What is Forex And Is More Regulation Necessary? This Is The Short and The Long of It

By David T. Ackerman

Introduction

Foreign Exchange Trading, more colloquially known as "Forex," is a worldwide decentralized over-the-counter (OTC) financial market for the trading of currencies, wherein financial centers around the globe serve as anchors of trading between a wide range of different types of buyers and sellers 24 hours a day, five days a week.[1] At $5.3 trillion USD per day in trading, the forex market is the largest in the world, far dwarfing that of stock exchanges.[2]

Foreign Exchange Trading (FX) has been around since the Middle Ages, when the first paper money was introduced as a form of promissory note for merchants and traders.[3] "National Governments, provinces and municipalities began storing gold, silver, and other items of value" issued against these notes and set a value based upon the decisions of the monarchs or governors.[4] Modern forex trading as we know it began between 1850 and 1880.[5] The gold standard was introduced in 1880, and at that time FX was a system of "fixed exchange rates in relation to gold and in the absence of any exchange controls."[6] This removed the volatility caused by the whims of the aristocracy in power, and it helped the FX markets remain relatively stable until World War I.[7] From WWI until the early 1970s, increased global trade made the gold standard an increasingly ineffective method of currency valuation, and by 1973 the currencies of major industrialized nations became free floating.[8] Due to the new structure, the FX market is, in theory, no longer driven by national banks and governments, but by supply and demand.[9] Given the etymology of this vast industry, it is no surprise that legislators, academics, and commentators have "passionately debated the promise and the peril of permitting financial intermediaries to regulate their own activities,"[10] and in conjunction which government agencies should oversee FX activities.

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This paper extends previous scholarship on FX regulation in nine ways. First, it explains why FX trading is important, not simply to the wolves of Wall Street, but to everyone. Second, it gives a high level overview of what FX transactions are, and how they work. Third, this article gives an analysis of the US Commodity Futures Trading Commission (CFTC) with respect to FX regulation; including where the CFTC derives its authority from, and what authority is conferred. Fourth, it breaks down the *Dodd-Frank* Wall Street Reform and Consumer Protection Act with respect to FX trading—specifically, what effect the Act had on the Securities and Exchange Commission (SEC), the CFTC, and an overview of the present status of the requirements. Fifth, the article gives a high level overview of self-regulatory organizations (SROs) that regulate FX trading or FX trading participants, and includes a synopsis of the respective SROs role in the regulatory framework. Sixth, it discusses the overlap between the CFTC and the SEC when tasked to regulate FX trading; explaining how the *Howey* test can create some uncertainty in the legal regime. Seventh, the article argues that US regulators can (and have) effectively regulate FX market participants using the current regulatory structure—without need for any additional regulation or at a minimum without need for hasty regulation. Eighth, it outlines what market participants can do to comply with current regulations surrounding FX trading, in an effort to mitigate hefty fines or in some cases criminal penalties. This article concludes that although harmonization between the various regulatory entities surrounding FX trading would be ideal, US regulators currently have at their disposal all the authority and power needed to enhance market integrity and maintain high liquidity.

Should We Be Concerned When Wolves Devour Wolves? If You Have Tears, Prepare to Shed Them Now

The FX market is global, and no single global body polices it,[11] but only 5 percent of the market is retail in scope.[12] The other 95 percent of the market is Spot FX,[13] which the vast majority of trading is conducted by banks.[14] So why would the average investor care if wolves devour wolves?

First, even though retail transactions only make up a small fraction of the market as a whole; 5 percent of a $5.3 trillion dollar a day market is nothing to scoff at. Between 2001 and 2007, nearly 26,000 individuals in the US lost $460 million in currency-related swindles[15] to bad actors in violation of the law.[16] Furthermore, as the financial crisis of 2008 taught many, the actions of large global banks have a very real effect on the average investor through their immense influence on the markets—and Forex trading is no different.

