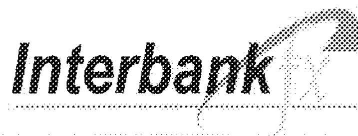
From: Lydia Lorenz <llorenz@mwmlaw.com>
Sent: Friday, February 26, 2010 4:55 PM
To: secretary <secretary@CFTC.gov>
Subject: Regulation of Retail Forex
Attach: IBFX CFTC Comments 2-26-10.pdf

Dear Mr. David Stawick, Secretary:

Attached are comments submitted on behalf of Interbank FX in reference to Regulation of Retail Forex (RIN 3038-AC61).

Thank you,

Lydia Lorenz
202-842-2345



ONLINE FOREIGN EXCHANGE BROKER

February 26, 2010

Mr. David Stawick, Secretary
Commodity Futures Trading Commission
1155 21st Street, N.W.
Washington, D.C. 20581

Re: RIN 3038-AC61

Dear Mr. Stawick:

These comments are submitted on behalf of Interbank FX (IBFX). IBFX is an off-exchange retail foreign currency broker whose pioneering efforts have created a unique foreign exchange (forex) trading environment. Interbank FX has distinguished itself as an industry leader with our unique Multibank Liquidity feed, proprietary trading tools and service and focus on customer care. We were founded in 2001 by a group of foreign exchange trading veterans who wanted to pioneer an alternative method of trading in the forex marketplace. Our proprietary technology and distinctive approach to forex trading allow our customers to execute directly from a streaming quote feed. IBFX is registered with the National Futures Association (NFA) as a futures commission merchant (FCM) and Forex Dealer Member (FDM).

IBFX believes that sensible regulation, including both self-regulation through the NFA and federal oversight through the Commodity Futures Trading Commission (CFTC), is sound public policy and in the interest of our customers and our industry. Our company strongly supported the establishment by Congress of a separate regulatory category for retail forex dealers, strict capital standards for retail forex firms, and CFTC authority to police against fraud and other abusive practices.

We also support most aspects of the rule proposed on January 20, 2010, by the CFTC (Commodity Futures Trading Commission, "Regulation of Off-Exchange Retail Foreign Exchange Transactions and Intermediaries.")[1] Among the proposals that we support are those applicable to --

- Registration with the CFTC and NFA;
- Disclosure of relevant information to customers;
- Record-keeping;
- Financial reporting; and
- Minimum capital.

[1] *Federal Register* Vol. 75, No. 12, pp. 3282-3330

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IBFX strongly opposes one aspect of the proposed rule: a 10:1 limit on leverage that may be offered to customers, i.e., a requirement that customers post a security deposit in cash or other specified financial instruments equal to 10% of the notional value of a forex transaction. We believe that this proposal --

- Is unnecessary to protect retail investors because this goal is already achieved through rigorous capital requirements that will prevent fly-by-night operations from defrauding investors;
- Will make retail forex trading in the United States uncompetitive and hence drive retail business either offshore to venues that permit higher leverage, or to trading venues not subject to the leverage requirement, including futures exchanges and potentially banks or other financial intermediaries not regulated by the CFTC;
- Runs counter to the considered judgment of the NFA, which late last year began to apply a 100:1 leverage limit, a level arrived at through an analysis of the leverage requirements of U.S. futures exchanges and comparable developed-country financial regulators;
- Is inconsistent with the intent of Congress, which could have chosen to ban retail forex trading but chose instead to regulate it, a decision that presupposes that Congress intended that the industry could continue to exist; and
- Is inconsistent with the Commodity Exchange Act's requirement[2] that the CFTC "take the least anticompetitive means of achieving the objectives of" the Act, in that the proposed rule unfairly and unjustifiably favors on-exchange forex trading even though customers in that trading venue can lose more than their initial investment while retail forex customers cannot.

