From: Alexis Hall <ahall@ruddylaw.com>
Sent: Friday, March 19, 2010 3:35 PM
To: secretary <secretary@CFTC.gov>
Subject: Regulation of Retail Forex
Attach: FX Solutions, LLC Comment Letter.pdf

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Via Hand Delivery and E-mail (Secretary@cftc.gov)

Mr. David Stawick, Secretary
Commodity Futures Trading Commission
1155 21st Street, NW
Washington, DC 20581

Re: RIN-3038-AC61

Dear Mr. Stawick:

FX Solutions, LLC ("FX Solutions") appreciates the opportunity to comment on the rule proposed on January 20, 2010 by the Commodity Futures Trading Commission ("CFTC") "Regulation of Off-Exchange Retail Foreign Exchange Transactions and Intermediaries."[1] As a National Futures Association ("NFA") registered FCM that has operated as a forex counterparty since 2002, we believe our perspective and tenure affords us an opportunity to provide constructive comment on the CFTC's proposed efforts to better regulate the forex industry.

FX Solutions strongly supports the CFTC's initiative to properly regulate the forex market. Accordingly we support a majority of the CFTC's proposal. FX Solutions fully supports the comments of the Foreign Exchange Dealers Coalition ("FXDC") in its forthcoming comment letter regarding the Regulation of Retail Forex. We do, however, oppose additional aspects of the proposed rules, which we set forth in detail below.

I. Proposed Rule 5.9 Regarding Leverage

Proposed Regulation 5.9 would require forex dealers to collect a security deposit equal to ten percent of the notional value of the retail forex transaction. The CFTC believes that this regulation will reduce retail forex customers' exposure to risk.

With respect to Proposed Regulation 5.9, we reiterate and fully agree with the points set forth by the FXDC. In addition to the items expressed in FXDC's letter, we have a few additional comments, which are outlined below.

The proposed rule regarding leverage is based on the mistaken belief that margin is for the protection of customers. In actuality, margin is for the protection of FCMs. In fact, the CFTC, has held that the concept of margin results from the "desire that futures commissions merchants have adequate

[1] *Federal Register*, Vol. 75, No. 12, pp. 3282-3330.

means to assure their own financial integrity and thereby contribute to the financial integrity of the entire marketplace."[2] Though the CFTC itself recognizes the true purpose of margin, it now seeks to use it as a mechanism to reduce customer exposure to risk.

In attempt to reduce customer exposure to risk, the CFTC is ignoring its objective to protect customers from the fraudulent acts of industry professionals, and is, instead, attempting to protect customers from themselves. The proposed rule regarding leverage will, in essence, prohibit customers from making their own economic decisions. The ultimate decision regarding a customer's risk tolerance should remain with the customer.

Since decisions regarding risk tolerance are best left to the customers, adequate customer protection can be derived from proper disclosure. Like commodity futures dealers, forex dealers are already required to provide customers with risk disclosure statements. The practice of providing risk disclosure statements to customers has been deemed an appropriate and adequate customer protection for decades in the futures trading industry. Since the CFTC has not established any basis for holding forex dealers to higher standards than futures dealers, the provision of risk disclosure statements should be sufficient in the forex industry as well. Accordingly, imposing a blanket ten percent margin requirement is unwarranted.

II. Guarantee Agreements

A. Requiring Guarantee Agreements Conflicts with the Intent of Congress

Prior to 1982, FCMs regularly used agents to solicit business. These agents sometimes made misrepresentations and engaged in other wrongful acts, which caused harm to customers. As these agents frequently had little capital, injured customers were often left without recourse. Consequently, the CFTC sought an amendment to the Commodity Exchange Act, pursuant to which FCMs would be held liable for the acts of agents.

Congress recognized that these agents were, for the most part, independent firms. As such, FCMs could not exercise adequate control over these entities. As a result, Congress dismissed the notion that FCMs should be held liable for the acts of agents. Instead, Congress created the IB registration category. Congress determined that registrants in the new IB category should be held accountable for their own conduct and established certain requirements to ensure such accountability.[3]

Requiring guarantee agreements between IBs and RFEDs or FCMs would make RFEDs and FCMs accountable for the actions of IBs. Thus, it appears that the CFTC is seeking to reargue the issue of accountability, but this time it is doing so in the forex arena. The CFTC has not established any reasoning behind applying more stringent standards to the forex industry. Thus, as the CFTC has failed in its endeavor to hold FCMs liable for the actions of IBs in the futures arena, it must also fail in the forex arena.

