

Please note that the comments expressed herein are solely my personal views

Board of Governors of the Federal Reserve System
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Chris Barnard

13 August 2011

- Docket No. R-1428
- Retail Foreign Exchange Transactions (Regulation NN)

Dear Jennifer Johnson.

Thank you for giving us the opportunity to comment on your notice of proposed rulemaking: Retail Foreign Exchange Transactions (Regulation NN).

The Board of Governors of the Federal Reserve System (Board) is publishing for comment a regulation to permit banking organizations under its supervision to engage in off-exchange transactions in foreign currency with retail customers. The proposed rule also describes various requirements with which banking organizations must comply to conduct such transactions.

I broadly support your proposed rules. I would like to comment on some specific issues, which could be improved in order to optimise the rulemaking.

Prohibited transactions

Proposed § 240.3 prohibits fraud, knowingly making false statements and knowingly deceiving or attempting to deceive any person. Proposed § 240.3(a) states that:

- (a) *Fraudulent conduct prohibited.* No banking institution or its related persons may, directly or indirectly, in or in connection with any retail forex transaction:
- (1) Defraud or attempt to defraud any person;
 - (2) Knowingly make or cause to be made to any person any false report or statement or cause to be entered for any person any false record; or
 - (3) Knowingly deceive or attempt to deceive any person by any means whatsoever.

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Although this is not unreasonable in principle, it does not provide a strong enough level of investor protection for relatively unsophisticated retail customers and investors. I would rather recommend that you should change the wording from “defraud” to “cheat or defraud” in proposed § 240.3(a)(1). This would in addition more clearly cover manipulative and deceptive behaviour, rather than just fraud. I would also recommend that you should replace “knowingly” with “willfully” in proposed §§ 240.3(a)(2) and (3). I believe that “willfully” more appropriately includes reckless behaviour, compared with “knowingly”, which suggests an element of scienter and a stronger burden of proof. These changes would also help to improve regulatory consistency in this particular arena.

Disclosure

Proposed § 240.6 covers the various disclosure requirements. Proposed §240.6(e)(1) requires disclosure of the “profitable accounts ratio”. Whilst I appreciate your arguments and intention here, this ratio will not necessarily provide meaningful information to retail customers and investors. It is manipulable and intransparent, and may confuse or even deceive existing and potential retail customers and investors. As a minimum I would recommend that you should propose an objective and uniform calculation methodology for the “profitable accounts ratio”. Additionally, I would strongly recommend that you should require the calculation thereon to be weighted by the amount of profits or losses, rather than just the number of profitable accounts, as this would then disclose the actual accounts profitability, rather than just the chance of making any profit, however small.

Proposed § 240.6(f) requires the disclosure of fees and other charges. Please would you confirm whether such “fee, charge, or commission”¹ should also include any spreads in the banking organization’s prices over actual market prices?² For completeness I believe that it should, and that this wording should be changed to “fee, charge, spread, or commission”. Secondly, would you confirm whether this should also cover interest income on the retail forex account or retail forex transaction?

I answer to your specific question II.6.3, I would argue that banking institutions should not be allowed to combine the retail forex risk disclosure with other disclosures that banking institutions make to their customers, as combining disclosures would definitely diminish the impact of the retail forex disclosure.

As a passing comment I find it remarkable that any retail customers would undertake off-exchange transactions in foreign currency with banking organizations, when the Risk Disclosure Statement³ contains such wording as: “Your banking institution may offer any prices it wishes” and “your banking institution is your trading counterparty and has conflicting interests.”

¹ See proposed §240.6(f)(1).

² E.g. actual market prices could be official exchange rates, quoted rates in a deep and liquid market, best available price or some other widely accepted measure. In many cases, the spread over this price is the largest source of profit.

³ See proposed § 240.6(d).

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Recordkeeping

Proposed § 240.7 establishes the recordkeeping requirements. I would recommend that records should be required to be kept indefinitely rather than for the “at least five years”⁴ proposed here. Original documents should be scanned after five years. There is really no technological or practical reason for limiting the retention period, and it would be useful to keep this information for future analytical and investigative purposes.

Yours sincerely

Chris Barnard

⁴ See proposed § 240.7(h).