



**TESTIMONY OF DANIEL J. ROTH
PRESIDENT AND CHIEF EXECUTIVE OFFICER
NATIONAL FUTURES ASSOCIATION**

**BEFORE THE SUBCOMMITTEE
ON GENERAL FARM COMMODITIES AND RISK MANAGEMENT
COMMITTEE ON AGRICULTURE
U.S. HOUSE OF REPRESENTATIVES**

JUNE 4, 2009

My name is Daniel Roth, and I am President and Chief Executive Officer of National Futures Association. Thank you Chairman Boswell and members of the Subcommittee for this opportunity to appear here today to present our views on closing a regulatory gap that allows fraudsters to sell unregulated OTC derivatives to retail customers.

Since 1982, NFA has been the industry-wide self-regulatory organization for the U.S. futures industry, and in 2002 it extended its regulatory programs to include retail over-the-counter forex contracts. NFA is first and foremost a customer protection organization, and we take our mission very seriously.

Congress is currently expending significant time and resources to deal with systemic risk and to create greater transparency in the OTC derivatives markets. Those are important economic issues, and we support Congress' efforts to address them. Understandably, most of the debate centers around instruments offered to and traded by large, sophisticated institutions. However, there is a burgeoning OTC derivatives market aimed at unsophisticated retail customers, who are being victimized in a completely unregulated environment.

For years, retail customers that invested in futures had all of the regulatory protections of the Commodity Exchange Act. Their trades were executed on transparent exchanges and cleared by centralized clearing organizations, their brokers had to meet the fitness standards set forth in the Act, and their brokers were regulated by the CFTC and NFA. Today, for too many customers, none of those protections apply. A number of bad court decisions have created loopholes a mile wide, and retail customers are on their own in unregulated, non-transparent OTC futures-type markets.

The main problem stems from a Seventh Circuit Court of Appeals decision in a forex fraud case brought by the CFTC. In the *Zelener* case, the District court found that retail customers had, in fact, been defrauded but that the CFTC had no jurisdiction because the contracts at issue were not futures, and the Seventh Circuit affirmed that

decision. The “rolling spot” contracts in *Zelener* were marketed to retail customers for purposes of speculation; they were sold on margin; they were routinely rolled over and over and held for long periods of time; and they were regularly offset so that delivery rarely, if ever, occurred. In *Zelener*, though, the Seventh Circuit ignored these characteristics and based its decision on the terms of the written contract between the dealer and its customers. Because the written contract in *Zelener* did not include a guaranteed right of offset, the Seventh Circuit ruled that the contracts at issue were not futures. As a result, the CFTC was unable to stop the fraud.

Zelener created the distinct possibility that, through clever draftsmanship, completely unregulated firms and individuals could sell retail customers forex contracts that looked like futures, acted like futures, and were sold like futures and could do so outside the CFTC’s jurisdiction. For a short period of time, *Zelener* was just a single case addressing this issue. Since 2004, however, various Courts have continued to follow the Seventh Circuit’s approach in *Zelener*, which caused the CFTC to lose enforcement cases relating to forex fraud.

A year ago, Congress closed the loophole for forex contracts. Unfortunately, the rationale of the *Zelener* decision is not limited to foreign currency products. Customers trading other commodities—such as gold and silver—are still stuck in an unregulated mine field. It’s time to restore regulatory protections to all retail customers.

In testimony before this Subcommittee in 2007, I predicted that if Congress plugged the *Zelener* loophole for forex but left it open for other products, the fraudsters would simply move to *Zelener*-type contracts in other commodities. That’s just what has happened. We cannot give you exact numbers, of course, because these firms are not registered. Nobody knows how widespread the fraud is, but we are aware of dozens of firms that offer *Zelener* contracts in metals or energy. Recently, we received a call from a man who had lost over \$600,000, substantially all of his savings, investing with one of these firms. We have seen a sharp increase in customer complaints and mounting customer losses involving these products since Congress closed the loophole for forex.

NFA and the exchanges have previously proposed a fix that would close the *Zelener* loophole for these non-forex products. Our proposal codifies the approach the Ninth Circuit took in *CFTC v. Co-Petro*, which was the accepted and workable state of the law until *Zelener*. In particular, our approach would create a statutory presumption that leveraged or margined transactions offered to retail customers are futures contracts unless delivery is made within seven days or the retail customer has a commercial use for the commodity. This presumption is flexible and could be overcome by showing that delivery actually occurred or that the transactions were not primarily marketed to retail customers or were not marketed to those customers as a way to speculate on price movements in the underlying commodity.

