



By Electronic Mail

January 4, 2010

Ms. Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
100 F Street NE
Washington DC 20549-1090

Re: File Number SR-FINRA-2009-40

Dear Ms. Murphy:

The Futures Industry Association (“FIA”)¹ submits this letter in response to the Securities and Exchange Commission’s (“SEC’s”) request for comment on Amendment No. 2 to the Financial Industry Regulatory Authority, Inc.’s (“FINRA’s”) proposed Rule 2380 (Leverage Limitation for Retail Forex). 74 Fed.Reg. 64776 (December 8, 2009). This is the second letter that FIA has filed with the SEC with respect to Rule 2380. FIA also filed a comment letter when the SEC first published FINRA Rule 2380 for comment (“original letter”).² We reaffirm the bases underlying our opposition to Rule 2380 as set forth therein and ask that the original letter be deemed to be incorporated herein by reference. Our comments in this letter challenge FINRA’s assertion that the proposed rule is consistent with the provisions of the Securities Exchange Act of 1934 (“Act”).

FINRA contends that proposed Rule 2380 is consistent with the provisions of section 15A(b)(6) of the Act, which requires, among other things that FINRA’s rules be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade and, in general, to protect investors and the public interest.³ We respectfully disagree. Proposed Rule 2380 does no

¹ FIA is a principal spokesman for the commodity futures and options industry. FIA’s regular membership is comprised of approximately 30 of the largest futures commission merchants (“FCMs”) in the United States, the majority of which are either registered with the SEC as broker-dealers or are affiliates of broker-dealers. These broker-dealers are members of FINRA and, therefore, may be affected by the proposed rule. Among FIA’s 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.

² Letter from John M. Damgard, President, Futures Industry Association, to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, dated July 27, 2009.

³ 74 Fed.Reg. 64776, 64777 (December 8, 2009).

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more than shift responsibility for protecting investors and the public interest from FINRA to other regulatory authorities and self-regulatory organizations.

As FINRA acknowledges, broker-dealers comprise only one of several types of entities described in section 2(c)(2)(B) of the Commodity Exchange Act ("CEA") authorized to act as counterparties to retail customers with respect to over-the-counter ("OTC") foreign currency transactions. Other such permitted counterparties include FCMs, material affiliated persons of broker-dealers and FCMs, retail foreign exchange dealers, financial institutions, financial holding companies and insurance companies. The rules governing the sales practices and related activities of these permitted counterparties may be more or less stringent than FINRA's existing requirements governing the conduct of member firms.⁴

By proposing to fix a leverage limitation that is so much lower than market convention,⁵ proposed Rule 2380 effectively prohibits broker-dealers from offering OTC foreign currency products to their retail customers that are competitive with the products offered by other permitted counterparties. As a result, the proposed rule would simply cause those broker-dealer customers that wish to engage in OTC foreign currency transactions to interact with other permitted counterparties.⁶ We respectfully submit that such a result is both self-defeating and unsound as a matter of regulatory policy.

Although Rule 2380 does nothing to enhance the investor protections that retail customers would otherwise enjoy under FINRA's rules, it denies broker-dealers an opportunity to offer their customers an otherwise lawful product, in apparent violation of section 15A(b)(9) of the Act. This latter section of the 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."

The potential burden on competition is real. Many broker-dealers provide services to high net worth individuals, small businesses and investment entities, many of which may not have the assets necessary to be considered eligible contract participants. These customers may want to enter into foreign currency transactions to hedge or otherwise manage the foreign currency exposure of international securities investments or other business transactions or in connection with a diversified investment portfolio. The proposed leverage of 4:1, however, would make the cost of such

⁴ Prior to adopting Rule 2380, FINRA issued Regulatory Notice 08-66, in which it noted that NASD Rule 2110, which requires member firms to observe high standards of commercial honor and just and equitable principles of trade, would apply to broker-dealers engaging in OTC foreign currency transactions. Regulatory Notice 08-66 then sets out a litany of actions that would constitute a violation of Rule 2110, including: (i) failing to disclose that the firm is acting as a counterparty to a transaction; (ii) failing to adequately disclose the risks of trading in foreign currency; (iii) failing to disclose to customers the risks and terms of leveraged trading; (iv) soliciting business for and introducing customers to a foreign currency dealer without doing adequate due diligence of the foreign currency dealer, or in a way that misleads the customer about the foreign currency dealer or foreign currency trading, including how customer funds will be held; and (v) failing to conduct due diligence into any solicitors that introduce foreign currency customers to the firm, and failing to supervise any unregistered solicitors or agents of the firm.

⁵ Permitted leverage in connection with OTC foreign currency transactions involving retail customers generally ranges from approximately 10:1 to 100:1, but could be higher or lower. These ratios are established by the relevant foreign currency dealer based on the dealer's assessment of the credit worthiness of the customer and the expected volatility of the subject currency, among other factors.

⁶ We understand that nothing in proposed Rule 2380 is intended to prohibit a broker-dealer from referring a customer to a permitted counterparty, including an affiliated bank or FCM.

transactions prohibitive, causing a customer either to forgo the transaction entirely or to effect the transaction with another permitted counterparty. This counterparty may not appreciate the customer's circumstances as fully as the customer's broker-dealer. Neither alternative, therefore, is in the best interest of the customer.