Interest rate derivatives (swaps and futures, for example), are financial products that are used by banks or large companies to manage risk with respect to interest rate fluctuations.[17] "These products are traded worldwide and play a key role in the economy," and are derived from a benchmark interest rate, such as the London interbank offered rate (Libor).[18] Libor is intended to be a reliable reflection of the rate at which banks are lending to one another. "Based on the average of that rate, after highs and lows are discarded, the Libor index is used not just for financial derivative products but as a key index for setting loan rates around the world, including adjustable rate mortgages, credit card payments and student loans here in the U.S."[19] In recent news, regulators around the world found traders at banks engaging in rate manipulation in the now famous Libor and Euro Interbank Offered Rate (Euribor) scandals.[20] With rate rigging you find "collusion between banks who are supposed to be competing with each other."[21] Competition and transparency are crucial for the markets to work, servicing the economy as a whole as opposed to the economic interests of a few.[22] "[T]here very well could have been distortion effects on relative prices for imports and exports related to the various currencies,"[23] leading to a manipulation of interest rate derivatives.

Although the average person has likely never heard of Libor, the effect it has on the daily lives of everyone in the US is plain. In light of the far-reaching effect of FX trading on the daily lives of so many, it is safe to conclude that FX manipulation is a genuine concern to everyone, and not just the wolves.

How Forex Transactions Work,[24] Forever and a Day + 2

Traders speculate on the fluctuating values of currencies between two countries, and then trade based upon their belief. As the value of one currency rises or falls relative to another, traders decide to buy or sell currencies in order to make a profit. The mechanics of a trade are virtually identical to those found in other markets, but because of the symmetry of currency transactions, you are always simultaneously long in one currency and short in another. Spot (or cash) forex transactions normally settle on the second day after trade (T+2), and so long as they are concluded within T+2 they are specifically exempt from Dodd-Frank. The spot market is in essence a market of immediate delivery of and payment for the currency.[25] The price of FX is customarily an amount equivalent to a single monetary unit of foreign country that will commend in respect to a local or another currency.[26] The spread between the spot and forward rates of exchange expresses the expectation of the future strength of the two currencies in relation to one another.[27]

Many securities transactions typically settle on the third day after trading (T+3), such as foreign ordinaries or other foreign market investment, and as such are subject to regulation. Because FX trading with foreign ordinaries often involves broker-dealers, they are subject to Dodd-Frank and are typically regulated by the SEC, Financial Industry Regulatory Authority (FINRA), and state Blue Sky Laws. It is important to note that is it currently unclear whether a purchase or sale of foreign ordinaries involves a retail forex transaction under Dodd-Frank, however, this may not be an issue in practicality because most transactions are handled through broker-dealers as noted previously.

Regulatory Authorities: We Know What They Are, But Know Not What They May Be

In the modern US era, the rules promulgated by the various agencies regulating FX trading are, at least in part, "designed to ensure the financial integrity of firms engaging in … forex transactions,"[28] and ultimately

provide for robust customer protections. However, due to the complexity of the US regulatory regime, it is difficult to understand what agencies regulate what behavior with respect to FX trading. As of 2010 with the passage of Dodd-Frank, the jurisdiction over retail forex transactions is allocated among the SEC) CFTC, and "appropriate" federal banking agencies.[29] The ambiguity associated with the regulatory overlap has caused delays in implementation and compliance, and created uncertainty in the market. When currency movements can dictate the fortunes of the largest nation to individual consumers, one might think that it should not remain a largely unregulated business. It should be noted that to minimize FX regulation potentially leaves the US market vulnerable to systemic trading losses suffered in less or non-regulated jurisdictions;[30] however, this discussion is beyond the scope of this paper.