The Proposed Limitation on Leverage is Unnecessary

First, the leverage limitation is unnecessary to achieve customer protection. As Congress recognized in the CFTC Reauthorization Act of 2008,[3] longstanding retail forex fraud problems were overwhelmingly centered on poorly-capitalized boiler-rooms that operated outside CFTC scrutiny because of the legal uncertainty as to whether they were subject to the Commodity Exchange Act (the Act). Congress resolved this problem by giving the CFTC clear authority over retail forex transactions regardless of whether various courts considered them to be futures contracts or not; and by laying out, in the statute, specific capital requirements for retail forex dealers. The NFA, and now the CFTC in its proposed rule, have actually strengthened the capital requirements above the statutory minimums by requiring additional capital when a firm's trading volume exceeds a certain threshold.

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[2] 7 U.S.C. § 19(b).
[3] P.L. 110-246, 122 Stat. 2189 *ff.*.

Relatedly, the leverage limitation is also unnecessary to avoid systemic financial risk. Congress and regulators alike consider that excessive leverage contributed to the financial meltdown of 2008. However, this leverage occurred in the context of institutional derivatives markets where many trillions of dollars in notional value changed hands daily. The leverage also involved large financial institutions either explicitly or implicitly backed up by the taxpayers, or otherwise considered "too big to fail." By contrast, the retail forex markets involve customers who, by definition, are retail rather than institutional investors, and no retail forex firm is large enough that anyone would suggest the possibility of a taxpayer bailout. Indeed, the entire U.S. retail forex market is estimated at $800 million in customer assets, and a little over $700 million in adjusted net capital for the industry itself. These are not sums that pose any systemic risk in our multi-trillion-dollar economy. (It might also be noted that forex instruments generally were not among those that were implicated in the meltdown; rather, derivatives and other instruments based on real estate and credit risk were most prominent in the debacle of 2007 and 2008.)

The Proposed Leverage Limits Will Make the U.S. Retail Forex Industry Uncompetitive

Today, retail investors have a wider range of trading opportunities than ever before. The ability of customers to trade on a variety of platforms over the Internet means that U.S. regulators must be mindful of how comparable transactions in similar developed-country jurisdictions are regulated. Customers can and will move their business elsewhere if the requirements to trade in the U.S. are perceived as overly onerous.

Now, U.S. retail forex firms provide a range of leverage to customers, but under NFA rules 100:1 is the maximum allowed, and some firms offer this level. For the customer of such a firm engaging in a forex transaction with a value of $5,000, the CFTC's proposed rule means that instead of posting a security deposit of $50, the customer must post $500. One can easily understand that a change of this magnitude will cause investors to look for alternatives. We believe that customer comments already publicly filed with the CFTC make this clear.

It is not necessary to hypothesize new trading venues in traditional havens for offshore banking or similar transactions. Instead, investors need only locate firms operating in the United Kingdom, where 200:1 leverage is typical. Practices in Australia, France and Germany are similar.

Thus, the regulators of these developed-country markets are content for customers to enter into forex transactions with leverage twice that now permitted by the NFA, and *20 times* what would be allowed under the proposed rule. The NFA's leverage limitation already constrains U.S. firms to some degree, but the CFTC's proposed rule would simply make it untenable to conduct retail forex business in the United States.

Business would necessarily migrate offshore, to non-CFTC-regulated entities such as national banks, or to trading on designated contract markets (futures exchanges). These alternative trading venues are available and, except for futures exchanges, cannot be regulated by the CFTC. Thus, it is likely that the proposed rule will have the ironic effect of leaving the CFTC with less, not more, regulatory control over retail forex trading.

The Proposed Rule is Inconsistent with NFA Rules

The CFTC certainly is not constrained to abide by decisions made by the NFA. Nevertheless, since the NFA only recently went through a rulemaking process on the very subject of retail forex leverage, and since the CFTC accepted the resulting NFA rules, it is quite strange that the CFTC largely ignored the NFA's decision and logic in crafting its proposed rule.

The NFA submitted its leverage requirements to the CFTC on February 23, 2009. In discussing its proposals, the NFA stated that it was revising its previous requirement for a 2% security deposit for major currencies down to 1%, in part because of positive experience from permitting firms to offer 1% on a temporary basis; in part because of the contemporaneous introduction of higher capital requirements for retail forex firms; and in part because unlike futures exchanges, retail forex firms "use systems that liquidate customer positions before they reach a negative balance ..."[4]

This last point bears out the wisdom of the NFA's approach. The self-regulatory agency recognized that there is a fundamental difference between security deposits in retail forex trading and margins in on-exchange futures trading, even though both have some features and purposes in common. A retail forex customer cannot normally lose more than his or her initial investment because his or her account will be liquidated before its value reaches zero. By contrast, margin calls in futures trading make it quite possible (and even common) for an investor in futures contracts to lose more than his or her initial investment. Hence, the same degree of leverage poses less risk to an individual customer trading retail forex than to the same customer trading forex futures on an exchange.

