VIA ELECTRONIC MAIL

December 20, 2011

Jennifer J. Johnson
Secretary
Board of Governors of the Federal Reserve System
20th and C Streets, N.W.
Washington, D.C. 20551
Regs.comments@federalreserve.gov

Robert E. Feldman
Executive Secretary
Attention: Comments
Federal Deposit Insurance Corporation
550 17th Street, N.W.
Washington, D.C. 20429
Comments@FDIC.gov

John Walsh
Acting Comptroller of the Currency
Office of the Comptroller of the Currency
250 E Street, S.W.
Mail Stop 2-3
Washington, D.C. 20219
Regs.comments@occ.treas.gov

Re: **Request for Different Standards for "Professional" Retail Foreign Exchange Investors and the Right to Opt-In Under the New Retail Forex Rules**

Dear Ms. Johnson and Messrs. Walsh and Feldman,

As a result of changes under the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 ("**Dodd-Frank**"), federal banking authorities are in the process of drafting or implementing regulations governing the manner in which banks and branches of foreign banks conduct foreign exchange activities with retail clients. The result of which will be that foreign exchange conducted by banks in the over-the-counter market ("**OTC**") will be regulated by specific disclosure, order taking, business conduct, reporting, documentation and sales practices requirements. The rules (the "**Retail FX Rules**") proposed by the Board of Governors of the Federal Reserve System ("**Board of Governors**") as well as those adopted by the Office of the Comptroller of the Currency ("**OCC**") and the Federal Deposit Insurance Corporation ("**FDIC**") (collectively the "**Agencies**") are focused on the protection of unsophisticated, individual investors – generally those having insufficient assets to cushion losses.[1] Although the Retail FX Rules are tailored for traditional, individual investor, retail clients, the definition of retail investor is drawn from the definition of "eligible contract participant" ("**ECP**") in the Commodity Exchange Act (the "**CEA**") and includes a substantial number of institutional entities. In addition, for the true

[1] For example, the types of prescribed disclosures are those that are generally provided to individual investors with little-to-no investing experience, such as disclosing that trading is conducted on a principal-to-principal basis and not on a market or exchange and that trading is subject to investment risks, including loss of all amounts invested. A large and sophisticated investor, particularly one for which a regulated and experienced adviser is conducting the trading, would already be aware of these types of risks. Similarly, these types of investors and their advisers have access to prices available in the foreign exchange market and do not need the protections provided by some of the trading standards, such as requiring that prices be the same and comparable for all clients.

retail investors it can be difficult to know whether to treat these individuals as retail or institutional since, in the case of natural persons, the dividing line between retail and non-retail clients under the ECP definition is measured by the value of investment assets, which fluctuate depending upon market conditions.[2] As a result, the status of clients as "ECPs" (*i.e*, institutional investors that fall outside of the Retail FX Rules) can fluctuate frequently, requiring banks to move clients between the swap platform for days on which the clients' portfolio is valued above the retail range, and back to the retail platform when the market falls and the portfolio value falls within the retail range.

In order to avoid the serious consequences we fear may follow adoption of this regime, the GFMA's Global Foreign Exchange Division ("**GFXD**")[3] is writing to urge the Agencies to revise or adopt Retail FX Rules that:

(i) establish a new regulatory standard for a Professional Non-ECP investor (as described below);

(ii) treat as a Professional Non-ECP under the Retail FX Rules any person that is an ECP for all purposes, but as a result of the "Look-Through Rule" described below, is not an ECP for foreign exchange;

(iii) treat as a Professional Non-ECP under the Retail FX Rules any person that is an entity, and not a natural person, and is managed by a regulated adviser having at least $100 million in assets under management, whether or not such managed entity would today or after implementation of Dodd-Frank be an ECP; and

(iv) allow banks with individual clients who migrate to ECP status to continue to transact with them under the Retail FX Rules as a non-ECP, notwithstanding that they are an ECP.

Failure by the Agencies to act has the potential to seriously harm the U.S. foreign exchange market. In particular, we are concerned that the Retail FX Rules (unless appropriately tailored) will drive a number of important liquidity providers off-shore in order to avoid the burdens of transacting as retail investors. In addition, we believe that transaction costs will rise significantly in the U.S. market as participants pass on to the marketplace generally the costs of meeting the enhanced compliance burdens.

---

[2] The definition of ECP applicable to natural persons, as amended by Dodd-Frank, is based on "amounts invested on a discretionary basis the aggregate of which is in excess of $10 million or $5 million, if the agreement, contract or transaction is designed to managed the risk associated with an asset owned or liability incurred, or reasonably likely to be owned or incurred, by the individual. *See* Section 1a(18)(A)(xi) of the CEA, as amended by Dodd-Frank.

[3] The members of the GFXD comprise 22 global FX market participants, collectively representing more than 90% of the FX market. *See* Euromoney FX Survey 2011: Overall Market Share. The Global Financial Markets Association ("**GFMA**") joins together some of the world's largest financial trade associations to develop strategies for global policy issues in the financial markets, and promote coordinated advocacy efforts. GFMA currently has three members: the Association for Financial Markets in Europe ("**AFME**"), the Asia Securities Industry and Financial Markets Association ("**ASIFMA**"), and, in North America, the Securities Industry and Financial Markets Association ("**SIFMA**").

