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Washington Watch for the Forex Industry

Washington Watch for the Forex Industry is a bi-monthly newsletter published by FXCM and intended for Referring Brokers that are domiciled and/or have customers in the United States. The newsletter will report relevant regulatory and political matters that affect the Referring Broker community. It will also include educational articles intended to shed light on the many new regulations that will be enforced in the months ahead.

The Coming Transformation of Retail Forex

By Charlie Delano

Director of Government Affairs, FXCM

Last year, Congress passed the Commodity Futures Trading Commission (CFTC) Reauthorization Act of 2008 as part of the larger Farm Bill legislation, which clarified the CFTC's authority to create rules and regulations for the retail forex industry in the United States.

The new law has far ranging implications for all retail forex Referring Brokers. For the first time, Money Managers and Referring Brokers (RBs) in the forex industry will be subject to licensing requirements by the CFTC and will have to operate in accordance with government rules and regulations [These rules are expected to be issued by the CFTC in the next few months for public comment].

For many in the RB community, this will be the first time many of you will come face to face with this powerful government agency. Many RBs will not be able to adhere to the government's new standards, nor will they be able to comply with expected new RB capital requirements. Indeed, it is likely that at least half of the existing retail forex Referring Brokers in existence today will leave the business within the next 12 months, as happened in the forex dealer community when regulatory restrictions were tightened.

Now more than ever, it is important that Referring Brokers have access to the latest news and information coming out of Washington. The *Washington Watch for the Forex Industry* newsletter has been designed for just that purpose.

Over the past five years as FXCM's director of government affairs, I have watched the retail forex industry grow in stature in Washington. When we first started lobbying Congress, the only image many in Washington had of retail forex was of the "forex fraud" bucket shop that routinely appeared in CFTC press releases. However, years of meetings with

officials like Speaker Nancy Pelosi, House Financial Services Chairman Barney Frank, New York Senator Charles Schumer, CFTC Chairman Gary Gensler, and many others have helped to change this image for the better. Over the last several years, forex dealers have been able to offer some real input in the crafting of legislation that directly impacted the retail forex industry. Major forex dealers, like FXCM, are routinely meeting with government officials about the implementation of these new laws.

Some sections of the Reauthorization Act were added in response to the perception of fraud and actual fraud that has existed in the unregulated retail forex Referring Broker community. The CFTC is expected to continue its focus on unregulated retail forex Referring Brokers in the months ahead. It is vital that you are prepared for the upcoming registration requirements and are able to distinguish yourself from those RBs who have given all retail forex Referring Brokers a bad name.

Here are just some of the topics that Thomas Gipson (FXCM Compliance Officer) and I will be discussing in this newsletter in the months ahead:

- Will the Derivatives Reform Debate Affect Retail Forex?
- The Current Regulatory Status of Trade Robots and Expert Advisor's
- Regulatory Dos and Don'ts for Marketing
- Navigating the Customer Arbitration System
- How to Use Regulation to Your Advantage

We think you will find this newsletter to be an invaluable resource as the U.S. retail forex market undergoes a wholesale transformation in the months ahead. We at FXCM are always happy to address any questions or concerns you may have about the content of this newsletter or any other regulatory developments concerning retail forex. We look forward to sharing our knowledge with you.

Know Your Regulator - the CFTC & the NFA

By Charlie Delano

Director of Government Affairs, FXCM

One of the most confusing aspects of the due diligence process in the United States is understanding who the regulators are and what role they play in the day to day lives of traders, Referring Brokers, and dealers. This quick primer will give you an overview of the roles and responsibilities of both the CFTC and the NFA, as well as describe the most recent activities of each respective regulator.

A Brief History of the CFTC

The Commodity Futures Trading Commission was created by Congress in 1974 as an independent agency with the mandate to regulate commodity futures and options markets in the United States. The agency protects market participants against manipulation, abusive trade practices, and fraud.

After a series of laws were passed (starting in 2000 and ending in 2008), retail forex went from being a partially regulated market to a fully regulated market. Retail forex dealers are required to be registered as per the guidelines outlined in the Commodity Exchange Act and, for the first time, forex solicitors and Referring Brokers will be required to register as well.

The CFTC has struggled to regulate the industry due to legal challenges and the absence of legislative language that would provide a firm mandate to draft industry-wide rules. While the CFTC now has that mandate, it appears they will follow past precedent and rely on the National Futures Association (NFA) to police the retail forex industry. This explains why the NFA has been so active the past few years in developing rules to govern the retail forex market.

A Brief History of the NFA

First, it is important to clarify that the National Futures Association is *not* a government agency. It is an SRO (Self-Regulatory Organization) in the futures industry, similar to FINRA in the securities industry.

The National Futures Association officially began operations on October 1, 1982, with the goal of maintaining the integrity of the commodities and futures marketplace. All companies trading in futures are required by law to become NFA

members. Futures firms that are not NFA members are subject to closure by the CFTC. Indeed, the CFTC sets forth many of the guidelines the National Futures Association is required to follow and at the end of the day is the NFA's regulator.

Essentially, the NFA was setup to do the day to day job of policing the futures industry. The NFA handles more mundane things like licensing, auditing, and marketing issues, thus allowing the CFTC to focus on market manipulation and fraud. That is not to say that the NFA doesn't police fraud as well. The NFA routinely sanctions member firms that violate NFA rules. The NFA website contains information on many firms that have been disciplined or expelled for acting in an unethical or fraudulent manner. The CFTC also has a Division of Enforcement and may bring its own cases independently for violations of the Commodity Exchange Act or other CFTC regulations. At the end of the day, the NFA wants a smooth running futures market, so they put an extra emphasis on weeding out fraud before it happens. This preemptive action includes pre-screening and testing potential solicitors and routinely examining member firms' books in addition to reviewing their trading practices.

The Future Roles of the CFTC & the NFA

As discussed earlier, the NFA has loomed very large in the retail forex industry due to the CFTC's absence of a clear mandate to comprehensively regulate forex trading. Recently, the NFA came out with rules requiring forex dealers to execute customer orders using a "First In, First Out" model that has had a dramatic impact on the industry. The NFA is also considering best execution pricing that could result in severe restrictions on the practice of re-quoting traders.

However, now that the CFTC has its mandate they will be releasing their own rules which may not necessarily be identical to the rules the NFA already has in place for forex dealers. In regards to Referring Brokers, there is no telling what the rules will look like, or if they will even resemble the rules that govern introducing futures brokers.

Therefore, in the short term, it is the CFTC that will be the dominant regulatory body in the retail forex industry. After the rules are made public and adopted, the NFA will set about implementing them,

but for the next several months all eyes will be on Washington, D.C. This is where the action will be for Referring Brokers, and this will certainly be a

prominent area of interest for *Washington Watch for the Forex Industry* throughout the year.

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