From: Daniel Ford <dford@trendlinesystems.com>
Sent: Sunday, February 14, 2010 10:41 AM
To: secretary <secretary@CFTC.gov>
Subject: Proposed Regulation of Retail Forex RIN 3038-AC61

To:

Secretary of the Commission
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street NW
Washington, DC 20581

From:

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Burlington KY 41005

Subject:

Proposed Regulation of Retail Forex, RIN 3038-AC61

Dear Sirs or Madam:

As a home-based trader of stocks, options, futures, and retail Forex, I wish to comment on the CFTC's proposed rule to regulate retail Forex trading.

In general, there is indeed a need for honesty, integrity, and transparency in the Forex industry and regulations intended to promote these principles are healthy for the industry and our nation as a whole. However, the proposal to reduce the margin rules from the recently enacted 100:1 requirement to 10:1 reflects a misunderstanding of how margin works in Forex and if enacted would destroy the domestic retail Forex industry. This in turn would cost thousands of high-paying U.S. jobs, harm U.S. investors, and deny the U.S. Treasury needed revenue while driving business to the America's competitors overseas. If the CFTC indeed wishes to reduce unnecessary risks, then it should focus on specific unscrupulous practices, not the use of essential leverage.

My specific comments are as follows:

Punish Unscrupulous Operators, Not All Operators

The broker registration and capitalization requirements are reasonable. For any industry to prosper, there must be integrity and transparency. However, while a few "bad apples" can destroy the retail Forex industry, so can overreaching and ill-advised regulations. The regulations should protect reputable operators, not run them out of business.

In lieu of forced reductions in the use of essential leverage, the CFTC can better protect retail Forex investors by ensuring all brokerages work for their clients, not against them. Some needed improvements include limits on pricing irregularities, the honoring of stop-loss orders, and the alleged practice of "stop hunting" by the brokerages themselves.

The "Extreme Volatility" Characterization of the Forex Markets is Demonstrably False

(1) At the peak of the recent global financial crisis, the value of the U.S. Dollar only fluctuated 18%, compared to nearly 50% in the S&P 500 index and 80% for many stocks.
(2) The global Forex markets operate on a 24-5 basis, eliminating the risk of overnight "gaps", except over the weekends. This makes stop-loss orders far more effective than they are in the equities markets and reduces another form of volatility inherent in stocks.
(3) The liquidity of the Forex market is estimated to be 300% greater than the U.S. equity markets and is furthermore heavily concentrated in the eight major currencies. The massive liquidity divided between the major currencies

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precludes volatility caused by low liquidity, a characteristic of many stocks.

100:1 Leverage is Not "High" and Essential in Retail Forex Trading

Because of the low volatility inherent the Forex markets, most currency prices are quoted in .0001 increments, a.k.a. "pips". It is the 100:1 leverage that creates the profit potential. Without it, the risk of loss increases and it would be impossible for all but the wealthiest "retail" investors and institution to profitably trade Forex. The alternative is for the retail investor to keep positions open for weeks or months at a time while awaiting a larger move in prices. This increases exposure of the retail trader to the risks of weekend gaps or geopolitical events.

The Rule-making Doesn't Recognize Recently NFA Mandated Reductions in Leverage

As of November 1, 2009, the National Futures Association (NFA) mandated the reduction of leverage on the major currency pairs to 100:1 and 25:1 on the non-major pairs. It is ill-advised for any rule-making to overlook regulations implemented just months before and the CFTC should evaluate the effectiveness of the NFA margin rules before it rushes to implement far more restrictive rules of its own.

Small Lot and Account Sizes Reduce Risk

Overlooked in the proposed rule-making is that the small Forex accounts and small position sizes actually reduce risk. It is well known that back-testing and "paper" trades, while beneficial, do not fully replicate actual trading conditions. Forex is the only trading environment that allows traders to learn or experiment with $10 or $20 positions under real-world conditions, making their risk very small in terms of actual dollars. Yes, you can trade stocks in small amounts too, but then the pattern day-trader rules apply limiting the ability of the trader to test multiple entry and exits in the same day or week.

Mandate Best Practices Rather Than Reduce Leverage

The rule-making acknowledges that most brokers will liquidate accounts that reach a zero balance, therein recognizing a unique and essential Forex practice that reduces risk levels far below other vehicles such as futures contracts, some forms of options contracts, and the shorting of stocks. Rather than reducing leverage, which is not the source of the risk, the CFTC can instead mandate that all accounts be liquidated upon reaching a zero balance.

Other "best practices" may include the mandatory use and honoring of stop losses, which as noted earlier are far more effective in the Forex markets than in the equity markets. Many brokers no longer guarantee the timely execution of stop-loss orders which itself is a questionable practice as the Forex markets have 3 times the liquidity of the equities markets and no overnight gaps during the trading week. Other than during the weekend "gap", I am not aware of any reason why a stop-loss order cannot be quickly filled at a guaranteed price.

The Rule-making Limiting Margin Will Increase Risk, Not Reduce Risk

By analysis, futures contracts, certain options contracts, and the shorting of stocks are far risker than Forex trading. Logically, if ill-advised regulations on leverage force smaller traders out of the Forex markets, they will be forced to use these other vehicles that carry commensurately more risk. Another consideration is whether the proposed rule-making will incentivize retail investors to utilize less regulated or unregulated off-shore Forex brokers. If retail Forex customers are forced by regulation to use risker vehicles or less regulated overseas brokers, then the rule-making has increased risks, not reduced them.

The Proposed Leverage Changes Will Reduce Tax Receipts and Harm the Economic Activity

The rule-making fails to consider the collateral damage caused by the loss of economic activity. If, due to the forced reductions in leverage, retail Forex traders cannot trade, then retail Forex brokers cannot exist. This would cause a commensurate reduction in employers, employment, and all that entails, including lost tax receipts. Other victims will include the already depressed commercial real estate market which houses the brokerages and those municipalities that depend upon a healthy and diverse financial community.

Environmental Impact

The proposed rule-making does not consider the potential adverse environmental impact if retail Forex traders are forced to find other forms of employment. One characteristic of retail Forex trading is that it is home-based, largely paperless, and produces virtually no waste. Home-based businesses are also resource efficient in that they utilize pre-existing residential structures and do not require purpose-built buildings and structures. The proposed change in margin rules will likely drive retail Forex traders out of the business and some of them may opt to quit trading

altogether and reenter the traditional workplace with the environmental impact that such would entail.

Summary

If the CFTC wishes to remove unacceptable risks from the retail Forex industry, is should (1) seek to better understand retail Forex trading and (2) focus on unscrupulous operators and their unscrupulous practices. In lieu of arbitrarily reducing the use of essential leverage, the CFTC should embrace best practices such as the use of of stop-loss orders and the honoring of such when placed, the liquidation of zero balance accounts, and limits on "slippage." The CFTC should not impose regulations that drive reputable retail brokerages and their clients out of the business.