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FIA

July 27, 2009

Elizabeth M. Murphy, Secretary
Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-1090

Re: File No. SR-FINRA-2009-040

Dear Ms. Murphy:

Through limitations on customer leverage ratios, FINRA Rule 2380 would bar broker-dealers, including those broker-dealers that are also futures commission merchants ("FCMs"), from engaging in the business of offering bilateral foreign currency ("FX") contracts to customers that are not "eligible contract participants" as defined in the Commodity Exchange Act ("CEA") (7 U.S.C.§1a(13)). Of the over 100 public comments on Rule 2380, none supported its adoption, and all but one opposed it. FINRA responded to this wall of opposition by expanding Rule 2380 to include additional non-securities transactions -- spot and forward transactions in FX -- because FINRA claims it may always act to protect investors "irrespective of whether such activity relates to securities." (74 Fed. Reg at 32025) Now FINRA asks the Commission to approve Rule 2380.

The Futures Industry Association supports investor protection but opposes Commission approval of FINRA Rule 2380 as self-defeating and regulatory unsound. By preventing Commodity Futures Trading Commission-registered FCMs that are also broker-dealers from competing with all other CFTC-registered FCMs and retail FX dealers for the business of retail customers, FINRA will encourage this business to develop, ironically, in other regulated entities operating outside Rule 2380's leverage constraints. In so doing, FINRA's Rule 2380 would discriminate against FCMs that are also broker dealers, in violation of FINRA's statutory duty to avoid imposing unnecessary and inappropriate burdens on competition. (Section 15A(b)(9) of the Exchange Act) In addition, FINRA's assertion of unlimited jurisdiction over the non-securities activities of broker-dealers exceeds its statutory authority generally (Section 15A(b)(6) of the Exchange Act) and conflicts with the retail FX provisions of

the CEA specifically, including those provisions that would strengthen customer protections in this area.

Instead of approving FINRA Rule 2380, FIA recommends that the Commission communicate and coordinate with the CFTC on its new regulatory regime for retail FX transactions based on the CEA amendments Congress enacted in 2008. As the Commission may know, in 2008 Congress rationalized and strengthened various aspects of the CFTC's authority over retail FX transactions, including enhanced antifraud authority and a $20 million minimum net capital standard for FCMs that are primarily or substantially engaged in the traditional futures brokerage business and intend to act as counterparties for retail FX transactions. FINRA's Rule 2380 would supersede, perhaps inadvertently, those congressional standards for jointly registered FCMs and broker-dealers, a result that underscores the need for cooperation and coordination by the Commission and the CFTC in this area as contemplated by the Memorandum of Understanding the agencies announced on March 11, 2008. FIA urges the Commission not to approve FINRA 2380 and to begin now the process of working with the CFTC to coordinate federal regulatory policy over retail FX transactions.[1]

FIA's Interest

FIA is a principal spokesman for the commodity futures and options industry. FIA's regular membership is comprised of approximately 30 of the largest FCMs in the United States. Among its associate members are representatives from virtually all other segments of the futures industry, both national and international. Reflecting the scope and diversity of its membership, FIA estimates that its members effect more than eighty percent of all customer transactions executed on United States contract markets.

Some FIA member FCMs would be competitively disadvantaged under FINRA Rule 2380. Other FIA member FCMs would be competitively advantaged under FINRA Rule 2380. The difference in treatment for these FCMs does not relate to investor protection in any way. Instead, the difference rests on how the FCMs are structured, whether as the same legal

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[1] Banks also engage in retail FX transactions with retail customers and would not be subject to FINRA Rule 2380 The Commission and the CFTC may decide it would be appropriate to coordinate their discussions with the Foreign Exchange Committee, an industry group that is sponsored by the Federal Reserve Bank of New York and includes representatives of major financial institutions engaged in foreign currency trading in the United States. The FXC's most recent letter on retail FX activities of banks can be found at: http://www.newyorkfed.org/fxc/2005/fxc051209.pdf

entity as a broker-dealer, or not. FIA does not choose competitive winners and losers from among its members. FIA supports a level competitive playing field. FIA is writing the Commission to make certain that all registered FCMs are treated alike for purposes of retail FX contracts with no group helped or hurt by virtue of their joint registration as a broker-dealer.

