

May 28, 2015

**Via Federal Express**

Mr. Christopher J. Kirkpatrick  
Secretary  
Office of the Secretariat  
Commodity Futures Trading Commission  
Three Lafayette Centre  
1155 21st Street, N.W.  
Washington, DC 20581

Re: National Futures Association: Proposed Amendments to NFA Compliance Rule 2-36 Regarding Requirements for Forex Transactions and Financial Requirements Sections 11 and 12 and the Adoption of the Interpretive Notice Entitled NFA Compliance Rule 2-36: Risk Management Program for Forex Dealer Members

Dear Mr. Kirkpatrick:

Pursuant to Section 17(j) of the Commodity Exchange Act, as amended, National Futures Association (NFA) hereby submits to the Commodity Futures Trading Commission (CFTC or Commission) the proposed amendments to NFA Compliance Rule 2-36 and Financial Requirements Section 11 and 12 and the proposed Interpretive Notice to NFA Compliance Rule 2-36 entitled "Risk Management Program for Forex Dealer Members." NFA's Board of Directors (Board) approved the proposal on May 21, 2015, and NFA respectfully requests Commission review and approval of the proposed amendments to NFA Compliance Rule 2-36 and Financial Requirements Sections 11 and 12 regarding requirements for forex transactions, and the adoption of the Interpretive Notice to NFA Compliance Rule 2-36 regarding a risk management program for Forex Dealer Members (FDMs).

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**PROPOSED AMENDMENT**

(additions are underscored and deletions are ~~stricken through~~)

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**COMPLIANCE RULES**

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**Part 2 – RULES GOVERNING THE BUSINESS CONDUCT OF MEMBERS  
REGISTERED WITH THE COMMISSION**

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**RULE 2-36. REQUIREMENTS FOR FOREX TRANSACTIONS**

(j) FDM Chief Compliance Officer

Each Forex Dealer Member shall designate one ~~or more~~ principal(s) to serve as Chief Compliance Officer(s) (CCO). ~~Each CCO must certify annually to NFA that the FDM has a process in place to establish, maintain, review, modify and test policies and procedures that are reasonably designed to achieve compliance with the CEA, CFTC Regulations and orders thereunder, and NFA Requirements. Each CCO must also certify that the FDM has compliance processes in place and that the CCO has apprised the FDM's chief executive officer (or equivalent management personnel) of the FDM's compliance efforts to date, as well as identified any significant compliance problems and the CCO's plan to address those problems. Each FDM must file this annual certification with NFA at the time it files its annual certified financial report. Each CCO must prepare an annual report that meets the requirements of CFTC Regulation 3.3(e) and must provide the annual report to the Forex Dealer Members Board of Directors or Senior Officer. Each Forex Dealer Member must submit the annual report to NFA within 60 days after the Forex Dealer Member's fiscal year end. The annual report must include a certification by the Forex Dealer Member's CCO or chief executive officer that to the best of his or her knowledge and reasonable belief, and under penalty of law, the information contained in the annual report is accurate and complete.~~

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(m) Risk Management Program

Each Forex Dealer Member must establish, maintain and enforce a Risk Management Program as prescribed by NFA's Board of Directors.

(n) Public Disclosure by Forex Dealer Members

Each Forex Dealer Member must make the following information readily available on its website and update such information as is necessary, but no less frequently than on an annual basis:

- (i) The name, title, business background, areas of responsibility, and the nature of the duties of each person that is a listed principal of the Forex Dealer Member;
- (ii) A discussion of the significant types of business activities and product lines engaged in by the Forex Dealer Member, and the approximate percentage of the Forex Dealer Member's assets and capital used in each type of activity;
- (iii) A discussion of the Forex Dealer Member's business on behalf of its customers, including types of customers, markets and currencies traded, international businesses, prime brokers and/or liquidity providers used, and the Forex Dealer Member's policies and procedures concerning the choice of bank depositories, custodians and counterparties to permitted transactions under CFTC Regulation 1.25;
- (iv) A discussion of the material risks associated with the Forex Dealer Member acting as a counterparty to eligible contract participants (ECP) as defined in Section 1a(18) of the Act, including any risks created by the Forex Dealer Member's affiliates and other ECPs acting as dealers;
- (v) A discussion of any pending or completed material administrative, civil, enforcement or criminal complaints or actions filed against the Forex Dealer Member during the last three years;
- (vi) A summary schedule of the Forex Dealer Member's adjusted net capital; net capital and excess net capital; all computed in accordance with CFTC

