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Via E-Mail: [submissions@cftc.gov](mailto:submissions@cftc.gov)

Mr. David Stawick  
Secretary of the Commission  
Office of the Secretariat  
Commodity Futures Trading Commission  
3 Lafayette Centre  
1155 21<sup>st</sup> Street, N.W.  
Washington D.C. 20581

**RE: Self-Certification Rule Amendments: Nadex Amends its Real-time Account Funding Level from \$250 to \$500 -Submission Pursuant to Commission Regulation §40.6(a)**

Dear Mr. Stawick:

Pursuant to Section 5c(c)(1) of the Commodity Exchange Act, as amended (“Act”), and section §40.6(a) of the regulations promulgated by the Commodity Futures Trading Commission (the “Commission”) under the Act (the “Regulations”), North American Derivatives Exchange, Inc. (“Nadex”, the “Exchange”) hereby submits to the Commission its intent to amend its Real-time Account Funding Program (“RTAF”) to increase the amount of funds immediately available for trading upon a member’s first deposit from \$250 to \$500. This increase would be effective for the start of business on November 7, 2012.

### **Background**

Pursuant to its Order of Registration as a Derivatives Clearing Organization, Nadex (formerly HedgeStreet, Inc.)

“shall limit its activity as a registered DCO to clearing fully collateralized, cash-settled, futures and options contracts listed for trading on the contract market Nadex. In this regard, Nadex’s contracts will be considered to be ‘fully collateralized’ if Nadex holds, at all times, sufficient funds of each Nadex

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Member to cover the maximum possible loss that may be sustained by such Member upon liquidation of any or all Nadex contracts to which such Member or customer of such Member is a party...”.

In other words, Nadex must hold, at all times, 100% of the necessary collateral to cover the maximum potential loss of all members prior to execution of the trade. Nadex performs a “cap-check” at the time a member submits an order to the exchange, and will only accept the order if sufficient funds exist in that member’s account to fully collateralize the order, if filled. Additionally, Nadex maintains a cushion of excess funds in its customer segregated account to ensure that the positions on the Exchange are, at all times, fully collateralized.

The RTAF Program was first implemented in 2005 by the Exchange – then known as HedgeStreet, Inc. – in order to provide its members who had recently funded their accounts access to a certain amount of those funds in order to begin trading immediately. The stated intent of providing immediate access to a portion of the member’s funds was to promote liquidity and orderliness on the market, while still abiding by its obligation of full collateralization in accordance with its Order of registration as a DCO. At that time, members who had recently funded their accounts could have immediate access to funds up to \$100, depending on the amount of their deposit. On February 1, 2007, HedgeStreet increased the initial amount of RTAF to \$250 for a new member (“initial RTAF”) and to \$1,000 for existing members in good standing (“maximum RTAF”). A member was deemed to be “in good standing” for purposes of RTAF and, accordingly, was entitled to the maximum RTAF level of \$1,000 if that member had no previous depositing issues such as bounced checks, had not deposited from a new bank account within the previous 2 weeks from the date of the new deposit, and had not violated any Exchange rules.

The \$250 initial RTAF level for new members and \$1,000 maximum RTAF level for members in good standing has remained constant from February 2007 to the present.

### **Proposed RTAF Increase**

Nadex intends to amend the initial RTAF level for a new member from \$250 to \$500. The \$1,000 maximum RTAF level for existing members in good standing would not change. Nadex believes the increase in initial RTAF will benefit the marketplace by providing further liquidity without negatively impacting the fully collateralized nature of Nadex’s markets.

In the five years since Nadex last increased the level of initial RTAF from \$100 to \$250, Nadex has significantly improved its financial resources and its technology. Moreover, Nadex’s experience in extending RTAF has resulted in only miniscule bad debts in connection with checks returned for insufficient funds. Over the past six months (April through September 2012), even as Exchange trading volumes have increased, total bad debts from the RTAF

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program that had to be covered by the Exchange amounted to roughly one-fifth of one percent (i.e., 0.22%) of the total amount of checks deposited during that time period. All such losses were fully collateralized with excess funds maintained in the segregated account by Nadex.

