October 17, 2011

VIA ELECTRONIC MAIL (rule-comments@sec.gov)

Ms. Elizabeth Murphy
Secretary
United States Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549

Re: File No. S7-30-11 – Retail Foreign Exchange Transactions

Dear Ms. Murphy,

On behalf of the Securities Industry and Financial Markets Association ("**SIFMA**")[1] and the International Swaps and Derivatives Association[2] ("**ISDA**" and, together with SIFMA, the "**Associations**"), we are pleased to comment on the interim final temporary rule (the "**Interim Rule**") adopted by the Securities and Exchange Commission ("**SEC**" or the "**Commission**") on July 13, 2011 regarding regulation of foreign exchange conducted by broker-dealers.[3] The Associations support the Interim Rule and urge the SEC to adopt a final rule that is based on the approach followed in the Interim Rule, with a few modifications as discussed below. In addition, in light of the fact that the Commodity Futures Trading Commission ("**CFTC**") does not have jurisdiction over retail foreign exchange activities conducted by broker-dealers, including entities that are dually registered as broker-dealers with the SEC and as futures commission merchants ("**FCMs**") with the CFTC ("**Dual Registrants**"),[4] the Associations respectfully request that the Commission clarify, that the rules of the SEC, and not those of the CFTC or National Futures Association ("**NFA**"), govern foreign exchange conducted by broker-dealers with retail customers (defined below) and ask that the SEC provide additional clarifying guidance described below. The Associations believe that it is in the best interest of retail customers to have the opportunity to conduct foreign exchange activity as part of their broader investing activity, through their broker-dealers, with the assistance of personnel who have expertise in foreign exchange. In our experience, foreign exchange transactions undertaken by broker-dealer customers are most efficiently carried out in a

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[1] The Securities Industry and Financial Markets Association ("SIFMA") brings together the shared interests of hundreds of securities firms, banks and asset managers. SIFMA's mission is to support a strong financial industry, investor opportunity, capital formation, job creation and economic growth, while building trust and confidence in the financial markets. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association ("GFMA"). For more information, visit www.sifma.org.

[2] ISDA's members comprise a broad range of OTC derivatives market participants, including banks, asset managers, commodities firms, exchanges and clearinghouses. ISDA, with seven offices nationally and globally, commits to building robust, stable financial markets and a strong financial regulatory framework. For more information, visit www.isda.org.

[3] *See* Retail Foreign Exchange Transactions, Interim Final Temporary Rule, Exchange Act Release No. 34-64874, 76 Fed. Reg. 41,676 (July 15, 2011) ("Adopting Release").

[4] *See* Sections 2(c)(2)(B)(i)(II)(cc), 2(c)(2)(C)(i)(I)(aa) and 2(c)(2)(E) of the Commodity Exchange Act ("**CEA**").

coordinated fashion with the customers' broader investment activities. In order to provide retail customers the convenience of investing through their broker-dealers, as well as the expertise, robust regulatory framework and other benefits that transacting through broker-dealers offers, the Associations urge the Commission to adopt a permanent final rule to allow broker-dealers to continue conducting the full range of foreign exchange activity with retail customers. In this letter, our references to "retail customers" include both institutions and individual investors that are not eligible contract participants ("**ECPs**") within the meaning of the Commodity Exchange Act ("**CEA**"). As a result of changes to the definition of ECP made in the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 ("**Dodd-Frank**") and the application of the "Look-Through Rule,"[5] in the absence of appropriate regulatory relief, non-ECP entities could even include a number of private funds, including funds with substantial assets (i.e., $1 billion or more) and expertise with investing in foreign exchange.

Background

On July 13, 2011, the Commission adopted the Interim Rule in response to Section 2(c)(2)(E) of the CEA and the mandate of Dodd-Frank. The Interim Rule sunsets on July 16, 2012. In the adopting release for the Interim Rule ("**Adopting Release**"), the Commission noted that it had adopted the Interim Rule in response to industry assertions that failure of the Commission to engage in rulemaking would have adverse consequences to retail investors.[6] The Associations continue to believe that final and permanent adoption of a rule that is based on the Interim Rule is necessary and that failure by the SEC to adopt a permanent final rule will disadvantage retail customers and the marketplace generally.

SEC rulemaking in regard to foreign exchange is necessary in order to implement an express authorization by Congress for broker-dealers to provide over-the-counter ("**OTC**") foreign exchange services to their retail customers. The CEA (as a result of amendments set forth in Dodd-Frank) prohibits regulated entities, including SEC-registered broker-dealers, from continuing to enter into certain OTC foreign exchange transactions with persons that are not ECPs (i.e., retail customers), unless the transactions are conducted pursuant to regulations promulgated by the federal regulatory agency responsible for regulating the activities of the entity and the regulations satisfy the requirements of the CEA.[7] The CFTC, the Federal Deposit Insurance Corporation ("**FDIC**") and the Office of the Comptroller of the Currency ("**OCC**") have all adopted final rules to permit retail customers to enter into

[5] For all purposes, other than foreign exchange transactions, a commodity pool with at least $5 million in assets that is formed and operated by a person regulated under the CEA qualifies as an ECP. *See* Section 1a(18) of the CEA. In respect to foreign exchange transactions only, Dodd-Frank added the additional requirement that every participant in the pool be itself an ECP. *See* Section 1a(18)(iv) of the CEA. The CFTC and the Commission, have jointly proposed that "participants in a commodity pool" be defined to include not only direct participants but also indirect participants in the pool. 75 Fed. Reg. 80,174 (Dec. 21, 2010). Because of the requirement that the status of pool participants be considered in determining whether the commodity pool itself qualifies as an ECP, we refer to this requirement in the CEA ECP definition as the "Look-Through Rule."

[6] Adopting Release at 41,677.

[7] Section 2(c)(2)(E)(iii) of the CEA provides that regulations promulgated by the SEC must include requirements with respect to disclosure, recordkeeping, capital and margin, reporting, business conduct and documentation. A final rule permitting broker-dealers to conduct foreign exchange services within the SEC's existing regulatory framework meets such requirements.

foreign exchange transactions with FCMs, retail foreign exchange dealers ("**RFEDs**") and banks.[8] Under the CEA, Dual Registrants are subject to the exclusive jurisdiction of and regulation by the SEC with respect to their OTC foreign exchange activity with retail customers. In the CEA, Congress expressly provided that the CFTC has jurisdiction over an FCM's retail foreign exchange activities only if the FCM is not also registered as a broker-dealer.[9] The CEA, thereby, makes clear that OTC foreign exchange transactions conducted by broker-dealers with retail customers should be subject to exclusive regulation by the SEC and by the Financial Industry Regulatory Authority, Inc. ("**FINRA**") as well as, in regard to margin, subject to Regulation T (as defined below).[10] Accordingly, unless the SEC adopts rules permitting retail customers to transact OTC foreign exchange transactions through and with registered broker-dealers, retail customers will not have the ability to conduct foreign exchange with a broker-dealer, including a Dual Registrant.[11]

Significantly, unless the Commission adopts express regulation (either by passing a permanent final rule or by extending the Interim Rule), SEC-registered broker-dealers, including Dual Registrants, will be the only group of financial service providers to which Congress expressly delegated authority to conduct foreign exchange with retail investors that will be prohibited from carrying foreign exchange transactions with those customers (other than, possibly, with respect to a limited number of transactions excepted by the CEA or by applicable interpretive guidance).[12] The Associations believe it would be an odd result if retail customers would be permitted to enter into foreign exchange transactions with

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[8] *See* 75 Fed. Reg. 55,409 (adopting CFTC Rules Part 5, effective Oct. 18, 2010); 76 Fed. Reg. 40,779 (adopting FDIC Rules Part 349, effective July 15, 2011); 76 Fed. Reg. 41,375 (adopting OCC Rules Part 48, effective July 15, 2011).

[9] *See* Sections 2(c)(2)(B)(i)(II)(cc), 2(c)(2)(C)(i)(I)(aa) and 2(c)(2)(E) of the CEA.

[10] The U.S. Department of the Treasury has proposed to exempt physically settled foreign exchange forwards and foreign exchange swaps, as defined in the CEA, from many of the requirements of the rules imposed on transactions in swaps by Dodd-Frank. *See* 76 Fed. Reg. at 25,774 (May 5, 2011). This proposal, even if granted, would not result in SEC-registered broker-dealers being permitted to offer foreign exchange transactions to non-ECPs.

[11] The CFTC has similarly provided that a broker-dealer is not permitted to conduct the activity by registering as an RFED. *See* 17 C.F.R. § 5.1(h)(1). This makes clear the CFTC's belief it does not have the authority to regulate a broker-dealer with respect to its retail foreign exchange activity.

[12] The CEA excepts the following OTC foreign currency transactions with non-ECPs from regulation: (i) non-leveraged OTC foreign exchange transactions, (ii) physically settled OTC foreign exchange transactions that settle within trade date + 2 ("**T+2**"), and (iii) transactions conducted in connection with a customer's line of business. *See* CEA Section 2(c)(2)(C)(i)(I) and (II)(C)(i)(I) ("This subparagraph shall apply to any agreement, contract, or transaction in foreign currency that is—(aa) offered to, or entered into with, a person that is not an ECP (except that this subparagraph shall not apply if . . . [not] (bb) offered, or entered into, on a leveraged or margined basis, or financed by the offeror, the counterparty, or a person acting in concert with the offeror or counterparty on a similar basis. (II) Subclause (I) of this clause shall not apply to—. . . (bb) a contract of sale that—(AA) results in actual delivery within 2 days; or (BB) creates an enforceable obligation to deliver between a seller and buyer that have the ability to deliver and accept delivery, respectively, in connection with their line of business."). Although its application is not entirely clear in the context of foreign exchange transactions, particularly those described under Section 2(c)(2)(C) of the CEA, it is possible that the "forward exclusion" under the CEA could also serve to exempt certain physically settled OTC foreign exchange transactions regardless of settlement date. In any event, however, the forward exclusion, even if applicable, would only cover a portion of the foreign exchange services offered by broker-dealers.

stand-alone FCMs, RFEDs and banks but not with SEC-registered broker-dealers that are subject to robust rules and regulations regarding, among other things, registration of associated persons, regulatory examination and oversight, regulatory capital, margin, sales practices, supervisory responsibilities, disclosure, recordkeeping and reporting.

Foreign Exchange Business Conducted by SIFMA Broker-Dealer Members

SIFMA broker-dealer members carry out a variety of securities-related and other businesses that may include, depending on the firm, correspondent clearing, full-service brokerage, prime brokerage, discretionary and non-discretionary investment advisory services, discount brokerage, DVP/RVP executions, customized brokerage and advisory services targeting high-net-worth individuals, family offices, private funds, endowments and foundations, and brokerage services provided as part of a broader private banking relationship. A significant number of these firms are Dual Registrants. Each of these businesses serves customers that qualify as ECPs as well as customers that do not qualify as ECPs.[13] In some cases, broker-dealers may not distinguish between ECPs and non-ECPs in respect to retail-type investors, such as natural persons. All of the businesses include OTC foreign exchange services, although the services required by customers vary depending upon the nature of the broker-dealer's business and the investing activities of the customers.