Regulation 5.7 and reflecting balances as of the month-end for the most recent 12 months;

- (vii) The Statement of Financial Condition and all related footnotes that are part of the Forex Dealer Member's most current certified annual report pursuant to CFTC Regulation 1.16;
- (viii) The total customer liability as reported each day to NFA on the Forex Financial Report for the last 12 months; and
- (ix) The disclosure, displayed in a prominent manner, required by CFTC Regulation 5.5(e) for each of the most recent four calendar quarters during which the Forex Dealer Member maintained retail forex customer accounts.

If any of the financial information required under (iv)-(vii) is amended, the Forex Dealer Member must clearly notate that it has been amended.

~~(m)~~(o) Scope

This rule governs forex transactions as defined in Bylaw 1507(b).

~~(n)~~(p) Exemptions for Certain Transactions

Transactions entered into through a Member to hedge currency exposure from positions on regulated exchanges are exempt from all forex requirements except sections (b) and (c) of this rule if the on-exchange transactions are handled by the same Member.

~~(o)~~(q) Definitions of customer

For purposes of this rule:

(1) "Affiliate" means any person that controls, is controlled by, or is under common control with the Forex Dealer Member;

~~(2) For purposes of this rule the term "customer"~~"Customer" means a counterparty that is not an eligible contract participant as defined in Section 1a(12)(18) of the Act; and

(3) "Dealer" means any person that (i) holds itself out as a dealer in forex or in retail commodity transactions as defined in 2(c)(2)(D) of the Act; (ii) makes a market in forex or in retail commodity transactions as described in 2(c)(2)(D) of the Act; (iii) regularly enters into forex or in retail commodity transactions as

described in 2(c)(2)(D) of the Act with counterparties as an ordinary course of business for its own account; or (iv) engages in any activity causing the person to be commonly known in the trade as a dealer or market maker in forex or in retail commodity transactions as described in 2(c)(2)(D) of the Act. Dealer includes other FDMs, as well as any entity acting in this manner that is not required to be an FDM.

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#### **NFA COMPLIANCE RULE 2-36: RISK MANAGEMENT PROGRAM FOR FOREX DEALER MEMBERS**

Each NFA Member Futures Commission Merchant (FCM) is required under NFA Compliance Rule 2-26 (incorporating CFTC Regulation 1.11) to establish, maintain and enforce a system of risk management policies and procedures designed to monitor and manage the risks associated with its activities as an FCM (known as a Risk Management Program). Each NFA Member Swap Dealer (SD) and Major Swap Participant (MSP) is subject to similar requirements under NFA Compliance Rule 2-49 (incorporating CFTC Regulation 23.600) and must have a Risk Management Program with respect to monitoring and managing the risks associated with its swap dealing activities.

NFA's Board of Directors (Board) believes that each NFA Forex Dealer Member (FDM) should be subject to Risk Management Program requirements with respect to monitoring and managing its forex activities<sup>1</sup>. Therefore, the Board is amending NFA Compliance Rule 2-36 to specifically require FDMs to establish, maintain and enforce a Risk Management Program designed to monitor and manage the risks associated with their forex activities<sup>2</sup>. The purpose of this interpretive notice is to provide guidance relating to the FDM Risk Management Program requirements.

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<sup>1</sup> The FDM Risk Management Program requirements are drawn from similar requirements set forth in CFTC Regulations 1.11 and 23.600. In light of the counterparty nature of forex transactions and the fact that FDMs accept customer funds, the Board believes it appropriate to apply certain requirements set forth in CFTC Regulations 1.11 and 23.600.

