Rules and Regulations – The Forex Trader's Guide to A Changing Regulatory Environment

April/May 2009 Update

The off-exchange Foreign Exchange market is currently undergoing regulatory changes that are unprecedented in the last 10 years. The changing rules and regulations can seriously affect your Forex trading. The initial changes will take place on **MAY 15, 2009.** Read this guide to learn what changes are coming and how to effectively deal with those changes.

HEDGING – NFA Rule 2.43(b) – Effective May 15, 2009!

On April 13, the CFTC approved NFA Compliance Rule 2-43(b) regarding off-exchange Foreign Exchange orders. *The new rule will prohibit customers from carrying offsetting positions in the same account; a practice referred to as "hedging".* The new rule requires the clearing firms to offset positions in a customer account on a first-in, first-out basis, thereby prohibiting hedging. A customer may, however, direct the FDM to offset same-size transactions even if there are older transactions of a different size. The rule is effective for all positions established after May 15, 2009. Hedged positions that were established prior to the effective date do not have to be liquidated, but once either position is closed out after May 15, it may not be reestablished as a hedge.

The NFA's Rule 2.43(b) effectively states that if a client account is both long and short the same currency pair, then the client has no financial exposure to the currency pair, and therefore should reflect no position.

Example: Let's assume that you trade on the Metatrader 4 platform at a U.S. based, NFA regulated broker. Let's also assume that you run an Expert Advisor **(EA)** with a hedging feature programmed in. For this example let's take the EURUSD into consideration. If your EA opens a long EURUSD position in the amount of 50,000 (.5 lots) and the trade goes against you, the EA may trigger a short position on the same currency pair, EURUSD, to mitigate potential losses. Now, under the NEW NFA rule 2-43(b), instead of allowing you to have both a long position and a short position open, you will be closed out of your original position and **realize a loss.**

Many clients have used hedging as a core part of their trading strategy. In particular we see many systematic (and particularly Expert Advisors) trading programs using hedging on the Metatrader 4 platform. This ruling will force those traders using hedging to either change their strategy, or find alternative options for their trading.

Back Bay FX has crafted solutions for those clients who wish to continue their trading styles without the restrictions on hedging. **Please contact us for details at (617) 357-6100 or info@backbayfx.com**

LEVERAGE – Pending NFA Rule Change

NFA Financial Requirements Section 12 currently requires clearing firms to collect a security deposit of 1% of the notional value for specified (major) currencies and 4% of the notional value of all other transactions. This rule is what allows firms to offer clients 100:1 leverage on their FX trading accounts. Section 12 further allows firms with certain financial conditions to offer leverage of up to 400:1 in certain cases.

The NFA has taken the first steps towards reducing the leverage available to retail FX traders. The NFA has proposed an amendment that will eliminate leverage that exceeds 100:1 on any trade. This amendment is awaiting CFTC approval before implementation. In addition, Back Bay FX has been advised by multiple independent sources that the NFA is proposing to further decrease leverage by reducing the amount of leverage available on certain "non-major" currencies.

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Leverage cont…

The proposal that is being reviewed would put a cap of 25:1 leverage on any traded pair that contains a non-major currency. The NFA's non-major currencies are said to include: New Zealand Dollars, Canadian Dollars, Australian Dollars, and Norwegian Krone.

Our information on the proposed reduction of leverage is not confirmed by the NFA and while we believe the accuracy of the above commentary, we note that it is subject to revision as information warrants.

Frequently Asked Questions

We have received a number of questions about the pending rule changes in the last two weeks. Here are the most frequently asked:

Q: I am a US citizen/resident. Am I allowed to use a non-NFA regulated firm or offshore broker?
A: Yes.

Q: How do non-NFA regulated US brokers like FXDD fall into the mix? Do they have to comply with the leverage restriction or not? In other words, is this an NFA member compliancy issue or does it apply to all US brokers?
A: The amendments above have been passed by the NFA and are therefore only applicable to NFA-member firms. All clearing firms that operate in the US fall under NFA regulation except FXDD. However as FXDD is pending NFA approval, FXDD is abiding by the NFA's new rulings. If you find a clearing firm that is asking you to send funds to a bank account with their name on it, and the clearing firm is not listed as a FCM or FDM on the NFA's website, do not send them funds!

Q: Can I open 2 accounts, one account long only, the other account short only? That will allow me to hedge my trades; just can't have the hedge in the same account.
A: Two problems with this approach. In the short term, this multiplies the amount of equity that you need to use in order to have the "hedged" position on. This means it uses more margin. In the longer term, the NFA has already informed the clearing firms that they expect the clearing firms to honor the "spirit" of the ruling, not just the letter of the ruling. Firms will be expected to police this activity.

Q: It seems like the NFA is protecting the brokers with this ruling. Are they?
A: The clearing firms do not care if clients hedge or do not hedge. They just want the clients to be able to trade as they so choose. Removing the ability of clients to hedge hurts the clearing firms as clients may choose to trade with non-NFA regulated firms. Clearing firms calculate their P&L and their Net Capital costs based on client equity levels, not client balances levels. This is a technical difference, but an important difference nonetheless.

What are my options

Since the inception of the retail Forex market, choosing a Forex broker has never been an easy task. It has always been a general rule of thumb to go with a U.S. based, NFA regulated firm; but what is a trader to do when industry regulators are deterring them from trading the way they want?

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Your Options cont...

As an established introducing broker, Back Bay FX has been pairing clients up with suitable clearing firms for years. At Back Bay FX, we've already done the due diligence necessary for recommending brokers to traders depending on a number of different variables.

These variables include, but are not limited to: trading style, trade frequency, necessary leverage, account size, funding options, platform type, and account type.

Regardless of what trading style you have or platform you need (MetaTrader 4, Currenex, etc.), Back Bay FX has options for you that will allow you to continue trading under the conditions that you choose.

Look out for an email and phone call from one of our research team members with more information on these new rules and regulations. Please do not hesitate to contact us with any questions or concerns that you may have.

Please contact Back Bay FX at +1.617.357.6100 or email us at info@backbayfx.com to discuss the best brokerage fit for your needs.

This article is published by Back Bay FX Services, LLC, an NFA member firm (NFA ID # 0388617), registered as a Commodity Trading Advisor and Introducing Broker. The intent of this guide is to alert retail off-exchange Foreign Exchange traders to the changes that have recently passed or are expected to pass in the coming months that affect your trading. If you have any questions regarding how these changes will effect your trading, please contact Back Bay FX at (617) 357-6100.