Broker-dealers typically offer a broad range of foreign exchange investing, trading, hedging and conversion services to their retail customers. At a number of firms, these services include risk management-type services, including transactions designed to hedge currency risk in securities, non-security assets or a portfolio generally held in a customer's brokerage account or in an investment advisory account that is custodied at a broker-dealer. In addition, services provided by broker-dealers may include purchases and sales of currencies for customers in connection with transactions in foreign securities,[14] as well as execution of transactions for customers seeking to obtain exposure to foreign markets as part of their investment strategy or as a surrogate for investing in certain foreign securities where investment in the securities may not be generally available to U.S. retail customers (e.g., countries such as Brazil, South Korea, China and India restrict investing by foreigners or require licenses that are not available to individual investors or smaller institutions and individual investors). For the convenience of the SEC, we have summarized in Annex A many (but not all) of the types of OTC foreign exchange services and products provided by SIFMA broker-dealer members to their non-ECP customers.

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[13] Retail customers that do not qualify as ECPs are not necessarily unsophisticated and in many other circumstances would not be considered retail customers. For example, as revised by Dodd-Frank, the CEA provides that generally a commodity pool that has total assets exceeding $5 million would be an ECP, except for purposes of certain OTC foreign exchange transactions, in which case it would not be an ECP unless all of its direct participants and, if the CFTC's proposal is adopted, all of its indirect participants, are also ECPs.

[14] Although these transactions are physically settled and viewed by the customers as spot transactions, as a legal matter, when entered into by non-ECPs, they typically do not qualify as spot transactions as defined in the CEA since they are settled within the usual settlement cycle for securities transactions – i.e., T+3 or longer, depending upon the securities involved – rather than T+2, as required by the CEA for a transaction to constitute a "spot transaction" in OTC foreign exchange conducted with non-ECPs. As a result, unless another exemption is available, these transactions are subject to regulation under the CEA and are eligible to be conducted by broker-dealers with non-ECPs only if carried out pursuant to rules adopted by the SEC. *See* Section 2(c)(2)(C)(i)(II) of the CEA. As indicated in Note 11 above, the "forward exclusion" under the CEA may apply to such transactions.

The Associations believe that it is important for the financial protection and well-being of retail customers and of the market generally for broker-dealers to be able to offer full foreign exchange services to their retail customers. A permanent final SEC rule that allows broker-dealers to provide these important services is consistent with and would facilitate full compliance by broker-dealers with suitability requirements imposed on broker-dealers that require examination of a customer's overall investment objectives, needs and restrictions across all available asset classes.[15] Transactions would be subject to suitability obligations, to the full extent applicable to securities transactions (i.e., assuming that the broker-dealer makes a "recommendation" to the customer),[16] requirements relating to reporting on confirmations and periodic statements, compliance with existing margin regulations under Regulation T ("**Regulation T**") of the Board of Governors of the Federal Reserve System ("**Federal Reserve**"), as discussed further below, capital requirements,[17] customer complaint procedures, oversight by designated supervisors and examination by the examination staffs of FINRA and the SEC, fair and equitable pricing

[15] NASD Rule 2310, which will be replaced by FINRA Rule 2111, effective July 9, 2012, requires broker-dealers to make reasonable efforts to evaluate all of the customers' positions to ensure that a recommendation with respect to the purchase and sale of securities is suitable for the customer.

[16] Under both the current rule and the new FINRA rule, suitability standards are somewhat different for institutional investors and retail investors. Under NASD IM 2310-3, which currently is in effect, broker-dealers may effectively delegate authority for determining that a recommendation by a broker-dealer is suitable for an institutional investor if the broker-dealer determines that the investor is capable of evaluating investment risk independently and is in fact exercising independent judgment in evaluating the firm's recommendations. Broker-dealers typically have determined that institutional investors – particularly those with professional investment advisers – meet this standard. As a result, broker-dealers generally do not take responsibility for suitability when recommending securities to institutional customers. When recommending securities transactions to retail customers, however, broker-dealers are clearly subject to customer-specific suitability (i.e., determining that a recommendation meets the customer's needs and restrictions) as well as reasonable basis suitability (i.e., determining that a product is appropriate for at least some customers). Under new FINRA Rule 2111, which takes effect on July 9, 2012, suitability requirements imposed on broker-dealers for institutional customers will be enhanced. *See* Exchange Act Release No. 63325 (Nov. 17, 2010); 75 Fed. Reg. 71,479 (Nov. 23, 2010) (Order Approving Proposed Rule Change, File No. SR-FINRA-2010-039). Broker-dealers will not be able to delegate authority for suitability to institutional investors unless the investors are among a list of designated regulated entities or have at least $50 million in total assets (as compared to the current interpretive guidance that allows the broker-dealer to delegate suitability obligations to institutions with $10 million invested in securities only). Under the new rule, however, institutional investors arguably include natural persons, provided the customers have at least $50 million in total assets, whereas under the current rule, delegation is only authorized in respect to institutional investors. In addition, under the new rule, broker-dealers will need to obtain from institutional customers an affirmative undertaking that the customer accepts responsibility for suitability. In any event, even with institutional customers that affirmatively consent to delegation, under the new rule, broker-dealers will continue to be responsible for making determinations relating to reasonable basis suitability and quantitative suitability (i.e., the broker-dealer must have a reasonable basis for believing that a series of recommended transactions, even if suitable when viewed in isolation, are not excessive and unsuitable for the customer when taken together in light of the customer's investment profile). For non-institutional customers or institutional customers that do not provide the affirmative undertaking relating to customer specific suitability, the new rule will require that broker-dealers collect more information regarding customers than they are currently required to do as part of the account opening and know-your-customer process and to consider a broader range of aspects of the customer's investments, goals, needs and economic status.

[17] For example, SEC Exchange Act Rules 15c3-1 and 15c3-3 (17 C.F.R. §§ 240.15c3-1 and 15c3-3). *See* FINRA NTM 08-66 (Nov. 2008) (discussing the application of existing FINRA and SEC rules to the retail foreign exchange activities of broker-dealers, including net capital calculations and reserve formula treatment).

obligations and full and fair disclosure of conflicts, risks and associated fees, charges and expenses.[18]

Benefits to Retail Customers from Interim Rule and Continuation through a Permanent Final Rule

Retail customers elect to conduct their foreign exchange investing through registered broker-dealers, including Dual Registrants, for the trading expertise and regulatory protections offered, the ability to consult their regular sales representative or retail financial adviser or, if they have an investment advisory account with the broker-dealer, with investment advisory personnel, regarding the full range of their investment activities, as well as the convenience, offered by some broker-dealers, of consolidated customer statement and/or performance reporting, reflecting the customer's total portfolio across asset classes. In addition, SEC regulation of foreign exchange, within the framework of broader securities regulation, encourages broker-dealers to provide products and services as part of a diversified platform to facilitate hedging, provide access to a variety of different markets internationally and allocate investment monies in a coordinated manner across diverse asset classes. By providing for regulation of foreign exchange services offered by broker-dealers within the existing regulatory framework that is tailored to broker-dealers, the SEC ensures that the structure is efficient, understandable to customers, familiar to the regulatory and self-regulatory officials charged with examining the operations (since the model leverages the existing compliance and regulatory infrastructure in place at broker-dealers) and subject to ongoing training and educational requirements, including for supervisors. These factors enhance the safety and soundness of the business and substantially mitigate the risk that the business could have an adverse effect on the broader market.

Mitigation of Stated Concerns

The Associations agree that many of the highly leveraged, OTC foreign exchange services offered to individuals who are non-ECPs by certain entities have presented suitability concerns and systemic risk,[19] as noted by the Commission in the Adopting Release and as highlighted in two comment letters submitted to the SEC.[20] This high-pressure OTC business, in which customers are encouraged to trade foreign currency regardless of whether the transactions are suitable for them, is not the business that is conducted by or through the SIFMA member firms, including both broker-dealers that are Dual Registrants and those that are not. Instead, the foreign exchange transactions entered into by individuals who are customers of SIFMA broker-dealer members are typically not highly leveraged and, in most cases, either (i) are designed to mitigate risk, (ii) provide exposure to a market as part of a broader investment strategy, often in consultation with experts at the firm, or (iii) are conducted in connection

[18] In adopting any new rules, the Associations urge that the SEC and FINRA, as they have in other contexts such as in the margin and suitability rules adopted by self-regulatory organizations relating to securities, take into account the differences in the types of retail customers that enter into retail foreign exchange with broker-dealers. As noted in Note 12 above, because of changes to the definition of ECP, retail customers may include highly sophisticated, large private funds, some of which have net assets in excess of $1 billion, substantial financial expertise and a long history of investing in foreign exchange transactions. In our view, it would not be appropriate to provide these customers with the same sorts of risk disclosures or subject them to the same sort of margin or suitability requirements as are applicable to less sophisticated retail customers, such as lower-net-worth individual investors who do not have much experience trading foreign exchange.

[19] *See* Adopting Release at 41,677.

[20] Letter from Justin Hughes, Philadelphia Financial Management of San Francisco (Aug. 2, 2011); Letter from Dennis M. Kelleher and Stephen W. Hall, Better Markets, Inc. (Sept. 12, 2011).

with or in order to carry out related securities transactions.[21] Foreign exchange services are not marketed by broker-dealers, including Dual Registrants, to their customers as part of a "get rich quick" scheme. The services are offered only to those customers for whom the services are deemed to be suitable and to those who understand the utility and risks of foreign exchange trading and can appropriately employ foreign exchange products within the context of their broader investment portfolios.

As provided by the SEC in the Interim Rule, sales literature relating to foreign exchange services that are offered by broker-dealers is subject to FINRA marketing rules, including the National Association of Securities Dealers, Inc. ("**NASD**") Rule 2210. Materials are reviewed and approved by a registered principal and retained as records of the firm for further examination within the context of internal and external compliance audits and regulatory examinations. The compliance infrastructure that broker-dealers have in place to review marketing materials mitigates against publication of the types of potentially misleading advertisements regarding foreign exchange services that are highlighted in a comment letter submitted to the SEC.[22]

Risks to Market if Relief Is Denied

If retail customers are denied the choice of investing in foreign exchange through their registered broker-dealers, including Dual Registrants, not only will these customers be inconvenienced, but they will also be exposed to greater costs and greater risks than those presented by the foreign exchange transactions themselves. Even though retail customers would still be able to conduct foreign exchange transactions with banks and separately incorporated FCMs and RFEDs,[23] the foreign exchange transactions would be required to be separately custodied, priced and margined from a customer's portfolio at the broker-dealer. In addition, in the case of some firms, foreign exchange positions executed through and with an unaffiliated entity would generally not be reflected on the periodic statements and performance reports prepared by broker-dealers that reflect securities and other positions held in the customer's portfolio at the broker-dealer. As a result, retail customers would be required to reconcile different types of statements and monitor correlations and tracking between the different asset classes on their own. These separate recordkeeping and custodial arrangements are likely to lead to reconciliation errors and failure by customers to remember to take off the foreign exchange position at the non-broker-dealer entity when the asset being hedged at the other firm (e.g., a security being hedged and carried at a broker-dealer) is subsequently sold. This may also discourage customers from hedging their currency and

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[21] Retail customers of broker-dealers, including Dual Registrants, wishing to transact in OTC foreign exchange typically have access not only to the assistance of a sales representative or, if the customer has entered into an advisory relationship with the firm, with advisory personnel, as well as directly or indirectly through their sales representative, to trading experts at the firm. Together, these personnel are well equipped to respond to customers' questions and to describe the general benefits and risks of the relevant foreign exchange transactions to retail customers.