<sup>2</sup> RFEDs that are also registered as an FCM and/or SD may have one risk management program that addresses all the risks associated with the activities of each registration category.

### **Written Risk Management Program**

Each FDM must establish, maintain, and enforce a Risk Management Program designed to monitor and manage the risks associated with its forex activities. Each FDM must adopt written policies and procedures that describe its Risk Management Program, and those policies and procedures along with any material changes thereto must be approved in writing by the firm's governing body.<sup>3</sup> The Risk Management Program must also include procedures for the timely distribution of the written Risk Management Program to relevant supervisory personnel. The FDM must maintain records of the persons to whom the Risk Management Program is distributed, along with the date of distribution. The FDM must also submit a copy of the Risk Management Program to NFA and/or the CFTC upon request.

### **Risk Management Unit**

Each FDM must establish and maintain a risk management unit. This unit must have sufficient authority; qualified personnel; and financial, operational and other resources to carry out the firm's Risk Management Program. The risk management unit must report directly to the firm's senior management<sup>4</sup> and be independent from those employees involved (including in a supervisory capacity) in pricing, trading, sales, marketing, advertising, and solicitation activities of the FDM (collectively business trading unit).

### **Elements of the Risk Management Program**

At a minimum, the Risk Management Program must include policies and procedures to monitor and manage the following risks:

- a. Market Risk shall take into account, among other things, for all counterparties (i.e., ECP and Non-ECP) the daily measurement of market exposure, volatility of prices, basis and correlation risks, leverage, sensitivity of option positions (if

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<sup>3</sup> Governing body means (a) board of directors; (b) a body performing a function similar to a board of directors; or (c) any committee of a board or body.

<sup>4</sup> Senior management means, any officer or officers specifically granted the authority and responsibility to fulfill the requirements of senior management by the governing body.

applicable), and position concentration to comply with market risk tolerance limits; timely and reliable valuation data derived from, or verified by, sources that are independent of the business trading unit; and periodic reconciliation of profits and losses resulting from valuations with the general ledger.

- b. Credit Risk shall take into account, among other things, for all counterparties the daily measurement of overall credit exposure to comply with forex counterparty credit limits; monitoring and reporting violations of counterparty customer credit limits performed by persons independent of the business trading unit; the firm's process for monitoring and adjusting security deposit requirements imposed upon all counterparty customers; and regular valuation of collateral (including appropriate haircuts) used to cover credit exposures and safeguarding of collateral.
- c. Liquidity Risk shall take into account, among other things, the daily measurement of liquidity needs, risks presented by prime brokers and/or liquidity providers, and, if applicable, procedures for liquidating all non-cash collateral in a timely manner and without significant effect on price and application of appropriate collateral haircuts that accurately reflect market and credit risk.
- d. Foreign Currency Risk shall take into account, among other things, the daily measurement of the amount of capital exposed to fluctuations in the value of foreign currency to comply with applicable limits and the establishment of safeguards against adverse currency fluctuations.
- e. Legal Risk shall take into account, among other things, the determination that any transaction and netting arrangements entered into have a sound legal basis, account opening documents are properly completed and adequate risk disclosure provided, and an evaluation of what impact any potential litigation may have upon firm capital.
- f. Operational Risk shall take into account, among other things, secure and reliable operating and information systems with adequate, scalable capacity and independence from the business trading unit; safeguards to detect, identify and promptly correct deficiencies in the operating and information systems; automated financial and risk management controls reasonably designed to prevent the placing of erroneous trades, including those that exceed pre-set capital, credit or volume thresholds; and reconciliation of all data and information in operating and information systems.