In its August 27, 2009 letter to the SEC responding to the letters filed when Rule 2380 was first published for comment, FINRA asserts that the "more sensible reading of legislative intent [of the CFTC Reauthorization Act of 2008] is that each channel offering foreign exchange would do so under rulemaking of the applicable regulator for that channel." We do not disagree. However, FINRA's proposed rule would not regulate foreign currency transactions between broker-dealers and their retail customers. As FINRA is fully aware, Rule 2380 would effectively prohibit broker-dealers from offering a competitive product to their customers.

Our discussion of the CFTC Reauthorization Act of 2008 and the regulatory regime adopted by the National Futures Association ("NFA") and approved by the Commodity Futures Trading Commission ("CFTC"), was not intended to suggest that FINRA must either adopt the same rules as NFA or defer to NFA entirely. We view the CFTC Reauthorization Act of 2008 and NFA's rules as a starting point and guide from which the SEC and the CFTC, along with FINRA and NFA, could coordinate their regulatory programs for the benefit of their respective registrants, including dually-registered entities,⁷ and all investors.⁸ Such a coordinated regulatory approach would also provide a more level playing field, thereby assuring that no category of registrant — stand-alone broker-dealers, stand-alone FCMs, and dually-registered broker-dealer/FCMs — would have a competitive advantage.⁹

Such a coordinated approach is consistent with the policy of the Obama Administration, as set forth in its June 17, 2009 White Paper on Financial Regulatory Reform, and endorsed by both the SEC and the

⁷ We note that 26 of the 33 largest FCMs with capital in excess of \$20 million are also registered with the SEC as broker-dealers and are members of FINRA.

⁸ In its August 27, 2009 letter, FINRA alleges that, in opposing Rule 2380, FIA was placing the pecuniary interests of its members at the expense of the protection of investors. FINRA's allegation is without foundation. FIA has consistently supported appropriate regulation of the retail OTC foreign currency transactions. In particular, FIA supported the amendments to section 2(c) of the CEA adopted in 2008, which closed certain regulatory gaps that became evident after the enactment of the Commodity Futures Modernization Act of 2000 and strengthened the CFTC's regulatory authority over the offer and sale of OTC foreign currency transactions to retail customers.

Certainly, approval of Rule 2380 would impose on broker-dealers that wish to offer OTC foreign currency products to their customers the additional costs of establishing a stand-alone FCM or other permitted counterparty. This is true whether or not such broker-dealers are currently dually-registered as FCMs. However, FINRA does not explain why customers will be better protected, if they are forced to conduct business through entities that are not subject to its regulation. We submit that a coordinated regulatory approach, endorsed both in our original letter and herein, which will allow a broker-dealer to provide efficient, comprehensive services to its customers, is in the best interest of all investors.

⁹ In this regard, proposed Rule 2380 creates a competitive imbalance between stand-alone broker-dealers and stand-alone FCMs, as well as between stand-alone FCMs and dually-registered entities.

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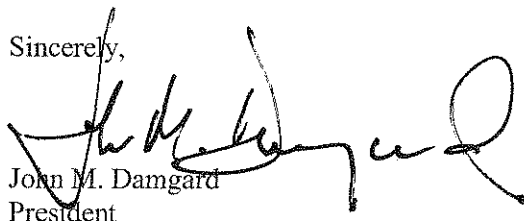
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CFTC.¹⁰ As noted in our original letter, it is also consistent with the Memorandum of Understanding that the SEC and CFTC executed in March 2008.

For the reasons stated above, we respectfully submit that FINRA proposed Rule 2380 is inconsistent with the provisions of the Act and should not be approved. The rule is inconsistent with the provisions of section 15A(b)(6) in that it fails to prevent fraudulent and manipulative acts and practices, promote just and equitable principles of trade, or protect investors and the public interest. The rule further violates the provisions of section 15A(b)(9), which requires that FINRA's rules not "impose any burden on competition not necessary or appropriate in furtherance of the purposes of this chapter."¹¹

We appreciate the opportunity to submit these comments. If the Securities and Exchange Commission has any questions concerning the matters discussed in this letter, please contact Tammy Botsford, FIA's Assistant General Counsel, at (202) 466-5460.

Sincerely,



John M. Damgard
President

cc: Gary Goldsholle, Vice President and Associate General Counsel, FINRA
Matthew E. Vitek, Counsel, FINRA
Eric Juzenas, Senior Counsel to the Chairman

¹⁰ The SEC and CFTC were directed to identify "all existing conflicts in statutes and regulations with respect to similar types of financial instruments and either explain why those differences are essential to achieve underlying policy objectives with respect to investor protection, market integrity, and price transparency or make recommendations for changes to statutes and regulations that would eliminate the differences."

¹¹ Finally, we note that, in adopting HR 4173, the Wall Street Reform and Consumer Protection Act of 2009, the House of Representatives made no change in the provisions of section 2(c)(2) of the CEA relating to retail OTC foreign currency transactions, notwithstanding the adoption of amendments to this section prohibiting leveraged retail OTC transactions in essentially all other commodities. The House of Representatives has once again made clear that retail OTC foreign currency transactions are permitted, subject to appropriate regulation, and are not to be prohibited.