Risk.net
Financial Risk Management News and Analysis

CFTC rules increase credit risk

Author: Saima Farooqi

Source: Risk magazine | 21 Jul 2010

Categories: Counterparty Credit Risk

Topics: Commodity Futures Trading Commission (CFTC), Christopher Dodd, Barney Frank, foreign exchange (FX), Counterparty credit risk, CLS Bank

Proposed rules to limit leverage on margin FX trading accounts at retail forex brokers will have the unintended consequence of increasing counterparty risk, according to Josh Levy, managing director at Tactical Asset Management.

Speaking on the implications of new regulations on currency markets at the *FX Week USA* congress, Levy expressed concerns over a proposal by the Commodity Futures Trading Commission (CFTC) to restrict leverage on these accounts to 10:1 from 100:1. He noted margin foreign exchange trading is a large and growing percentage of the forex market and, despite the focus of the regulators, is not limited to retail traders.

“As a high-frequency trading firm, the data dictates where we trade, whichever rate stream provider we trade with, including margin brokers. We trade millions of dollars through them and now we might have to worry about credit risk too because we’re going to have to send in 10 times more money to trade the same amount,” said Levy. “Foreign exchange brokers are not regulated in the same way as securities brokers with the Securities Investor Protection Corporation insurance.”

Levy said the proposed rules not only serve to hurt the foreign exchange industry, but also call into question the credibility of CFTC policymakers.

“Some say that one of the intentions of the CFTC is to move over-the-counter products to exchanges in Chicago – which is the real power centre,” said Levy. “But it’s not going to happen; business is not going to move to an exchange because the products are not fungible. What will happen is that these markets will move offshore, as we’re seeing right now, to Europe.”

The same level of frustration at the lack of clarity in the regulations being drip fed into the market was shared by Cynthia Tazioli, head of sales and relationship management at CLS. “There are still a lot of unknowns as it pertains to trading/clearing, transparency and territoriality. We’re not clear on whether there will be multiple clearing entities, standards around liquidity management, variation margins, the number of data repositories, what data will have to be reported, and whether Europe will be as tough,” she said.

“If we look at the exclusion [in the Dodd-Frank Act], the buy side is excluded up to a to-be-determined value. But hedges can often be large. And even if swaps and forwards are excluded from central clearing, banks would still have to set up for non-deliverable forwards and options.”

However, Georges Pineau, European Central Bank representative to the US, said that there is a notion among the Group of 20 countries to maintain basic consistencies on major rules at large financial centres.

Read more articles like this one at FX Week.com

Print | Close