FINRA
Financial Industry Regulatory Authority

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August 27, 2009

Elizabeth M. Murphy
Secretary
U.S. Securities Exchange Commission
100 F Street, N.E.
Washington, DC 20549-1090

Re: File No. SR-FINRA – 2009-040 – Response to Comments

Dear Ms. Murphy:

This letter responds to comments submitted to the Securities and Exchange Commission ("SEC" or "Commission") regarding the above-referenced rule filing, a proposed rule change to adopt FINRA Rule 2380 (Leverage Limitation for Retail Forex) to prohibit any member firm from permitting a customer to: (1) initiate any forex position with a leverage ratio of greater than 1.5 to 1; and (2) withdraw money from an open forex position that would cause the leverage ratio for such position to be greater than 1.5 to 1.[1]

The Commission received 12 comment letters on the proposed rule.[2] FINRA has had an opportunity to review the comment letters and believes that the proposed rule change should be approved, with only one minor change to exempt a security already subject to Regulation T initial margin and FINRA maintenance margin requirements from the leverage limitations imposed by the proposed rule change.

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1 See Securities Exchange Act Release No. 60172 (June 25, 2009); 74 FR 32022 (July 6, 2009) (SR-FINRA-2009-040).

2 Letter from Mike Andrews (February 8, 2009) ("Andrews"); Letter from Mike Andrews (February 8, 2009) ("Andrews 2"); Letter from Steve Gallagher et al. (February 11, 2009) ("Gallagher et al."); Letter from Steve Gallagher (February 11, 2009) ("Gallagher"); Letter from Mary M. Jackson (February 17, 2009) ("Jackson"); Letter from Aaron I. Cohn (February 21, 2009) ("Cohn"); Letter from George Selinsky (June 13, 2009) ("Selinsky"); Letter from Ryan Koester (June 13, 2009) ("Koester"); Letter from Douglas W. Schriner, CEO, Harrison Douglas, Inc. (July 20, 2009) ("Schriner"); Letter from Interactive Brokers LLC (July 27, 2009) ("Interactive Brokers"); Letter from TD AMERITRADE, Inc and thinkorswim, Inc. (July 27, 2009) ("TD/thinkorswim"); Letter from Futures Industry Association (July 27, 2009) ("FIA"). The letter from Andrews appears to address an NFA rule proposal and, thus, FINRA will not respond to that letter.

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We wish to note that the instant proposal, unlike the predecessor in Regulatory Notice 09-06, received almost no opposition from the retail investor community.[3] FINRA believes that the relative paucity of investor opposition stems from the fact that retail investors now better understand that nature of the proposal and the scope of FINRA's jurisdiction. Moreover, FINRA has already addressed the issues raised by these commenters.[4]

The thrust of the remaining three comment letters is to advance the pecuniary interests of dually registered broker-dealer/futures commission merchants ("BD/FCMs") at the expense of investor protection.[5] FINRA staff will respond to each of the specific arguments raised, but at the outset we note that the arguments of the BD/FCMs, demanding a level playing field, lack credulity by virtue of the fact that this group currently avoids many of the forex regulations of the Commodity Futures Trading Commission ("CFTC") and National Futures Association ("NFA") by being registered as a broker-dealer. The commenters, rather than seeking a level playing field, seek a field of play with the fewest rules in connection with offering a highly speculative product to retail investors.