- g. Counterparty Risk shall take into account, among other things, all risks including but not limited to, settlement risks, pricing risks associated with offsetting the FDM's forex positions with counterparties, including different prime brokers, banks and other FDMs.
- h. Liabilities to Retail Forex Customers Risk shall take into account, among other things, the process to ensure that the FDM has sufficient assets to cover the amount owed to retail forex customers on a daily basis. This process must include:
- a separation of duties among individuals responsible for advising customers on trading activities, approving or overseeing customer cash receipts and disbursements and recordkeeping and reporting financial transactions;
  - a method for ensuring the firm is accurately computing its liability to retail forex customers and accurately monitoring and valuing the funds used to cover the liability to retail forex customers;
  - a method for evaluating on a continued basis the depositories used to hold funds used to cover the amount owed to retail forex customers including ensuring that the depositories meet specified criteria relating to the depository's capitalization, creditworthiness, operational reliability and access to liquidity, as well as the requirements of CFTC Regulation 5.8 and NFA Financial Requirements Section 14;
  - a method for assessing the appropriateness of specific investments of funds used to cover the liability to retail forex customers in permitted investments under CFTC Regulation 1.25; and
  - the timely recording of all transactions, including transactions impacting retail forex customers' accounts, in the FDM's books and records.
- i. Technological Risk shall take into account, among other things, the process to identify and guard against all risks relating to technology including but not limited to the risks associated with both proprietary and third party trading platforms, the security of proprietary and third party platforms, technology changes and the firm's business continuity plan.
- j. Capital Risk shall take into account, among other things, that the FDM has sufficient capital to be in compliance with the Commodity Exchange Act and its regulations and NFA Financial Requirements, as well as having sufficient capital and liquidity to meet the reasonably foreseeable needs of the FDM.



k. Any Other Applicable Risks.

**Risk Tolerance Limits**

The Risk Management Program must also set risk tolerance limits for each of the elements described above and discuss the underlying methodology used in setting these limits, as well as any policies and procedures governing exceptions to these limits and detecting and reporting to appropriate management. These risk tolerance limits must be reviewed and approved quarterly by the firm's senior management and annually by the firm's governing body. The FDM must maintain a copy of these approvals.

Additionally, the Risk Management Program must include policies and procedures for detecting breaches of risk tolerance limits set by the FDM and alerting supervisors within the risk management unit and senior management, as appropriate.

**Stress Testing**

As part of the Risk Management Program, the FDM must conduct stress tests under extreme but plausible conditions of all positions in the proprietary account and in each counterparty account (both retail customers and ECPs) at least on a semi-monthly basis.

**Affiliate Risk**

The Risk Management Program must also consider all risks posed by the FDM's affiliates, including the risks affiliates pose when the FDM functions as the primary risk manager and/or liquidity provider for affiliates, the FDM's other business lines and any other trading activity engaged in by the FDM.

**Periodic Risk Exposure Reports**

Each FDM's risk management unit must provide to senior management and its governing body quarterly written risk exposure reports, which set forth all applicable risk exposures of the FDM, breaches of any established risk limits, any recommended or completed changes to the Risk Management Program, the recommended time frame for implementing the recommended changes; and the status of any incomplete implementation of previously recommended changes to the Risk Management Program.

Each FDM must also provide senior management and the governing body with interim risk exposure reports immediately at any time the FDM detects a material change in the risk exposure of the FDM. An FDM must provide to NFA a copy of all quarterly and interim risk exposure reports provided to its senior management and governing body within 5 business days of providing the report to the FDM's senior management and governing body.

### **Supervision of the Risk Management Program**

The FDM must have a supervisory system in place to ensure that the Risk Management Program is being diligently followed by all appropriate personnel.

### **Review and Testing**

The FDM must ensure that the Risk Management Program is reviewed and tested at least annually or upon any material change in the FDM's business that is reasonably likely to alter the FDM's risk profile by qualified internal audit staff that are independent of the business trading unit, or by a qualified third party audit service, which reports to FDM staff that are independent of the business trading unit. The review must include an analysis of adherence to, and the effectiveness of, the risk management policies and procedures, and any recommendations for modifications to the Risk Management Program. The results of the review must be reported to and reviewed by senior management and the FDM's governing body.

The FDM must document all internal and external reviews and testing of the Risk Management Program including the date of the review or test; the results; any identified deficiencies; the corrective action taken; and the date the corrective action was taken.