Until recently, almost all trading relating to foreign currency was outside the CFTC's jurisdiction.[31] The CFTC, as established by the Commodity Exchange Act (CEA),[32] is authorized to regulate the "volatile and esoteric" market in futures contracts in fungible commodities, which includes nonagricultural commodities "in which contracts for future delivery are presently or in the future dealt in."[33] The Commodity Futures Modernization Act (CFMA) gave the CFTC authority over foreign currency transactions,[34] or so they thought. In *Zelner*, the prevailing case until 2008, the US Court of Appeals for the Seventh Circuit held that "spot" foreign currency transactions traded over-the-counter were not subject to CFTC regulation.[35] The Seventh Circuit determined that the CFTC does not have jurisdiction to bring enforcement actions relating to trading in off-exchange foreign currency contracts, because the contracts did not guarantee a right of offset and thus are not subject to regulation under Section 2(c) of the CEA.[36]

Critics argue that this ruling created a gap in consumer protection,[37] a criticism largely supported by the statistics of fraud from 2001–2007 noted previously. It was not until the CFTC Reauthorization Act of 2008 that the commission was given regulatory authority over all exchange retail transactions in foreign currency.[38] The act clarified CFTC's authority over FX transactions, and overruled the Seventh Circuit's findings in *Zelner*.[39] The CFTC Reauthorization Act amends Section (2)(c)(2) of the CEA to give the commission regulatory authority over off-exchange retail forex transactions that are:[40]

(1) Offered to retail customers that are exclusive of eligible contract participants as defined by the act; and
(2) Offered or entered into on a leveraged or margined basis, or financed by the offeror, the counterparty or a person acting in concert with them, on a similar basis, unless offered by a qualifying entity specified in Section 2(c)(2)(B)(ii).

The CEA does not permit regulation of OTC FX transactions that settle in two days by actual delivery of currency by the CFTC, but does provide the commission with expanded authority over FX trading industry participants other than the counterparty[41] to the transaction.[42]

Oh Dodd, Wherefore Art Thou?

The SEC has maintained a regulatory role over commodity pools through the backdoor of the Securities Act of 1933 and the Securities Exchange Act of 1934. The SEC claims those ownership interests are securities and thus subject to its regulation. Whether the SEC had jurisdiction over such securities was in doubt after the CFTC was created because the latter agency was given exclusive jurisdiction over the regulation of futures trading.

In 2010, Congress attempted to address retail and OTC forex trading with the passage of Dodd-Frank.[43] Dodd-Frank gave regulatory jurisdiction to a number of federal regulators, in an attempt to close loopholes in the FX trading markets.[44] Specifically, Section 742(c) of the Dodd-Frank Act grants jurisdiction to the SEC over retail forex transactions that are processed by a broker-dealer.[45] Transactions conducted under these circumstances are to be conducted according to rules adopted by the SEC,[46] although at present the SEC has only adopted interim rules allowing for such transactions if conducted in accordance with its existing rules and those of FINRA (and other self-regulatory organizations).[47] Only recently has the SEC imposed new requirements and restrictions on broker-dealers.[48]

Dodd-Frank also expanded the scope of the CRTC's authority to regulate fraud and manipulation claims.[49] Dodd-Frank allows the CRTC to regulate certain rolling spot contracts, which typically require delivery of the commodity, in this case foreign currency, within three days.[50] Until this alteration, rolling spot contracts

sidestepped CFTC jurisdiction because they were not considered "contracts of sale of a commodity for future delivery."[51] Dodd-Frank amended the CEA to allow for CFTC regulation of "any agreement, contract, or transaction in any commodity that is entered into with, or offered to, a non-eligible contract participant or non-eligible commercial entity on a leveraged, margined, or financed basis" except when the sale results in actual delivery within 28 days or other limited circumstances.[52] Subsequent to the enactment of Dodd-Frank, the CFTC has broad anti-fraud authority involving almost all retail transactions of commodities.

The CFTC released a statement meant to clarify positions held by the various commissions included in the alphabet soup of regulators under Dodd-Frank:[53]

> While the CEA permits several types of entities to act as counterparties to retail forex transactions, the question of who regulates the activity depends on the type of entity offering to be the counterparty. For example, SEC-registered brokers or dealers doing retail forex transactions are regulated by the SEC and financial institutions are regulated by banking regulators. The CEA provides that the CFTC has jurisdiction over FCMs [Futures Commission Merchants] RFEDs [Retail Foreign Exchange Dealers], or entities that are otherwise not regulated.