Commodity Exchange Act Background

In 1997, the Supreme Court held that the CEA contained a provision known as the Treasury Amendment which provided a "complete exclusion" from the CEA for all retail FX transactions so long as they were not traded on a CFTC-licensed exchange. (*Dunn* v. *Commodity Futures Trading Commission*, 519 U.S. 465, 476 (1997)) In 2000, Congress modified that exclusion to make off-exchange FX transactions with non-eligible contract participants (as defined in 7 U.S.C. § 1a(12) (2006)) subject to certain provisions of the CEA, including the antifraud provisions, if the counterparty to the retail transaction was a CFTC-registered FCM. (7 U.S.C. §§ 2(c)(2)(B) and (C) (2006)). Some firms thereafter registered with the CFTC as FCMs solely to engage in the retail FX business. Many of those firms engaged in fraudulent sales practices resulting in enforcement actions by the CFTC and disciplinary actions by National Futures Association, the self-regulatory body for FCMs.

In 2008, Congress sought to strengthen the CEA's provisions related to retail FX transactions and remove any possible regulatory gaps. (H.R. Rep. No. 110-627 at 979-980 (Conf. Rep. 2008)). To that end, Congress amended the CEA to confirm that only FCMs that were "substantially or primarily engaged" in the futures business could be counterparties to retail FX transactions and then only if the FCMs met a stringent $20 million minimum net capital requirement.[2] Those firms formerly registered as FCMs which were not engaged in the traditional futures business and still wanted to act as counterparties to retail FX transactions under the CEA could do so only if they registered with the CFTC in a new category for retail FX dealers, met the same $20 million net capital requirement and complied with other regulatory restrictions the CFTC would adopt.[3] In addition, Congress enacted an elaborate and parallel regime of enforcement and regulatory restrictions that applied to qualifying FCMs and retail FX dealers for both retail FX futures transactions and certain leveraged non-futures transactions.[4]

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2 CFTC Reauthorization Act of 2008, 122 Stat. 2190.

3 CFTC Reauthorization Act of 2008, 122 Stat. 2190.

4 CFTC Reauthorization Act of 2008, 122 Stat. 2190-94.

Broker-dealers are not subject to these CEA provisions and CFTC regulations. See CFTC Reauthorization Act of 2008, 122 Stat. 2189-2190, to be codified at 7 U.S.C. § 2(c)(2)(B)(i)(bb). According to FINRA, CFTC-registered FCMs that are jointly registered broker-dealers also may not be subject to these CEA provisions and CFTC regulations. See CFTC Reauthorization Act of 2008, 122 Stat. 2189-2190, to be codified at 7 U.S.C. § 2(c)(2)(B)(i)(cc).[5] If CFTC-registered FCMs are not subject to these new CEA provisions, it would defeat the customer protection purpose of the amendments Congress enacted in 2008.

FINRA Rule 2380

The rule FINRA has submitted for Commission approval specifies that "No [FINRA] member shall permit a customer to initiate any forex position with a leverage ratio

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5 These CEA provisions, items (bb) and (cc), read as follows:

> "(bb)(AA) a broker or dealer registered under section 15(b) (except paragraph (11) thereof) or 15C of the Securities Exchange Act of 1934 (15 U.S.C. 78o(b), 78o-5); or
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> "(BB) an associated person of a broker or dealer registered under section 15(b) (except paragraph (11) thereof) or 15C of the Securities Exchange Act of 1934 (15 U.S.C. 78o(b), 78o-5) concerning the financial or securities activities of which the broker or dealer makes and keeps records under section 15C(b) or 17(h) of the Securities Exchange Act of 1934 (15 U.S.C. 78o-5(b), 78q(h));
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> "(cc)(AA) a futures commission merchant that is primarily or substantially engaged in the business activities described in section 1a(20) of this Act, is registered under this Act, is not a person described in item (bb) of this subclause, and maintains adjusted net capital equal to or in excess of the dollar amount that applies for purposes of clause (ii) of this subparagraph; or
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> "(BB) an affiliated person of a futures commission merchant that is primarily or substantially engaged in the business activities described in section 1a(20) of this Act, is registered under this Act, and is not a person described in item (bb) of this subclause, if the affiliated person maintains adjusted net capital equal to or in excess of the dollar amount that applies for purposes of clause (ii) of this subparagraph and is not a person described in such item (bb), and the futures commission merchant makes and keeps records under section 4f(c)(2)(B) of this Act concerning the futures and other financial activities of the affiliated person."

greater than 1.5 to 1." Rule 2380 broadly defines the term "forex position" to mean "any foreign currency spot, forward, future or option or any other agreement, contract or transaction in foreign currency" that meets three tests:

A) offered or entered into on a leveraged basis, or financed by the offeror, the counterparty, or a person acting in concert with the offeror or counterparty on a similar basis;

B) offered to or entered into with persons that are not eligible contract participants as defined in Section 1a(12) of the CEA; and

C) not executed on or subject to the rules of a designated contract market, a derivatives transaction execution facility, a foreign board of trade (all under the CEA) or a national securities exchange.

