



July 10, 2012

VIA ELECTRONIC MAIL

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:

Customers access over-the-counter foreign exchange markets through broker-dealers in order to purchase and sell foreign-denominated securities, hedge their securities portfolios and obtain currency exposure. With the regulation of retail foreign exchange in 2000,<sup>1</sup> Congress determined that broker-dealers were one of a handful of appropriate intermediaries to provide retail customers access to the foreign exchange markets. In connection with the adoption of the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank”),<sup>2</sup> Congress required the Securities and Exchange Commission (“SEC”), for broker-dealers, and other regulators, for designated financial intermediaries they regulate, to develop rules covering retail foreign exchange. All of the other regulators have adopted or proposed final rules.<sup>3</sup> The SEC has not yet done so.<sup>4</sup>

The Securities Industry and Financial Markets Association (“SIFMA”)<sup>5</sup> urges the SEC, *prior to the deadline of July 16, 2012*, to (i) propose permanent rules that allow retail customers and institutional commodity pools that are treated as retail under Dodd-Frank to transact in all types of foreign exchange transactions through broker-dealers; (ii) include in the permanent rules an express right for employees of broker-dealers and their affiliates to conduct foreign exchange transactions allowed by personal trading policies in the broker-dealer, to allow for proper surveillance; (iii) exclude from regulation currency conversions conducted to consummate the purchase or sale of a security; and (iv) extend interim final temporary rule 15b12-1T indefinitely until permanent rules allowing broker-dealers to carry out a retail foreign exchange business are adopted and become effective.<sup>6</sup>

### **Retail Foreign Exchange Conducted by Broker-dealers**

The foreign exchange business currently carried out by broker-dealers is significant. We believe that the estimates below, from five member firms, are representative of SIFMA members generally and likely understate the size of the business since, among other things, they do not include institutional commodity pool investors who may be forced to transact in the future as “retail.”<sup>7</sup> Member firms expect retail interest in foreign exchange to continue to increase in light of global political events.

<b>Category</b>	<b>Number</b>
OTC FX Forwards, Currency Options & Rolling Spot with Non-ECPs	\$550 million <i>per month</i> (principal)

Conversions – FX relating to the purchase and sale of securities	\$1.2 billion <i>per month</i>
Hedging as % of activity	Approx. 50-85% of total retail FX business
Discretionary Accounts	A limited # of firms offer but in some portfolios, FX may involve a significant portion of the strategy
Types of Customers	Typically \$1 million or more in net worth, other than broker-dealer employees permitted to trade foreign exchange under their firm policies and who <i>must</i> effect all trades through the broker dealer for compliance reasons. <sup>8</sup>

### Suitability Criteria and Customer Disclosures

SIFMA member firms apply disclosure and suitability standards to foreign exchange transactions (other than spot trades or conversions<sup>9</sup>) even though the applicable rules do not apply to transactions in non-securities. SIFMA member firms take into account each retail customer's specific circumstances, including the customer's investment objectives, horizon and liquidity needs prior to recommending that a retail customer enter into foreign exchange transactions.<sup>10</sup> Many broker-dealers establish additional qualification standards. For example, some broker-dealers require that retail foreign exchange customers (other than those conducting conversion or spot transactions) meet minimum asset levels in excess of \$2 million and subject the customers to a heightened credit review. Several firms require supervisory personnel to review each foreign currency trade entered into by a retail customer as a double check on the financial advisor's determination.

SIFMA broker-dealer members provide retail customers with disclosures regarding foreign exchange transactions. The disclosures vary from firm to firm but typically include the following:

- Disclosure that transactions subject the customers to credit risk (due to the fact that the broker-dealer is the customer's counterparty on the transaction);
- Clear statements that the transactions are not eligible for protection by the Securities Investor Protection Corporation (with the exception of foreign exchange cash balances that are held pending investment in securities) in the event of the broker-dealer's insolvency;
- A warning that customers may experience volatility;<sup>11</sup>
- Statements that embedding leverage into transactions may cause customers to lose money in an accelerated fashion;
- A warning that a transaction may not provide the hedge or exposure that the customer is looking for;
- Disclosure that transactions may be subject to transfer restrictions and are not traded on an organized exchange; and
- A copy of the SEC's Investor Bulletin regarding individual foreign exchange trading.<sup>12</sup>

### Retail Investors Should be Allowed to Have Access to the Foreign Exchange Market Through Broker Dealers

Failure to adopt these rules will constrain the ability of U.S. retail investors to purchase foreign securities, diversify their holdings by investing in the currency markets and hedge their foreign exchange exposure inherent in foreign security holdings and limit the ability of foreign retail investors to access the U.S. securities markets. In addition, lack of regulation will create operational risks for retail

investors by forcing them to conduct their foreign exchange activity in a separate entity from their securities investments. In many cases, this separate entity will be less well capitalized<sup>13</sup> than a broker-dealer, offer only a narrow range of products -- most of which are designed for speculation and not for hedging -- and not offer investment advice.