It is important to note that the aforementioned Dodd-Frank requirements relate to retail forex transactions, which as previously stated comprise 5 percent of the FX market. The remaining 95 percent is largely unregulated, but this market is conducted primarily by banks, which are heavily regulated by the SEC and various banking regulators. Furthermore, critics of Dodd-Frank point out the inability of regulators to comply with the complexity of the requirements. As of July 19, 2016, the six-year anniversary, a total of 271 Dodd-Frank rulemaking deadlines have passed (out of the 390 total rulemaking requirements).[54] In addition, 20.5 percent of the 390 total rulemaking requirements do not have proposals, and of the 271 passed rulemaking deadlines, 61 have been missed.

Do the Wolves Cower or Celebrate, When Self-Regulatory Organizations Regulate?

The Securities Exchange Act of 1934 created the SEC, and empowers the agency to create SROs made up of market participants, called members, conducting various tasks within the securities industry.[55] Under the supervision of the SEC, SROs are tasked with creating rules that allow for disciplining members for improper conduct and for establishing measures to ensure market integrity and investor protection.[56]

The National Futures Association (NFA) is the "self-regulatory organization for the U.S. derivatives industry, including on-exchange traded futures, retail off-exchange foreign currency (forex) and OTC derivatives (swaps)."[57] The NFA incorporates Forex dealers into their own category of membership, which as of October 1, 2011, includes any NFA member that acts as a counterparty or offers to act as counterparty to a retail customer in a FX trade.[58] As Forex Dealer Members, market participants are subject to a variety of obligations including, obtaining approval from the NFA to engage in retail forex activities; not engaging in any forex transaction that is prohibited under the Commodity Exchange Act; and not engaging in any forex transaction that would attempt to or successfully cheat, defraud, or deceive any other person.[59]

Similar to that of the NFA, FINRA regulates and monitors broker-dealers and other market participants in the securities industry.[60] They conduct examinations of securities firms; and when appropriate levy penalties and fines against firms that violate laws, FINRA rules, the public trust, or required public trade reporting. FINRA also monitors markets for suspicious activity in conjunction with the SEC.[61] As the largest SRO in the country, FINRA monitors 6 billion share trades every day.[62] In November 2008, FINRA issued a Regulatory Notice advising members that certain rules will apply to FINRA members engaged in retail forex transactions, and the communications discussing retail FX transactions.[63] Within this Notice, FINRA stated that Rule 2110, which requires members to act in a "just and equitable" way, applies to all the business of a broker-dealer, including FX trading.[64]

From an overview of the positions SROs take with respect to FX trading, one could easily justify the position that SROs view their role in FX enforcement as anti-fraud, retroactive-looking measures, as opposed the perpetual supervisory role played with other types of trading activities.

The Course of True Regulation Never Did Run Smooth

With so many regulators and regulations, overlap between agencies can happen as lines are blurred. As previously discussed, the CFTC has exclusive jurisdiction over futures markets, whereas the SEC has jurisdiction over securities markets.[65] An issue that has generated considerable scholarship surrounds the discretionary commodity futures accounts—and whether they are securities subject to SEC regulation.[66]

A commodity futures contract is a standardized agreement to buy or sell a fixed quantity of a commodity.[67] The CEA defines "commodity" as including "all services, rights and interests in which contracts for future delivery are presently or in the future dealt."[68] Thus any financial instrument or other interest can be a "commodity," including FX futures. Alternatively, Section 2(1) of the Securities Act of 1933 defines "security" to include an "investment contract."[69] The US Supreme Court held that an "investment contract" is a "contract, transaction or scheme whereby a person invests his money in a common enterprise and is led to expect profits solely from the efforts of the promoter or a third party."[70] Thus, discretionary commodity futures accounts *can* be considered securities depending upon the court's view of whether vertical commonality, as opposed to horizontal commonality, meets the investment contract definition under the *Howey* test.[71]