[2] *Baker v. Edward D. Jones & Co.*, Comm. Fut. L. Rep. (CCH) ¶21,167 at 24,772 (C.F.T.C. 1981).
[3] *Federal Register*, Vol. 48, No. 150, p. 35248.

B. Guarantee Agreements are Alternatives to Meeting Net Capital Requirements

In furtherance of the goal to hold IBs accountable for their own conduct, Congress established a minimum net capital requirement with the idea that such a requirement would "guarantee the accountability and responsible conduct of introducing brokers."[4] IBs that maintained the required minimum net capital were classified as independent.

Congress held that in lieu of meeting the minimum net capital requirement, an IB could become guaranteed by entering into a guarantee agreement with an FCM.[5] Congress noted that "the purpose of the guarantee agreement is to enable the introducing broker to meet the alternative adjusted net capital requirement . . . ."[6] The legislative history surrounding guarantee agreements makes clear that guarantee agreements are to be used in lieu of, and not in conjunction with, meeting the minimum net capital requirement.

By providing IBs with the option to either meet the minimum net capital requirement or enter into a guarantee agreement, Congress created two separate and distinct categories of IBs. When assessing an FCM's liability for an IB, a clear distinction between independent and guaranteed IBs has been made. With respect to independent IBs, liability will attach to an FCM where there has been a failure of a duty to supervise.[7] An FCM will not be required to supervise the activities of an independent IB, unless it is has been shown that the independent IB was a de facto branch office of the FCM or an agent in the common law sense of the term.[8] The CFTC now seeks to ignore the concept of the independent IB and require all IBs in the forex industry to enter into guarantee agreements. Requiring guarantee agreements will make FCMs and RFEDs liable for the actions of IBs regardless of the relationship between the two.

Additionally, when determining whether an FCM should be held liable for the actions of an IB, courts have emphasized the necessity of a case-by-case examination of the relationship between the FCM and the IB. By requiring guarantee agreements, forex dealers will always be held liable for the actions of the IBs. This outcome completely ignores the long history of analyzing such issues on a case-by-case basis.

III. The Closing Out of Offsetting Long and Short Positions

Pursuant to proposed Regulation 1.46, forex dealers engaging in off-exchange retail forex transactions would be required to close out offsetting long and short positions in an off-exchange retail forex customer's account. Unlike existing Regulation 1.46, the requirement that RFEDs and FCMs close out offsetting positions would apply regardless of whether a customer instructs otherwise.

The CFTC believes that keeping open long and short positions in a retail forex customer's account removes the opportunity for the customer to profit on the transaction, increases the fees paid by the customer, and invites abuse. Despite this contention, there is actually no economical distinction

[4] *Id.*
[5] *Federal Register*, Vol. 48, No. 150, p. 35264.
[6] *Id.*
[7] *In re Big Red Commodity Corp.*, Comm. Fut. L. Rep. (CCH) ¶22,263 (C.F.T.C. 1985); *Reed v. Sage Group, Inc.*, Comm. Fut. L. Rep. (CCH) ¶23,943 (C.F.T.C. 1987)
[8] *In re Big Red Commodity Corp.*, Comm. Fut. L. Rep. (CCH) ¶22,263 (C.F.T.C. 1985); *Reed v. Sage Group, Inc.*, Comm. Fut. L. Rep. (CCH) ¶23,943 (C.F.T.C. 1987).

between commodity futures and forex transactions with respect to offsetting long and short positions. Consequently revising the rule in the context of forex makes little sense.

Absent a prohibition spread trades are common in the marketplace due to variable demand for two positions and the ability to capture a gain on a change in spread positions. Additionally, spread transactions are generally recognized as a more conservative method of investing than a one-side-only transaction. Thus, at minimum customers should be able to instruct an forex dealer not to close out offsetting long and short positions.

As previously expressed, FX Solutions strongly endorses the CFTC's initiative to properly regulate the forex industry. For the reasons stated above, we do, however, oppose proposed regulations 1.10, 1.46 and 5.9.

Thank you for your time and consideration of our points. Please do not hesitate to contact us if you with to further discuss our views.

Sincerely,

FX Solutions, LLC

By:
Michael Cairns
Chief Executive Officer

cc: Hon. Gary Gensler, Chairman
Hon. Michael Dunn, Commissioner
Hon. Jill E. Sommers, Commissioner
Hon. Bart Chilton, Commissioner
Hon. Scott D. O'Malia, Commissioner

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