### **Recordkeeping**

An FDM shall maintain copies of all written policies and procedures, changes thereto, and approvals required in this notice pursuant to NFA Compliance Rule 2-10 for the period required under CFTC Regulation 1.31.

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## FINANCIAL REQUIREMENTS

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### SECTION 11. FOREX DEALER MEMBER FINANCIAL REQUIREMENTS.

(a) Each Forex Dealer Member must maintain "Adjusted Net Capital" (as defined in CFTC Regulation 5.7) equal to or in excess of the greatest of:

(i) \$20,000,000;

(ii) the amount required by subsection (a)(i) above plus:

(aa) 5% of all liabilities owed the Forex Dealer Member owes to customers (as customer is defined in Compliance Rule 2-36(q)(2)(m)) and to eligible contract participant counterparties that are not an affiliate of the Forex Dealer Member and are not acting as a dealer exceeding \$10,000,000; or and

(bb) 10% of all liabilities the Forex Dealer Member owes to eligible contract participant counterparties that are an affiliate of the Forex Dealer Member not acting as a dealer; and

(cc) 10% of all liabilities eligible contract participant counterparties that are an affiliate of the Forex Dealer Member and acting as a dealer owe to their customers (including eligible contract participants), including liabilities related to retail commodity transactions as described in Section 2(c)(2)(D) of the Act;

(dd) 10% of all liabilities the Forex Dealer Member owes to eligible contract participant counterparties acting as a dealer that are not an affiliate of the Forex Dealer Member, including liabilities related to retail commodity transactions as described in Section 2(c)(2)(D) of the Act;

or

(iii) For FCMs, any other amount required by Section 1 of these Financial Requirements.

(b) A Forex Dealer Member may not include assets held by an affiliate (unless approved by NFA) or an unregulated person in its current assets for purposes of determining its adjusted net capital under CFTC Regulation 5.7. ~~An affiliate is any person that controls, is controlled by, or is under common control with the Forex Dealer Member.~~

For purposes of this section and section (c), a person is unregulated unless it is:

- (i) a bank or trust company regulated by a U.S. banking regulator;
- (ii) a broker-dealer registered with the U.S. Securities and Exchange Commission and a member of the Financial Industry Regulatory Authority;
- (iii) a futures commission merchant registered with the U.S. Commodity Futures Trading Commission and a Member of NFA;
- (iv) a retail foreign exchange dealer registered with the U.S. Commodity Futures Trading Commission and a Member of NFA;
- (v) a bank or trust company regulated in a money center country which has in excess of \$1 billion in regulatory capital; or
- (vi) any other entity approved by NFA.

(c) A Forex Dealer Member may not use an affiliate (unless approved by NFA) or an unregulated person, as defined in section (b), to cover its currency positions for purposes of CFTC Regulation 5.7(b)(2)(v)(A).

(d) An FDM for which NFA is the DSRO that is required to file any document with or give any notice to its DSRO under CFTC Regulations 5.6 [Maintenance of minimum financial requirements by retail foreign exchange dealers and futures commission merchants offering or engaging in retail forex transactions], 5.7 [ Minimum financial requirements for retail foreign exchange dealers and future commission merchants offering or engaging in retail forex transactions] and 5.12 [Financial reports of retail foreign exchange dealers], or is required to file any financial report or statement with any other securities or futures self-regulatory organization of which it is a member shall also file one copy of such document with or give such notice to NFA at its Chicago office no later than the date such document or notice is due to be filed with or given to the CFTC or the self-regulatory organization.