1. **Background**

The foreign exchange market is the world's largest financial market.[4] The deep and liquid marketplace provides an important adjunct to all of the other financial markets. Institutional investors regularly participate in the market to reduce risks by hedging currency exposures; to convert returns from international investments into domestic currencies; and to make cross-border investments. Private funds, including funds that constitute "commodity pools" under the CEA, are significant participants in this market and provide a considerable amount of liquidity to the market. Likewise, large, institutional money managers managing monies for a wide spectrum of institutional clients, including both ECPs and non-ECPs, trade frequently in the OTC foreign exchange market with U.S. banks and U.S. branches of foreign banks. These money managers typically execute on a bunched trade basis, aggregating orders across a number of institutional, managed accounts. This execution methodology helps to provide smaller orders with more favorable pricing than they would otherwise achieve. Both of these constituencies (*i.e.,* private funds and smaller accounts managed by large money managers) currently transact as principal through the institutional platform of the counterparty bank or branch. These entities do not receive the types of risk disclosures and investment advisory assistance from the bank or branch that is provided to individual clients.

Individual clients, on the other hand, typically transact foreign exchange through their accounts on a private banking or retail brokerage platform. Many banks provide risk disclosure and educational materials to these clients and conduct sufficient due diligence on the client to conclude that the trading is suitable for the client prior to allowing the client to transact in OTC foreign exchange. At many banks and foreign branches, margining procedures applicable to individual clients are separate from those applicable to institutional investors.

Prior to October 2010, non-ECP investors were required to transact with entities that were licensed as banks, broker-dealers, futures commission merchants ("**FCMs**"), insurance companies or material affiliates of broker-dealers or FCMs; however, the activity was not subject to statutorily mandated rules. Institutional foreign exchange was not directly regulated. Congress changed that paradigm with the enactment of Dodd-Frank. Among other things, Congress required that, unless the OTC foreign exchange activity conducted by U.S. banks and foreign branches with non-ECPs was expressly exempted by statute (*e.g.*, spot), banking entities could only carry out such activity pursuant to rules adopted by the Agencies that covered specific requirements. Although there is no legislative history explaining Congress's purpose in requiring adoption of the Retail FX Rules, it is generally understood that Congress was seeking to ensure that entities conducting retail foreign exchange activities were subject to a comprehensive regulatory scheme that provided protections to small, unsophisticated retail clients from potentially problematic business practices employed by a class of thinly-capitalized, retail forex dealers.[5]

---

[4] Bank for International Settlements Quarterly Review, *The $4 trillion question: what explains FX growth since the 2007 survey?* (Dec. 2010), p. 4.

[5] *See, e.g.*, Foreign Exchange Currency Fraud: CFTC/NASAA Investor Alert (available at: http://cftc.gov/ConsumerProtection/FraudAwarenessPrevention/ForeignCurrencyTrading/cftcnasaaforexalert) and SEC Investor Bulletin; Foreign Currency Exchange (FOREX) Trading for Individual Investors (July 2011)(available at: http://sec.gov/investor/alerts/forextrading.pdf). Section 2(c)(2)(E)(iii) of the CEA provides that regulations promulgated by the Agencies must include requirements with respect to disclosure, recordkeeping, capital and margin, reporting, business conduct and documentation.

At the same time as Congress required that retail foreign exchange be conducted pursuant to appropriate rules, Congress adopted a change to the definition of ECP that applies exclusively to entities that are "commodity pools" under Section 1a(10) of the CEA (*i.e.*, generally, entities that transact in listed futures and options on futures). That change, which is referred to as the "Look-Through Rule," provides that for purposes of transactions in OTC foreign exchange, commodity pools can qualify as ECPs only if *all* of the participants in the commodity pool are themselves ECPs.[6] The Look-Through Rule appears to have been designed to prevent unscrupulous persons from forming a pool of retail investors in order to avoid application of the new Retail FX Rules. The Commodity Futures Trading Commission ("**CFTC**") and the Securities and Exchange Commission (the "**SEC**", together, the "**Commissions**") proposed rules that would apply the Look-Through Rule more expansively to include a substantial number of hedge funds and other private funds and not simply funds formed for the purpose of evading the Retail FX Rules.

The Asset Management Group of SIFMA (the "**AMG**") submitted a comment letter on September 15, 2011 (the "**AMG Letter**")[7] urging the Commissions to significantly revise their proposal and interpret the Look-Through Rule in a manner so that private funds that are commodity pools can qualify as ECPs for purposes of transacting in OTC foreign exchange even though one or more of the investors in the fund is itself a non-ECP. The GFXD strongly supports that letter and is working with colleagues in the AMG to advocate for this approach with the Commissions.[8] We have attached the AMG Letter for your reference.

2. Definition of Professional Non-ECP

Although the GFXD is hopeful that the interpretive approach recommended by the AMG will result in private funds that are currently ECPs continuing to qualify as such for purposes of transacting in foreign exchange, regardless of the actions taken by the Commissions, it is important that the Agencies develop workable Retail FX Rules. Even if the Commissions do provide some or all of the relief requested under the AMG Letter, there will continue to be a number of institutional investors that currently trade OTC foreign exchange on the institutional platforms of banks or branches of foreign banks through large money managers that will not meet the definition of an ECP. This latter group includes entities such as new funds and managed accounts for substantial investors where the asset size of the portion using foreign exchange is relatively small, that are not ECPs and will not be ECPs after implementation of Dodd-Frank – but whose assets are managed by large, well-established and regulated investment managers that are capable of looking out for their interests.

---

[6] *See* CEA 1a(18)(A)(iv)(II), as amended by Dodd-Frank.

[7] Letter to the CFTC and SEC from SIFMA's 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)* (Sep. 15, 2011).