The over-the-counter foreign exchange market is the largest and most liquid market in the world.<sup>14</sup> Given the global nature of investing, all investors – both retail and institutional – need to have access to the foreign exchange market. SIFMA believes that it is in the best interest of retail customers to have the opportunity to conduct their foreign exchange activity in a coordinated fashion with their broader investing activity through their broker-dealers. Broker-dealers want to be able to service these clients in the manner contemplated by Congress but are dependent upon action by the SEC in order to be able to do so. We urge the SEC to remember its fundamental mission to protect investors – including retail investors – and pass rules allowing them the ability to invest in foreign exchange, have well-diversified portfolios that may include foreign currencies or foreign securities (which depend on foreign currency conversions in order for the client to invest) and hedge risky foreign exchange associated with securities holdings in a safe and sound manner under permanent broker-dealer rules.

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Thank you for your consideration of our views. We welcome the opportunity to discuss these matters further. If you have additional questions or need any additional information, please feel free to contact our outside counsel, P. Georgia Bullitt at 212-309-6683 ([gbullitt@morganlewis.com](mailto:gbullitt@morganlewis.com)) at Morgan, Lewis & Bockius LLP.

Sincerely,



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

cc: The Hon. Mary L. Schapiro, Chairman, SEC  
The Hon. Elisse B. Walter, Commissioner, SEC  
The Hon. Luis A. Aguilar, Commissioner, SEC  
The Hon. Troy A. Paredes, Commissioner, SEC  
The Hon. Daniel M. Gallagher, Commissioner, 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  
Lourdes Gonzalez, Division of Trading and Markets, SEC  
Bonnie L. Gauch, Division of Trading and Markets, SEC  
Joseph Furey, Division of Trading and Markets, SEC

The Hon. Gary Gensler, Chairman, CFTC  
Dan Berkovitz, General Counsel, CFTC  
Julian Hammar, Office of General Counsel, CFTC

David E. Aron, Office of General Counsel, CFTC

Tena Alexander, Office of Comptroller of the Currency  
Stephanie Boccio, Office of Comptroller of the Currency  
Roman Goldstein, Office of Comptroller of the Currency  
Thomas Hearn, Counsel, Federal Deposit Insurance Corporation

Scott Holz, Senior Counsel, Board of Governors of the Federal Reserve System  
Robert L. D. Colby, Chief Legal Officer, FINRA  
Gary L. Goldsholle, Vice President, Associate General Counsel, FINRA

<sup>1</sup> The Commodity Futures Modernization Act of 2000 (the “CFMA”), for the first time, imposed restrictions on the type of intermediaries who are authorized to carry out over-the-counter foreign exchange business with persons who are not “eligible contract participants” (“ECPs”) as defined in the Commodity Exchange Act (the “CEA”). Section 102, Pub. L. No. 106-554, 114 Stat. 2763 (2000), codified at Section 2(c)(2)(B) of the CEA. The CFMA authorized the following types of entities to enter into foreign exchange transactions with non-ECPs: financial institutions (*i.e.*, banks), registered broker-dealers and material associated persons of registered broker-dealers, registered futures commission merchants (“FCMs”) and material affiliated persons of registered FCMs, insurance companies or regulated affiliates thereof, financial holding companies and investment bank holding companies.

<sup>2</sup> See Dodd-Frank, Section 742(c), Pub. L. No. 111-203, 124 Stat. 1376–2223 (2010), codified at Section 2(c)(2)(E) of the CEA.

<sup>3</sup> See 75 Fed. Reg. 55,409 (adopting Commodity Futures Trading Commission (“CFTC”) Rules Part 5, effective Oct. 18, 2010); 76 Fed. Reg. 40,779 (adopting Federal Deposit Insurance Corporation Rules Part 349, effective July 15, 2011); 76 Fed. Reg. 41,375 (adopting Office of the Comptroller of the Currency Rules Part 48, effective July 15, 2011); 76 Fed. Reg. 46,652 (proposing Board of Governors of the Federal Reserve System Regulation NN, Aug. 3, 2011). The SEC adopted interim final temporary rule 15b12-1T, which, absent SEC action, will expire effective July 16, 2012. 76 Fed. Reg. 41,676 (July 15, 2011).