[22] *See* Hughes Letter, Exhibit II, providing links to video advertisements for foreign exchange trading seminars that suggest the possibility of large profits trading foreign exchange. The Associations note that the persons and entities offering these trading seminars do not appear to be registered with any federal regulatory agency and are not subject to the same type of regulatory oversight and scrutiny as broker-dealers.

[23] If the SEC fails to adopt rules that allow broker-dealers to provide foreign exchange services to retail customers, broker-dealers, including Dual Registrants, would not be permitted to enter into many types of foreign exchange transactions with their retail customers as a result of the requirements in Section 2(c)(2)(E) of the CEA.

market risks because of the added inconvenience and difficulty of having to go through another entity.[24]

Prohibiting retail customers from engaging in foreign exchange transactions with their broker-dealers will also potentially dissuade customers from investing in foreign markets altogether by making the process both more expensive and more burdensome. Requiring these retail customers to execute foreign exchange transactions away from a broker-dealer exposes the customers to operational risks due to the fact that the currencies must be transferred between the broker-dealer and the other entity that executes the foreign exchange transaction.[25] In the case of foreign exchange trades for which collateral requirements are imposed, customers could potentially face the additional complication and credit exposure of having to post margin – possibly both to the broker-dealer (to protect the broker-dealer against risk of a fail) and to the foreign exchange entity used by the customer. Requiring retail customers to use a firm other than a broker-dealer to execute foreign exchange transactions may increase costs for retail customers. The converting firm, particularly when unaffiliated with the broker-dealer, will typically impose transaction charges in connection with a foreign exchange transaction (whereas broker-dealers who execute foreign exchange transactions in conjunction with securities transactions often do not charge an additional fee in connection with the trade)[26] as well as transfer charges, in the event that the currency being purchased or sold is required to be transferred to a broker-dealer for a customer in connection with a securities transaction. Finally, forcing retail customers to effect currency conversions away from a broker-dealer creates systemic risk by increasing the risk of security fails upon settlement of foreign security purchases and sales due to errors or problems with the currency transfer from the executing entity to the broker-dealer.[27]

Prohibiting broker-dealers from engaging in foreign exchange transactions with retail customers may cause them to withdraw from certain portfolio-building and other services regarding foreign securities and foreign markets currently provided to institutional and individual retail customers. In addition, withdrawing the ability of broker-dealers to provide foreign exchange services to retail customers will impede the ability of broker-dealers to service foreign customers that often will need conversion, hedging and other foreign exchange services in connection with investing in U.S. securities. Restricting the ability of institutional and individual retail investors globally to access currency markets through the same entities through which investors are required to transact in order to purchase or sell securities in the U.S. is illogical and clearly not in the best interest of customers or the market generally. It is likely to place U.S.-registered broker-dealers at a competitive disadvantage as compared to banks and

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[24] This is particularly true for customers of Dual Registrants where they are likely to maintain a portfolio across all asset classes and not just securities.

[25] In addition, customers may experience delays or mismatches in timing because of differences in the hours of operation between broker-dealers and banks or FCMs. For example, banks are typically closed on Columbus Day while broker-dealers are open on that holiday.

[26] Because foreign exchange is traded on a principal basis, broker-dealers will earn a spread between the bid and ask prices for the currency.

[27] Depending upon the particular facts and circumstances, the inability of broker-dealers to transact in foreign exchange for customers, including with respect to purchases and sales in connection with securities transactions, may interfere with the ability of those broker-dealers to achieve the best prices in foreign securities. In many instances, broker-dealers are able to obtain a better net price for a customer by accessing the foreign market (even after factoring in the cost of the foreign exchange conversion) for a given security than can be obtained from a U.S. market-maker trading the same security domestically in USD.

to significantly reduce the investment choices available to retail customers.

Recommendation

The Associations recommend that the Commission rely on the robust regulatory regime to which broker-dealers are already subject in connection with the conduct of their securities business and allow broker-dealers to provide foreign exchange services to retail customers by adopting a permanent final rule. In our view, it would be consistent with the intent of Congress that the SEC regulate all retail foreign exchange conducted at a broker-dealer, including Dual Registrants, for the Commission to adopt a permanent final rule that leverages the existing regulatory structure that is currently in place for broker-dealers. As recognized by the Commission in connection with adoption of the Interim Rule,[28] the comprehensive framework and rules adopted by the Commission and applicable self-regulatory organization ("**SRO**") for broker-dealers are sufficient and appropriate to govern this business and to provide necessary customer protections.[29]

We also request that the Commission, in consultation with the CFTC, provide a safe-harbor to broker-dealers that would apply in the event that the status of a customer that is a natural person (including their investment vehicles and family offices) changes from that of a retail customer when a foreign exchange transaction is first entered into with the broker-dealer, including a Dual Registrant, to that of an ECP, because of fluctuations in net assets, a change in market prices or other factors. In that regard, we request that the Commission provide that a broker-dealer would not be violating the Commission's rules or the CEA by continuing to carry an OTC foreign exchange transaction entered into with a retail customer simply because the customer subsequently becomes an ECP. Similarly, we request that the Commission, in consultation with the CFTC, authorize a broker-dealer, under these circumstances to terminate the OTC foreign exchange transaction with the customer by entering into an off-setting OTC foreign exchange transaction with the customer. Although the primary purpose of the retail foreign exchange provisions was to allow less sophisticated investors to conduct their foreign exchange activities with specified regulated entities, there is no indication that Congress intended to punish a regulated entity transacting with a retail customer in the event that the customer subsequently becomes an ECP. In addition, it would be consistent with Congressional intent to provide additional protections to retail customers under the rule for the broker-dealer to be able to terminate a foreign exchange transaction with a customer through an off-setting transaction a foreign exchange transaction even though the counterparty has subsequently, through increases in net worth, a change in market prices or other factors, becomes an ECP.

The Associations also believe that in order to fully implement the purpose of Dodd-Frank, the Commission should make clear that its rules, together with Regulation T, which governs margin

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[28] This is consistent with the Commission's own finding in connection with its adoption of the Interim Rule that broker-dealers engaging in a retail foreign exchange business are already subject to numerous regulatory requirements with respect to their businesses under the Securities Exchange Act of 1934, as amended ("**Exchange Act**"), the rules and regulations thereunder and the rules of the SROs; as a result, the Commission did not need to create any new obligation. Adopting Release at 41,679.

[29] For example, SEC Exchange Act Rules 15c3-1 and 15c3-3 (17 C.F.R. §§ 240.15c3-1 and 15c3-3). *See* FINRA NTM 08-66 (Nov. 2008) (discussing the application of existing FINRA and SEC rules to the retail foreign exchange activities of broker-dealers, including net capital calculations and reserve formula treatment).

applicable to broker-dealers,[30] and FINRA's rules, are the exclusive rules applicable to all SEC-registered broker-dealers, including Dual Registrants, conducting a retail foreign exchange business. The CEA expressly restricts the ability of the CFTC to regulate the retail foreign exchange business of a broker-dealer, including a Dual Registrant.[31] Moreover, Dodd-Frank made clear that the SEC is responsible for regulating the retail foreign exchange business of a Dual Registrant.[32] NFA recently adopted amendments to NFA Bylaw 306 that would appear to require a Dual Registrant to comply with NFA rules, even though the CEA, under which NFA is authorized as a registered futures association, does not apply, and the CFTC, which oversees NFA, does not have jurisdiction over foreign currency transactions executed at a Dual Registrant.[33] In order to avoid duplicative regulation and customer confusion regarding the regulatory scheme to which customers are subject by electing to carry out a retail foreign exchange business through a Dual Registrant, and in recognition of the congressional intent expressed in Dodd-Frank that the SEC is responsible for regulating the retail foreign exchange business of all broker-dealers, including Dual Registrants, the Associations respectfully request that the Commission clarify that the retail foreign exchange business of Dual Registrants is subject exclusively to the jurisdiction and regulation of the SEC and FINRA, including registration requirements for broker-dealer representatives, and the CFTC and NFA retail foreign exchange rules do not apply to such broker-dealer activity. The Associations do not believe that the retail foreign exchange rules of NFA and the CFTC are appropriate for transactions effected through broker-dealers or are necessary in light of the existing capital, margin, suitability, business practices, customer reporting and other rules to which broker-dealers, including Dual Registrants, are subject. Given the different approaches to regulation taken generally by the CFTC and the SEC, the Associations believe that attempting to over-lay the CFTC and NFA rules on top of the existing broker-dealer regulatory framework would lead to customer confusion and impose unnecessary burdens and expenses on broker-dealers attempting to implement both set of regulations. Due to the uncertainty surrounding this issue, the Associations request that the Commission issue this clarification without delay.[34]

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[30] As discussed in Annex A, although Regulation T governs the establishment of initial margin for broker-dealers, FINRA rules set maintenance margin requirements. FINRA Rule 4210. On June 25, 2009, FINRA proposed new maintenance margin requirements applicable to retail foreign exchange based on the total notional value of the foreign exchange transaction. 74 Fed. Reg. 32,022. As SIFMA noted in a comment letter dated February 20, 2009**,** the FINRA Rule is not appropriate for foreign exchange transactions and does not appropriately measure risk in connection with these transactions since, among other things, the proposed rule focuses on the notional amount of a transaction rather than the amount owed by a party (i.e., the mark-to-market). The Associations urge the SEC not to approve the previously submitted FINRA margin proposal for retail foreign exchange. In the event that the SEC were to reconsider adoption of the proposed FINRA rule, we believe that the SEC should recirculate the proposal for comment and reconsideration by the general public given the age of the proposal as well as the material intervening events, such as the enactment of Dodd-Frank. Additionally, as discussed in foot note 17 above, in our view, any new rules adopted by the SEC or FINRA regarding foreign exchange activity for retail customers should take into account the wide range of retail customers in light of the changes to the definition of ECP made by Dodd-Frank.

[31] *See* Sections 2(c)(2)(B) and 2(c)(2)(C) of the CEA.

[32] Dodd-Frank Section 742, codified at Section 2(c)(2)(E) of the CEA.

[33] Effective October 1, 2011, NFA Bylaw 306 subjects all NFA members that engage in retail foreign exchange transactions to NFA's foreign exchange requirements. Pursuant to CFTC Rule 170.15, a registered FCM is required to be a member of NFA.

[34] This clarification would be consistent with the oft-repeated goal of avoiding unnecessary duplicative regulations. *See, e.g.*, Improving Regulation and Regulatory Review, Executive Order of the President of the United States (Jan.

