MGSecurities

Comments on FINRA Proposed Rule 2380 (Leveraged Limitation for Retail Forex)

The implementation of the FINRA Proposed Rule 2380 will have unintended consequences for U.S. retail customers as well as for U.S. headquartered companies. The proposed rule will drive most of the leveraged retail forex business out of the U.S. Customers that wish to trade leveraged forex will be restricted to deal with the few U.S. companies with capital sufficient to satisfy the new requirement imposed by the CFTC or take their business offshore. The leverage requirement proposed in Rule 2380 by FINRA is so onerous that it will effectively prohibit broker/dealers from offering a competitive product in the leveraged retail forex arena.

The competition provided by the many small businesses that heretofore have offered leveraged retail forex business has helped maintain fair markets for customers in the United States. This competition will be gone as smaller businesses will no longer be able to compete with the few Retail Forex Dealers that have the minimum capital required. The customers who deal with the few remaining U.S. companies will be captive to the prices set by these companies instead of having access to a broad range of prices that are transparently provided by the 15-20 companies that are currently offering the product.

The U.S. risks losing other related business by not allowing its broker/dealers to offer leveraged retail forex business. Customers that wish to trade with a firm that offers "one-stop shopping" may choose to take their equity business and bond business out of the country along with their forex business. At least 25% of the customers at most of the retail forex businesses operating in the U.S. today are foreign domiciled. This has resulted in money flow into the U.S. as well as the potential for cross-selling other financial products to international clients. Money flows that have been inward into the US will reverse and flow out to other countries that permit leveraged retail forex trading.

Traditionally and globally retail leveraged forex market transactions have very high leverage ratios. According to the Background and Discussion section in the FINRA Regulatory Notice 09-06, the leverage ratios for retail forex were set to be comparable with the leverage ratios for currency futures traded on futures exchanges. It may be inferred from reading this proposed rule that regulators believe that because retail forex trading is not traded on an exchange, retail foreign exchange customers incur a greater risk than if they were trading on an exchange and therefore, the leverage ratios for retail foreign exchange trading have to be prohibitive in order to "protect" the customer.

MG Securities LLC
One Battery Park Plaza, 2nd Floor
New York, NY 10004

1.646.233.5855
MGSecurities.com

Comments on proposed FINRA Rule 2380 continued…

It is well known, however, that in commodity futures trading, investors can and do lose much more than their original deposit. In retail foreign exchange trading, the systems are established precisely to prevent the possibility of a customer losing more than he invests. In retail forex, the customer almost never loses any more than his "good faith" deposit.

To accommodate the increased volatility in the retail forex markets, the electronic trading platforms allow the customers to monitor their positions constantly in real time. The customers can calculate the rates at which they will lose their margin deposits and are therefore well aware of the state of their position(s) at any given moment. They are also able to follow the market movements as they occur and therefore monitor any increasing likelihood that their positions may be closed. An example of a mechanism available to customers is an automatic "stop loss" order that can be used individually or in conjunction with margin call to close a position before a margin call occurs. Many customers use the automatic close-out mechanism as a stop loss in order to limit their losses. Finally, the customers may send in funds at any time, in order to keep their positions open, or have their positions closed as part of their strategy.

The assumption that simply creating prohibitive margin requirements will stop all retail forex investing is clearly wrong. There are so many outlets for the retail investor to trade foreign exchange that this proposed rule will only keep the customers from doing this business with U.S. broker/dealers and therefore FINRA will not have the opportunity to supervise the business. According to new rules of the CFTC and NFA, retail foreign exchange customers may only deal with futures commission merchants and retail forex dealer members that have in excess of $20,000,000. This certainly does not protect the investor from losing his entire deposit. It doesn't even protect the investor from losing his entire deposit even if he has no open positions at all. As has been seen in the last two years, merely showing a large amount of capital on the books is no guarantee that the investors will be able to collect their funds when they wish to do so.

Leveraged retail forex has become increasingly popular, especially with brokers and securities companies that operate out of London and Hong Kong. There are also many other centers, (less well-regulated) which host companies that offer leveraged retail forex. Customers already know where they can go to do their trading if the U.S. imposes regulations that drive the business out of the U.S.

It should also be noted that if the U.S. regulators really wish to protect the U.S. investors, the best way to effect this is to enforce existing regulations, strictly

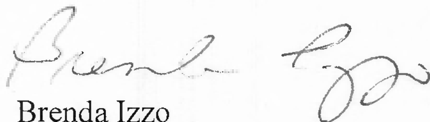
MG Securities LLC
One Battery Park Plaza, 2nd Floor
New York, NY 10004

1.646.233.5855
MGSecurities.com

Comments on proposed FINRA Rule 2380 continued…

monitor the risk management activities of the U.S. based companies and ensure that reputable well-intentioned management is in charge. If the U.S. regulators persist in making it almost impossible for U.S. companies to offer leveraged retail foreign exchange products, U.S. investors will simply move their business offshore with potentially dire consequences for the investor and for the competitiveness of the U.S. marketplace.

Due to the nature of Forex Trading, it is not feasible to offer retail forex with the kind of leverage FINRA is proposing. No customers will open accounts to trade with this proposed leverage of 1.5 to 1. The practical effect of the new rule will make it impossible for FINRA members to offer leveraged Retail Foreign Exchange altogether and force businesses offering leveraged Retail Forex to go offshore as described above. In the interests of providing a viable alternative, we would suggest that FINRA allow Broker/Dealers to offer leveraged foreign exchange transactions at a reasonably competitive leverage. We believe that the interests of a large number of investors interested in leveraged Retail Foreign Exchange can be better served by FINRA adopting a few Forex specific rules that will address its concerns about leverage by enforcing the use of margin calls and other similar protective mechanisms. The necessary rules can be derived from those of other regulators (which have proved effective), and when such rules are combined with FINRA's stringent regulation of Broker/Dealers, they will offer perfectly adequate protection to investors in this market and at the same time keep the U.S. customers dealing with U.S. based businesses regulated by FINRA.



Brenda Izzo
Managing Director
MG Securities, LLC
brenda@mgsecurities.com

MG Securities LLC
One Battery Park Plaza, 2nd Floor
New York, NY 10004

1.646.233.5855
MGSecurities.com