[8] The approaches recommended by the AMG include, among other things, allowing commodity pool investors to qualify as ECPs under another prong of the ECP definition and allowing commodity pool investors to qualify as ECPs based on a $5 million in assets test provided that the investor was not "formed for the purpose" of evading the Retail FX Rules. There is no guarantee, however, that the Commissions will act to support this proposal. As a result, if the proposed interpretive rule of the Commissions goes forward as planned, a significant portion of the private funds trading in the U.S. foreign exchange market today could become non-ECPs and be subject to the Retail FX Rules.

The GFXD believes that Retail FX Rules adopted by the Agencies should be customized expressly to address both: (i) institutional investors that would today qualify as ECPs but, as a result of implementation of the Look-Through Rule (and the interpretations of the Look-Through Rule ultimately adopted by the Commissions) will no longer qualify as ECPs for purposes of transacting in foreign exchange, and (ii) institutional investors represented by large, sophisticated, regulated money managers, regardless of whether the entities would themselves qualify as ECPs.

It will not be efficient or cost effective to transfer these clients, who currently transact billions of dollars a day in foreign exchange, to the retail or private banking platform of banks or branches which handle retail foreign exchange.[9] In addition, it would create substantial credit, operational and market risk to transfer these clients' trading accounts to a separate legal entity from the entity that trades other types of OTC instruments, such as swaps, or holds accounts for the entity that are being hedged through a foreign exchange trade. To the extent that foreign exchange positions are booked in a separate entity or division from that which houses a client's securities, swaps and other positions, that booking in a separate entity or division will increase operational risk for the bank and the client, because foreign exchange positions held on the retail platform may need to be transferred to another entity or division within the bank or financial group in connection with the entity's usual institutional activity. This paradigm will also create systemic risk for entities transacting their swap activity from outside the bank entity by eliminating the benefits of close-out netting since both operationally[10] and legally[11] the swap dealer, which will transact swaps with the entity, may not be able to transact OTC foreign exchange with the non-ECPs.

In order to avoid these results and customize the Retail FX Rules for these sophisticated institutional investors, the GFXD recommends that the Agencies adopt a new Professional Non-

[9] As explained above, the retail financial services business is generally conducted on a separate platform or division from the institutional business because the operational needs are quite different. The retail platform is set up in a manner to accommodate handling of a larger number of small orders, a large number of accounts, higher required margin levels, simple account documentation and more exhaustive suitability monitoring. The institutional platform relies on the manager of the institution to make suitability judgments, often allows for lower margin levels based on negotiated portfolio margining and similar arrangements, relies on counterparty documentation (e.g., ISDA standard, negotiated master agreements) and accommodates execution of extremely large orders and booking in a relatively small number of accounts.

[10] The structure, systems and supporting operations of foreign exchange platforms differ depending on the client base for which they are created. Specifically, platforms meant for trades placed by institutional clients and their advisers must accommodate large trades, but not necessarily a large volume of trades; whereas platforms intended for retail clients must accommodate a large volume of trades, each of which tend to be much smaller. Additionally, the number of accounts, i.e., the number of persons that execute trades on an institutional platform are significantly smaller than the number traded on a retail platform. Accordingly, moving institutional traders to a retail platform would result in these traders no longer receiving the type of investing experience or readily available pricing for execution of trades with the size that they require and are used to. Additionally, the systems as currently designed would not be able to accommodate a significant migration of traders from one platform to the other.

[11] Under Section 2(c)(2)(B) of the CEA, only enumerated types of regulated entities are allowed to trade OTC foreign exchange with non-ECPs. Swap dealers are not included in this list. Some swap dealers may be dually licensed as a bank or a broker-dealer who would be eligible to transact in OTC foreign exchange with retail investors as well as swaps with institutional investors. However, as an operational matter, it is not clear that firms will be able to and find it efficient to structure their business so that the retail foreign exchange platform is conducted from the same entity as the institutional swaps business. To the extent that the swaps and the retail foreign exchange businesses are conducted from different entities within a financial services group, it is likely that the financial services firms will not be able to net positions with the counterparty upon an insolvency of the counterparty. *See In re Lehman,* 2011 WL 4553015 (Bankr. S.D.N.Y. 2011); *In re SemCrude, LP,* 399 B.R. 388 (Bankr. D. Del. 2009), *aff'd* 428 B.R. 590 (D. Del. 2010).

ECP category. A Professional Non-ECP would be defined as an investor that does not satisfy the definition of ECP in the CEA because: (i) it is a commodity pool, as defined in Section 1a(10) of the CEA, that is unable to prove that all participants are themselves ECPs or (ii) it does not have sufficient assets or regulatory status to satisfy any of the ECP standards but it is a trust, foundation, corporation, limited liability corporation, partnership, or similar institutional entity or an account whose beneficial owner is an institution and is managed with discretion by a registered adviser[12] having assets under management in excess of $100 million (or such other amount as the Agencies deem appropriate). The definition would also require that the Professional Non-ECP not be formed for the purpose of avoiding the Retail FX Rules.

Once a Professional Non-ECP standard has been set, the GFXD recommends that the Agencies exempt transactions with such Professional Non-ECP investors from the Retail FX Rules or allow investors to opt out of the protections. For those Professional Non-ECPs that would be ECPs but for the Look-Through Rule, we believe that banks and bank branches should be able to elect to transact OTC foreign exchange with these entities under the same regime as they trade swaps. Given the substantial net worth, expertise and experience of Professional Non-ECPs and the sophistication and regulated status of their professional advisers, we believe it would be appropriate to allow for a more arms-length, less paternalistic means of regulating the conduct of foreign exchange activity with this group of investors. As the Agencies have recognized in other contexts, regulation should take account of the relative wealth, sophistication, experience and needs of investors as well as the access of investors to registered advisers.[13]

In the event that the Agencies elect not to exempt Professional Non-ECPs from all of the retail foreign exchange standards, the rules should, at a minimum: (i) allow investors a one-time opt out of required disclosures, such as those relating to whether retail accounts are profitable or not and those describing generic market risks of foreign exchange, (ii) provide for reduced margin levels and (iii) accommodate transaction execution flexibility so that investment manager counterparties are able to customize transactions or enter into transactions in a manner that enables execution at prices and sizes that they deem appropriate for their investors. We believe it is appropriate to regulate financial transactions with unsophisticated, individual retail investors differently from those conducted with large, sophisticated institutional investors of the type that would ordinarily satisfy the definition of Professional Non-ECP.