The Associations recommend that the Commission adopt a permanent final rule permitting retail customers to continue to conduct foreign exchange transactions through registered broker-dealers, leveraging the existing regulatory structure that is currently in place for broker-dealers. We also request that the SEC clarify that the SEC's rule, together with FINRA regulation, would exclusively govern the retail foreign exchange activity of all broker-dealers, including Dual Registrants. We believe this would be consistent with the intent of Congress and in the best interest of customers and the market generally. To the extent that the Commission might determine to adopt retail foreign exchange specific rules or even to permit the Interim Rule to expire, the Associations also request that the Commission provide sufficient time (i.e., at least six (6) months) for broker-dealers to make all customers aware of any changes that might be necessary and to implement necessary changes.

* * *

We thank the staff for the consideration of our views on this issue and welcome an opportunity to meet with you and discuss these matters in person. If the staff has questions regarding these comments and the more detailed answers to the questions raised by the Commission that we have attached hereto as Annex A, please feel free to contact P. Georgia Bullitt at 212-309-6683 (gbullitt@morganlewis.com) or Michael A. Piracci at 212-309-6385 (mpiracci@morganlewis.com) at Morgan, Lewis & Bockius LLP.

Sincerely,

Kenneth E. Bentsen, Jr.
Executive Vice President
Public Policy and Advocacy
SIFMA

Robert Pickel
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ISDA

cc: Mary L. Schapiro, Chairman, SEC
Robert W. Cook, Director, Division of Trading and Markets, SEC
David W. Blass, Chief Counsel, Division of Trading and Markets, SEC
John Ramsay, Deputy Director, Division of Trading and Markets, SEC
Jo Anne Swindler, Assistant Director, Division of Trading and Markets, SEC
Richard Vorsmarti, Special Counsel, Division of Trading and Markets, SEC
Angie Le, Special Counsel, Division of Trading and Markets, SEC
Bonnie L. Gauch, Division of Trading and Markets, SEC

18, 2011) (directing that regulation should "impose the least burden on society, consistent with obtaining regulatory objectives, taking into account . . . the costs of cumulative regulations").

Joseph Furey, Division of Trading and Markets, SEC

Gary Gensler, Chairman, CFTC
Dan Berkovitz, General Counsel, Office of the General Counsel, CFTC
Ananda Radhakrishnan, Director, Division of Clearing and Risk, CFTC
Gary Barnett, Director, Division of Swap Dealer and Intermediary Oversight, CFTC

ANNEX A

In the Interim Rule, the Commission sought comments regarding (i) the scope of the retail foreign exchange business conducted by broker-dealers; (ii) the benefits and risk mitigants of the business; and (iii) any aspects that may pose substantial undue risks to customers. The Commission further requested comments in response to a number of questions. Below is a summary of a number (but not all) of the foreign exchange services provided by broker-dealers that are SIFMA members to their retail, non-ECP customers as well as responses by the Associations generally to the questions presented by the Commission in the Adopting Release.

I. Summary of Many of the Types of Foreign Exchange Business Services Provided by SIFMA Broker-Dealer Members to Their Retail Customers

The retail customers of SIFMA broker-dealer members enter into OTC foreign exchange transactions as an integral part of the investment activities conducted through their broker-dealer. Foreign exchange services offered by broker-dealers to retail customers include, without limitation, the following products and services:

- Currency forwards, including non-deliverable forwards, swaps and options for customers in connection with hedging transactions covering portfolio securities holdings or transactions conducted in a customer's account (e.g., a non-deliverable forward to hedge currency risk with respect to a security, such as a foreign bond, another asset or a portfolio).

- Currency forwards, including non-deliverable forwards, swaps and options to hedge general currency risks inherent in a customer's securities portfolio.

- Currency forwards, swaps, and options that provide exposure to a foreign market, including in situations in which the domestic securities are difficult or impossible for a foreign investor to purchase efficiently (e.g., Brazil, India and China) as well as providing broader market and economic exposure to retail customers, in a more economic way than may otherwise be available in a particular market.

- Currency forwards, including non-deliverable forwards, swaps and options as part of an overall investment portfolio.

- Currency positions (short-term and margined) as part of a strategy by hedge funds and other commodity pools that, prior to implementation of the new Dodd-Frank definitions, qualify as ECPs.[1]

- Currency transactions for retail customers that, during the course of a transaction, become ECPs.[2]

- Currency positions (short-term and margined) as part of a managed account that is managed by

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[1] As discussed more fully in response to Question 5(a), the definition of ECP was amended by Dodd-Frank with regard to funds that enter into foreign exchange transactions in a manner that includes certain large, private funds. *See also* Comment Letter to the SEC and CFTC from SIFMA Asset Management Group Re: Further Definition of "Swap Dealer," "Security-Based Swap Dealer," "Major Swap Participant," "Major Security-Based Swap Participant" and "Eligible Contract Participant" (CFTC: RIN 3235-AK65; SEC File No. S7-39-10) (Sept. 15, 2011).

[2] *See* request in the accompanying letter for relief with respect to these transactions.

an investment adviser at the firm consistent with an approved strategy and asset allocation program – and assuming that a customer satisfies heightened suitability and eligibility requirements.

- Purchases, sales and exchanges of foreign currencies for customers in connection with the purchase, sale, settlement and/or clearing of foreign securities where payment by a customer is made in accordance with the standard settlement cycle for the securities but later than the T+2 time frame exempted from the scope of the retail foreign exchange prohibition by Section 2(c)(2)(C)(i)(II)(bb)(AA) of the CEA.

- Conversions of foreign currency in connection with corporate actions (i.e., distributions, coupons, dividends, class action settlements and rights offerings) made with respect to foreign securities held for a retail customer in its account at the broker-dealer into the currency in which the account is denominated (e.g., USD).

- Conversions of USD to foreign currency or vice versa on a longer than T+2 basis where the customer has linked an independent foreign exchange transaction to the purchase or sale of securities to allow both transactions to settle simultaneously on the same settlement cycle.

- Purchases and sales of USD for foreign customers holding their accounts in a non-USD currency in connection with purchases, sales, settlement or clearing of U.S. securities for such customers.

- Conversions of distributions on USD-denominated securities for customers carrying their accounts on a non-USD basis.

II. Responses to the SEC's Questions Regarding the Interim Rule

1) ***Should the Commission clarify or modify any of the definitions included in Rule 15b12-1T? If so, which definitions and what specific modifications are appropriate or necessary?***

The Commission should revise the definition of "retail forex business" to make clear that it is the foreign exchange business conducted by a broker-dealer that involves soliciting, providing guidance or advice on, entering into, settling and/or clearing OTC foreign exchange transactions with both customers that are not ECPs and customers that are not ECPs when the transactions are entered into but later become ECPs. The Associations do not believe that the condition in the Interim Rule's definition regarding "intent to derive income" is necessary or should be a requirement for the Interim Rule to apply. For example, in some cases, in connection with foreign exchange transactions conducted by broker-dealers in conjunction with the purchase, sale, clearing or settlement of a security for a retail customer, the broker-dealer might not charge an additional fee for the currency conversion.[3] In the view of the Associations, such transaction should be one that a broker-dealer is eligible to conduct, and the final rule should make that clear, including through deletion of the reference to intent to obtain a profit.

In addition, the Associations believe that the definition of "registered broker or dealer" included in the Interim Rule should be revised to make clear that the retail foreign exchange business of Dual Registrants would be subject exclusively to the rules of the Commission and, with respect to margin, Regulation T, and for FINRA members, FINRA rules, and not to the rules of the CFTC or of the NFA.

[3] Because OTC foreign currency transactions are effected on a principal basis, the broker-dealer would still earn a spread equal to the difference between the bid and ask prices for the currency.

Although the CEA expressly provides that the CFTC does not have jurisdiction over the retail foreign exchange business of Dual Registrants,[4] NFA Bylaw 306 provides that a Dual Registrant must comply with NFA rules, regardless of the fact that its retail foreign exchange business is subject to the exclusive jurisdiction of the SEC.[5] In order to avoid duplicative regulation and customer confusion regarding the regulatory scheme to which customers are subject by electing to carry out retail foreign exchange business through a broker-dealer that is a Dual Registrant, and in recognition of the congressional intent expressed in Dodd-Frank that the SEC is responsible for regulating the retail foreign exchange business of such Dual Registrants,[6] the Associations respectfully request that the Commission clarify that its rules, together with Regulation T in respect to margin, and FINRA's rules, in relation to its member firms, are the exclusive rules applicable to a Dual Registrant conducting a retail foreign exchange business pursuant to its status as a registered broker-dealer. The Associations do not believe that the rules of NFA and the CFTC are appropriately applied to broker-dealers or are necessary to protect investors in light of the existing capital, margin, suitability, business practices, customer reporting and other rules to which Dual Registrants, as broker-dealers, are subject. We also believe that application of the rules to broker-dealers would cause customer confusion and impose unnecessary burdens and expenses on broker-dealers attempting to implement the two different regimes in light of fundamental differences in approach to regulation between the CFTC and the SEC.

2) ***Are the requirements in Rule 15b12-1T sufficiently clear? Is additional guidance from the Commission necessary?***

The Interim Rule allows broker-dealers to conduct a retail foreign exchange business in a manner that is consistent with the way in which they currently conduct the brokerage business. This is appropriate, since the foreign exchange business conducted by broker-dealers is one that complements the brokerage and advisory businesses offered by broker-dealers. As explained above, retail customers enter into foreign currency transactions with and through their broker-dealers for any number of reasons, including as part of the broader investment activity conducted through a broker-dealer in order to obtain exposure to foreign markets, in connection with conversions necessary to purchase or sell securities or to convert dividends and coupons received for a customer's account and to hedge exposures to foreign securities and other investments, as well as to hedge a broader portfolio. These foreign currency transactions may be entered into with the assistance of a discretionary or non-discretionary investment adviser, based upon the recommendations of a registered securities representative of the broker-dealer, or entered into exclusively upon the direction of the customer, without reliance on a recommendation from the broker-dealer (which is substantially always the case in respect to highly sophisticated private fund customers who constitute non-ECPs as a result of the Look-Through Rule).

The Associations urge the Commission to adopt the Interim Rule as a permanent final rule, with the changes and guidance requested in this Annex and the accompanying letter. In order to provide additional transparency to market participants regarding the specific concerns of regulators relating to this business, the Associations recommend that FINRA and the SEC's Office of Compliance and Examinations publish sample examination request letters and informal guidance regarding the types of policies and procedures that the regulators will look for from broker-dealers in respect to this asset class

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[4] *See* Sections 2(c)(2)(B) and 2(c)(2)(C) of the CEA.

[5] Effective October 1, 2011, NFA Bylaw 306 subjected all NFA members that engage in retail foreign exchange transactions to NFA's foreign exchange requirements. Pursuant to CFTC Rule 170.15 (17 C.F.R. § 170.15) a registered FCM is required to be a member of NFA.

[6] Section 742 of Dodd-Frank, codified at Section 2(c)(2)(E) of the CEA.

and business when conducting examinations.

