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CORRECTED VERSION

By Electronic Mail

July 6, 2009

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

Re: Revised Adjusted Net Capital Requirements for Futures Commission Merchants and Introducing Brokers, 74 Fed.Reg. 21290 (May 7, 2009)

Dear Mr. Stawick:

The Futures Industry Association ("FIA") is pleased to submit these comments on the Commodity Futures Trading Commission's ("Commission's") proposed amendments to its minimum financial requirements (17 CFR § 1.17). 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 Securities and Exchange Commission ("SEC") as broker-dealers or are affiliates of registered broker-dealers. Our larger members are part of integrated financial services companies, with affiliates world-wide.[1]

The Commission's minimum financial requirements currently require an FCM to maintain adjusted net capital equal to or in excess of the greatest of: (i) $250,000; (ii) 8 percent of the total risk margin requirement for positions carried in customer accounts, plus 4 percent of the total risk margin requirement for positions carried in non-customer accounts ("risk-based capital requirement"); (iii) the amount of adjusted net capital required by a registered futures association of which it is a member; and (iv) for securities brokers and dealers, the amount of net capital required by SEC Rule 15c3-1(a). 17 CFR § 1.17(a)(1)(i).

[1] 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.

To "ensure the sound financial strength" of FCMs, the Commission proposes to amend Rule 1.17(a)(1)(i) to increase the minimum dollar amount of adjusted net capital that an FCM would be required to maintain from $250,000 to $1,000,000, and to increase to 10 percent from 8 percent and 4 percent, respectively, the alternative risk-based capital requirement for customer and non-customer positions.[2] The Commission further proposes to amend the definitions of "customer" and "non-customer account" set out in Commission Rule 1.17(b) to confirm that cleared over-the-counter (OTC) derivative instruments (whether cleared in the U.S. or abroad) would be included in the calculation of an FCM's risk-based capital requirement.[3] The definition of a "proprietary account" in Rule 1.17(b) is similarly proposed to be revised to assure that an FCM takes an appropriate capital charge with respect to the FCM's proprietary positions in cleared OTC derivatives.[4]

Separately, the Commission has requested comment on the advisability of increasing the Commission's adjusted net capital requirements for FCMs that are also securities broker-dealers to include, in addition to the amount that would otherwise be required by the Commission's rules, an amount equal to such FCM/broker-dealer's net capital requirement under SEC Rule 15c3-1. Currently, Commission and SEC rules each require a dually-registered firm to maintain net capital in excess of the higher of the two capital requirements. If the Commission were to move forward, a dually-registered firm's requirement would be the sum of the two calculations.[5]

FIA appreciates and supports the Commission's interest in assuring that FCMs maintain sufficient capital to maintain their futures-related and other business activities. We, therefore, are pleased to endorse several of the Commission's proposals. In particular, we support the proposed amendment to Rule 1.17(a)(1)(A)(i), which would increase the minimum dollar

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2 The Commission has also proposed to increase the minimum adjusted net capital requirement for introducing brokers from $30,000 to $45,000. As the Commission notes, the National Futures Association ("NFA") currently requires introducing brokers to maintain adjusted net capital of at least $45,000. Therefore, adoption of this proposed amendment would not increase the adjusted net capital requirement for introducing brokers.

3 A "cleared over-the-counter derivatives instrument" is defined in proposed rule 1.17(b)(9) to mean an "over the counter derivative instrument" (as defined in 12 USC 4421), positions of any person carried on the books of the futures commission merchant and cleared by any organization permitted to clear such instruments under the laws of the relevant jurisdiction."

4 As with exchange-traded futures and options positions, an FCM would not take a capital charge with respect to positions in cleared OTC derivatives that are "covered," as defined in Commission Rule 1.17(j). In general, a transaction or position in a contract for future delivery on a board of trade or commodity option is "covered" where such transaction or position normally represents a substitute for transactions to be made or positions to be taken at a later time in a physical marketing channel.

5 FIA understands that the request for comment on the advisability of requiring a joint FCM/broker-dealer to maintain adjusted net capital equal to the sum of its capital requirements under Commission and SEC rules is in the nature of an advance notice of proposed rulemaking. Thus, the Commission would not amend its rules to impose such a requirement without first publishing a notice of proposed rulemaking and soliciting additional comments.

adjusted net capital requirement for FCMs from $250,000 to $1,000,000. We also favor adoption of the proposed amendments to Rule 1.17(b), revising the definitions of "customer," "non-customer account" and "proprietary account" to ensure that cleared OTC derivatives are taken into account in computing an FCM's risk-based capital requirement and required capital charges for uncovered positions.

Further, we agree with the Commission that "the risk associated with non-customer accounts may not necessarily be less than the risk associated with customer accounts under conditions of financial stress for the FCM." 74 Fed.Reg. 21290, 21293 (May 7, 2009). Therefore, we can support applying the same percentage to customer and non-customer accounts in calculating an FCM's risk-based capital requirement.[6] However, we oppose the proposal to increase this percentage to 10 percent and, instead encourage the Commission to require that risk-based capital be calculated at 8 percent for positions carried in both customer and non-customer accounts.[7]

FIA understands that, based on financial reports filed routinely by its member FCMs, the Chicago Mercantile Exchange ("CME") provided an historical analysis of the impact of a 10 percent requirement in calculating risk-based capital and found that the proposed increase would have an adverse impact on a significant number of CME clearing member firms. FIA obviously does not have access to the same financial reports as the CME. However, based on discussions with many of our member firms, we have every reason to believe the CME's findings are accurate.[8] Rough calculations based on the monthly financial data for FCMs published on the Commission's website confirm that the increased capital requirements for larger firms could be in the hundreds of millions of dollars.