Furthermore, Nadex will continue to maintain its current procedures to ensure trades are fully collateralized. Nadex will continue to maintain excess funds in its segregated account and cap-check all orders when they are submitted. Nadex has a “Customer Identification Program” in place which prevents account activation until the identity of the applicant has been verified and Nadex requires the deposits to a Member’s Nadex account to come from an account at a U.S. financial institution in the same name as the Member’s Nadex account. As an added protection, a member is not able to withdraw funds from his or her Nadex account for 14 days following an initial deposit from a new bank account.

Finally, RTAF is, and will remain, a privilege extended to Nadex members rather than a right. Depending on a member’s situation, such as past deposit issues, answers to qualifying questions, or any alerts we might receive from background checks or other sources, Nadex may restrict the member’s RTAF level or prohibit RTAF altogether.

### **Compliance with Core Principles**

Nadex has identified the following Derivatives Clearing Organization Core Principles as potentially being impacted by this amendment:

Commission Regulation 39.12 Participant and Product Eligibility and 39.13 Risk Management: These Principles require members to have access to sufficient financial resources to meet obligations arising from participation in the DCO in extreme but plausible market conditions, and also require Nadex to establish and maintain policies, procedures, and controls to manage its risk exposure. Nadex currently requires members to have sufficient funds in their account at the time an order is submitted to fully collateralize the order if executed. This requirement will not change with the increase in RTAF. Nadex’s cap-check on member accounts to ensure full collateralization virtually eliminates its risk exposure. Nadex will continue to maintain excess segregated funds in its customer segregated funds account to ensure full collateralization in the event of customer funds do not successfully clear.

Nadex has identified the following Designated Contract Market Core Principles as potentially being impacted by this amendment:

Commission Regulation 38.602 under Core Principle 11 Financial Integrity of Transactions: This Principle requires the DCM establish and maintain appropriate minimum financial standards for its members and non-intermediated market participants.

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Nadex currently requires its members to maintain sufficient funds in their accounts in order to fully collateralize any order submitted if executed. This requirement will not change with the increase in RTAF. Nadex will also have the ability to restrict or remove RTAF as necessary to provide for the financial integrity of its transactions.

Commission Regulation 38.607 under Core Principle 11 Financial Integrity of Transactions: This Principle requires the DCM have in place effective systems and controls to facilitate financial risk management. Nadex currently cap-checks a member's account prior accepting an order to ensure the order would be fully collateralized if executed. This cap-check will not change with the increase in RTAF. Additionally, Nadex's treasury department verifies daily that it holds excess segregated funds sufficient to meet any financial obligation in the event a member's check deposit does not successfully clear.

Commission Regulation 38.651 under Core Principle 12 Protection of Markets and Market Participants: This Principle requires the DCM to have and enforce rules that protect the market and its participants from abusive practices including fraudulent, non-competitive, or unfair actions and provide a competitive, open and efficient market and mechanism for executing transactions. Nadex currently has in place a Customer Identification Program to verify the identity of each applicant before that applicant can make a deposit to the Exchange. Members are also required to make deposits into their Nadex account from a US financial institution in the same name as the Nadex account, and are prohibited from making a withdrawal for 14 days after an initial deposit from a new bank account. These controls will not change with the increase in RTAF. The increase in RTAF will encourage a competitive, open and efficient market as it will allow members to access additional funds for trading.

Pursuant to the 10-day filing period under Regulation 40.6(a)(3), Nadex intends to implement these new rules and amendments on trade date November 7, 2012.

No substantive opposing views were expressed to Nadex with respect to this amendment.

Nadex hereby certifies that the revisions contained herein comply with the Act, as amended, and the Commission Regulations adopted thereunder.

Nadex hereby certifies that a copy of this amendment was posted on its website at the time of this filing.

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Should you have any questions regarding the above, please do not hesitate to contact me by telephone at (312) 884-0171 or by email at [tim.mcdermott@nadex.com](mailto:tim.mcdermott@nadex.com).

Sincerely,



Timothy G. McDermott  
General Counsel and Chief Regulatory Officer

cc: [DMOSubmission@cftc.gov](mailto:DMOSubmission@cftc.gov)  
Jon Hultquist – CFTC (Acting Branch Chief, DMO, Chicago)  
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