3) ***Rule 15b12-1T is an interim final temporary rule that is set to expire on July 16, 2012. Should the Commission extend the expiration date of the rule and if so, for how long?***

Yes. The Associations support adoption of the Interim Rule as a permanent rule and believe that it would be in the best interest of customers and the market generally to allow for continuation of the foreign exchange activity sought by broker-dealer customers. As provided in the Interim Rule, we support leveraging the current compliance rules applicable to broker-dealers and making retail foreign exchange subject to the same robust regulatory and compliance regime that governs the securities brokerage business of broker-dealers.

4) ***Should the Commission propose new rules relating to the retail forex business operated by broker-dealers for public comment, issue a final rule amending the interim final temporary rule, issue a final rule adopting the interim final temporary rule as final, or allow the interim final temporary rule to expire without further action, which would allow the statutory prohibition to take effect? If further rulemaking is appropriate, what should those rules provide?***

As noted above, the Associations support adoption of the Interim Rule as a permanent rule, with the modifications and clarifications described herein.

5)(a) ***Should the Commission prohibit a broker-dealer from engaging in retail forex transactions altogether?***

No. Prohibiting a broker-dealer from engaging in a retail foreign exchange business will limit access by retail customers to foreign securities and currency markets and will unfairly prevent such retail customers from being able to hold a fully diversified portfolio at a broker-dealer. The Associations believe that it is important to note that retail customers, in the context of foreign currency, are not unsophisticated or inexperienced individual investors. For example, as amended by Dodd-Frank, a natural person would generally not be an ECP unless he or she has in excess of $10 million invested on a discretionary basis.[7] Additionally, small but sizeable institutional investors, including corporations, partnerships, proprietorships and other entities with total assets just below $10 million, fall outside the definition of ECP.[8] Furthermore, the definition of non-ECP is not limited to natural persons and small institutional investors but also, as a result of changes to the definition of ECP enacted in Dodd-Frank through the Look-Through Rule, large sophisticated institutional investors. As an illustration, a fund that has more than $5 million in assets and is operated by a regulated adviser would be a retail customer solely for purposes of retail foreign exchange if any one of its direct and, if the CFTC's proposal is adopted, indirect, participants is not an ECP (i.e., regardless of the number of investors who *are* ECPs). To prevent these customers from engaging in foreign currency transactions with a registered broker-dealer would not serve any regulatory purpose. This is particularly true in light of the fact that the CFTC, the FDIC and the OCC have all adopted final rules to permit retail customers to enter into foreign

[7] Section 1a(18)(A)(xi) of the CEA. The requirement is $5 million invested on a discretionary basis if the transaction is entered into to manage a risk associated with an asset owned or a liability incurred or reasonably likely to be owned or incurred.

[8] See Section 1a(18)(A)(v) of the CEA.

exchange transactions with entities subject to their jurisdictions.[9] A prohibition by the SEC would simply limit the choices of retail customers, subject retail customers to additional operational and market risk and increase the costs associated with their investing, without providing any greater customer protections. Further, customers look to their broker-dealers to permit them to engage in a full range of investments. As the need and ability to diversify across countries and markets has increased, the need to be able to enter into foreign currency transactions as part of a well-diversified investment portfolio has increased. If retail customers are unable to conduct this investment activity through their broker-dealers, they will be forced to look to other financial service providers and, thereby, increase transactional costs and expose customers to operational and market risks. For example, forcing customers to use a separate entity to conduct the foreign exchange component associated with a securities transaction may force customers to pay higher prices, since they will be required to pay transaction costs to two different entities and then to pay wire or transfer fees in connection with movement of the currency to the broker-dealer to carry out the securities purchase or sale. In addition, these transactions increase the opportunity for fails to occur since the executing broker-dealer is dependent upon another entity to deliver the currency that is required to effect the transaction.

Regulatory relief is necessary because of the narrow exceptions provided in the CEA for retail foreign exchange. Spot transactions, which are exempt from regulation under the CEA as retail foreign exchange, are defined solely as those that settle within a T+2 basis. Similarly, the CEA also exempts transactions conducted with non-ECPs in connection with a "line of business"[10] and those that do not involve "leverage."[11] The scope of these exemptions and their potential application to transactions with retail customers is not clear. For example, because any delayed settlement transaction may be deemed to involve "leverage," since the recipient is extending credit to the payor until the payment date, any transaction beyond T+2 could be deemed to be "leveraged." A purchase of a foreign security, which typically requires a purchase of the foreign currency by the U.S. customer to pay for the securities being purchased on T+3, could be viewed as being outside the exemption in the CEA.[12] Similarly, it is not clear that foreign exchange transactions effected with retail customers would be deemed to be effected in connection with a "line of business" since in many (but not all) cases, such investors are not financial professionals. As a result, if broker-dealers are not allowed to conduct retail foreign exchange transactions, retail customers would be forced to purchase the necessary amount of foreign currency required to conduct a purchase of foreign securities through another entity, such as an FCM (that is not a Dual Registrant), an RFED or a bank. The inability to effect a currency conversion for a retail customer may also prevent the broker-dealer from accessing a better price for a dually listed security by trading in the local market for the customer rather than through a U.S. market-maker trading the security in USD.

In the experience of SIFMA broker-dealer members, the foreign exchange market made available to institutional and individual retail investors by their broker-dealers is liquid. Foreign exchange pricing in

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[9] *See* 75 Fed. Reg. 55,409 (adopting CFTC Rules Part 5, effective Oct. 18, 2010); 76 Fed. Reg. 40,779 (adopting FDIC Rules Part 349, effective July 15, 2011); 76 Fed. Reg. 41,375 (adopting OCC Rules Part 48, effective July 15, 2011).

[10] CEA Section 2(c)(2)(C)(i)(II)(bb)(BB).

[11] CEA Sections 2(c)(2)(C)(i)(I)(aa) and (bb).

[12] Although its application is not entirely clear in the context of foreign exchange transactions under Section 2(c)(2)(C) of the CEA, there are arguments that the "forward exclusion" under the CEA could serve to exempt certain physically settled OTC foreign exchange transactions regardless of settlement date. In any event, however, the forward exclusion, even if applicable, would only cover a portion of the foreign exchange services offered by broker-dealers.

the interbank "market" is often a factor of the size of the transaction and the credit quality of the counterparty.[13] Because the broker-dealers themselves are often able to trade in institutionally sized lots and in many cases (particularly at the clearing firm or self-clearing firm level) are deemed highly creditworthy counterparties, the broker-dealers are typically able to negotiate prices based upon prevailing interbank market rates with other dealers or banks, which they may pass through to customers. As a result, broker-dealer customers often benefit from transacting through a broker-dealer in terms of the pricing achieved.

(b) ***Alternatively, should the Commission prohibit a broker-dealer from engaging in retail forex transactions other than forex transactions engaged in solely (1) to effect the purchase or sale of a foreign security or in order to clear or settle such purchase or sale, or (2) to facilitate distribution to customers of monies or securities received through corporate actions (e.g., coupons, dividends, class action settlements, and rights offerings) with respect to foreign securities?***

No. Although the Associations support adoption of rules allowing broker-dealers to purchase and sell currency for retail customers in connection with purchases, sales, clearance and settlement of securities transactions or distributions on the securities (including foreign securities, with respect to U.S. customers whose accounts are denominated in USD and U.S. securities, and with respect to foreign customers whose accounts are denominated in a foreign currency), the Associations believe that it is in the best interest of both U.S. and foreign retail customers to allow them to transact in the full complement of foreign currency transactions through broker-dealers. Broker-dealers have been providing customers with access to a wide range of foreign exchange transactions for many years, consistent with their capital, margin, suitability, disclosure, reporting and business conduct obligations under the SEC and FINRA rules and, with respect to margin, under Regulation T.

Although retail customers do need to access foreign exchange services in connection with investments in foreign securities, retail customers have a variety of legitimate needs for entering into foreign currency transactions that are independent of securities transactions. These include obtaining exposure to the currency markets as part of an overall investment strategy. Institutional and individual retail customers may elect to invest in foreign currencies rather than mutual fund or closed-end fund shares or foreign securities that provide exposure to the foreign markets for a number of reasons. These may include (i) easier access to the foreign currency markets than the foreign securities markets (e.g., in countries such as India, Brazil, South Korea, Taiwan, and China, where a foreign investor is not permitted to trade in securities unless it obtains a license to do so); (ii) a determination that currency provides broad market economic exposure as opposed to investment in securities; (iii) a recognition that investment through currency is the only way for institutional and individual retail customers to obtain exposure of any kind to a particular foreign securities market (e.g., China) since investment by foreign entities is limited; and (iv) as compared to closed-end funds or mutual funds, more favorable pricing or access to a more customized portfolio that meets the customer's particular investment goals and avoid particular restrictions. As a result, it is important for retail customers to have the flexibility to invest directly in foreign exchange, through a regulated broker-dealer, in conjunction with the customer's broader investments, including securities, which must be executed through an SEC-registered broker-dealer.

The Associations believe that retail customers are best served by having the flexibility to manage both their securities and their foreign exchange transactions through a single account. In our view, retail

[13] The volatility of the currency and complexity of the transaction are the two other primary factors impacting foreign exchange pricing. However, these two factors are independent of the regulatory structure of the firm that executes the transaction for the retail customer.

customers will ultimately be harmed if they are unable to manage these two interrelated asset classes through a fully regulated broker-dealer. The interests of retail customers will be best protected by allowing them to choose a single regulated entity through which to transact, custody and hedge their positions. This facilitates evaluation of a portfolio on a holistic basis and allows customers to reconcile hedged positions. It also reduces overall transaction costs and provides for a consistent and robust regulatory framework that mitigates against regulatory arbitrage and ensures that retail customers deal solely with an entity that is examined by regulatory authorities and is subject to an active enforcement regime designed to protect investors.

(c) ***Should the Commission permit other retail forex transactions that otherwise facilitate customers' securities transactions and minimize risk exposure to customers from changes in foreign currency rates?***

Yes. SIFMA broker-dealer members believe that it is essential that individual investors have the ability to enter into foreign exchange transactions for a number of legitimate investment purposes. For example, retail customers should be allowed to appropriately hedge currency exposure risks they take on through investments in foreign securities or other assets in accordance with diversified asset allocation models. In the view of the Associations, restrictions on hedging – such as a prohibition on entering or carrying trades through a broker-dealer – would potentially expose customers to significant risks. Although leveraged foreign exchange trades increase the magnitude of customer losses, these risks are mitigated to the extent that the transaction is hedging an existing exposure as well as the fact that customers can typically offset their foreign currency positions at any time. Unhedged exposures to foreign bonds, foreign portfolios of securities and other assets denominated in foreign currencies that cannot be quickly liquidated may, depending upon the facts and circumstances, pose significantly greater risk of loss than would a related foreign exchange transaction. In addition, valuation of a loss associated with failure to hedge foreign currency risk inherent in a foreign security or other asset is difficult to value since the currency is embedded in the value of the security or asset. Finally, although non-ECP customers are permitted to conduct foreign exchange transactions with banks, FCMs and RFEDs to hedge the currency risks inherent in their holdings, if the Commission were to prohibit customers from entering into foreign exchange hedging transactions of this type with broker-dealers, including Dual Registrants, this prohibition would make it more difficult for customers to keep track of the correlation between their currency hedges and their holdings being hedged since the positions would be custodied in two different places and in the case of many broker-dealers reflected on two different types of periodic statements, particularly where the foreign exchange transaction is with an unaffiliated entity.

