September 12, 2011

Ms. Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: Retail Foreign Exchange Transactions; File Number S7-30-11

Dear Ms. Murphy:

Better Markets, Inc.[1] appreciates the opportunity to comment on the interim final temporary rule ("Interim Rule") captioned above, adopted by the Securities and Exchange Commission ("Commission") on July 13, 2011. The Interim Rule allows broker-dealers to continue engaging in forex transactions with retail investors, at least until July 16, 2012, without any of the additional regulatory protections that Congress intended the Commission to establish for those retail investors under Section 742 of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act").

INTRODUCTION

As the Commission and its staff well know, retail investors have long been, and continue to be, the relentless targets of fraudulent and criminal conduct by firms dealing in off-exchange forex futures and options contracts. As clearly and compellingly explained in the Release, the Commodity Futures Trading Commission ("CFTC") regards retail forex as the largest area of retail fraud that the agency oversees.[2] Forex fraud is not confined to the world of CFTC registrants, and it has prompted the Financial Industry Regulatory Authority ("FINRA") to caution its broker-dealer members about numerous investor protection concerns arising from retail forex transactions.[3] FINRA characterizes the forex market as "opaque, volatile, and risky."[4] This description is in fact charitable, since much of the forex market is a cauldron of criminality that cries out for a more aggressive regulatory and law enforcement response.

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1 Better Markets, Inc. is a nonprofit organization that promotes the public interest in the capital and commodity markets, including in particular the rulemaking process associated with the Dodd-Frank Act.

2 Release at 41677 n. 18.

3 *Id.*

4 *Id.*

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In addition to a wide variety of misrepresentations and omissions regarding the profits, risks, and fees associated with forex trading, investors are exposed to other hazards that are inherent in the forex market. Retail customers lack adequate access to pricing information, dealers act as counterparties and therefore have conflicts of interest, and the currency market is extremely volatile.[5]

Congress chose to address these problems, in part, by enacting Section 742 of the Dodd-Frank Act. That section prohibits certain financial market participants, including broker-dealers, from engaging in off-exchange forex futures and options transactions with retail investors after July 16, 2011, ***unless*** the federal regulators overseeing those market participants adopt rules imposing terms and conditions on such trading. Retail investors are defined to include those who are not "eligible contract participants."

It appears from the Release that the Commission was prepared to allow the statutory ban against off-exchange retail forex trading to take effect without promulgating any new rules. This approach certainly would have been appropriate, given the well-known, long-standing, and egregious abuses occurring in the retail forex market. However, in mid-June of 2011, almost a year after enactment of Section 742, certain market participants suddenly raised concerns with the Commission that the ban would impair their ability to assist clients in hedging, or facilitating the settlement of trades in foreign securities.

As a result of that last-minute lobbying effort, on July 13, 2011, the Commission issued the Interim Rule, ***without notice and opportunity for comment***, essentially preserving the status quo and allowing all retail forex trading by broker-dealers to continue for another year under existing laws and regulations.

Unfortunately, preserving the status quo also means that criminals and fraudsters will have another year in which to prey on unsuspecting investors, who are victimized in the forex markets with astonishing regularity.

The Commission is well aware of the chronic abuses occurring in the forex market and it has received specific authority from Congress to address the problem. Under these circumstances, deferring action for another year is unjustifiable and inconsistent with the law. As argued below, the SEC must immediately rescind the Interim Rule or at least drastically limit its scope.

COMMENTS

The interim rule conflicts with the language and intent of the Dodd-Frank Act.

Section 742 of the Dodd-Frank Act ***requires*** the Commission either to let the prohibition against retail forex trading take effect, or to promulgate rules addressing the well-documented abuses that gave rise to the prohibition. The Interim Rule, however, does

[5] Release at 41677 nn. 18 & 19.

neither. Instead, it follows the least desirable path by simply allowing the status quo to persist. Under the Interim Rule, retail forex trading will continue for a full year beyond the Congressionally imposed deadline, without the benefit of any new rules providing retail investors with additional protections that are clearly necessary and that Congress plainly intended.

The claimed reasons for delaying the trading ban for a year were insubstantial and not properly tested by the Commission.

Some market participants claim that their clients who trade foreign securities need to hedge currency risk or facilitate the settlement of foreign securities transactions by entering into certain retail forex trades. The Release cites a memorandum requesting relief from the SEC on behalf of a single firm, Pershing LLC.[6] Although the request appears to seek narrow relief for certain types of forex transactions, it raises more questions than it answers, and none of them are adequately addressed in the Release.