(e) For purposes of this rule:

- (1) "Forex" has the same meaning as in Bylaw 1507(b);
- (2) "Forex Dealer Member" has the same meaning as in Bylaw 306; and
- (3) As used in section (c), "currency" refers to open foreign currency positions with counterparties regardless of whether those counterparties are eligible contract participants as defined in Section 1a(12) (18) of the Act;
- (4) "Affiliate" means any person that controls, is controlled by, or is under common control with the Forex Dealer Member; and
- (5) "Dealer" means any person that (i) holds itself out as a dealer in forex or in retail commodity transactions as described in 2(c)(2)(D) of the Act; (ii) makes a market in forex or in retail commodity transactions as defined in 2(c)(2)(D) of the Act; (iii) regularly enters into forex or in retail commodity transactions as described in 2(c)(2)(D) of the Act with counterparties as an ordinary course of business for its own account; or (iv) engages in any activity causing the person to be commonly known in the trade as a dealer or market maker in forex or in retail commodity transactions as described in 2(c)(2)(D) of the Act. Dealer includes other FDMs, as well as any entity acting in this manner that is not required to be an FDM. For purposes of (a)(ii)(dd) above, dealer does not include a bank or trust company regulated in a money center country which has in excess of \$1 billion in regulatory capital.

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## **SECTION 12. SECURITY DEPOSITS FOR FOREX TRANSACTIONS WITH FOREX DEALER MEMBERS.**

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(a) Each Forex Dealer Member shall collect and maintain the following minimum security deposit for each forex transaction between the Forex Dealer Member and its customers and/or eligible contract participant counterparties ~~a person that is not an eligible contract participant as defined in Section 1a(12) of the Act:~~

- (i) 2% of the notional value of transactions in the British pound, the Swiss franc, the Canadian dollar, the Japanese yen, the Euro, the Australian dollar, the New Zealand dollar, the Swedish krona, the Norwegian krone, and the Danish krone;
- (ii) 5% of the notional value of other transactions;

(iii) for short options, the above amount plus the premium received; and

(iv) for long options, the entire premium.

(b) The Executive Committee may temporarily increase these requirements under extraordinary market conditions.

(c) For purposes of this rule:

(1) "Forex" has the same meaning as in Bylaw 1507(b); and

(2) "Forex Dealer Member" has the same meaning as in Bylaw 306.

(d) In addition to cash, a Forex Dealer Member may accept those instruments described in CFTC Rule 1.25 as collateral for customers' security deposit obligations. The collateral must be in the FDM's possession and control and is subject to the haircuts in CFTC Rule 1.17.

(e) An FDM is required to collect additional security deposits from a retail forex customer, or liquidate the retail forex customer's positions, if the amount of the retail forex customer's security deposits maintained with the FDM is not sufficient to meet the requirements of this section.

(f) An FDM is required to immediately notify NFA's Compliance Department if the FDM changes the security deposit amount established by either subsection (a) or (b) above provided, however, that any decrease cannot fall below the highest minimum security deposit amount required by either subsection (a) or (b) as applicable to a particular currency.

(g) An FDM is prohibited from acting as a counterparty to an eligible contract participant acting as a dealer (as that term is defined in Financial Requirements Section 11(e)) unless that dealer collects and maintains from its customers and eligible contract participant counterparties security deposit amounts for forex equal or greater to the amounts required in subsection(s) (a) and (b).

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#### EXPLANATION OF PROPOSED AMENDMENTS

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In light of the market turmoil and losses incurred by FDMs in January 2015 when the Swiss National Bank unexpectedly abandoned its cap on the Swiss franc's exchange rate against the Euro, NFA has been exploring appropriate regulatory

responses designed to minimize similar losses in the future. As a result, and as described more fully below, NFA's Board has determined that FDMs should be subject to risk management program requirements similar to Futures Commission Merchants (FCMs) and Swap Dealers (SDs), FDMs should be subject to increased capital requirements that take into account the risks associated with forex transactions between an FDM and eligible contract participant (ECP) counterparties, especially those acting as foreign dealers, FDMs should be required to collect security deposits from ECP counterparties and FDMs should be prohibited from acting as counterparty to an ECP acting as a dealer unless that dealer collects and maintains from its customers and ECP counterparties security deposit amounts at least equal to the amount that the FDM is required to collect and maintain. The Board has also determined to require FDMs to make applicable public disclosures similar in nature to those required of FCMs under CFTC Regulation 1.11 and to require FDMs to comply with a CCO annual report requirement similar to that required under CFTC Regulation 3.3.