3. Ability for Individuals that are ECPs to Opt for Treatment as non-ECPs

An investor's status as an ECP may change periodically. In the context of individual investors in particular (including their investment vehicles and related family offices), it can be disruptive for a client to change the manner in which the individual transacts in foreign exchange as well as the entity with which it transacts.[14] In order to avoid this disruption, the GFXD requests

---

[12] Registered advisers would include any (i) investment adviser registered with the SEC or any U.S. state securities commission, (ii) commodity trading adviser or commodity pool operator regulated under the CEA, (iii) trust department of a bank that has been granted trust powers by the OCC or any U.S. state banking department or (iv) foreign person performing a similar role or function.

[13] *See, e.g.,* Board of Governors' Regulation E, providing protections relating to electric funds transfers with respect to the clients categorized as "consumers" (i.e., natural persons only) and limiting the ability of a financial institution to assess an overdraft fee for paying automated teller machine (ATM) withdrawals and one-time debit card transactions that overdraw a "consumer's" account.

[14] To the extent that an investor is an ECP, the proposed regulatory regime contemplates that it would transact in the OTC foreign exchange markets through swaps with regulated swap dealers. Swap dealers are not authorized under the

that individual investor clients that become ECPs be permitted to be treated by their banks as non-ECPs, subject to retail foreign exchange rules and regulations. Although the retail foreign exchange provisions provide non-ECPs with additional protections that are not required for ECPs, there is no regulatory reason why an individual investor who is or subsequently becomes an ECP should be denied the additional protections offered to retail clients because the client has subsequently, through increases in total assets, a change in market prices or other factors, becomes an ECP. Since individuals investors typically transact through a retail platform, even if they are high net worth, this rule would allow clients to book all of their holdings on a single platform or entity within the bank or branch.

4. Conclusion

Substantially all of the entities that the GFXD would define as Professional Non-ECPs currently transact in the OTC foreign exchange market through the institutional platforms of banks and foreign bank branches. It seems to us to be patently inappropriate to require institutional investors, many of which are represented by some of the most sophisticated money managers in the world, to receive disclosures designed to warn individuals about high pressure, highly leveraged trading schemes or to be given only price quotes that fall within a designated range. The GFXD believes that it is critical to the smooth operation of the global foreign exchange markets and necessary to maximize the benefits of close-out netting and aggregation of client assets within a single banking entity[15], and that these investors be allowed to continue to participate in the U.S. foreign exchange market as institutional investors, without the restrictions and burdens – appropriate for true retail clients but not necessary and potentially problematic for sophisticated clients -- that would be imposed by retail foreign exchange regulation. In order to address these concerns, the GFXD urges the Agencies to develop a Professional Non-ECP standard and exempt such investors from the operation of all or most of the Retail FX Rules or allow them to opt out of such Retail FX Rules.

In addition, the GFXD requests that the Agencies recognize and address in their Retail FX Rules the issue that occurs when an individual investor migrates from non-ECP status to ECP status. In that regard, we request that the Agencies adopt rules authorizing investors to opt into the retail foreign exchange regime if desired to avoid transferring accounts and transactions, mid-stream, because of a change in the value of the investor's total investments that would make them an ECP.

****

CEA to transact in OTC foreign exchange with Non-ECPs. Accordingly, as the regulatory framework is currently crafted, individual investors that migrate from Non-ECP to ECP status or vice versa must change the entity they transact with each time their total assets go above or fall below the $10 million line.

[15] As discussed above, treating institutional investors as retail will significantly increase market, credit, operational and systemic risk to the extent those institutional investors that are ECPs for other purposes are forced to trade OTC foreign exchange with a different entity than the one with which they trade swaps. This would eliminate the benefits of close-out netting. As a result, both the dealer entity and the institutional client will be exposed to heightened risk of loss in bankruptcy and operational inefficiencies due to the lack of consolidation of client assets, including the ease of making margin calls through inter-account transfers and payment netting.

We appreciate the opportunity to share our views on these issues. We would welcome an opportunity to meet with the staffs of the Agencies' individually or collectively to further discuss these matters. Please do not hesitate to contact me (+44 (0) 207 743 9319, jkemp@gfma.com), or Mandy Lam (212-313-1229, mlam@gfma.org) should you have any questions.

Yours sincerely,

James Kemp
Managing Director
Global Foreign Exchange Division

cc: Scott Holtz
Board of Governors Federal Reserve System

Enclosure

asset management group

September 15, 2011

Mr. David A. Stawick
Secretary
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, DC 20581

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

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)[1]

Dear Mr. Stawick and Ms. Murphy:

The Asset Management Group (the "**AMG**") of the Securities Industry and Financial Markets Association ("**SIFMA**") appreciates the opportunity to provide the Commodity Futures Trading Commission (the "**CFTC**") and the Securities and Exchange Commission (the "**SEC**" and, together, the "**Commissions**") with our comments on the Notice of Proposed Rulemaking (the "**NPR**") further defining, among other terms, the term "eligible contract participant" ("**ECP**") specifically with regard to the proposed application of the ECP definition in CFTC Rule 1.3 to commodity pools.