In 1975 the Mordaunts brought suit against Incomco, who held the plaintiffs' discretionary trading accounts, claiming allegations of fraud under 10b-5.[72] Plaintiffs' claim was that because the profits from the investments depended on the skill and efforts of Incomco in predicting the market, their accounts were investment contracts and thus subject to regulation by the SEC.[73] The favorable ruling in the lower court was ultimately reversed in the US Court of Appeals for the Ninth Circuit, with the court concluding that a common enterprise must be present for an investment contract to exist and that "the prosperity of the third party must hinge on the success or failure of the Investor in order to have a common enterprise."[74] Because Incomco's prosperity did not hinge on the success or failure of the Mordaunts' investments, the court found that the accounts were not "investment contracts."[75] The majority of courts seem to agree, concluding that discretionary accounts are not securities subject to SEC jurisdiction,[76] but given the presence of horizontal commonality in commodity pools the result may be different for investment in those strategies.

The importance of this conflict is not limited to the classification of discretionary commodities futures contracts, but to the nature of the *Howey* test and the question of which type of commonality is more stringent and how it is defined.[77] Lower courts are similarly divided as to whether *Howey* requires vertical or horizontal commonality. For example, the Ninth Circuit rejected the vertical commonality requirement ruling that "it is not enough that the promoter has control of the investments. "Vertical commonality" also requires a correlation between the success of the promoter and that of the accounts themselves."[78] The US Court of Appeals for the Fifth Circuit has stated that the "critical inquiry" is whether there is "promoter dominance," that is, "whether the fortuity of the investments collectively is essentially dependent upon promoter expertise."[79] This divide leaves us questioning when and how to apply *Howey*, and in turn how to analyze the discretionary commodity future account conundrum.

Congress created the CFTC and the SEC as independent federal agencies to regulate distinct aspects of financial markets without overlapping jurisdiction, but, as shown previously, those markets have converged in certain respects.[80] It is prudent to note that unlike the CFTC, the SEC does not have a limiting jurisdictional mandate,[81] but questions still remain in situations brought on by ever-increasing legislation and judicial interpretation.

Hefty Fines or FX Regulation: Enforcement by Any Other Name Would Smell As Sweet

Financial markets regulators were not created with overlapping jurisdiction.[82] Even when Congress determines it is prudent to coordinate activities, it is done with the intention of avoiding duplication and unnecessary costs.[83] This is not an immediate concern in the area of retail and wholesale FX rule promulgation, because it does not appear the SEC will be adopting any FX rules anytime soon.[84] "[T]he staff's rationale is that it needs additional time to assess the Retail Forex market and determine whether, among other options, Retail Forex rules need to be proposed or the rule extension be allowed to expire."[85] In light of these

concerns, coupled with the complexities listed in the aforementioned sections, it can be argued that definitive regulations to regulate wholesale FX transactions, and additional regulations governing retail FX trading are unnecessary to restrain, discipline, or otherwise regulate the massive FX market.

As of November 14, 2014, more than $4.3 billion in fines have been levied on the six firms connected to the FX rigging scandal, with additional fines expected from additional regulatory agencies.[86] As a result of the Libor investigation by US regulators, the Office of the Comptroller of the Currency (OCC) has fined JPMorgan and Bank of America $950 million to settle allegations of FX rigging; and the CFTC fined Citigroup, JPMorgan, Royal Bank of Scotland, UBS, and HSBC a total of $700 million.[87] A "lesson learning" approach is already used by US regulators, and may address the immediate need of the way to effectively regulate the FX markets while regulators and lawmakers determine appropriate rules and statutes.

Recently, the CFTC has successfully fined several banks $1.4 billion, using the current regulatory regime.[88] The fines were coupled with additional requirements, noncompliance of which can result in further action by the CFTC.