**Amendments to Compliance Rule 2-36 and Adoption of Related Interpretive Notice – FDM Risk Management Program.**

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Each NFA Member FCM is required under NFA Compliance Rule 2-26 (incorporating CFTC Regulation 1.11) to establish, maintain and enforce a risk management program designed to monitor and manage the risks associated with its activities as an FCM. Similarly, each NFA Member SD is required under NFA Compliance Rule 2-49 (incorporating CFTC Regulation 23.600) to have a risk management program designed to monitor and manage the risks associated with its swap dealing activities. NFA's Board has determined that each FDM should also be required to adopt a risk management program designed to monitor and manage the risks associated with its forex activities, and therefore the Board has amended NFA Compliance Rule 2-36 to specifically impose this requirement on FDMs. The Board has also adopted an Interpretive Notice that more fully discusses the essential components of a risk management program. Given the counterparty nature of forex transactions and the fact that FDMs accept customer funds, the Board imposed requirements similar to those set forth in CFTC Regulations 1.11 and 23.600.

The amendments to Compliance Rule 2-36 and the related Interpretive Notice apply to all FDMs, including FCMs that engage in retail forex transactions. However, since CFTC Regulation 1.11 (CFTC's FCM risk management rule) requires an FCM to consider the risks associated with all lines of business, the risk management program of any FCM engaging in retail forex activities should already consider the firm's forex activities.

NFA's Board also determined to amend Compliance Rule 2-36 to require each FDM to make certain specified information readily available on its website and to update that information as necessary (at least annually). The information required is similar in nature to the applicable public disclosures required of FCMs under CFTC Regulation 1.55. Importantly, the revised rule requires an FDM to disclose the material risks associated with the FDM acting as counterparty to ECPs, including any risks created by the FDM's affiliates acting as dealers. This disclosure is important given the fact that when the Swiss National Bank abandoned its cap on the Swiss franc's exchange rate against the Euro, one FDM suffered significant losses, which were primarily attributable to losses of its foreign U.K. affiliate. The U.K. affiliate acted as a dealer to foreign retail customers and hedged its risk at the FDM.

Finally, NFA's Board is amending Compliance Rule 2-36 to impose the CCO annual report required on FDMs to keep it consistent with the requirements of FCM and SD Members.

**Amendment to Financial Requirements Section 11 – FDM Capital Increases Related to Acting as a Counterparty to ECPs**

NFA Financial Requirements Section 11 currently requires FDMs to maintain adjusted net capital equal to \$20 million plus 5% of all liabilities owed to customers that exceed \$10 million.<sup>5</sup> The term customer specifically excludes ECPs and therefore there is no additional capital charge for liabilities owed to any ECP, including those acting as dealers. As described below, given the financial risks posed to FDMs by ECP transactions and to promote a further financial safeguard, NFA's Board has determined that the FDM capital requirement should include an additional charge for the amount owed to ECP counterparties, including with ECP counterparties acting as a dealer.

One FDM suffered significant losses on January 15 when the Swiss National Bank unexpectedly abandoned the cap on the Swiss franc's exchange rate against the Euro. Specifically, this FDM fell below its minimum capital requirement by nearly \$220 million and if the firm had filed for bankruptcy, the firm's customers would have been treated as general creditors with no preference in bankruptcy; and the customer losses would have been significant.

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<sup>5</sup> FDMs that are FCMs must meet the higher FCM capital requirement, if applicable.



The vast majority of losses experienced by the FDM resulted from losses suffered by its U.K. affiliate – a foreign broker that acted as counterparty to foreign customers. The foreign affiliate hedged its risk with the FDM. Additionally, the FDM's other foreign affiliates covered transactions with their foreign customers through the U.K. affiliate, which the U.K. affiliate also covered through the FDM. As a result, the risk attributed to these positions ultimately held by the foreign customers rested with the FDM.

Although the U.K. affiliate is a dealer engaging in forex transactions with foreign customers (as well as covering positions for the FDM's other foreign affiliates), the foreign affiliate qualifies as an ECP counterparty in its transactions with the FDM. Therefore, neither NFA's nor the CFTC's current forex requirements cover the FDM's activities with the U.K. affiliate. More specifically, the FDM does not take a capital charge for any of its transactions with the U.K. affiliate.

