 PIP. Foreign exchange transactions are conducted through a transparent, ECN-like interface that displays quotations from 10 of the world's largest foreign exchange dealers. Commissions and spreads are all completely transparent. Margin requirements on foreign exchange transactions executed by our customers through IBKR range from 2.5% (40-to-1) to 10% (10-to-1) depending on the currency. These requirements are substantially *higher* and *more conservative* than most of our competitors.

IBKR is subject to regulatory oversight by, at least: the Securities and Exchange Commission ("SEC"), the Commodity Futures Trading Commission ("CFTC"), FINRA, the National Futures Association ("NFA"), state securities regulators in all 50 states, the American Stock Exchange, the Boston Options Exchange, the Boston Stock Exchange, the Chicago Board Options Exchange, the Chicago Stock Exchange, the International Securities Exchange, the National Stock Exchange, OneChicago, the Nasdaq/Philadelphia Stock Exchange, the Sydney Futures Exchange, the Australian Securities Commission, the Hong Kong Securities and Futures Commission, the Canadian Depository for Securities, the Depository Trust & Clearing Corporation, the National Securities Clearing Corporation and the Options Clearing Corporation.

There Is A Legitimate Market of Non-Eligible Contract Participants Who Wish to Trade Foreign Currencies through Reputable Broker-Dealers at Competitive Margin Rates in a Single Portfolio along with Stocks, Options, Bonds and Other Investment Products.

With rapid globalization and increased interest in investing in other economies outside the U.S., there is a large and legitimate market for foreign currency trading by sophisticated individual investors and small entities who may have less then $5 or $10 MM in assets yet who wish to gain exposure to a foreign market, or to hedge the value of the dollar or to hedge the value of stocks or bonds issued by foreign companies or companies with substantial exposure to foreign currency fluctuations. IBKR and other well-capitalized and reputable FINRA members have thousands of such investors who wish to be able to trade foreign currencies through a U.S. broker-dealer on a single platform in conjunction with their portfolio of stocks, bonds, options and other investment products. FINRA's forex leverage limitation as proposed would make this impossible, by imposing margin requirements that are profoundly uneconomical and that are disparately applied to broker-dealers and no one else. For example, under the rule proposal, a sophisticated investor with $3 MM in assets who owns $100,000 of stock in European companies in his or her brokerage account would have to tie up an additional $67,000 in new capital to do nothing more than hedge the Euro currency risk. This is completely infeasible.

The Margin Requirement that Would Be Imposed on FINRA Members by the Proposed Rule Is Far in Excess of Margin Rates Charged by Competing U.S. Banks, Futures Exchanges, Futures Commission Merchants and NFA Forex Dealer Members, Yet the Proposal Provides No Legal Authority or Economic Rationale for this Gross Regulatory Disparity

The 1.5-to-1 (67%) margin requirement is overwhelmingly more restrictive (on the order of ***twenty times higher***) than the industry-standard margin charged by federally-regulated futures exchanges, banks, futures commission merchants ("FCMs") and NFA Forex Dealer Members ("FDMs"), who generally charge between 1% and 5% margin and who routinely offer foreign exchange transactions to "retail" non-ECP's.

FINRA has not provided any significant description or economic analysis or data or studies explaining how it arrived at the 67% margin requirement for foreign exchange transactions, or explaining how the 67% requirement can be squared with the 1% to 5% margin offered to non-ECP investors by other federally-approved and regulated U.S. financial institutions competing with FINRA members. There does not appear to be any justification in law or reason for placing FINRA members at such a huge and unprecedented regulatory and competitive disadvantage compared to similarly situated U.S. financial institutions that happen to be under the jurisdiction of other U.S. regulators. This is not even taking into account overseas competitors with whom U.S. "retail" investors easily and legally can open forex-trading accounts.

The Proposed Rule Is Sharply at Odds with the Actions of Congress, the Federal Reserve and the CFTC and SEC toward Foreign Exchange Trading

When Congress amended the Commodity Exchange Act in 2008, it specifically studied the foreign exchange market and it specifically imposed enhanced registration, anti-fraud and capital requirements on certain financial institutions offering foreign exchange transactions. But Congress did not enact any leverage limitations/margin requirements, nor did it suggest or provide specific authority for the Federal Reserve or the SEC or the CFTC to do so. Indeed, none of those federal agencies has ever imposed any margin requirement. Federal Reserve Regulation T is the most universal and comprehensive federal regulation regarding margin lending and leverage limits on particular customer trades and Reg T contains no margin requirement for foreign exchange transactions.