> The Orders also require the Banks to cease and desist from further violations, and take specified steps to implement and strengthen their internal controls and procedures, including the supervision of their FX traders, to ensure the integrity of their participation in the fixing of foreign exchange benchmark rates and internal and external communications by traders.[89]

Prior to that staggering fine, the commission ordered David R. Lynch to pay more than $470,000 in restitution, plus a civil monetary penalty, in connection with charges of fraud, misappropriation, and false statements in connection with a commodity pool trading leveraged or margined off-exchange foreign currency contracts.[90] According to the Order, "Lynch falsely told pool participants that he had earned as much as 7 percent per month trading Forex, that they could never lose their principal, and that they could get their funds back at any time."[91]

As further evidence of success, the CFTC has successfully brought numerous claims before US courts, in attempts to stop or cure fraudulent behavior. In *CFTC v. The Liberty Mutual Group, et al.,* a US magistrate judge of the Southern District of Florida found that the defendants were unregistered, and committed fraud in connection with the sale of an off-exchange foreign currency option to retail customers.[92] The court's orders required the defendants to pay more than $7 million in restitution to defrauded investors; in addition, the orders impose civil monetary penalties, totaling more than $5 million from all parties involved.[93]

The CFTC is not the only SRO that has enjoyed successful enforcement of FX actions. Much like the CFTC, FINRA has broad investigatory and disciplinary powers.[94] These powers were used in the context of FX trading in August 2011, when it found that Richard Garaventa misappropriated funds from his firm by entering, or causing to be entered, numerous false journal entries into the firm's electronic system to transfer and credit approximately $1,786,052 from different firm sources, including the firm's Fee and Foreign Exchange accounts, among other violations.[95] Although this is not a direct example of FINRA enforcement of FX trading, the disciplinary proceeding does illustrate the myriad of ways the SRO can address FX trading concerns by broker-dealers in the absence of any further regulation by the SEC. FINRA has, at its core, a mission to protect investors against fraud and in 2012 the organization assessed $68 million dollars in fines.[96] Furthermore, there is no statute of limitations with respect to FINRA disciplinary proceedings, making past prohibited FX-related conduct fair game under current fraud and misappropriation theories if discovered in the future.[97] This is consistent with the absence of a limitations period for SEC administrative actions, and allows FINRA to impose sanctions based on a showing that the person is unfit to continue as a registered person within the terms of the securities laws.[98] It is not beyond the scope of imagination that FINRA could utilize its supervisory capacity to fine FX trading broker-dealers for fraud, misappropriation, or manipulation of FX trading, without promulgating any additional rules.

As a final example, in 2010 the SEC filed a civil complaint against Boston Trading and Research, LLC (BTR), Ahmet Devrim Akyil, and Craig Karlis (*Boston*

Trading).[99] The SEC alleged that defendant BTR, as founded by Akyil and Karlis, offered investors, in writing or orally, the opportunity to invest money for the purposes of trading in FX.[100] Over the course of a year, the SEC alleged the defendants raised approximately $40 million from around 750 investors.[101] As the SEC complaint further states, ultimately "the defendants diverted the investor funds for their own personal purposes, including funding BTR's operations, personal expenses, and expenses for other companies with which they were associated."[102] The two men told customers that they had various strategies to reduce risk, including a mechanism to shut down trading if an individual customer's account lost more than 30 percent of its value, but in reality no such mechanism existed.[103] The SEC instituted the complaint in response to activities that the SEC claimed were:[104]

(1) Fraud in the offer or sale of securities, in violation of Section 17(a) of the Securities Act of 1933;
(2) Fraudulent or deceptive conduct in connection with the purchase or sale of securities, in violation of Section 10(b) of the Exchange Act of 1934 and Rule 10b-5;
(3) The sale of securities without being registered as brokers or dealers, in violation of Section 15(a) of the Exchange Act of 1934; and
(4) The offer and sale of unregistered securities, in violation of Sections 5(a) and (c) of the Securities Act.