The AMG's members represent U.S. asset management firms whose combined assets under management exceed $20 trillion. The clients of AMG member firms include, among others, registered investment companies, state and local government pension funds, universities, 401(k) or similar types of retirement funds, and private funds such as hedge funds and private equity funds. In their role as asset managers, AMG member firms, on behalf of their clients, may engage in transactions that will be classified as swaps under Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("**Dodd-Frank**") and transactions to which the Commissions' proposed ECP definition would apply.

The AMG respectfully submits that clause (5) of proposed Rule 1.3(m), if adopted, would prove not only burdensome, but would also cause undue harm and be unworkable, in large part, because of the informational requirements that must be obtained from 2nd, 3rd and 4th (*etc.*) tier investing funds with whom a transacting commodity pool and its counterparty have no relationship. Additionally, clause (6) of proposed Rule 1.3(m), if adopted, would cause undue

[1] 75 Fed. Reg. 80174 (Dec. 21, 2010) ("Joint Definitions Proposal").

harm by limiting the ability of certain commodity pools to engage in over-the-counter swap transactions in circumstances where there is no evidence that Congress intended such a limitation and no empirical evidence of abuses necessitating such limitations. The significance of this result is accentuated by the large numbers of collective investment vehicles that utilize over-the-counter foreign exchange ("**Fx**") transactions for incidental investment purposes. The AMG further submits that the Commissions' proposed approach is not necessary to achieve the investor protection objectives of Dodd-Frank, particularly in circumstances where the relevant transactions would, but for the Commissions' proposed rules, be subject to, and conducted in accordance with, Dodd-Frank's regulatory framework for swaps.

BACKGROUND

Sections 2(c)(2)(B) and 2(c)(2)(C) of the Commodity Exchange Act ("**CEA**") provide the CFTC with jurisdiction over certain over-the-counter Fx transactions entered into by non-ECPs ("**covered Fx transactions**"). Sections 741(b)(8) and (b)(9) of Dodd-Frank amended these provisions of the CEA to provide that the "Act applies to, and the Commission [CFTC] shall have jurisdiction over, an account or pooled investment vehicle that is offered for the purpose of trading, or that trades, any agreement, contract, or transaction in foreign currency described in clause (i)." Simultaneously, Section 741(b)(10) of Dodd-Frank created an exception to the commodity pool prong of the ECP definition codified in CEA Section 1a(18)(A)(iv) ("**clause (A)(iv)**") with respect to covered Fx transactions, which provides that "for purposes of section 2(c)(2)(B)(vi) and section 2(c)(2)(C)(vii), the term 'eligible contract participant' shall not include a commodity pool in which any participant is not otherwise an eligible contract participant". The result is that any commodity pool with non-ECP investors will be subject to the statutory and regulatory retail Fx requirements, unless it qualifies as an ECP under another prong of the ECP definition (*i.e.*, other than under clause (A)(iv)).

In the Joint Definitions Proposal, the Commissions propose to expand the exception from the ECP definition beyond that adopted by Congress to include commodity pools whose investors have direct or indirect non-ECP participants. The Commissions, in articulating how they propose to approach commodity pools with non-ECP investors, state:

> Because commodity pools can be structured in various ways and can have one or more feeder funds and/or pools, many with their own participants, the Commissions propose to preclude a Retail Forex Pool from being an ECP pursuant to clause (A)(iv) of the ECP definition if there is a non-ECP participant at any investment level (e.g., a participant in the pool itself (a direct participant), an investor or participant in a fund or pool that invests in the pool in question (an indirect participant), an investor or participant in a fund or pool that invests in that investor fund or pool (also an indirect participant), etc.).[2]

As a result, a commodity pool engaging in covered Fx transactions that is itself an ECP for all other purposes under the CEA and CFTC regulations would cease to be an ECP if it has a single

[2] Joint Definitions Proposal, supra note 1, at 80185.

non-ECP investor. If that fund, in turn, invested in another fund that was otherwise an ECP, that investee fund would also cease to be an ECP, ad infinitum.[3]

With respect to covered Fx transactions specifically, the text of the NPR indicates that the Commissions would restrict clause (A)(v) of the ECP definition "to preclude a Retail Forex Pool with one or more direct or indirect non-ECP participants from qualifying as an ECP by relying on clause (A)(v) of the ECP definition if such Retail Forex Pool is not an ECP due to the language added to clause (A)(iv) of the ECP definition by section 741(b)(10) of the Dodd-Frank Act (*i.e.*, because the pool contains one or more non-ECP participants)."[4] However, the proposed text of Rule 1.3(m)(5) is not precise in codifying this intent.

The Commissions also propose to exclude a commodity pool that would be a non-ECP pursuant to clause (A)(iv) from qualification as an ECP under CEA Section 1a(18)(A)(v) ("**clause (A)(v)**"). In order to qualify as an ECP under clause (A)(iv), a commodity pool would be required to (i) have total assets exceeding $5,000,000 and (ii) be formed and operated by a person subject to regulation under the CEA or a foreign equivalent and have only ECP investors. In contrast, any business organization or other entity, whether or not a commodity pool, may qualify as an ECP under clause (A)(v) if it (i) has total assets exceeding $10,000,000[5] or (ii) has a net worth exceeding $1,000,000 and enters into the transaction in connection with the conduct of its business or to manage the risk associated with an asset or liability owned or incurred or reasonably likely to be owned or incurred by the entity in the conduct of its business.