<sup>4</sup> Dodd-Frank added Section 2(c)(2)(E) to the CEA permitting regulated entities to conduct retail foreign exchange activities in accordance with regulations prescribed by the regulators. If Congress had intended to prohibit exchange it could have explicitly done so, rather than providing for its regulation. The intent of Congress to regulate and not prohibit retail foreign exchange is supported by the fact that every regulatory agency, with the exception of the SEC, has adopted or proposed rules to regulate this activity.

<sup>5</sup> 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”).

<sup>6</sup> SIFMA supports the views expressed in the comment letter submitted by the American Bankers Association and the Global Foreign Exchange Division of GFMA regarding currency conversions in connection with the purchase and sale of a security. Letter dated April 18, 2012, *Re: Retail Foreign Exchange Transactions; Determination Requested on Foreign Exchange Transactions with Retail Customers Related to Foreign Securities Settlement*, available at <http://www.sec.gov/comments/s7-30-11/s73011-16.pdf>.

<sup>7</sup> Under the CEA, a “retail investor” is a person that is a non-ECP, as defined in the CEA. The ECP definition was amended by Dodd-Frank as well as in recently adopted CFTC rules. For individual investors, the ECP definition is dependent upon the market value of invested assets. Commodity pools must satisfy several conditions to qualify as an ECP, including registration of its operator as a commodity pool operator or an exempt operator under CFTC Rule 4.13(a)(3). Additionally, a commodity pool operated by a foreign commodity pool operator with only one U.S. participant does not qualify as an ECP. Member firms do not yet have a sense how many commodity pools will be required to be treated as retail. Finally, in light of the fact that ECP status for many types of customers will change as market values change, it would be helpful for the SEC to coordinate with the CFTC to develop rules regarding how firms should deal with customers who migrate during the course of a foreign exchange transaction from ECP status to non-ECP status and vice versa.

<sup>8</sup> SIFMA believes that employee trading in foreign exchange should be surveilled alongside employee securities transactions, which generally must be effected at the broker-dealer employing such persons.

<sup>9</sup> Foreign exchange conversions are not subject to FINRA suitability determinations although the underlying securities transactions to which they relate are.

<sup>10</sup> Broker-dealers may obtain from institutional customers (*i.e.*, those with at least \$50 million in total assets) an affirmative undertaking that the customer accepts responsibility for suitability. Even for institutional customers that affirmatively consent to delegation, broker-dealers remain responsible for making determinations relating to reasonable basis suitability and quantitative suitability. For non-institutional customers or institutional customers that do not provide the affirmative undertaking relating to customer specific suitability, broker-dealers collect information regarding customers and consider a broad range of aspects of the customer's investments, goals, needs and economic status.

<sup>11</sup> In this regard, we note that currencies are typically less volatile than equities. For example, an unleveraged EUR-USD position has a 30 day volatility of only 8% whereas an unleveraged position in IBM common stock has a 30 day volatility of 14%. Similarly, an unleveraged position in Wal-mart common stock has a 30 day volatility of 18%. *Source Bloomberg.*

<sup>12</sup> SEC Office of Investor Education and Advocacy Investor Bulletin: Foreign Currency Exchange (Forex) Trading For Individual Investors, *available at*: <http://www.sec.gov/investor/alerts/forextrading.pdf>.

<sup>13</sup> Entities conducting non-deliverable forwards or currency options will have to register as swap dealers, which must satisfy certain capital requirements established by the CFTC or a prudential regulator.

<sup>14</sup> With \$4 trillion in daily volume, the over-the-counter foreign exchange market dwarfs the combined U.S. treasury market, with only \$545 billion in average daily volume, and the U.S. equities market, with \$118 billion in average daily volume. Bank for International Settlements, Triennial Central Bank Survey, *Foreign Exchange and Derivatives Market Activity in April 2010* (Sept. 2010), p. 7; Securities Industry and Financial Markets Association ("SIFMA"), Statistics, US Treasury Trading Volume (as of May 2012); US Key Stats (as of May 2012), *available at* <http://www.sifma.org/research/statistics.aspx>.