The Proposed Leverage Limitations are Contrary to the Intent of Congress

The legislation passed by Congress in 2008 which is the basis of CFTC's present rulemaking[5] contains not one word about limiting leverage. To our knowledge, nothing in the legislative history, hearing records or committee reports explicitly discusses the prospect of limits on leverage. Thus, it is difficult to argue that in imposing a limitation on leverage that will unquestionably drive the retail forex industry out of the United States, the CFTC is simply following the will of Congress.

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[4] National Futures Association: Forex Security Deposits – Proposed Amendments to NFA Financial Requirements Section 12 and Interpretive Note Regarding Forex Transactions. Correspondence from NFA to CFTC, Feb. 23, 2009.
[5] P.L. 110-246, *loc. cit.*

A limit on leverage, in and of itself, may be within the CFTC's authority. But in taking an action that is all but guaranteed to put U.S. retail forex firms out of business – and their employees on the unemployment lines – the CFTC is clearly acting against the intent of Congress.

The logic is simple. If Congress had wanted to ban this entire industry, it could have done so by making all retail forex transactions illegal. That is not what Congress did. Instead, Congress made all retail forex transactions *subject to regulation.* If Congress feels that an industry needs to be regulated – a judgment with which, as already stated, IBFX fully agrees – then Congress is necessarily also saying that it is satisfied for that industry to exist. No public purpose is served in regulating a non-existent industry.

All the purposes of regulation become harder to achieve – if not impossible – once an industry has been driven outside U.S. borders. The CFTC can offer little more than words to investors defrauded by firms operating outside the United States. Capital requirements cannot be enforced against firms not subject to U.S. laws. Thus, the CFTC is proposing to destroy an industry and eliminate the jobs associated with it, and in the process will fail to achieve what Congress told the commission to do in the first place.

The Leverage Limitations Would Be Anti-Competitive

The most likely outcome of the CFTC's proposed limits on leverage would be to send existing business offshore. However, another possible outcome is that a portion of the business will migrate to designated contract markets in the United States.

To the extent that the CFTC foresees or desires this outcome, the commission should feel obliged to defend this proposed rule in the context of Sec. 15(b) of the Act,[6] which requires the least anti-competitive means of achieving a given objective to be chosen. The CFTC's proposed rule would certainly enhance the competitive position of futures exchanges at the expense of retail forex dealers.

Congress gave no evidence of such an anti-competitive intent in legislating CFTC's authority over retail forex trading. But under the CFTC's proposal, futures exchanges would offer customer leverage perhaps twice as high as the levels permitted to retail forex customers (using the average exchange margins cited by NFA in its rule submission). This is unquestionably a competitive advantage. Yet the CFTC has not explained why it desires to give futures exchanges a competitive advantage over retail forex dealers, if that is indeed the CFTC's wish – and if it is not, the commission should reconsider the proposal in light of the competitive consequences.

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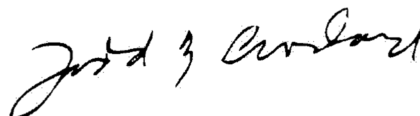
[6] 7 U.S.C. § 19(b).

The Solution is Regulation, Not Prohibition

Most of the CFTC's proposed rule is sound. Indeed, these parts of the rule presuppose that there will be a U.S. retail forex industry to be regulated. Unfortunately, if the leverage limitations are adopted, no such industry is likely to exist. Instead, most if not all of the retail forex business will be driven overseas and the jobs now associated with the retail forex industry will follow. We do not believe that is the CFTC's intent. We are certain it was not Congress's intent. Therefore, we implore the commission to reconsider this ill-advised leverage limitation and adopt a more sensible alternative that permits the retail forex industry to remain viable -- and regulated -- in the United States.

Sincerely,



Todd Crosland, President