Each of these commenters concedes that joint BD/FCMs do not have the same regulatory requirements as sole futures commission merchants ("FCMs"). Unlike joint BD/FCMs, sole FCMs have to meet the regulatory requirements of the NFA which include:

- Increased adjusted net capital requirements of $20 million under Section 11 of NFA's financial requirements;
- General standards that apply to Forex Dealer Members regarding fraud, doing business with non-members, supervision, disclosures and filing of promotional materials under NFA Compliance Rule 2-36;
- Requirements regarding soliciting, introducing, or managing forex transactions or accounts under NFA Compliance Rule 2-39;
- Procedures for the bulk assignment or liquidation of forex positions under NFA Compliance Rule 2-40; and
- Regulatory fees that include an annual fee based on the number of solicitors the firm uses, surcharges that are graduated according to the firm's gross annual revenue from

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3 Andrews 2, Gallagher et al., Gallagher, Jackson, Cohn, Koester, Schriner and Selinsky. Five of these letters (Andrews 2, Gallagher et al., Gallagher, Jackson, Kohn) are duplicates of letters submitted in response to Regulatory Notice 09-06 (January 2009).

4 Andrews 2, Gallagher et al., Gallagher, Jackson and Schriner believe they should be entitled to invest their money at whatever leverage ratio they see fit. Andrews 2, Gallagher et al., Gallagher, Cohn, Selinsky and Koester state that the proposed rule change will force retail investors to trade in less regulated markets.

5 FIA, Interactive Brokers and TD/thinkorswim.

forex transactions and an assessment fee of .0001% on the notional value of each initiating (non-rollover) forex transaction under NFA Bylaw 1301(e).

Furthermore, joint BD/FCMs will not have to comply with upcoming regulations that will be issued by the CFTC regarding retail forex transactions, because the CFTC Reauthorization Act of 2008 ("Reauthorization Act") exempts joint BD/FCMs from CFTC jurisdiction.[6]

The FIA criticizes the proposal because it only reaches FCMs that are dually registered as broker-dealers. This argument merely restates FINRA's jurisdictional reach and does not provide a rationale for opposing a rule proposal.[7]

FIA and Interactive Brokers state that FINRA has not made the case for the 1.5 to 1 leverage limitation it has proposed and suggest that "FINRA is capable of formulating more than adequate protections for investors without imposing a de facto regulatory ban."[8] FINRA does not believe that its judgment for what is appropriate for an effective regulatory regime should be supplanted by the very entities it regulates, and in its judgment the current regulatory environment, with such high leverage ratios, does not adequately protect investors.

Interactive Brokers notes that because Congress did not enact any leverage limitations or margin requirements in the Reauthorization Act, and because it did not provide specific authority for the Federal Reserve, SEC or the CFTC to do so, that no margin is appropriate. FINRA disagrees with this claim. Congress was well-aware that each of these regulatory bodies has the authority to impose margin requirements, so there was neither a reason to grant that authority nor to assume that Congress wanted forex trading to commence without any leverage limitations. Moreover, FINRA can not read an intent to preempt SEC or SRO margin requirements from the fact that Regulation T contains no margin requirements for foreign exchange transactions.[9] The fact that Congress explicitly contemplated that banks, broker-dealers, FCMs and insurance companies may offer foreign exchange – recognizing that these entities have very different regulatory schemes – lends further support for the proposed rule change.[10] The more sensible reading of legislative intent is that each channel

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6 CFTC Reauthorization Act of 2008, 1303 (to be codified at 7 U.S.C. 2(c)(2)(B)(i)(II)(cc)(AA)).

7 Moreover, this argument is a canard as FIA is not supporting broader application of FINRA's proposal to entities beyond FINRA's jurisdiction.

8 See FIA at 5.

9 12 CFR 220.

10 CFTC Reauthorization Act of 2008, 1303 (to be codified at 7 U.S.C. 2(c)(2)(B)(i)(II)). For the same reason FINRA does not believe a bank would be

offering foreign exchange would do so under the rulemaking of the applicable regulator for that channel.

The commenters criticize the proposed rule change because its application depends on whether a firm is a joint BD/FCM or a sole FCM. Yet, these very distinctions exist in federal law today. The Reauthorization Act clearly puts sole FCMs under CFTC jurisdiction for forex transactions, while joint BD/FCMs are exempted and do not have to comply with CFTC's and NFA's forex rules that cover net capital, sales practice and fee requirements.[11] FIA concedes that Congress created regulatory disparities based on whether an FCM is also a broker-dealer but now seeks to prohibit FINRA from fulfilling its statutory mandate to regulate those entities who are broker-dealers in a manner it believes is appropriate.

