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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 is 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.

CFTC Proposes New Margin Requirements

By Charlie Delano

Director of Government Affairs, FXCM

On Wednesday, January 20, 2010, the Commodity Futures Trading Commission (CFTC) published for comment their long awaited proposed rules outlining a new regulatory framework for the U.S. retail forex industry. While there is much in these rules that FXCM supports, the new rule that would require customers to trade using 10% margin has rightly become the focus of industry scrutiny over the past several weeks.

And it is this industry scrutiny that has led a coalition of forex dealers to unite and form the Foreign Exchange Dealers Coalition (FXDC). The dealers that belong to this coalition are:

Oanda
Gain Capital
FX Solutions
FXDD
Interbank FX
CMS Forex
FXCM
GFT Forex
PFG Best

This coalition opposes the proposed 10 to 1 leverage rule because it would be a crippling blow to the U.S. retail forex industry and would drive it offshore into the hands of foreign competitors. Even worse, it would encourage fraud both at home and abroad as customers seeking to trade retail forex would have no other legitimate domestic alternative.

The FXDC opposes the proposed 10 to 1 leverage rule for the following reasons:

- Today, the U.S. retail forex industry boasts hundreds of thousands of live accounts. If the 10 to 1 leverage rule is adopted, the vast majority of these accounts can be expected to go offshore. The fact is the 10 to 1 leverage rule will be highly unpopular with traders. Leverage set at 100 to 1 is very popular with the retail forex trading public. They simply will not accept 10 to 1 leverage. And the United Kingdom is the first place they will go since customers can trade with leverage as high as 200 to 1.
- The U.S. retail forex industry (forex dealers and introducing brokers) employs thousands of people. The vast majority of these jobs are high paying, white collar jobs that require advanced education. These jobs range from software developers to accountants to foreign exchange dealers. The industry is just as much a high-tech industry as it is a financial services industry.
- The domestic industry's revenue is well over \$1 billion. This revenue is money generated from a product that is, in many ways, an export. Furthermore, as capital markets open in the BRIC countries, the number of new accounts that will flow out of places like China and India will lead to huge job and revenue gains in the United States. Trillions of dollars of trade volume are at stake. This is money that could (and should) be booked in the United States as taxable revenue. But if this rule passes, the United States could well be costing itself billions of dollars in taxes down the road.

- The problem of retail forex fraud will get worse without legitimate dealers offering retail forex. Retail forex fraud is not something that is caused by the actions of regulated retail forex dealers; rather, it is caused by unlicensed con men who masquerade as forex experts promising silly and unjustifiable returns before disappearing with customer funds. That is why the FXDC supports licensing introducing brokers. Licensing and aggressive enforcement action will stop forex fraud, not 10 to 1 leverage.
- Unregulated dealers around the world will also be the beneficiaries of the 10 to 1 leverage rule. These unregulated forex dealers don't have to worry about capital requirements, risk management models, marketing ethics, dealing practices, or even returning a customer's funds. These dealers will be out of the reach of the CFTC and they will thrive.
- On November 30, 2009, a CFTC approved rule was implemented by the NFA that established 100 to 1 leverage for the most liquid currencies. The CFTC's sudden reversal on 100 to 1 leverage is unjustified, highly anti-competitive, and must be withdrawn.

The case against the 10 to 1 leverage rule is clear. The rule will be a boon to foreign forex dealers (both regulated and unregulated) who will grow entirely at the expense of retail forex dealers in the United States. Thousands of high paying jobs will be lost and the potential for tens of thousands more jobs will forever vanish as well. Consumers will be hurt and will be more vulnerable to fraud. And the United States will toss away one of the most promising export industries it has, all in the midst of 10% unemployment. There is no good reason this should be so.

The FXDC is actively lobbying in Washington to get the CFTC to withdraw this proposed rule. However, it will be difficult to accomplish this without the support of the entire retail forex industry and the customers who trade retail forex. The public can comment on this rule by e-mailing

secretary@cftc.gov and including "Regulation of Retail Forex" in the subject line. Please note that all comments are made public on the CFTC's Web site, which can be found here:

<http://www.cftc.gov/lawandregulation/federalregister/federalregistercomments/2010/10-001.html>

We at FXCM will work to keep the public apprised of developments in Washington. At the moment, this is the number one issue confronting the industry and we encourage anyone that is affected by these rules to add their comments as soon as possible.