The FDM, however, not only carried the risk of these transactions involving foreign customers, but the risk associated with these transactions was higher than with U.S. retail customers because the security deposits required of these foreign customers were often lower than the amounts required by NFA and the CFTC. For example, the U.K.'s Financial Conduct Authority does not prescribe any security deposit requirements. The FDM informed NFA, however, that its U.K. affiliate required new customers to deposit funds to meet a security deposit ranging from .25%-7.5% depending on the currency and execution method.

As amended, Financial Requirements Section 11 will include the liability to non-affiliate ECP counterparties not acting as dealers when calculating the current additional 5% capital charge on liabilities that exceed \$10 million owed to customers. Additionally, it will impose a capital charge of 10% of any liabilities the FDM owes to: (1) ECP counterparties that are an affiliate of the FDM not acting as a dealer; and (2) ECP counterparties that are not an affiliate of the FDM acting as a dealer (excluding any dealer that is a bank or trust company regulated in a money center country which has in excess of \$1 billion in regulatory capital). Section 11 will also impose a capital charge of 10% of the liabilities ECP counterparties that are an affiliate of the FDM and acting as dealer owe to its customers, including eligible contract participant customers. Some of these foreign dealers (both affiliate and non-affiliate) also engage in other retail commodity transactions in metals and other commodities. Since these transactions may also impact the FDM's financial position, NFA believes it is prudent to impose requirements on its Member to address these financial risks. Therefore, the Board has

determined that the 10% charge will also be applied to liabilities related to those transactions if the foreign dealers attempt to cover the risks of these transactions with the FDM.

NFA has reviewed the impact of including ECP counterparties (that are not affiliates or dealers) in the current 5% charge on liabilities that exceed \$10 million owed to customers. Although many of the FDMs have ECP customers, it appears that none of the firms would have difficulty meeting the additional charge.

NFA has also reviewed the impact on FDMs to imposing a 10% charge on the liability owed to the underlying customers of ECP counterparties that are affiliates acting as dealers. Only two of the FDMs have a significant liability to ECP counterparties acting as dealers and based on current customer liability and capital information, at least one of these FDMs would have to infuse additional capital to meet the new requirement.

### **Financial Requirements Section 12 – Security Deposit Requirements**

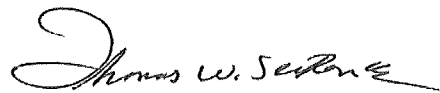
NFA Financial Requirements Section 12 currently requires an FDM to collect specified security deposit amounts from its customers that are not ECPs. The Board has determined that the risks associated with transactions with ECP counterparties have a direct impact on the FDM's retail customers, and therefore the Board is amending Financial Requirements Section 12 to require FDMs to also collect and maintain the same security deposit amounts from ECP counterparties. The Board is also amending Financial Requirements Section 12 to prohibit an FDM from acting as counterparty to a dealer that does not collect and maintain the same security deposits from its customers and ECP counterparties that an FDM is required to collect and maintain. The final amendment to Financial Requirements Section 12 requires an FDM to notify NFA if it changes the security deposit amount for any currency. Obviously, any change cannot fall below the highest minimum security deposit amount required by Section 12. The purpose of this amendment is to alert NFA if an FDM is raising security deposit amounts, which will allow NFA to consider this information and determine if it would be prudent for NFA to impose an increase on all FDMs.

Mr. Christopher J. Kirkpatrick

May 28, 2015

NFA respectfully requests that the Commission review and approve the proposed amendments to NFA Compliance Rule 2-36 regarding requirements for forex transactions and Financial Requirements Sections 11 and 12 and the adoption of the Interpretive Notice to NFA Compliance Rule 2-36 entitled "Risk Management Program for Forex Dealer Members."

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Thomas W. Sexton". The signature is fluid and cursive, with a long horizontal stroke at the end.

Thomas W. Sexton  
Senior Vice President and  
General Counsel