TD/thinkorswim states that proposed rule change would inconvenience customers because it would force customers to have separate accounts at a broker-dealer and FCM. TD/thinkorswim has not made a compelling case for why non-eligible contract participant ("non-ECP") investors (the category of investors to whom the proposed rule change would apply) are harmed from having multiple accounts. Moreover, given the different regulatory regimes that exist today, customers that trade securities and futures must do so in different accounts.[12] TD/thinkorswim has not made the case for why forex, traditionally a futures product, must be allowed in a securities account (at a joint BD/FCM).

TD/thinkorswim states that "FINRA should consider mandating risk management guidelines that in combination with a more lenient leverage ratio, would result in a better balance between its goal of limiting excessive speculation and frequent customer liquidations and maintaining a competitive marketplace."[13] TD/thinkorswim's argument misses the point: the combination of volatility with excessive leverage is the very invitation to excessive risk to retail investors that the rule proposal directly targets. In sum, TD/thinkorswim's comment in this regard is that FINRA do something else. FINRA does not believe that it is compelled to consider alternative regulatory action when the basis of the comment is not that the proposed regulation is defective, but rather, some form of alternative regulation is desired by the parties being regulated.

TD/thinkorswim's fallback argument that FINRA should impose capital requirements that mirror those of the CFTC/NFA on FCMs and adopt policies regarding risk management

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required to follow the regulatory scheme established by the CFTC, FINRA does not believe a broker-dealer should be so required.

11 CFTC Reauthorization Act of 2008, 1303 (to be codified at 7 U.S.C. 2(c)(2)(B)(i)(II)(cc)(AA)).

12 For example, on securities accounts are protected by SIPC; futures accounts are covered by the CFTC's segregated funds requirements.

13 See TD/thinkorswim at 5.

similar to the policies of the NFA is not persuasive. Again, the fact that FINRA could have proposed an alternative regulatory regime is not a basis for failing to approve the proposed rule change, particularly when the basis of the proposed rule is to eliminate a major part of the equation that provides the incentive for potentially injurious and undue levels of speculation by retail customers who may lack either the financial wherewithal or the sophistication to absorb the risks of this product.

Interactive Brokers offers as an alternative that it and other joint BD/FCMs voluntary submit to the jurisdiction of NFA for purposes of their foreign exchange business, sign a certification and post a disclosure to customers that FINRA will *not* oversee the firm's foreign exchange business and that the firm will follow all applicable CFTC, NFA and futures exchange rules regarding the conduct of their business. FINRA considered this proposal but concluded that it could not fulfill its statutory obligation to regulate broker-dealers and protect investors by ceding its regulatory authority to another SRO, even if such delegation of responsibility was legally cognizable under the Exchange Act.

FIA believes that the proposed rule change could be read to impose new requirements on securities such as structured notes involving a foreign currency. To avoid any potential confusion, FINRA is filing an amendment to the proposed rule change to exempt any security that is subject to the Regulation T initial margin and FINRA maintenance margin requirements. FINRA believes that securities subject to these margin requirements should not be subject to additional requirements under the proposed rule change.

Lastly, in setting an implementation date for the proposed rule change, FINRA will be mindful on the impact on existing positions so as not to force immediate and unanticipated liquidation. [14]

FINRA believes that the foregoing responds to the material issues raised in the comment letters to this rule filing. If you have any questions, please contact me at (202) 728-8104, or Matthew Vitek at (202) 728-8156.

Sincerely,

Gary L. Goldsholle
Vice President and Associate General Counsel

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14 FINRA believes it is appropriate for the SEC rather than FINRA to respond to FIA's comment that the SEC coordinate its policies with the CFTC.