The Federal Register Notice prepared by FINRA to accompanying Rule 2380 makes clear that FINRA intends its leverage prohibition to apply to only those registered FCMs that are dually registered broker dealers. (74 Fed. Reg. at 32025). FINRA does not state in this Notice that Rule 2380 applies to CFTC-registered FCMs that are substantially or primarily engaged in the traditional futures brokerage business and either affiliated with a broker-dealer or operating as a stand alone entity. FINRA also does not refer to any theory under which Rule 2380 could be applied to those firms qualifying under the new CEA registration category provided in the 2008 amendments -- retail FX dealers. Thus, it appears to be FINRA's position that only those FCMs that are dually registered as broker-dealers are subject to FINRA 2380.

FIA Opposes Approval of FINRA Rule 2380

FIA opposes FINRA Rule 2380 on multiple grounds. As the comments submitted to FINRA confirm, the rule is overkill. FINRA's restrictive leverage ratios would make it commercially impossible for any broker-dealer or dually registered FCM to attract customers to a retail FX business. FINRA has not explained why it must impose these draconian leverage restrictions to protect investors. It surely has not made the case that any retail FX transactions with lower leverage restrictions, like those customary in the retail FX business (under NFA rules, 100 to 1 for major currencies and 25 to 1 for others) are per se fraudulent or deceptive for investors. FIA knows FINRA is capable of formulating more than adequate protections for investors without imposing a de facto regulatory ban. We therefore urge FINRA to reconsider.

The sweeping textual breadth of FINRA 2380's prohibition further underscores why it is unsound regulatory policy that would exceed FINRA's jurisdictional reach. By stating that "no member shall permit a customer" to initiate an FX transaction with leverage above the prescribed 1.5 to 1 ratio, the rule potentially prohibits any broker dealer, as well as a jointly

registered FCM, from simply referring a client to an affiliated or third party bank or other entity that, operating perfectly lawfully under the regulatory regime applicable to it, transacts with clients at leverage ratios greater than 1.5 to 1. Similarly, the rule potentially would prohibit a FINRA member firm from allowing a client to pledge assets held at the member firm to an affiliated or third party bank or other entity for the purpose of margining or securing forex transactions that involve leverage greater than 1.5 to 1. In fact,, the Rule's scope is so broad that it could be read to prohibit member firms from offering or selling to their retail clients FX-linked notes or other securities with embedded leverage in excess of the FINRA permitted ratios. [6]

As we will discuss below, FIA also believes that FINRA Rule 2380 is blatantly anticompetitive and exceeds FINRA's jurisdiction. Regulation of retail FX transactions has been the subject of recent statutory amendments to the CEA which have laid the statutory groundwork for CFTC regulations in this area, which we understand will be proposed soon. Given the regulatory interplay that dual FCM and broker-dealer registration necessarily involves, FIA urges the Commission to suspend its consideration of approval of FINRA 2380 until the CFTC has completed its rulemaking relating to retail FX transactions. As an alternative and in the interim, the Commission and the CFTC should consider following the road map for inter-agency consultation and coordination set out in the Addendum to the CFTC-SEC Memorandum of Understanding signed on March 11, 2008.

Competition

Section 15A(b)(9) of the Securities Exchange Act provides that FINRA's rules may not "impose any burden on competition not necessary or appropriate in furtherance of the purposes of this chapter." FINRA's asserts, without any explanation or analysis, that it meets this statutory burden. (74 Fed. Reg. at 32024). Yet FINRA offers no justification for barring CFTC-registered FCMs that are dually-registered as a broker-dealer from competing with all other CFTC-registered FCMs as well as CFTC-registered FX dealers.

The unwarranted anticompetitive impact of FINRA's Rule could not be more stark. FINRA would bar one group of CFTC-registered FCMs from competing with other qualified FCMs and retail FX dealers. The reason is not that as a matter of substance jointly registered FCMs pose a greater threat to investor protection; the reason is purely a matter of

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6 One simple example illustrates the potential unintended consequences as well as arbitrary and capricious nature of FINRA's sweeping leverage restrictions. If applicable to a structured note involving foreign currency, FINRA Rule 2380 would outlaw the offer and sale of that note on a 50% margin basis to a non-eligible contract participant investor.

corporate form, which FINRA seemingly concedes. Pure form without regard to substance is never an adequate reason to discriminate in favor of one set of competitors over another equally qualified group of competitors. FINRA Rule 2380 does not comply with Section 15A(b)(9) of the Exchange Act.