First, the firm did not request relief from the Commission until mid-June, only a month before the ban was to take effect, thus placing significant pressure on the Commission to act in haste. Yet neither the memorandum seeking relief nor the Release itself provides any justification for the eleventh-hour nature of the request.

The Release also fails to include any concrete assessment or quantification of the need for the relief requested. And it offers no analysis of the extent to which alternative trading strategies or financial products might substitute for the retail forex trades in question. On this point, the Release simply notes that the Interim Rule may result in economic benefits for retail investors "to the extent this provides hedging opportunities for foreign investments" and "***assuming*** that no close substitutes exist."[7] Yet it appears that such substitutes do exist. For example, one comment letter submitted on the Interim Rule suggests that exchange-listed currency ETFs provide an alternative means for effectively hedging against currency risk, but that such products are less profitable for broker-dealer firms and therefore not promoted to retail clients.[8]

The Release compounds these omissions by making no attempt to address the threat of abuse that even forex hedging and settlement transactions pose to retail investors. Undoubtedly, many of those trades involve the same forms of exploitation so common in purely speculative forex transactions: distorted pricing, lack of disclosure, and conflicts of interest. The fact that those forex transactions may be part of an investor's larger trading strategy hardly means that they are not being used in fraudulent ways.

[6] Memorandum from P. Georgia Bullit, Morgan Lewis, on behalf of Pershing LLC, to James Brigagliano, SEC, Proposed Relief Regarding Transactions in Retail Foreign Exchange (June 17, 2011) (cited in Release at 41677 n. 15).

[7] Release at 41684 (emphasis added).

[8] Letter from Justin Hughes, Philadelphia Financial Management of San Francisco, to Elizabeth M. Murphy, SEC (Aug. 2, 2011), at 8.

In short, the industry request for relief from the retail forex trading ban was not substantiated, nor was it tested or analyzed by the Commission.

The Commission's response to the industry's concern is inappropriate.

Even if there is a need for broker-dealers to engage in certain retail forex transactions to hedge or facilitate their clients' foreign securities trades, the Commission's proposed remedy is unjustifiable. At best, the Interim Rule sacrifices the known interests of many retail investors (those who will be victimized in retail forex trades over the next year) to the unknown, industry-claimed interests of other investors (those who purportedly employ forex trading to manage their investments in foreign securities).

This decision is questionable on its face, and the Release makes no attempt to balance the real and continuing threat to all investors against the supposed benefits that will be enjoyed by a select few. Moreover, those benefits are claimed without concrete support and by industry participants whose profits are at stake. There is no reason to accept those arguments at face value.

At worst, the Interim Rule is doubly harmful, since, as noted above, the investors who need to hedge or facilitate settlement of other trades may be subject to the same abuses that ordinary retail investors suffer in the forex world.

Much of the Release is devoted to demonstrating an irrelevant point: broker-dealers who trade retail forex are already subject to extensive rules governing business conduct, recordkeeping, and reporting. However, reliance on those existing regulatory protections has been and remains a woefully inadequate justification for maintaining the status quo. Those measures have not prevented the ongoing epidemic of abuses that have plagued the forex market for years, and that gave rise to the change in law and the requirement that the Commission take action.

The Commission should rescind the Interim Rule and allow the ban to take effect, or at least narrow the rule so that it permits continued retail forex trading only for specified purposes and upon a showing of independent proof that such purposes exist other than to protect the profitability of broker-dealers.

The only appropriate remedy under the circumstances is for the Commission to rescind the Interim Rule immediately, and to allow the ban to take effect with respect to all retail forex trading, unless and until the Commission adopts regulations that adequately strengthen protections for all retail investors in the forex market. This approach adheres to the requirements of the Dodd-Frank Act, and it maximizes protections for all investors.

If, for some reason, the Commission decides not to follow the dictates of the law, then, at a minimum, it should significantly limit the scope of the Interim Rule to the purported rationale given for it: hedging or facilitating settlement of investments in foreign securities through a narrowly defined class of forex transactions.

Assuming there is, in fact, a need to allow ***some*** trading in retail forex to continue for some specified purposes, there is no rationale for allowing ***all*** trading in retail forex to continue for all purposes, without the additional rules that are necessary to address the chronic abuses in the forex market.

The limited exemption from the ban on retail forex trading should not be put in place unless substantial, compelling, and independent evidence—something more than self-serving claims from market participants—demonstrates that it is, in fact, necessary. Finally, such a limited, narrowly tailored remedy should remain in effect only for as long as necessary to determine whether it too should be banned or subject to additional rules.

CONCLUSION

We hope these comments are helpful as you consider what additional steps are appropriate following adoption of the Interim Rule.

Sincerely,

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