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COMMENT

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Via E-Mail (secretary@cftc.gov)

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

Re: Proposed Amendment to Rule 1.17

Dear Ms. Webb:

NFA supports the Commission's proposal to provide an Alternative Capital Computation to certain broker-dealer FCMs. This change would conform the Commission's rules to SEC rules.

NFA also supports the change to Rule 1.17(c)(5). That change would codify the already well-established and commonly understood 6% capital charge for certain uncovered foreign currencies. However, we urge the Commission to adopt more comprehensive changes in this area.

As you know, the Commodity Futures Modernization Act of 2000 (CFMA) amended the Commodity Exchange Act to explicitly prohibit off-exchange foreign currency futures and options transactions (forex) with retail customers unless the counterparty is a regulated entity listed in the CFMA. FCMs are among the entities authorized to offer forex contracts to retail customers. As a result, a number of entities have registered as FCMs for the sole purpose of entering into these transactions. Rule 1.17 predates the CFMA by several decades and was not written with these forex dealer FCMs in mind.

As the designated self-regulatory organization (DSRO) for most of the retail forex dealers that have registered as FCMs, NFA has a vital interest in assuring that these firms are financially viable and are able to meet their obligations to their retail

customers. One of the best ways to accomplish this is to encourage these firms to cover their obligations to their counterparties (whether retail or non-retail).

Unfortunately, the current provisions of Rule 1.17 do not address dealer transactions, and it is unclear how certain parts of that rule apply to these firms. NFA staff has had frequent conversations with the Commission's Division of Clearing and Intermediary Oversight and has attempted to apply the rule to encourage cover and otherwise reflect the risks involved in a dealer business. Nonetheless, a number of issues are either still outstanding or should be codified in the rule. In particular, NFA believes that Rule 1.17 should address the following matters.

- The Commission should codify two interpretations that NFA has consistently applied with Commission staff's knowledge and consent. First, Rule 1.17 should explicitly state that the dealer's side of a transaction is inventory, making it subject to the 6% or 20% haircut charge if it is uncovered. Second, Rule 1.17 should recognize that a dealer's positions can be covered with other off-exchange positions to which it is the counterparty or with foreign currency held in deposit, investment, or trading accounts at other financial entities (if the foreign currency is unencumbered and immediately accessible so that it is available to satisfy the firm's obligations and as long as the foreign currency in the account is treated consistently for capital purposes) as well as with on-exchange positions. These interpretations protect a firm's financial viability – and therefore its ability to meet its obligations to customers – by encouraging it to cover its positions.

We are concerned that amending 1.17 without revising its current language that is limited to exchange-traded currencies would imply that off-exchange transactions and foreign currencies held in deposit, investment, or trading accounts cannot be used for cover. This would limit a dealer's alternatives and could discourage it from covering its positions. Furthermore, since currency is the ultimate fungible commodity (e.g., one Euro is completely indistinguishable from another) there is no basis for the distinction.

- When do the covering transactions qualify as current assets? Some CFTC staff members have taken the position that only transactions with other FCMs and broker-dealers qualify as current assets. We do not understand why transactions these entities are any different than transactions with banks and other authorized counterparties. This issue should be addressed and resolved.
- What charge applies to uncovered dealer options positions, and what types of transactions qualify as cover? We understand CFTC staff may be in the process of issuing guidance on these issues, but we believe the guidance should be included in the rule.

For the reasons discussed above, NFA urges the Commission to adopt more comprehensive changes to Rule 1.17 to address dealer foreign currency transactions. If you have any questions concerning this letter, please contact me at 312-781-1413 or tsexton@nfa.futures.org.

Respectfully submitted,

Thomas W. Sexton
Vice President and General Counsel

cc: Lawrence B. Patent (lpatent@cftc.gov)

(kpc/comment letters/Forex Capital Charges)