(d) ***Do investors have adequate recourse against broker-dealers for any misconduct related to retail forex transactions?***

Yes. Customers have a number of different alternatives available to them to address actual or perceived wrongdoing by a broker-dealer and its personnel relating to retail foreign exchange. First, an investor can file a complaint with its broker-dealer or with the regulator of the broker-dealer, which requires follow-up and tracking by the entity itself as well as by the regulator. Second, the customer can bring an arbitration proceeding against the broker-dealer for a range of allegations, including violations of specific rules of an SRO to which the broker-dealer is subject, such as suitability requirements or a duty to disclose conflicts of interest, including the fact that the broker-dealer is acting as principal on the trade, or breaches of general principles, such as just and equitable principles of trade. In some cases, customers may be able to bring a lawsuit against a broker-dealer for state law anti-fraud violations or breach of fiduciary duty claims under the Investment Advisers Act of 1940 ("**Advisers Act**") or applicable state law.

In addition to direct recourse against broker-dealers by retail customers, retail customers are protected in

respect to foreign exchange activities conducted with broker-dealers by the ability of the Commission and the SROs to bring actions against broker-dealers for wrongdoing involving any instrument in which the broker-dealer is transacting, including retail foreign exchange.[14] Under Sections 15(b)(4)(D) and (E) (which were added to the Exchange Act by Dodd-Frank), the SEC has authority to sanction broker-dealers and to suspend or revoke their registrations for, among other things, any willful violation of the federal securities laws and the CEA as well as any aiding and abetting of such activity or any failure to supervise with a view to preventing such violations. This provision grants the SEC broad authority to sanction broker-dealers in connection with their foreign exchange business. In addition, in the case of foreign exchange conversions that relate to securities, the SEC should be able to rely on the broad anti-fraud authority it has in respect to transactions "in connection with the purchase or sale of a security."[15] Under this authority, the SEC should be able to bring either an administrative action[16] or a civil action[17] against a broker-dealer in connection with foreign exchange conversions relating to the purchase or sale of a security.

FINRA also has authority to bring enforcement actions against and sanction broker-dealers for failure to comply with FINRA rules, including those relating to retail foreign exchange.[18] In FINRA NTM 08-66, FINRA expressly interpreted the "just and equitable principles of trade" requirement under NASD Rule 2110 (now FINRA Rule 2010) and its correspondence rules under NASD Rule 2210 to apply to a broker-dealer's retail foreign exchange business.

(e) ***Would retail forex customers be harmed if broker-dealers were unable to provide them with certain forex-related services? Which services?***

Yes. See the response to Question 5(c) above. The Associations believe that retail customers would be disadvantaged if they were not permitted to access all of the retail foreign exchange services that they currently access through broker-dealers.

(f) ***What benefits might retail forex customers receive in connection with forex-related services offered by broker-dealers, as compared to other intermediaries? Would the benefits outweigh potential harm?***

The primary benefits of allowing retail customers to continue to conduct their foreign exchange transactions through broker-dealers are the convenience of transacting with the same entity as the customers conduct securities activities through together with the protections granted to the customers under the existing suitability, disclosure, reporting, recordkeeping and other rules to which broker-dealers are subject. Additionally, retail customers will also continue to have (i) the ability to lock in foreign exchange rates while simultaneously executing a securities transaction, thereby limiting any undesired currency exposure as well as reducing costs from effectively bundled pricing when

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[14] *See* Exchange Act Section 15(b)(4). For a discussion regarding authority of the SROs over broker-dealers, *see, TradeStation Sec., Inc.*, FINRA AWC No. 20100237704 (Feb. 15, 2011); *Maximum Fin. Inv. Group*, *Inc.*, FINRA AWC No. 20080138504 (Aug. 13, 2009); *In the Matter of the Nikko Sec. Co. Int'l, Inc.*, Exchange Act Release No. 32331, 1993 WL 166954 (May 19, 1993).

[15] *See* Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.

[16] Section 15(b) of the Exchange Act; *see, e.g., In the Matter of Thomas H. Keesee*, Exchange Act Release No. 50803 (Dec. 7, 2004).

[17] *See, e.g.*, *SEC v. Haxton*, Civ. Act. No. 3:08-CV-1467-L (Aug. 22, 2008).

[18] FINRA Rules 8310 and 9211.

conversions are carried out by a broker-dealer on a customer's behalf in conjunction with securities transactions by the transacting broker-dealer; (ii) access to statements from the same firm showing all portfolio positions and, at many firms, access to consolidated portfolio reporting; (iii) the ability to benefit from the expertise of market professionals at the broker-dealer; and (iv) the use of a counterparty that is subject to strict capital and other regulatory requirements.

In our view, these benefits far outweigh any potential for harm.

6) ***Should the Commission adopt rules modeled on the Final CFTC Retail Forex Rule, the Final FDIC Retail Forex Rule, or the Proposed OCC Retail Forex Rule? If so, which aspects of those rules should the Commission consider adopting? What would be the associated costs and benefits?***

No. The Associations do not believe that the Commission should adopt rules for retail foreign exchange conducted by broker-dealers that are modeled on the CFTC Retail Forex Rule or on the banking retail foreign exchange rules, which are largely based on the CFTC rules. The CFTC rules were designed and developed based on the futures style of regulation and the foreign exchange business being conducted by entities subject to the jurisdiction of the futures regulators. The rule integrates retail foreign exchange into existing rules for exchange-traded futures. *See, e.g.*, CFTC Rule 1.35 (requiring similar records for retail foreign exchange as for futures and options) and CFTC Rule 1.46 – Application and closing out of offsetting long and short positions). In the Associations' view, this type of regulation is neither necessary to protect retail customers nor appropriate to impose on broker-dealers and their customers. The provisions contradict many of those inherent in SEC and FINRA rules. For example, CFTC Rule 5.5 requires that disclosure provided by a regulated entity transacting foreign exchange with retail customers must indicate the percentage of customer accounts held by the entity that transact in retail foreign exchange that were profitable as well as the percentage that were not. This requirement is contrary to FINRA and SEC guidance suggesting that prior performance reflecting profitable trading is misleading.[19] As a result, it would be difficult, if not impossible, for broker-dealers, to comply with both sets of requirements, and the resulting structure and disclosures would likely be confusing to retail customers. As a result of the potential difficulties in implementation, if the SEC were to adopt rules modeled on the CFTC rules, broker-dealers may decline to execute many types of foreign exchange trades with retail customers. In light of the fact that broker-dealers and their retail foreign exchange transactions are subject to robust regulatory oversight and Congress has recognized this, as demonstrated by Congress's excluding the CFTC from regulating the retail foreign exchange activities of broker-dealers, including Dual Registrants,[20] the Associations believe that the regulatory model adopted by the Commission in the Interim Rule is an appropriate and effective model to use and that the SEC should not pattern a final rule on the CFTC rule, which was tailored for a different type of regulated entity.

7) ***Should the Commission adopt final permanent rules governing retail forex transactions? If so, what should those rules address?***

Yes. The Associations believe that the Commission should make the Interim Rule a permanent final rule, subject to certain modifications and clarifications (as described herein). The Associations endorse the Interim Rule's approach of making the retail foreign exchange business subject to the disclosure,

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[19] *See* NASD Rule 2210; Rule 206(4)-1 under the Advisers Act.

[20] Since Congress first addressed retail foreign exchange transactions as part of the Commodity Futures Modernization Act of 2000, it has excluded the CFTC from regulating the retail foreign exchange activities of any SEC-registered broker-dealers, including Dual Registrants. Section 102 Pub. L. No. 106-554, 114 Stat. 2763 (2000).

recordkeeping, capital and margin, reporting and business conduct requirements to which broker-dealers are already subject.

8) ***Are there any requirements or prohibitions not covered in the Final CFTC Retail Forex Rule, the Final FDIC Retail Forex Rule, or the Proposed OCC Retail Forex Rule that the Commission should address? Do existing Exchange Act provisions, rules and regulations thereunder, and SRO rules governing broker-dealers appropriately protect retail forex customers of broker-dealers? Should the Commission consider rulemaking to address any concerns that are not adequately addressed under the current regulatory framework?***

As discussed above and as recognized by the Commission in connection with adoption of the Interim Rule,[21] the Associations believe that the comprehensive set of Commission and SRO rules and compliance requirements to which broker-dealers are already subject are appropriate to govern this business and to provide necessary customer protections tailored to the foreign exchange business actually conducted by broker-dealers. There are several areas, however, where broker-dealers and their customers need more definitive guidance regarding how the Commission expects broker-dealers to operate. The Associations suggest that the Commission take this opportunity to clarify the following points, either through rulemaking or by interpretive guidance:

- Confirmation that foreign exchange transactions may be entered into through a customer's cash account if the transaction will settle within the standard settlement cycle for a securities transaction or the customer holds in the account cover for the transaction.[22]

- Confirmation that the "good faith" provisions of Regulation T[23] continue to apply to foreign exchange transactions conducted by a broker-dealer with its retail customers.[24]

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[21] Adopting Release at 41,679.

[22] Section 220.8(a) of Regulation T provides that a broker-dealer may, in a cash account, "(1) buy for or sell to any customer any security or other asset if: (i) there are sufficient funds in the account; or (ii) the creditor accepts in good faith the customer's agreement that the customer will promptly make full cash payment for the security or asset before selling it and does not contemplate selling it prior to making such payment; (2) buy from or sell for any customer any security or other asset if: (i) the security is held in the account; or (ii) the creditor accepts in good faith the customer's statement that the security is owned by the customer or the customer's principal, and that it will be promptly deposited in the account."

[23] Section 220.6(e)(1)(ii) of Regulation T permits a broker-dealer to effect and finance transactions in currencies for their customers. A customer may purchase foreign currency for future delivery from a broker-dealer for either speculative or hedging purposes through a "good faith" account.

[24] The Associations believe that the existing margin regulations under Regulation T (on a stand-alone basis and without supplement by the leverage limitation proposed by FINRA in January 2009) are appropriate for broker-dealers effecting foreign exchange transactions with retail customers. We believe the "good faith" approach that the Federal Reserve adopted in Regulation T is appropriate for this business. Opposition to FINRA's proposed rule by customers and the industry is reflected in numerous comment letters, *available at* http://www.finra.org/Industry/Regulation/Notices/2009/P117744. We agree with these comments and recommend against adoption of the FINRA Rule or of any modified approach that bases margin on the notional amount of a transaction rather than its mark-to-market. In the event that the SEC were to decide to act on the proposal, given the length of time during which the proposal has been pending as well as the significance of intervening events, such as the adoption of Dodd-Frank, we would expect, at a minimum, that FINRA would be required to recirculate its proposal for comments.

- Clarification regarding the scope of confirmation and statement requirements for foreign exchange transactions, which should be the same as those in effect for customer transactions in securities.