Proposed Rule 1.3(m)(6) provides that a commodity pool that does not have assets exceeding $5,000,000 or is not operated by a person subject to regulation under the CEA or a foreign equivalent would not qualify as an ECP pursuant to clause (A)(v). Notably, this limitation on a commodity pool's ability to qualify as an ECP under clause (A)(v) would apply for all purposes and not merely for the purposes of covered Fx transactions.

DISCUSSION

1. Proposed Rule 1.3(m)(5)–Analysis

Dodd-Frank limits ECPs under clause (A)(iv) (for purposes of covered Fx transactions) to commodity pools that have only ECP investors, unless such pools qualify under another prong of the ECP definition, such as the prong for plans subject to the Employee Retirement Income and Security Act of 1974 ("**ERISA**") or SEC-registered investment companies, among others.[6] However, in contrast to the Commissions' proposed ECP definitional amendments, Dodd-Frank

[3] See CFTC Rule 1.3(m)(5). We refer herein to this as the "**ECP Look-through.**"

[4] Joint Definitions Proposal, supra note 1, at 80185. This would prevent even a commodity pool with assets exceeding $10,000,000 from relying on CEA 1a(18)(A)(v) to qualify as an ECP for purposes of covered Fx transactions if it has direct or indirect non-ECP investors.

[5] An entity would also qualify as an ECP under this prong if its obligations are guaranteed—under an agreement or contract—by an entity that is an ECP.

[6] As the Commissions recognize, under the ECP definition as codified, a person that fails to qualify under one prong of the ECP definition may nonetheless qualify under another prong of the definition.

only requires that the ECP status of a transacting commodity pool be determined by the ECP status of its direct investors, and not by reference to the ECP status of every commodity pool or fund indirectly investing in the transacting commodity pool.

We are sympathetic to the Commission's implicit objective: to ensure that a person that would not qualify as an ECP is not permitted to accomplish indirectly what it is not permitted to do directly. However, apart from statutory provisions authorizing the Commissions to address evasion, we see no evidence in Dodd-Frank or its legislative history that Congress intended or authorized the Commissions to expand the limitations on clause (A)(iv) commodity pool ECPs in the manner they have proposed to adopt under the NPR.

The prevention of evasion does not require the expansive limitations proposed by the Commissions through application of the ECP Look-through. We acknowledge that, in order to prevent evasion, some form of the ECP Look-through would be appropriate in cases where circumvention could otherwise occur. However, we do not believe that any such Look-through would be necessary or appropriate unless both the transacting pool and the investing pool are formed for the purpose of providing retail investor access to covered Fx transactions.

On a practical level, the additional burdens that commodity pools—and, indirectly, their investors—would face with respect to covered Fx transactions could cause undue harm. As described in the cost-benefit discussion of the NPR, the Commissions are of the view that the proposed ECP definition would "impose virtually no costs" but would provide "greater certainty".[7] We believe the Commissions are misguided in reaching both of these conclusions and do not fully appreciate the practical challenges that are presented by the Joint Definitions Proposal.

An unrestricted application of the ECP Look-through would not only be operationally burdensome, but, as a practical matter, unworkable. Very few, if any, pools have the ability to identify the status of every investor in each of the funds that invests in it, directly or indirectly, particularly funds with whom it has no direct relationship. No pool currently in existence has the subscription documentation and monitoring capability that would enable it to make the requisite determinations or to ensure that the fund meets the required investor qualifications. Moreover, ongoing, real-time monitoring would be required at all investment levels as funds take on new investors or as old investors withdraw or cease to qualify as ECPs. This would require systems and processes that funds do not currently have in place and that would be difficult, time consuming and expensive to implement.

Requiring pools to take the steps necessary to comply with the proposed unrestricted ECP Look-through would not only inject considerable uncertainty into a process that currently benefits from clarity, but would also create significant operational and compliance costs to the extent compliance with the requirement could be accomplished prospectively. This problem is compounded by the fact that contracting parties must know whether the covered Fx transaction regime is applicable to a transaction, as the rules applicable to that regime vary significantly from the swap rules. If a fund incorrectly assumes that an Fx transaction is governed by the

---

[7] Joint Definitions Proposal, supra note 1, at 80203.

covered Fx transaction regime (or by the swap rules), non-compliance and potentially significant liabilities could result.

Finally, the potential costs of the Commissions' proposed ECP Look-through are not limited to the operational costs of determining the status of all investors at each level of investment and having systems in place to monitor that status on an ongoing basis. Transactions between commodity pools that either have indirect non-ECP investors or cannot determine that they do not have such investors and entities that are not permitted to conduct covered Fx transactions (*e.g*., certain foreign affiliates of U.S. banks, broker-dealers or FCMs) would likely have to be re-booked, often at a substantial cost. Funds that would not qualify as ECPs or face uncertainty with respect to their status may choose not to engage in covered Fx transactions for hedging purposes, resulting in greater risk to funds and their investors, including funds and investors who may wish to engage in covered Fx transactions other than for purely speculative purposes.

Funds may be deterred from transacting under the covered Fx transaction regime as a result of concerns regarding capital requirements that differ from the institutional over-the-counter Fx market, less liquidity than exists in the institutional over-the-counter Fx market, and concerns that a change in investor status may require future Fx transactions to be executed with other counterparties, necessitating the potentially time-consuming and costly rebooking of transactions (where that can be arranged).

Given these considerations, we believe that Dodd-Frank's policy objectives are not furthered by a blanket and unrestricted application of the Commissions' proposed ECP Look-through and that the Commissions should not go further in their rulemaking than is necessary to faithfully implement the changes made by Congress to clause (A)(iv), or, at the very most, to prevent evasion.

