



NATIONAL FUTURES ASSOCIATION

RECEIVED  
CFTC

03-09

(9)

2003 SEP -8 PM 3: 59

September 8, 2003

Via E-Mail (secretary@cftc.gov)

Ms. Jean A. Webb  
Secretary  
Commodity Futures Trading Commission  
Three Lafayette Centre  
1155 21<sup>st</sup> Street., N.W.  
Washington, D.C. 20581

COMMENT

**Re: Minimum Financial and Related Reporting Requirements for Futures Commission Merchants and Introducing Brokers, 68 Fed. Reg. 131 (July 9, 2003)**

Dear Ms. Webb:

NFA appreciates the opportunity to comment on the Commission's proposed amendment that adopts a risk-based capital requirement and repeals the capital requirement based on segregated funds. The proposal also includes changes to various reporting requirements for FCMs and IBs. Overall, the proposal will increase efficiency, eliminate duplication and harmonize regulatory requirements.

NFA supports the Commission's move to a risk-based capital requirement. NFA also agrees that the alternative capital requirement equal to 4% of customer segregated funds should be eliminated because it is a less effective measure of risk and provides a disincentive for firms to maintain excess customer funds.

As the release notes, NFA has adopted the same risk-based requirement the Commission is proposing to adopt.<sup>1</sup> Therefore, that requirement is already included in the Commission's rules through their references to the amount of capital required by the rules of a registered futures association, and NFA's rules cannot be changed without submitting them to the Commission. For that reason, we can support an industry initiative to eliminate the segregated funds requirement without codifying a risk-based capital requirement as part of the Commission's rules. This approach would allow the industry to study the risk-based capital requirement and make any

<sup>1</sup> Since all active FCMs are Members of NFA and subject to its financial requirements, the Commission's proposal would not increase any FCM's capital requirement. Eliminating the segregated funds requirement would lower the capital requirement for a few firms but would not put any of those firms at greater risk.

adjustments that are appropriate in light of changes within the industry and the financial markets.

The Commission should eliminate the early warning requirement under Rule 1.12(b). The primary benefit of the early warning requirement is to trigger monthly financial filings for thinly-capitalized firms. Since the Commission proposes requiring all FCMs to file monthly financial statements, that benefit will disappear. The early warning requirement was also designed to warn the FCM's DSRO when a firm may have potential capital problems, but the Commission's rules contain other provisions that accomplish similar results – e.g., the 1.12(g) notification for substantial reductions in net capital and the 1.12(c) notification for failing to keep current books and records. Therefore, the burden to firms from retaining the early warning requirement will outweigh the benefits. We also note that the risk-based capital requirement is more sensitive to market movements than segregated funds are, so a firm's minimum capital requirement adjusts more quickly to market risk.<sup>2</sup>

NFA supports amending Rules 1.17(e) & (h) – relating to withdrawal of capital and subordination agreements – to eliminate the calculations based on the amount of segregated customer funds. The Commission's release states that the Commission proposes replacing the segregated funds calculations with 150% of the risk-based capital requirement.<sup>3</sup> We believe the percentage of risk-based capital should be consistent with the percentage for the other calculations, which is 120%.<sup>4</sup> This percentage is already incorporated in the Commission's rules through reference to the capital required by a registered futures association.

The Commission should not amend Rule 1.17(c)(5)(viii) to reduce the collection period before an FCM is required to take a capital charge for undermargined customer and non-customer accounts. Despite the advancements in electronic communication, many retail customers still meet margin calls by check. Therefore, lowering this period could be a hardship for FCMs with a retail client base. Additionally, NFA is concerned that the proposed collection period may not be adequate when customers are required to transfer the funds from an overseas location. Lastly, for institutional clients that invest excess cash early in the day, a margin call received late in the day could result in a delay in meeting the call beyond the proposed deadline.

---

<sup>2</sup> If the Commission does retain the early warning requirement, NFA firmly believes that the 150 percent trigger proposed by the Commission is too high and that shortening the time that the early warning notice must be filed from five business days to 24 hours is impractical. The Commission should give serious consideration to industry comments regarding these issues.

<sup>3</sup> NFA assumes that the *Federal Register* is incorrect when it uses 175% in Rules 1.17(e)(1)(iii), 1.17(h)(2)(vi)(C), 1.17(h)(2)(vii)(A) and 1.17(h)(v)(B).

<sup>4</sup> The one exception is the SEC's requirement for broker-dealers.

The current rule does not put customer funds at risk, and we see no reason to change it.<sup>5</sup>

NFA supports the amendment allowing a DSRO of an FCM or IB to approve an application for an extension to file an unaudited or audited financial statement. Further, the Commission should receive a copy of the DSRO's written approval or denial of the request. However, the rule should not require that the FCM or IB file a copy of its application with the Commission. Requiring the FCM or IB to provide these documents to the Commission is cumbersome and has no regulatory benefit.

Additionally, NFA supports the amendment to Rule 1.10(b) permitting IBs to file annual certified financial statements solely with NFA. Decreasing the required filings increases the efficiency of the Commission and reduces the amount of work for the IBs. Further, NFA supports expanding the list of persons from whom the Commission would accept the oath or affirmation required with the filing of the Form 1-FR under Rule 1.10(d)(4).

If you have any questions concerning this letter, please contact me at 312-781-1413 or [ts Sexton@nfa.futures.org](mailto:ts Sexton@nfa.futures.org).

Respectfully submitted,

Thomas W. Sexton  
Vice President and General Counsel

m:/ham/commentletters/minimumfinancial

---

<sup>5</sup> At the very least, the Commission should not lower the collection period by more than 24 hours.