We appreciate that many of the larger FCMs may appear to have substantial excess capital, but a number of the smaller firms do not.[9] In any event, institutional investors generally prefer to deal with FCMs and broker-dealers that hold significant amount of excess capital. A substantial reduction in excess capital, even if combined with a corresponding increase in required capital, could cause institutional customers to move their business to other FCMs or simply reduce their use of the futures markets entirely.

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6 We believe many FCMs will need more than 60 days to implement this change, however, and request that any final rules be effective no earlier than 120 days after publication in the Federal Register.

7 We note that the Federal Register release accompanying the proposed amendments provides no empirical, or even anecdotal, evidence that the current 8 percent risk based capital requirement is inadequate.

8 In its comment letter to the Commission, Newedge USA, LLC estimated that its minimum capital requirements could increase by as much as 45 percent, without any change in its risk profile.

9 In addition, most firms meet some portion of their capital requirements through the use of subordinated loans either directly or indirectly through a parent or affiliate. The interest payments on these loans are likely to be significant. Further, these loan agreements may have covenants that require the FCM to maintain a certain amount of excess capital.

Moreover, as the Commission is aware, the Administration's comprehensive financial regulatory reform proposal anticipates that the capital requirements of all financial firms will be strengthened.[10] It is likely, therefore, that with respect to those FCMs that are part of an integrated financial services company — which includes essentially all of the major FCMs, including the ten largest — affiliated entities will also face a demand for more capital, which may require FCMs to reduce their excess capital further. As a result of these potentially competing demands for capital, certain FCMs may elect to withdraw from registration and deploy their capital for use in more profitable business lines.

We respectfully disagree, therefore, with the Commission's conclusion that, if adopted, the proposed amendments should have no effect on competitiveness. To the contrary, adoption of the proposed amendments may well lead to further concentration of customer funds in a handful of FCMs. In light of the fact that the Commission's current capital rules served the industry and the markets well during the recent financial crisis, including the unwinding of Bear Stearns & Co. and the bankruptcy of Lehman Brothers Holdings, Inc., we encourage the Commission to move cautiously before imposing additional capital requirements that may be unnecessary to protect customers and the financial integrity of the markets and would serve only to reduce further competition within the financial services industry.

Appropriate capital requirements, of course, are not the sole means by which customer protection and the financial integrity of the markets are ensured. The obligations imposed by customer segregation provisions under section 4d of the Commodity Exchange Act ("Act") and Commission Rules 1.20-1.29, along with the foreign futures and foreign options secured amount account provisions in Commission Rule 30.7, are the primary regulatory vehicles through which the protection of customer funds is ensured. Financial integrity of the markets is achieved in large part through the implementation at the several derivatives clearing organizations ("DCOs") of sophisticated risk management systems required under Core Principle D in section 5b(c)(2)(D) of the Act, as supplemented by Appendix A to Part 39 of the Commission's Rules. DCOs use these risk management systems, among other things, to determine the permitted forms and necessary levels of margin "to secure prudentially obligations arising from clearing transactions."[11]

For the same reasons that we oppose the proposal to require FCMs to calculate their risk-based capital based on 10 percent of their total risk margin requirement, we would strongly oppose an amendment requiring a joint FCM/broker-dealer to maintain adjusted net capital equal to the sum of the firm's Commission and SEC capital requirements. Our members have not analyzed fully the financial or business implications of this suggestion. Nonetheless, it appears certain that the adverse financial impact described above would be magnified if firms

10 In this connection, although we understand the Commission's desire to move forward, we ask the Commission to consider whether it would be more appropriate to defer acting on the proposed amendments so they may be considered in coordination with the Administration's comprehensive regulatory reform proposals.

11 FCMs also endeavor to mange the risks of their businesses properly and, in that regard, may require their customers to deposit margin in excess of the minimum required by a relevant exchange or DCO.

were required to meet such a requirement. The contemplated approach, if adopted, would have an equally dramatic effect on the securities-related activities of these firms.

We urge the Commission to consider carefully the potential adverse consequences before making any proposals to amend so drastically its minimum financial requirements for FCMs. In this regard, if the Commission were to determine to move forward and propose such a requirement, Commission should first conduct a thorough economic analysis supporting such a dramatic increase, including the cost-benefit analysis required under section 15 of the Act and, to the extent appropriate, make that analysis, not simply its findings and conclusions, available to the public.

Thank you for the opportunity to submit these comments with respect to the proposed amendments to the Commission's minimum financial requirements. If the Commission has any questions concerning the matter discussed in this letter, please contact me at (202) 466-5460.

Sincerely,

John M. Damgard
President

cc: Honorable Gary Gensler, Chairman
Honorable Michael Dunn, Commissioner
Honorable Walter Lukken, Commissioner
Honorable Jill E. Sommers, Commissioner
Honorable Bart Chilton, Commissioner

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