2. Proposed Rule 1.3(m)(5)–Recommendations

Indirect Non-ECP Investors

Based on the foregoing considerations, we urge the Commissions to modify and clarify proposed Rule 1.3(m)(5) in certain respects. First and foremost, we believe that the proposed Rule 1.3(m)(5) changes should apply solely to the Congressional language added to clause (A)(iv) under Dodd-Frank. Going beyond this exceeds the Congressional intent underlying Section 741(b)(10) of Dodd-Frank and implies that Congress was not cognizant of the other clauses of the ECP definition. There is no evidence to support such a conclusion.

If, however, the Commissions determine that applying Rule 1.3(m)(5) solely to the clause (A)(iv) changes is not sufficient to address potential evasion concerns, they should apply Rule 1.3(m)(5) in a manner that is not unduly expansive and burdensome. In such case, we recommend that the Commissions modify Rule 1.3(m)(5) to clarify that (i) a commodity pool with non-ECP investors is only ineligible as an ECP (for purposes of covered Fx transactions) under clauses (A)(iv) and (A)(v)(III) of the ECP definition, and not under any other prong of the ECP definition for which it may otherwise be eligible; and (ii) the ECP status of indirect investors in a commodity pool is only required in circumstances where (a) the direct investor

does not qualify as an ECP under another prong of the ECP definition (other than clause (A)(iv)) or (b) the transacting pool is formed for the specific purpose of entering into covered Fx transactions.

Non-commodity pool investors. We note that, as drafted, proposed Rule 1.3(m)(5) goes further than Congress provided or intended under clause (A)(iv) in another respect. Specifically, the ECP Look-through is not drafted in a manner that would be limited to indirect investors in commodity pools that invest in the transacting commodity pool. Instead, the Joint Definitions Proposal purports to extend the ECP Look-through to any indirect investors. Ultimately, every corporation, plan, trust or collective investment vehicle has direct or indirect natural person investors who will not be ECPs. Virtually every fund could be captured as a result.

We do not believe it would be logical for the Commissions to take the position that Congress would expressly permit a corporation, investment company or ERISA plan to qualify as an ECP regardless of the fact that its investors include non-ECPs, but look through that corporation, investment company or ERISA plan to its non-ECP investors for the purpose of determining whether a commodity pool in which it is invested qualifies as an ECP. We assume that the Commissions did not intend this result. Accordingly, we recommend that, to the extent the ECP Look-through is applicable, it would only look to those indirect investors who invest in commodity pools (other than commodity pools that qualify as ECPs under a prong of the ECP definition other than clause (A)(iv)).

Formed for the specific purpose of entering into covered Fx transactions. In order to implement the concept of "formed for the specific purpose of entering into covered Fx transactions" in a manner that provides the necessary certainty for affected parties under clauses (A)(iv) and (A)(v)(III), we recommend that the Commissions adopt a safe harbor outlining those non-exclusive circumstances in which a commodity pool would be deemed not to have been formed for the purpose of entering into covered Fx transactions.[8] We recommend that the safe harbor include, at least, the following circumstances:

1. Less than 25% of the equity capital contributed to the fund is contributed by non-ECPs;[9] or

2. The fund engages in covered Fx transactions solely for hedging or risk management purposes or to extinguish or offset an existing covered Fx transaction or other Fx exposures; or

3. The fund engages in covered Fx transactions (other than for hedging or risk management purposes or to extinguish or offset an existing covered Fx transaction or other Fx exposure):

[8] In the case of a fund whose circumstances are not enumerated in the safe harbor, interested persons could seek confirmation from the CFTC that the relevant fund is not formed for the purpose of entering into covered Fx transactions.

[9] We note that this prong would be consistent with the application of ERISA to Investment Funds. Subject to certain exceptions, an Investment Fund becomes subject to ERISA in circumstances where 25 percent or more of any class of equity securities of the Fund is held by benefit plan investors. See 29 C.F.R. § 2510.3-101(f).

- solely for portfolio diversification purposes as part of an asset allocation strategy; and

- no more than 25% of the fund's aggregate notional investment exposure is to covered Fx transactions.

Transition Relief

We also recommend that the Commissions adopt a transition rule that would grandfather commodity pools in existence prior to the adoption of final rules. We believe such a transition rule would be critical because existing funds have not captured information regarding the ECP status of their investors, although they have in many cases obtained information regarding the qualified eligible participant, accredited investor and/or qualified purchaser status of their investors. As a result, many funds have not drafted transfer restrictions or monitoring provisions that address ECP status and may not have the contractual right to retrospectively expand transfer restrictions applicable to fund investors. Based on these concerns, we recommend that the Commissions adopt a transition rule for any commodity pool in existence prior to the effective date of the Commissions' implementing rules that would grandfather such commodity pools as ECPs in connection with covered Fx transactions in circumstances where each direct investor in the pool is an eligible contract participant, a qualified eligible participant, accredited investor or qualified purchaser under applicable SEC and/or CFTC rules.

In the event that the Commissions regard such relief as overly broad, we urge the Commissions to consider further limiting the transitional relief to commodity pools that, in addition to satisfying these criteria, also satisfy the criteria enumerated in either of clause (2) or clause (3) in the preceding sub-section entitled "*Formed for the specific purpose of entering into covered Fx transactions*."

Such an exemption would contribute significantly in mitigating the increased costs and risks to pools and investors described above in the sub-section entitled "**Proposed Rule 1.3(m)(5)–Analysis**."

Conditional Exemptive Relief

We also recommend that the CFTC use its exemptive authority to exclude from CEA Sections 2(c)(2)(B) and (C) any transaction by a commodity pool that would be an ECP but for the ECP Look-through in circumstances where (i) the pool satisfies either of the criteria enumerated in clause (2) or clause (3) in the preceding sub-section entitled "*Formed for the specific purpose of entering into covered Fx transactions*" and (ii) the transaction is conducted by the contracting parties in compliance with all rules that would be applicable to a swap transaction and the counterparty is a swap dealer registered with the CFTC. Such a step would facilitate legal certainty while ensuring that transactions remain subject to regulation.