Further, the Commodity Exchange Act and other federal statutes and regulations explicitly contemplate that banks, broker-dealers, futures commission merchants and exchanges all may offer foreign exchange instruments. There is no suggestion in any federal law or regulation that one class of competitors should be preferred or advantaged over another in their ability to offer foreign exchange trading.

The rule proposal upends this federal framework. If it enacts the rule, FINRA would be arrogating to itself the authority to enact prohibitive margin requirements on a class of instruments for which the federal government has not thought fit to impose *any* margin requirement, thereby effectively banning all broker-dealers (*i.e.*, an entire class of legitimate, federally-chartered financial institutions) from offering these legal instruments. Such an action would be far beyond FINRA's or any self-regulatory organization's proper ambit of authority.

At the Least, the Rule Should Contain an Exemption from the Leverage Limitation for Dually-Registered Broker-Dealer/FCMs or FDMs.

The proposed rule is paradoxical and unfair as applied to ***dually-registered*** broker-dealer/FCMs like IBKR. IBKR is dually-registered so that it can maintain a simple corporate structure that is transparent and easy to understand for our regulators and, more importantly, for our customers. IBKR customers can trade domestic and foreign stocks, bonds, mutual funds, options, futures and forex all through a single, well-capitalized entity (over $600 MM in net capital) and all on one trading platform. Rather than dealing with multiple systems, firms, counterparties and account statements, our customers can see one integrated portfolio and one total margin requirement and can easily see and manage their risk based on this integrated, "top-line" view.

As a registered broker-dealer/FCM, IBKR offers both ECP and non-ECP customers the ability to engage in self-directed foreign exchange transactions at a required "house" margin of 2.5% to 10%, which happens to be higher and more conservative than most of our competitor banks, FCMs and FDMs charge. Yet under the rule proposal, even though IBKR may legally offer foreign exchange trading as an FCM at these roughly competitive leverage levels, our choice to dually-register as a broker-dealer would effectively destroy our foreign exchange business and deprive our customers of the convenience of trading stocks, bonds, mutual funds, options, futures and foreign currencies on our single integrated platform and through one single firm.

At a minimum, therefore, the rule should contain an exemption for FINRA members who are also registered FCMs or FDMs and who would otherwise be able to offer forex trading without the 67% margin requirement.[1]

To the extent that FINRA is concerned that unscrupulous and thinly capitalized forex dealers will register *solely* as broker-dealers in an attempt to exploit gaps in existing regulatory coverage, such an exemption would address this concern, because to qualify for the dual registration exemption the FINRA member would by definition be subject to oversight by the CFTC and/or NFA and/or futures exchanges as an FCM or FDM. In an excess of caution, the rule could require such exempt firms to sign a certification and post a disclosure to their customers stating that FINRA will ***not*** oversee the exempt firm's foreign exchange business and that the firm will follow all applicable CFTC and NFA and futures exchange rules regarding the conduct of their business.

FINRA Should Explore Other Approaches to Address Its Legitimate Regulatory Concerns

There are a variety of approaches that FINRA could consider to address its concern about FINRA

[1] We believe that all dually registered broker-dealer/FCMs should be exempt from the leverage limitation if it is enacted, because FCMs are subject to comprehensive oversight by the CFTC and the NFA, including books and records rules and anti-fraud rules in the conduct of their foreign exchange business. However, if FINRA is concerned that some BD/FCMs are not subject to NFA's specific 1% and 4% margin requirements for foreign exchange transactions, FINRA should explore with NFA a program under which such BD/FCMs could submit to the jurisdiction of NFA for purposes of NFA's foreign exchange rules.

members that may be no more than small forex bucket shops. FINRA could look at the mix of business done by members and could refuse or restrict the membership of firms that do not have a significant and legitimate securities business to go along with their forex business. FINRA could impose higher net capital requirements on certain classes of firms to discourage unscrupulous forex dealers from operating under the aegis of FINRA membership, or could apply perhaps a more modest leverage limitation or a sliding scale leverage limit on firms with under a certain net capital (*e.g.*, firms with under $50 MM).

Whatever steps FINRA takes, they should be narrowly tailored such that reputable and well-capitalized firms may continue to offer foreign exchange trading to their customers on commercially competitive terms with other authorized market participants.

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Interactive Brokers sincerely appreciates your time and consideration in reviewing our comments and we are happy to meet with you or to provide any further information that you would find useful.

Sincerely,

David M. Battan

cc: Gary Goldsholle, Esq.
Matthew Vitek, Esq.