FINRA does cite what it calls "regulatory disparities" Congress created in 2008 when it increased the minimum net capital required for FCMs that want to qualify for retail FX business. (74 Fed. Reg. at 32025). Unlike FINRA, of course, Congress may discriminate among competitors without violating the Exchange Act or the antitrust laws. In any event, a congressional decision to increase the qualification standards all FCMs must meet does not justify FINRA's decision to superimpose on those qualification standards a regulatory ban that would single out some qualifying competitors for disparate anticompetitive treatment. FINRA's failure to meet its obligations under Section 15A(b)(9) offers strong grounds for the Commission to disapprove Rule 2380 or at least suspend its approval process until FINRA attempts to justify the anticompetitive impact its rule would have on dually registered broker-dealer/FCMs.

Jurisdiction over Non-Securities Activities

FINRA asserts that by statute it has been granted jurisdiction over all activities of broker-dealers because the statutory standards for the rules of a national securities association "include the 'protection of investors' irrespective of whether such activity relates to securities." (74 Fed. Reg. at 32025). Ironically FINRA cites Section 15A of the Exchange Act to support this position. But Section 15A(b)(6) actually limits FINRA's authority and prohibits FINRA from attempting to "regulate by virtue of any authority conferred by this chapter matters not related to the purposes of this chapter or the administration of the association."

The minimum leverage ratios jointly registered broker dealer/FCMs may impose on counterparties for purposes of retail FX business are no more related to the purposes of the Exchange Act than would be the leverage ratios those entities might impose if they provided home mortgages to customers, offered credit services to customers or even cleared customer futures transactions. None of those activities involves securities transactions. Therefore none of those activities relate to the purposes of the Exchange Act. In fact, the purposes clause of the Exchange Act focuses on securities transactions and never even mentions investor protection. See Section 2 of the Exchange Act. Thus, FINRA's invocation of a generic investor protection purpose to justify Rule 2380, which applies to transactions FINRA concedes are not securities transactions, can not be sustained.

Assuming FINRA believes its rule is necessary or appropriate to protect investors, FINRA's Rule would be self-defeating for another reason. Its Rule would apply only to FCMs that are also registered as broker-dealers. (74 Fed. Reg. at 32025). Other qualifying FCMs and

retail FX dealers would be able to engage in retail FX business without needing to meet the FINRA leverage ratios. If FINRA's ratios are essential for investor protection, as it insists, they will be easily side-stepped by many CFTC-registered firms that now, or may in the future, enter into retail FX contracts. To the extent FINRA must show that its Rule is grounded in an investor protection purpose to sustain its authority to adopt Rule 2380, FINRA's asserted investor protection rationale seems questionable at best.

Follow the MOU

FIA believes the best way to serve the interests of fair competition and investor protection would be to have the Commission and the CFTC coordinate policies in the retail FX area. This practice would not only comport with the directive from President Obama to the two agencies to harmonize their respective regulatory approaches, it would also follow the path set out in the Memorandum of Understanding agreement the Commission and the CFTC entered into in March 2008. Under the March 11, 2008, addendum to that agreement, the Commission and the CFTC agreed to, among other things:

> **Encourage Competition**. Both agencies shall endeavor to promote competition among and between securities, futures, and options markets and market participants, as such competition can expand the range of products available to the marketplace while lowering transaction costs and encouraging market depth and liquidity.
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> **Market Neutrality**. Each agency shall endeavor, for products that implicate areas of overlapping regulatory concern, to permit such products to trade in either or both an Sec- or CFTC-regulated environment, in a manner consistent with their respective laws and regulations.

Developing a coordinated approach to the retail FX business, generally, and the appropriate regulation in this area of jointly registered broker dealers and FCMs, specifically, would be perfectly consistent with both above quoted elements of the MOU. Even if FINRA Rule 2380 did not abridge FINRA's obligations under the Exchange Act, which it does, FIA would still recommend to the Commission that in this area of "overlapping regulatory concern" the Commission and the CFTC should work to develop appropriate regulatory means at least to allow those qualifying FCMs to engage in a retail FX business under an appropriately strong regulatory regime that treats all qualifying FCMs alike.

Conclusion

For these reasons, FIA respectfully requests that the Commission not approve FINRA Rule 2380 and prevent that Rule from going into effect. Instead, we urge the Commission to begin a dialogue with the CFTC on a coordinated regulatory approach to the retail FX business that would not discriminate against any qualifying FCMs. FIA stands ready to assist both Commissions in this effort and would be pleased to discuss this matter with either or both Commissions at your earliest opportunity.

Sincerely,

John M. Damgard
President
Futures Industry Association

cc: Gary Goldsholle, Vice President and Associate General Counsel, FINRA
Matthew E. Vitek, Counsel, FINRA
Eric Juzenas, Acting Chief of Staff, CFTC