This statutory presumption would not affect the interbank currency market dominated by institutional players, nor would it affect regulated instruments like securities and banking products. It would also not apply to those retail forex contracts that are already covered (or exempt) under Section 2(c). It would, however, effectively prohibit leveraged non-forex OTC contracts with retail customers when those contracts are used for price speculation and do not result in delivery.

I should note that NFA's proposal does not invalidate the 1985 interpretive letter issued by the CFTC's Office of General Counsel, which Monex International and similar entities rely on when selling gold and silver to their customers. That letter responded to a factual situation where the dealer purchased the physical metals from an unaffiliated bank for the full purchase price and left the metals in the bank's vault. The dealer then turned around and sold the gold or silver to a customer, who financed the purchase by borrowing money from the bank. Within two to seven days the dealer received the full purchase price and the customer received title to the metals. In these circumstances the metals were actually delivered within seven days, so the transactions would not be futures contracts under NFA's proposal.

In conclusion, while NFA supports Congress' efforts to deal with systemic risk and create greater transparency in the OTC markets, Congress should not lose sight of the very real threat to retail customers participating in another segment of these markets. This Subcommittee can play a leading role in protecting customers from the unregulated boiler rooms that are currently taking advantage of the *Zelner* loophole for metals and energy products. We look forward to further reviewing our proposal with Subcommittee members and staff and working with you in this important endeavor.

DANIEL J. ROTH

Daniel J. Roth is President and Chief Executive Officer of National Futures Association (NFA), the premier independent provider of innovative and efficient regulatory programs that safeguard the integrity of the derivatives market. Mr. Roth joined NFA in September 1983 as an Attorney and has held a number of positions with increasing responsibilities, including General Counsel, Executive Vice President and Chief Operating Officer. His tenure as President and CEO began on January 1, 2003.

During the past 26 years at NFA, Mr. Roth has led the organization on major rulemaking and enforcement initiatives, including strengthened anti-fraud rules, that have led to a dramatic drop in customer complaints in the U.S. futures industry. He has developed strong working relationships with international regulators, law enforcement agencies and members of the congressional committees that legislate the financial services industry.

Prior to coming to NFA, Mr. Roth served as Assistant State's Attorney in the Cook County State's Attorney's Office where he was a member of the Official Misconduct Task Force of the Special Prosecutions Bureau. Prior to that, Mr. Roth was an Associate Attorney in general litigation with the law firm of Sidley & Austin.

Mr. Roth holds a law degree from Loyola School of Law and earned his Bachelor of Arts degree in Communication Arts from the University of Notre Dame. He has served as an adjunct professor at the Loyola School of Law and has authored numerous articles for futures industry publications.

Committee on Agriculture
U.S. House of Representatives
Required Witness Disclosure Form

House Rules* require nongovernmental witnesses to disclose the amount and source of Federal grants received since October 1, 2004.

Name: Daniel J. Roth

Address: 300 S. Riverside Plaza, Suite 1800

Telephone: 312-781-1390

Organization you represent (if any): National Futures Association

1. Please list any federal grants or contracts (including subgrants and subcontracts) you have received since October 1, 2004, as well as the source and the amount of each grant or contract. House Rules do NOT require disclosure of federal payments to individuals, such as Social Security or Medicare benefits, farm program payments, or assistance to agricultural producers:

Source: None Amount: \$0

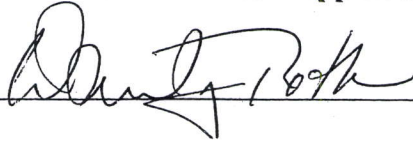
Source: _____ Amount: _____

2. If you are appearing on behalf of an organization, please list any federal grants or contracts (including subgrants and subcontracts) the organization has received since October 1, 2004, as well as the source and the amount of each grant or contract:

Source: None (see statement below) Amount: \$0

Source: _____ Amount: _____

Please check here if this form is NOT applicable to you: _____

Signature: 

* Rule XI, clause 2(g)(4) of the U.S. House of Representatives provides: *Each committee shall, to the greatest extent practicable, require witnesses who appear before it to submit in advance written statements of proposed testimony and to limit their initial presentations to the committee to brief summaries thereof. In the case of a witness appearing in a nongovernmental capacity, a written statement of proposed testimony shall include a curriculum vitae and a disclosure of the amount and source (by agency and program) of each Federal grant (or subgrant thereof) or contract (or subcontract thereof) received during the current fiscal year or either of the two previous fiscal years by the witness or by any entity represented by the witness.*

National Futures Association (NFA) is the congressionally authorized self-regulatory organization for the futures industry. NFA performs certain of its regulatory services, for example the registration of industry professionals, on behalf of the CFTC. NFA's funding, however, is provided entirely by the futures industry and NFA has never received any form of compensation from any governmental entity.