CFTC Proposed Rules on Registration for Forex Intermediaries

By T'Shae Sherman
 Compliance Associate, FXCM

The CFTC forex rule proposals have finally been published in the federal register for comment by the public. This came almost two years after the passing of the CFTC Reauthorization Act of 2008 which clarified the CFTC's jurisdiction over retail forex. The Reauthorization Act gave the CFTC authority to regulate retail forex transactions and to require the registration of intermediaries involved in such transactions. Intermediaries include Introducing Brokers, Trading Advisors, and Pool Operators.

In anticipation of these proposed rules, over the past few months many Referring Brokers (RBs) have been making significant strides in an effort to prepare for a regulated forex environment; some to the full extent of getting registered with the CFTC and becoming members of the National Futures Association (NFA).

After all the industry noise, speculation, and preparation regarding this rule, the questions to be answered now are: what does the rule proposal actually say and how will it affect you?

The rule proposed by the CFTC will require registration with the CFTC and membership with the NFA for all intermediaries of retail foreign exchange transactions. Major registration categories under the new retail forex regulatory scheme will include:

- Retail Foreign Exchange Dealer (RFED) - an entity that is offering to be or acting as a counterparty to retail forex transactions.
- Introducing Broker (IB) - an entity that solicits or accepts orders from a customer in connection with retail forex transactions. Essentially, this category refers to entities that introduce self-traded accounts to an RFED or Futures Commissions Merchant (FCM) for compensation.
- Commodity Trading Advisor (CTA) - exercises discretionary trading authority, or obtains written authorization to exercise discretionary trading authority, over retail forex client accounts.
- Commodity Pool Operators (CPOs) operate or solicit funds for a forex pool.
- Associated Person (AP) - any natural person associated with a registrant listed above as a partner, officer, or employee, in any capacity that involves the solicitation or acceptance of retail forex customers' orders, or the supervision of any person so engaged.

The CFTC's rule proposal will also require all IBs who are introducing forex accounts to an RFED or FCM to enter into a guarantee agreement with that RFED or FCM. A guarantee agreement is an exclusive agreement between an IB and an FCM or RFED. What this exclusivity means is that the IB may execute only one guarantee agreement and must introduce forex accounts to only one RFED or FCM. Additionally, an IB that is guaranteed by an FCM or RFED will not be subject to the minimum capital requirements set forth in Regulation 1.17(a)(1)(iii).

When a guarantee agreement is in place, the RFED or FCM will be held jointly and severally liable for the IB's violations of NFA rules that occurred during the term of the guarantee agreement.

Guarantee Agreements become effective either on the date an IB applicant is granted their registration, or in the event that the IB is currently registered with NFA, it will become effective on the date decided upon by both parties. Finally, the agreement may be terminated at any time; however, termination does not relieve any party from any

liability or obligation arising from acts or omissions which occurred during the term of the agreement.

Existing rules for the futures industry explicitly outline the various exemptions that may be applied to each registration category listed above, many of which will be applied to the forex industry. CFTC regulation Part 4 outlines the current exemptions from CTA and CPO registration which will be applied to the forex industry. Registration as an IB will not be required for an entity that is only introducing accounts of eligible contract participants as defined in section 1a(12) of the Act, or that is registered in another capacity with the CFTC.

The CFTC's proposed rule will also add a "Part 5" specifically for forex transactions to the CFTC's regulations. The following are among the Part 5 requirements:

Section 5.5 requires that, before opening an account for a retail forex customer, IBs will be required to provide the customer with a separate written disclosure statement which contains specific language as set forth within the rule. The IB must obtain from each retail forex customer, a signed and dated acknowledgement that the customer has received and understands the disclosure statement.

Section 5.20 states that the CFTC may, at its discretion, exercise a special call for information on controlled accounts from an RFED and IB. Upon receipt of such call, the RFED and IB shall file with the Commission the names and addresses of all persons who, by power of attorney or otherwise, exercise trading control over any customer's account in retail forex transactions.

FXCM encourages all of our RBs to read the CFTC's proposed rules. As we continue to evaluate the rule proposal and as more details become clear, FXCM will, as always, continue to keep the RB community informed. We hope that in the end, the most fair and reasonable rules will ultimately be adopted.

Questions? Contact Us!

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