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COMMENT
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To: secretary <secretary@CFTC.gov>
Subject: Regulation of Retail Forex

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On 2010-01-25 I briefly commented that 10% margin on retail forex positions is excessive for the risk characteristics of the currencies markets. Both history and theory demonstrate the correctness of my view.

Empirically, the forex markets have proven, during the crash of 2008 and at other trying times, that they can maintain their systemic integrity despite enormous volatility, and do so even on the scant margins that have prevailed heretofore. It was in mortgage-backed bonds, credit default swaps, and other esoteric instruments - not currencies (or even futures or stocks) - where capital reserves proved insufficient to contain the spread of losses, creating a domino-effect of insolvency. Currency prices experienced great volatility, but the currencies markets did not exhibit the same propagation of deficits contributing to the systemic collapse.

Theoretically, the currencies markets exhibit such excellent "containment" because of the relationship between margin requirements and market liquidity. The amount of margin a market needs to ensure its integrity is not determined by how much the market moves in a big day or in any other fixed time, nor by the notional size of a unit of position. Instead the necessary margin is determined by how much the position might lose before it can be liquidated. That amount depends on the economic characteristics of what is being traded, and on the breadth and depth of the pool of market participants. Because the markets for credit default swaps, for example, consisted of a relatively small number of interrelated participants, it was easy for liquidity to dry up in those markets. By contrast, the enormous size and liquidity of the currencies markets - to which no other market bears any comparison, and which necessarily results from currencies' ubiquitous economic role as a medium of exchange and liquid store of value - has allowed the forex markets to succeed on margin requirements that would cause other markets to fail.

In light of these considerations, and our successful experience with forex margins on the order of 1%, a tenfold increase in margin requirements is both unreasonable and unjustified by any experience or any expectation.

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