By September 2008, the firm lost approximately 90 percent of the customers' money, totaling a little over $30 million.[105] The civil case was stayed in 2011 pending the outcome of a criminal proceeding initiated by the US Attorney's Office.[106] In September of 2014, Craig Karlis was sentenced by Senior Judge Mark Wolf to nine years in prison and three years of supervised release, and ordered Karlis to pay $4,378,306 in restitution to the fraud victims.[107] The case clearly illustrates the ability the SEC and the Justice Department (DOJ) have to assert jurisdiction under Section 20(d) and Section 22(a) of the Securities Act, and use that authority to regulate FX trading, or more accurately, regulate FX fraud and misappropriation.

Assuming *arguendo* that no further regulations are passed with respect to FX trading, the aforementioned analysis clearly demonstrates that US regulatory agencies are more than equipped to effectively govern the fraudsters within the market.

What Can FX Trading Firms Do to Get Out of the Jaws of Death?

The regulatory environment has changed greatly from the "market integrity approach" pre-2008 to the "investor protection" mentality where we currently stand. In the wake of the nearly 400 rulemaking requirements of Dodd-Frank,[108] billion dollar fines, and criminal incarcerations, FX market participants are likely anxious of what the future may hold. Market participants must plan ahead with a strategy that will cover current trading activity, yet also be flexible enough to adjust to any future regulation. Guidance lies in the press releases, statements, and settlement orders of the entities recently fined in the LIBOR and WM/Reuters Rate scandals.

Of paramount importance is a detailed process control procedure that oversees all FX related activity of the business. In the settlement terms with UBS, the CFTC indicated that "UBS did not have adequate controls over its foreign exchange business,"[109] resulting in the $661 million dollar fine.[110] Britain's Lloyds Banking Group dismissed eight staff members following an investigation into manipulation of benchmark interest rates—but only *after* it was fined by US and British regulators this past July.[111] Both US and British regulators faulted JPMorgan for "inadequate internal controls and supervisory failures."[112] The CFTC noted that:[113]

> JPMorgan lacked adequate internal controls in order to prevent its FX traders from engaging in improper communications with certain FX traders at other banks. JPMC lacked sufficient policies, procedures and training specifically governing participation in trading around the FX benchmarks rates and had inadequate policies pertaining to, or insufficient oversight of, its FX traders' use of chat rooms or other electronic messaging.

It is expected that market participants will "have controls in place that are sufficiently robust to ensure that employees will follow the law and adhere to the highest standards of conduct."[114]

Second, training is an absolute must. If employees are trained about the dangers and pitfalls of FX trading

as regularly as they are trained about the perils of insider trading, an FX market participant can at a minimum assert that any action taken counter to that training is the act of a rogue employee, and not indicative of the business model of the firm or bank. As an example, "[r]egulators said traders from the three banks used online chat rooms to discuss ways to manipulate rates to benefit themselves and share confidential information such as customer orders."[115] When conducting training on best practices, it would be very easy and cost effective to include FX trading information alongside insider trading information where applicable.

Third, do not fear voluntary disclosure. Citigroup was granted full immunity for one of its three charged Yen Libor infringements, and avoided paying an additional €55 million ($74.6 million) in penalties to the European Commission.[116] Whereas federal securities laws "do not require a company to accuse itself of wrongdoing,"[117] voluntary disclosure can be a powerful tool. DOJ and SEC memoranda have emphasized that a company's willingness to cooperate with regulators—such as by taking remedial actions or voluntarily disclosing wrongdoing—is a crucial factor that influences agency enforcement decisions.[118]

It remains uncertain as to what shape FX regulation will take and whether it can be policed effectively on a global scale. In the interim, the aforementioned compliance measures will allow FX market participants to maintain the financial integrity of their forex transactions, both retail and wholesale, while simultaneously maintaining robust consumer protections. Many criticisms echoed across boarders revolve around the notion that "banks permitted an environment to develop in which unscrupulous traders discussed manipulating foreign exchange markets."[119] Creating procedures designed to identify and monitor possible FX manipulation can serve as an internal auditing tool for early intervention, dismissal, or a possible defense to regulators should the need arise—thus discouraging deceitful practices in the FX markets.