Although we have located no legislative history directly on point, we believe such an exemption would be appropriate because Congress likely made the changes to clause (A)(iv) to ensure that investors do not lose the protections of CEA Sections 2(c)(2)(B) and 2(c)(2)(C) as a result of participating in the covered Fx transaction market through a commodity pool, rather

than because it was expressing a preference for the covered Fx transaction rules over the more comprehensive swap rules.

Reliance on Representations

Finally, as noted above, we recommend that the Commission clarify, consistent with prevailing financial market practice, that the operator or manager of, or counterparty to,[10] a commodity pool may reasonably rely on the representations of commodity pool investors regarding their status as ECPs.

3. Proposed Rule 1.3(m)(6)–Analysis

Under proposed Rule 1.3(m)(6), the Commissions would limit the eligibility of commodity pools under clause (A)(v) of the ECP definition so as to exclude any commodity pool that does not qualify as an ECP under clause (A)(iv) as a result of the failure to satisfy both the $5 million net asset test and regulated person requirements. We understand the Commissions' concern that, as drafted, certain commodity pools that would not qualify under clause (A)(iv) could qualify under clause (A)(v) and, in particular, clause (A)(v)(III), without any additional mitigating considerations.

At the same time, we note that Congress did not amend the statute to prevent commodity pools from qualifying as ECPs under clause (A)(v) (and evidenced no intent to do so) and we are not aware of problems that have arisen from commodity pool reliance on clause (A)(v) generally or clause (A)(v)(III), in particular, of the ECP definition.[11] Even though the quantitative standard in clause (A)(v)(III) is lower than that in clauses (A)(iv) and (A)(v)(I), it is not surprising that commodity pool reliance on clause (A)(v)(III) has not given rise to problems in light of clause (A)(v)(III)'s line of business/risk management requirement. As a result, we do not believe that the modifications contemplated by proposed Rule 1.3(m)(6) are warranted, particularly in light of the changes in proposed Rule 1.3(m)(5).

If the Commissions nonetheless determine to impose further limitations under clause (A)(v) with respect to commodity pools, the Commissions should take steps to avoid an unduly broad limitation and adopt a narrower exclusion that would apply only to ECP status for purposes of the covered Fx regime and that would only apply to part (III) of clause (A)(v) under the circumstances set forth below.

4. Proposed Rule 1.3(m)(6)–Recommendations

We recommend that the Commissions withdraw proposed Rule 1.3(m)(6). In the event that the Commissions do not withdraw proposed Rule 1.3(m)(6) as we have recommended, we

[10] Counterparties proposing to enter into transactions with commodity pools would have particular difficulty determining whether a commodity pool must be treated as a retail investor, making it all the more critical that they be permitted to rely on their counterparty's representations as to its ECP status.

[11] The fact that Congress did not amend clause (A)(v) is particularly strong evidence that it did not intend to prevent commodity pools from relying on this prong of the ECP definition, since the Dodd-Frank amendments to clause (A)(iv) relate only to covered Fx transactions.

suggest that the Commissions modify proposed rule 1.3(m)(6) so that (i) it only applies to ECP status with respect to CEA Sections 2(c)(2)(B) and (C), and (ii) it would only apply to a commodity pool that does not satisfy one or more of the following criteria:

1. The commodity pool is a private investment fund (including any fund satisfying the requirements of Investment Company Act of 1940 Rules 3(c)(1), (7) or (11)) whose transactions are effected under the management of an SEC-registered investment adviser, CFTC-registered commodity trading advisor or bank as defined in Section 202(a)(2) of the Investment Advisers Act of 1940; or

2. The commodity pool satisfies part (I) or (II) of clause (A)(v) (*i.e*., is a business organization or other entity that has total assets exceeding $10,000,000 or has its obligations guaranteed under contract, letter of credit or other agreement by an entity with total assets greater than $10,000,000 or that qualifies as an ECP under another prong of the definition); or

3. The commodity pool is excluded from the definition of commodity pool under CFTC Rule 4.5, or its "operator" is eligible for exemption from commodity pool operator registration under CFTC Rule 4.5 or CFTC Rule 4.13.

Additionally, consistent with the ECP definition itself and our comments above with respect to proposed Rule 1.3(m)(5), and for the avoidance of any uncertainty or confusion arising from the Commissions' actions, the Commissions should clarify that a commodity pool that does not satisfy the requirements of clause (A)(iv) or (A)(v) (for any reason), but that does satisfy the requirements of any other prong of the ECP definition would continue to qualify, as it does currently, as an ECP for all purposes.

CONCLUSION

We believe the clarifications and modifications recommended above appropriately balance Congressional intent as evidenced in the statutory ECP definition and the Commissions' legitimate interests in preventing circumvention of fundamental protections contemplated by Congress. We believe these recommendations will provide appropriate protections, where needed, for market participants in need of such protections, while at the same time promoting a cost-effective regulatory framework that will not unduly burden market participants.

* * *

The AMG thanks the Commissions for the opportunity to comment on the Joint Definitions Proposal and for the Commissions' consideration of the AMG's views. The AMG would welcome the opportunity to further discuss our comments with you. Should you have any questions, please do not hesitate to call the undersigned at 212-313-1389.

Sincerely,

Timothy W. Cameron, Esq.
Managing Director, Asset Management Group
Securities Industry and Financial Markets Association