- Confirmation that, in determining suitability, the broker-dealer may evaluate and take into account the customer's overall investment objectives and risk tolerance as well as the aggregated portfolio of holdings of the customer of which the broker-dealer is aware.

- Confirmation that there is not any single "correct" suitability process. A broker-dealer should establish suitability guidelines for its retail foreign exchange business that are appropriate for its particular client base and the services it provides.

- Confirmation that a Dual Registrant's retail foreign exchange activities are subject exclusively to the jurisdiction of the Commission and a national securities association registered pursuant to Section 15A(a) of the Exchange Act (i.e., FINRA) [25] of which it is a member and not the retail foreign exchange rules of the CFTC or NFA.

The Associations also request that the Commission, in consultation with the CFTC, provide a safe-harbor to broker-dealers that would apply in the event that the status of a customer that is a natural person (including their investment vehicles and family offices) changes from that of a retail customer when a foreign exchange transaction is first entered into with the broker-dealer, including a Dual Registrant, to that of an ECP, because of fluctuations in net assets, a change in market prices or other factors. In that regard, we request that the Commission provide that a broker-dealer would not be violating the Commission's rules or the CEA by continuing to carry an OTC foreign exchange transaction entered into with a retail customer simply because the customer subsequently becomes an ECP. Similarly, we request that the Commission, in consultation with the CFTC, authorize a broker-dealer, under these circumstances to terminate the OTC foreign exchange transaction with the customer by entering into an off-setting OTC foreign exchange transaction with the customer. Although the primary purpose of the retail foreign exchange provisions was to allow less sophisticated investors to conduct their foreign exchange activities with specified regulated entities, there is no indication that Congress intended to punish a regulated entity transacting with a retail customer in the event that the customer becomes an ECP. In addition, it would be consistent with Congressional intent to provide additional protections to retail customers under the rule for the broker-dealer to be able to terminate a foreign exchange transaction with a customer through an off-setting transaction a foreign exchange transaction even though the counterparty has subsequently, through increases in net worth, a change in market prices or other factors, becomes an ECP.

9) ***What distinctive characteristics of retail forex transactions should the Commission take into consideration if it were to engage in further rulemaking relating to such transactions? Are there certain types of retail forex transactions (e.g., rolling spot transactions) that warrant Commission rulemaking to address specific disclosure and other investor protection concerns?***
See answers above.

10) ***What is the extent of the retail forex business currently conducted by broker-dealers? Does the retail forex business currently conducted by broker-dealers consist solely or primarily of forex transactions to facilitate customers' securities transactions and minimize risk exposure to customers from changes in foreign currency rates? In general, what proportion of the retail forex business currently conducted by broker-dealers do such transactions account for? Please provide as***

[25] 15 U.S.C. § 78o-3(a).

comprehensive of a description as possible of the retail forex activities of broker-dealers.

As described above, the foreign exchange businesses conducted by SIFMA broker-dealer members range from conversion trades in connection with customers' securities transactions to foreign exchange forwards, options and other products designed to provide customers with diversification and economic exposure to other securities and currency markets. Based on information from its members, the Associations understand that broker-dealers effect a substantial amount of conversion transactions such as those described above. The amounts vary by firm as does the breakdown among the different types of businesses. In addition, while some broker-dealers do not carry out a substantial business in foreign exchange with retail customers other than purchases or sales in connection with securities transactions, other firms conduct a much broader business with both institutional and individual retail customers. In the view of the Associations, the permanent final rule should allow broker-dealers to conduct the full range of foreign exchange transactions with retail customers for whom such transactions are found to be suitable.

11) ***For what other reasons do broker-dealers engage in retail forex transactions and what proportion of the retail forex business currently conducted by broker-dealers do such transactions account for? What benefits do these transactions provide to customers? What risks do customers face by engaging in such transactions?***

As mentioned previously, SIFMA broker-dealer members engage in foreign exchange transactions with retail customers for a number of reasons, including to accommodate customers who need (i) conversion services, (ii) the ability to hedge currency risk, (iii) to obtain economic exposure to currencies (such as in cases where securities may not be freely tradable) and (iv) as part of an overall trading strategy, exposure to the currency markets. For all retail customers, it is important to be able to build a diversified portfolio and gain exposure across asset classes as part of a unified investment strategy. Failure to provide retail foreign exchange services to retail customers would expose the customers to greater risk than the foreign exchange transactions themselves do. Without the ability to enter into conversion trades directly with a broker-dealer, for example, customers are exposed to, among other things, operational risks due to the need to transfer currencies from a currency dealer to the broker-dealer executing the securities purchase or sale and greater credit risk, in the event that the customer is required to post margin to two entities. Transacting with two different entities is also likely to result in higher charges for retail customers.

12) ***Provide estimates of the absolute size of the retail forex business (in both dollar amounts and numbers of transactions) conducted by the broker-dealer. What does this business represent as an estimated percent of the broker-dealer's total business? As an estimated percent of its total forex business?***

The Associations do not have an estimate of the absolute size of the retail foreign exchange business conducted by all broker-dealers. However, based on information from its members, the Associations understand that broker-dealers enter into a substantial number of foreign exchange transactions with retail customers each year. The amounts vary by firm as does the breakdown among the different types of businesses.

13) ***What is the estimated absolute size of the retail forex business (in both dollar amounts and numbers of transactions) conducted by broker-dealers overall? What does this business represent as a percent of their total business? As a percent of their total forex business?***

As noted above, the Associations are not able to estimate these amounts. However, based on customer interest expressed to SIFMA broker-dealer members as well as observations regarding trading activity encountered in the market, the business conducted by broker-dealers appears to be an important part of

their overall business. Additionally, as the need and demand for greater international exposure has grown and continues to grow, the demand for foreign exchange transactions has grown and is expected to continue to do so. In our experience, foreign exchange services are an essential component of the overall investment services demanded by retail customers of broker-dealers.

14) ***What types of customers engage in retail forex transactions, including rolling spot forex?***

There is not one type of customer that engages in retail foreign exchange transactions. Retail customers that are natural persons typically elect to effect the conversions associated with a purchase or sale of a foreign security directly through their broker-dealers executing or clearing the transaction. Retail customers that are institutions, on the other hand, will sometimes execute the conversions themselves either through a bank or FCM. With respect to non-conversion foreign exchange transactions, retail customers who direct their own foreign exchange transactions rather than engage an adviser tend to be quite sophisticated and experienced. Many of these customers qualify as ECPs for other purposes, as discussed above,[26] or come close to qualifying as ECPs on a net asset basis and are sophisticated.[27]

15) ***Is the existing regulatory framework for retail forex business as currently conducted by broker-dealers consistent with the protection of investors, the maintenance of fair, orderly, and efficient markets, and the facilitation of capital formation?***

Yes. The compliance infrastructure also operates efficiently by leveraging the systems in place for the securities business. Similarly, operation of the foreign exchange business is understandable to retail customers since transactions and positions are reflected on customer account statements and confirmations together with the securities positions and investment portfolios to which they relate.

16) ***What disclosures do broker-dealers provide to their customers regarding forex transactions that are conducted to facilitate settlement of securities transactions? What disclosures do broker-dealers provide to customers regarding forex transactions that are conducted for other purposes (e.g., at the customer's request to hedge against currency exchange risk exposure associated with securities transactions, or to engaged in speculative activity)? Do broker-dealers adequately and fully disclose the risks associate with forex trading? Do broker-dealers provide information to customers regarding pricing of forex transactions (e.g., pricing methodology, exchange rates for foreign currencies, how the price was calculate)? If so, is this information provided in advance of or following the forex transactions?***

SIFMA's broker-dealer members typically include disclosures regarding conversion trades in the customer agreements, investor representation letters, or other marketing materials. The language often warns customers that the broker-dealer does not guarantee that the customer could not obtain a better

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[26] As a result of the changes to the definition of ECP, solely for the purposes of regulation of foreign exchange transactions, non-ECPs may include commodity pools having substantial net assets but at least one participant that is not itself an ECP. CEA Section 1a(18).

[27] For example, a natural person is an ECP if it has in excess of $10 million "invested on a discretionary basis." This standard is stricter than the prior standard before enactment of Dodd-Frank that counted as an ECP a natural person having more than $10 million in assets. As a result, persons having assets in excess of $10 million may not qualify if such assets are invested largely in a business. Similarly, an individual having assets invested on a discretionary basis of $9.99 million would not qualify as an ECP under this test. Additionally, small but sizeable institutional investors, including corporations, partnerships, proprietorships and other entities with total assets just below $10 million, may fall outside the definition of ECP.

price elsewhere. In the context of OTC transactions other than conversion trades, some firms provide customers with customized risk disclosures. These vary from firm to firm but in substantially all cases where the disclosure is provided, the disclosure notes that the transactions (i) subject the customers to credit risk (due to the fact that the broker-dealer is the customer's counterparty on the transaction); (ii) are not eligible for protection under SIPC (with the exception of foreign exchange cash balances that are held pending investment in securities) in the event of the broker-dealer's insolvency; (iii) may experience substantial volatility given that the foreign exchange market is highly volatile; (iv) may lose money in an accelerated fashion given the presence of leverage in the transactions; (v) may not provide the hedge or exposure that the customer is looking for; and (vi) may be subject to transfer restrictions and are not traded on an organized exchange, ATS, ECN or other trading facility. In our experience, broker-dealers adequately and fully disclose the risks associated with foreign exchange trading to their retail customers.[28]

Broker-dealers will typically provide indicative market pricing information to customers – both prior to execution and after trading. Some broker-dealers will also disclose the fact that prices provided to customers may differ from those provided to other customers and that the customer may be able to get better prices with a different counterparty. Additionally, to the extent that a customer's foreign exchange transaction is entered into based upon a recommendation from the broker-dealer, the broker-dealer will generally apply the same suitability determinations as those for entering into a recommended security transaction, as set forth in NASD Rule 2310.

17) ***On what basis do broker-dealers price retail forex transactions? For example, do broker-dealers use the end-of-day currency exchange rate or some other benchmark? Do broker-dealers maintain policies and procedures that govern how forex transactions are handled and priced for retail forex customers? If broker-dealers do not provide pricing information to retail customers, what documentation does the broker-dealer maintain to demonstrate the price provided in retail forex transactions?***

Foreign exchange transactions are priced based upon prevailing market bids and offers. Generally, the pricing provided by broker-dealers to retail customers is based upon the prevailing rate being provided at that time by the broker-dealer to all of its customers, regardless of whether the customer is an ECP, assuming the same trade parameters, such as size of the trade. As a general matter, a broker-dealer's pricing will reflect pricing in the interbank market as reported on various reporting services, pricing that the broker-dealer's currency trading desk is seeing in the market and that is available through internalization (i.e., crossing with other customers of the broker-dealer or the firm's own market-making desk), and other interbank pricing resources. Generally, the pricing available for any transaction relative to the interbank quotes is a function of the credit quality, the notional size of the transaction, the volatility of the currencies involved and the complexity of the transaction.