Parting Is Such Sweet Sorrow

The nexus between FX trading and US regulation is truly complex, and is at a critical juncture regarding the future of how FX trading is conducted in this country. Regardless of the future of regulation, it is certain that market participants will take a far more active role in self-regulation of FX trading than ever before. The cost of business will be too great to ignore the supervisory role imposed upon those dealing with the immense FX market. It is likely that losses incurred over the coming years by market participants will prompt political pressure to develop a harmonized system of regulation with respect to FX. This will likely be accelerated if SROs and regulatory agencies begin to overlap to a greater extent in between respective jurisdictions.

Anything that fuels the process towards harmonization can be viewed as a positive; however, increasing the number of regulations under US securities law is not necessarily required. As this article has shown, the agencies and SROs tasked with watching the FX markets have more than enough authority to effectively police this industry using the "lesson learned" approach. By continuing to levy heavy fines to wrongdoers, regulators will force market participants to think of self-monitoring and compliance as a component of the investment strategy, and not merely as an afterthought. This tactic has been employed with great success in the past and can continue to yield results long into the future.

Those fearful of the immense size of the FX market will continue to shout from the rooftops for increased regulation. Opponents of regulation will likely echo the time-honored mantra that unintended consequences loom in the mist, and regulation puts the US at a disadvantage against other less regulated countries. Ultimately, the market will find a way regardless of what direction regulation goes. As Shakespeare wrote, "Though this be madness, yet there is method in 't."

Notes

1. *See* "What Is Foreign Exchange," *International Business Times* (2011), available at *http://www.ibtimes.com.au/what-foreign-exchange-forex-1278035*.
2. Triennial Bank Survey – Foreign Exchange Turnover in April 2013: Preliminary Global Results, 3 Bank for International Settlements (Sept. 2013), available at *http://www.bis.org/publ/rpfx13fx.pdf*, last accessed Sept. 6, 2016. (Comparing the forex market to the $28 billion USD of the NYSE).
3. History Year by Year 65 (2011).
4. *Id.*
5. *See* JW Markham, *A Financial History of the United States,* M.E. Sharpe, Volumes 1–2 (2002). *See also* M. Pohl, *European*

Association for Banking History – Handbook on the History of European Banks, Edward Elgar Publishing, (1994).

6. *See* Shani Shamah, *A Foreign Exchange Primer,* John Wiley & Sons, 2–3 (2011).
7. *Supra* n.3.
8. *Id*.
9. *Id*.
10. *See* Kristin N. Johnson, "Governing Financial Markets: Regulating Conflicts," 88 *Wash. L. Rev.* 185, 187 (2013).
11. *See* Roger Aitken, "Forex Market Regulation: Who Can Really Police This Global Market?," *Forbes* (Aug. 11, 2014), *http://www.forbes.com/sites/rogeraitken/2014/08/11/forex-market-regulation-who-can-really-police-this-global-market/*, last accessed Sept. 6, 2016.
12. *Id*.
13. *See generally*, Henry Gregstein, Katten Muchin Rosenman, *Impact of US Dodd-Frank and other reforms on alternative investment vehicles: a brief guide*, Practicing Law Institute, 23 (May 1, 2014) (Defining "Spot" as a foreign exchange transaction settled through actual delivery of the relevant currencies within two business days, provided however, that a transaction with a longer settlement period can be considered a *bona fide* spot transaction, depending on the customary timeline of the relevant market).
14. *See e.g.*, Rosemarie Oda, "Retail Foreign Exchange: A New Opportunity for Banks," 27 No. 1 *Banking & Fin. Services Pol'y Rep.* 1, 1, 2 (2008).
15. *Supra* n.11.
16. *Id*.
17. Michael Fleming *et al.*, Fed. Res. Bank of N.Y., An Analysis of OTC Interest Rate Derivatives Transactions: Implications for Public Reporting 3, (Oct. 2012).
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