CFTC letter No. 04-03
December 23, 2003
No-Action
Office of General Counsel

Other Written Communication

Division of Clearing and Intermediary Oversight

Re: National Futures Association Forex Rules

Dear :

This is in response to your letter, dated November 13, 2003, to Jane Kang Thorpe and myself in the Division of Clearing and Intermediary Oversight (the "Division") of the Commodity Futures Trading Commission (the "Commission").[1] We understand that your client, "X", objects to the National Futures Association's ("NFA") new Financial Requirements 12 (the "rule"), which was approved by the Commission and took effect on December 1, 2003. You have requested, on behalf of your client, that the Commission withdraw this rule[2] and conduct further appropriate review of this issue.[3]

The rule imposes a minimum security deposit requirement on retail forex transactions for NFA members that are Forex Dealer Members.[4] The requirement is two percent of the notional value for transactions in major currencies and four percent of the notional value for all other currencies.[5] This is consistent with forex transactions on the Chicago Mercantile Exchange, which have a two percent margin requirement for major currencies and four percent margin for all other currencies.

The rule, and other amendments to NFA's Bylaws and rules, were submitted to the Commission for approval in accordance with §17(j) of the Act. The Commission approved these rules on July 31, 2003.[6] As with all other NFA rules approved by the Commission, or permitted to become effective without formal Commission approval, the Commission expects that NFA will enforce its rules. You state that you understand that "the CFTC and NFA anticipate reviewing the rule in six months." The Commission has not stated that it will review the rule in six months and the Commission does not anticipate reviewing the rule unless and until NFA files an amendment thereto.

"X" objects to the security deposit requirement because the deposit applies to Forex Dealer Members and not to certain otherwise-regulated entities that it believes may have a cost-advantage if the otherwise-regulated entities are not required to take security deposits from retail customers. "X" believes that this unfairly disadvantages them and is, therefore, anticompetitive. When NFA submitted the rule for approval, it stated that requiring a minimum security deposit on retail forex transaction will protect a

Forex Dealer Member from absorbing too many customer losses by defaulting customers, which could render the Forex Dealer Member insolvent and jeopardize the funds of non-defaulting customers. We agree with this assessment. This rationale is consistent with the customer and market protection mandates of both the NFA and the Commission. Moreover, the otherwise-regulated entities include banks, insurance companies and broker-dealers, all of whom are subject to regulation regarding their financial positions, albeit not necessarily from NFA. Lastly, the margin requirements apply only to retail customers, and the Forex Dealer Members are still be free to compete with these otherwise-regulated entities for non-retail clients on the basis of margin.

Pursuant to Section 15(b) of the Commodity Exchange Act, the Commission has endeavored to take the least anticompetitive means of achieving the objectives of the CEA in approving the rule. The Commission has considered the public interest to be protected by the antitrust laws as well as the potential benefits of the rule.

The Commission does not plan on withdrawing its approval of or abrogating NFA's Financial Requirements 12, and the Division expects that NFA will enforce this rule, as well as the other rules and amendments approved by the Commission, as of December 1, 2003, the effective date. Accordingly, the Division does not believe that it is appropriate to recommend that the Commission grant the requested relief. If you have any questions concerning this correspondence, please contact me at (202) 418-5430, Deputy Director Lawrence B. Patent at (202) 418-5439 or Peter B. SÁnchez, an attorney on my staff, at (202) 418-5237.

Very truly yours,

James L. Carley
Director

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[1] Jane Kang Thorpe was the Director of the Division of Clearing and Intermediary Oversight at the time of your request. James L. Carley became the Director on November 21, 2003.

[2] The Commission is not authorized to withdraw an NFA rule. Section 17(k) of the Commodity Exchange Act (the "Act"), 7 U.S.C. § 21(k), authorizes the Commission by order to abrogate any rule of a registered futures association if, after appropriate notice and opportunity for hearing, it appears to the Commission that such abrogation is necessary or appropriate to assure fair dealing by the members of such association, to assure a fair representation of its members in the administration of its affairs or to effectuate the purposes of Section 17 of the Act.

[3] Prior to adopting this rule, NFA sought and received comment from its members and other interested parties over several months. The Commission also received an unsolicited comment letter, prior to approval, which raised similar objections that "X" has with regard to the rule. We are satisfied that the rule has been appropriately vetted.

[4] NFA Bylaw 306(a) defines Forex Dealer Members as NFA members that "are the counterparty or offer to be the counterparty to [over-the-counter] foreign currency futures and options transactions offered to or entered into with [retail customers]" unless the member is also one of certain otherwise-regulated entities listed in Bylaw 306(b).

[5] NFA has recently issued a no-action letter that states that NFA will not take action against a Forex Dealer Member if such entity collects a 1% security deposit on transactions in the British pound, Swiss franc, Canadian dollar, Japanese yen, Euro, Australian dollar, New Zealand dollar, Swedish krona, Norwegian krone, or the Danish krone, instead of the 2% deposit specified in the rule, during the period from December 1, 2003 to June 1, 2004. The 4% deposit requirement for other currencies remains in place.

[6] Section 17(j) of the Act does not require publication in the *Federal Register* prior to approval.