18) ***Are transaction-time records for retail forex transactions currently created and provided to retail customers? If not, what would be the cost to create transaction-time records for retail forex transactions? What would be the cost to report to customers the transaction time and/or the source or basis for the currency exchange rate provided on retail forex transactions?***

Retail customers generally receive confirmations regarding their foreign exchange transactions from

[28] Pursuant to FINRA guidance, a broker-dealer must provide disclosures of the risks associated with foreign exchange trading, including the risks associated with leveraged trading. *See* Retail Foreign Currency Exchange, FINRA NTM 08-66 (Nov. 2008).

broker-dealers that include the date the transaction is entered into, the relevant currency pair, the settlement date and the pricing for the transaction. Providing the source for the price of a foreign exchange transaction would be very difficult and would not provide customers with meaningful information. As discussed in response to Question 17, there is no single source or centralized market for foreign exchange prices; rather, broker-dealers determine the price of a foreign exchange transaction based upon a number of inputs from varied sources, which will change based upon various factors, including the relevant currency and comparison of pricing provided by different counterparties.

19) ***For broker-dealers that provide custody services to retail customers, please describe any retail forex business conducted with respect to these custody services. What disclosures are provided to retail customers in connection with custody services? What pricing information is provided to retail customers in connection with forex transactions conducted in relation to custody services (e.g., pricing methodology, exchange rates for foreign currencies, how the price was calculated)? If pricing information is provided, is this information provided in advance of or following the forex transactions? On what basis do broker-dealers price retail forex transactions conducted in connection with custody services? Do broker-dealers maintain policies and procedures that govern how forex transactions are handled and priced in connection with custody services for retail forex customers? If broker-dealers do not provide pricing information to retail customers in connection with their custody business, what documentation do broker-dealers maintain to demonstrate to examiners the price provided in retail forex transactions?***

See discussion above.

20) ***Do broker-dealers provide retail customers alternatives for obtaining prevailing prices on retail forex transactions? For example, do broker-dealers inform customers that the customer can choose whether the broker-dealers will handle retail forex transactions at rates set under a "standing instruction" (i.e., non-negotiated trades, where a customer provides the broker-dealer discretion with respect to handling the forex transaction) or as a negotiated trade? Where a broker-dealer provides a "standing instruction" process for customers, what methods are used to determine the appropriate exchange rate? Do retail customers receive the interbank rate or some other rate?***

Where retail customers are seeking to enter into a foreign exchange transaction in connection with corporate actions relating to securities, such as interest and dividend payments, the customers will generally give the broker-dealer a standing instruction to convert all payments into a single currency. In such circumstances, the pricing is typically determined in the same manner as for other transactions, described above.

21) ***What conflicts of interest exist in connection with broker-dealers handling and pricing of retail forex transactions? How do broker-dealers manage these conflicts of interest? Do broker-dealers disclose when they are acting as a counterparty to a forex transaction with a retail customer?***

The fact that the broker-dealer is a counterparty to the transaction is typically disclosed by broker-dealers to their retail customer.[29] Other conflicts that arise from time to time in respect to foreign exchange transactions conducted by broker-dealers with retail customers include the fact that a broker-dealer may be a market maker in the currency and/or invest in the currency for its proprietary trading book, or the

[29] Pursuant to existing FINRA guidance, for example, a broker-dealer must disclose that it is acting as a counterparty to a customer, when applicable. *See* FINRA NTM 08-66.

broker-dealer may provide investment banking services for or lend money to the sovereign issuer of the currency. As a result of these roles, the broker-dealer may have a different view on the currency than the customer or may have information about the sovereign that the broker-dealer cannot share with the customer.

22) ***What compensation structures do broker-dealers apply to retail forex transactions (e.g., per trade commissions, spreads, both)? Do broker-dealers charge retail forex customers rolling fees or additional transaction fees, such as maintenance charges, software licensing fees, commissions paid to introducing brokers or other third-party service providers? Are there breakpoints offered to retail customers based on, for example, volume or number of trades? If so, are the breakpoints available to all retail customers?***

SIFMA broker-dealer members generally do not charge commission on foreign exchange transactions, but rather are compensated based the difference between the bid and ask price and in some cases a markup and markdown. In a small number of transactions, a retail customer may seek to roll over an existing position rather than close out the position and enter into a new one. In such cases, the broker-dealer may charge, in addition to the spread, a rollover fee based upon the difference in the interest rates of the two currencies. The fee is either incurred by or paid by the broker-dealer to the customer. With regard to conversion trades, broker-dealers may elect not to charge a markup or markdown or fee if the foreign exchange transaction is carried out in connection with a securities transaction (although pricing would in all cases be subject to the spread built into the dealer's price quotes). In such trades, the fee or transaction pricing is often factored into the price of the entire transaction, i.e., the combined securities purchase or sale and foreign exchange conversion.

23) ***What fees are charged by broker-dealers for each type of retail forex trade? What is the prevailing market rate for retail forex transactions? How does this differ from the prevailing market rate for forex transactions with ECPs? Does the prevailing market rate differ for standing instruction fees and negotiated trade fees?***

Generally, broker-dealers do not differentiate between their ECP and non-ECP retail customers with regard to the amount of any markup or markdown, bid/ask spread, rollover fee or other transaction charge charged in connection with foreign exchange transactions. Pricing is based on the liquidity of the currency, the size of the transaction, the broker-dealer's access to the currency and the terms of the transaction, including time to maturity.

24) ***Do broker-dealers disclose all compensation charged to retail customers? At what point during the customer relationship are compensation disclosures made (e.g., prior to any forex transactions, following a forex transaction)? What is the scope and breadth of those disclosures? Should the Commission consider rules that would expand broker-dealers' disclosure obligations?***

Broker-dealers generally disclose in customer account agreements the fact that they are compensated with respect to execution of retail foreign exchange transactions, and customers are made aware of the pricing at the time that they enter into such transactions. To the extent that a broker-dealer might charge a rollover fee, such debits or credits will be disclosed upfront to the retail customer and actual charges made will be indicated on the customer's periodic account statements.

25) ***In light of the authority provided under section 742 of the Dodd-Frank Act for the Commission to consider any other standards or requirements in connection with retail forex transactions that it determines to be necessary, when a broker-dealer solicits business for and introduces customers to a forex dealer, what due diligence does the broker-dealer conduct about the forex dealer? What policies and procedures do broker-dealers have in place, if any, regarding supervision of***

unregistered solicitors that introduce forex customers to the broker-dealer and that are employees or agents of the broker-dealer?

The Associations believe that, to the extent that broker-dealers introduce customers to clearing firms for purposes of carrying customer accounts or clearing and settling foreign exchange transactions, the same requirements that apply to introducing arrangements with regard to securities transactions should apply to the clearing arrangements for foreign currency. For example, the introducing of accounts by an introducing broker to a clearing broker should be subject to the requirement that the broker-dealers enter into a carrying agreement setting forth the allocation of relevant regulatory obligations.

In the experience of the Associations, broker-dealers do not typically rely on unregistered entities or persons to solicit retail customers for their foreign exchange business.

26) ***What policies and procedures do broker-dealers have in place regarding advertisements and marketing materials related to forex services offered to retail customers?***

FINRA indicated in FINRA NTM 08-66 that NASD Rule 2210 regarding communications with the public applies to a broker-dealer's foreign exchange business. Accordingly, broker-dealers currently apply the same policies and procedures to foreign exchange marketing materials as they do for materials relating to securities. The Associations believe that it is appropriate to continue to apply these requirements.

27) ***Do broker-dealers provide information to customers regarding access to the interbank currency market?***

No. The interbank market is accessible only to the largest banks and financial institutions. Accordingly, while the pricing offered by a broker-dealer will generally reflect pricing in the underlying interbank, the broker-dealer does not indicate or suggest that a customer would be eligible to obtain such pricing in the interbank market. A broker-dealer may provide customers, upon request, with market bid and ask prices, based on size and terms, in connection with providing indicative price terms, especially for larger transactions.

28) ***What disclosures do broker-dealers make to retail customers regarding the performance and accuracy (including slippage rates) of electronic trading platforms or software sold or licensed by or through the firm to customers in connection with forex trading?***

SIFMA broker-dealer members provide certain highly sophisticated customers with access to electronic trading platforms. In that regard, customers are provided with substantial risk warnings and disclaimers of liability with respect to the performance and accuracy of the platform pricing and execution capabilities.

29) ***What information do retail customers believe is important for them to receive from broker-dealers regarding their forex transactions?***

Consolidated reporting is important to customers that are using foreign exchange transactions in connection with a specific securities transaction, but it is also important to customers using foreign exchange transactions as part of their broader portfolio strategy, which includes gaining exposure to foreign currency markets and hedging portfolio currency risks. Transaction-specific information most important to customers includes the size of the transaction, the price at which the transaction was executed and the settlement date of the transaction.

30) ***What business conduct concerns do retail customers have regarding the manner in which their broker-dealers handle and price forex transactions?***

Based on the experience of SIFMA broker-dealer members, customers are most focused on the quality of the execution, including that their order is placed accurately, in a timely manner, and in the size needed, and that the pricing is reflective of pricing in the broader market. For conversion trades related to securities transactions, it is also important that the settlement date of the foreign exchange transaction matches that of the security being purchased or sold. Moreover, convenience (i.e., not needing to transact through another vendor) is also a significant factor for retail customers, particularly those who infrequently transact in foreign exchange.

31) ***Do broker-dealers provide structured products to retail customers that require forex transactions at maturity? In connection with these types of products, how are the foreign exchange conversion fees calculated and disclosed? Is the cost of the conversion embedded in the transaction itself, or must investors pay additional fees for conversion?***

While some broker-dealers may, in certain cases, issue structured notes, particularly for non-U.S. customers, which involve related foreign exchange transactions, these related foreign exchange transactions are offered subject to the same procedures as other foreign exchange transactions with retail customers, including sales practice considerations. Further, these structured notes are generally registered or offered pursuant to Regulation S under the Securities Act of 1933.

32) ***What alternatives for handling forex transactions outside of broker-dealers are available to retail investors? Would a transition of retail forex business out of broker-dealers be efficient or costly from the standpoint of customers?***

As noted previously, although retail customers would still be permitted to conduct retail forex transactions with banks, FCMs and RFEDs if the Commission fails to adopt a rule allowing for retail foreign exchange activity by broker-dealers, this will result in additional risks and costs to retail customers. Transacting foreign exchange through an entity other than the retail customer's broker-dealer would make it more difficult for customers of most broker-dealers to keep track of the correlation between their currency positions and their securities and other positions held at their broker-dealers, since the positions would be custodied in two different places and be reflected on two different types of statements and confirmations, particularly if the foreign exchange transactions are conducted in an unaffiliated entity. Retail customers would also have the added cost of establishing a new account and counterparty relationship at a separate entity for purposes of their foreign exchange trading, including negotiating and executing a new set of customer agreements and related trading documents. In addition, retail customers would potentially face increased credit exposure as a result of margin posting requirements with two different entities and costs and operational risk as a result of the need to transfer currencies between the separate entity and the broker-dealer. From a systemic risk perspective, requiring retail customers to use a separate entity to carry out foreign exchange transactions increases the risk of fails in respect to foreign exchange conversions carried out in connection with securities purchases and sales effected through a broker-dealer.