WORKING PAPER

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ROLLING SPOT FOREX TRADING – FINANCIAL PROBLEM OR PONZI?

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1 INTRODUCTION

In past years we've been witnesses to the spread of trading platforms and, until 2007, the big bang on the stock and commodity exchanges. High yields in exchanges resulted in the higher interest of retail investors to invest their money in different financial products. As it was shown out of financial crisis in 2007, the yields were more important than risks. After year 2000 there was going on another process. With the falling prices of computer hardware and software literally everyone could afford a PC (even the older people). With well developed web of optical or classical lines internet was easy accessible for everyone at low cost (or no cost at all). All these factors have produced a niche for online forex trading. There is a huge inflation of websites offering forex trading.[1] Although there is not clear what forex trading means.

Speculation (purchase or sale with a view to repurchase or resale at later date at expectation of the change of relevant prices) is separated from investment, which is carried out to gain from interest payments, dividends etc. (the "gain accruing" from the use of the assets), from the purchase of intermediate goods which enter the production process ("transformation") and from arbitrage ("transfer between different markets") (Krueger 1996, 10).

For the investor/hedger exchange rate risk implies possible losses which he tries to avoid to a certain extent. The foreign currency speculator, on the other hand, wants to profit from exchange rate movements (Krueger 1996, 14).

This submission is divided in three parts. First part gives the explanation of forex trading. It shows what is understood under this term. Second part deals with the types of forex trading. This part gives also a brief explanation of each type of forex trading ant main type characteristics. Third part is main part. It deals with the problem of internet forex trading (which is spreaded around the world) .This part analyzes types of trading platforms. It shows who could be the counterparty in retail forex trade. It tries to find out what rolling spot forex trading means. Key question is, if rolling spot forex contracts fall under MiFID system. And finally deals with the problem of (il)legality of such trading.

2 FOREX TRADING

Term forex trading is used and misused for various meanings. Under this term we could find real interbank market, derivatives and even Ponzi schemes. Until year 2000 the term forex was

[1] The search of "forex trading" in google produces 35 million results.

connected only with the interbank market, in which commercial banks, central banks, currency speculators, corporations, governments and other institutions trade currencies amongst themselves. This market is an over-the-counter (OTC), decentralized market without any trade reporting. Retail clients have no access to this market because of its nature (closed circle of traders and high value of contract).[2]

After 2000 forex trade became interesting also for companies, which want to protect against currency risks, as for the speculators, who want to make profits on daily inter currency changes.[3] Forex trade becomes available for retail investors with:

- development of electronic trading platforms, connected to the databases about currency trading on interbank market;
- legislation's change in USA in year 2000 and 2008.[4]

Mentioned legislation's change allowed futures commission merchants, retail foreign exchange dealers, financial institutions, broker-dealers and certain other entities to act as counterparty to retail forex contracts. Retail forex contracts in which none party is authorized party,[5] are null and against law (Buckingham 2002, 3-4). Retail forex transactions conducted through a broker-dealer are expressly precluded from CFTC oversight under the terms of the Commodity Exchange Act.

Full swing of forex instruments was the result of holders' privileged position within the bankruptcy procedure and the low cost insurance against currency risks. On the other hand retail forex contracts became popular with the easy access to the electronic platforms and high leverage ratio (up to 1:400).

America's trends become also European dream. Information about daily turnover on the forex market, possibility to make big profits with a small investments, cheap bank credits and opening eastern – European economies caused a big demand for retail forex contracts. Such market became also interesting for local community investments as a source of possible additional income. On the other hand, for the banks this was a great way to pass the currency risks to the retail clients.
We should distinguish between:

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[2] 1 mio. USD is the standard value of the currency contract.
[3] Bank for international settlement reports that average daily turnover in 2007 on the currency market was 19 billons of USD (Connolly 2007, 27)
[4] The current retail forex regulatory environment is a by-product of the Commodity Futures Modernization Act of 2000 (CFMA of 2000, Pub. L. No. 106-554, 114 Stat. 2763, 2763A-378 (2001)) and the CFTC Reauthorization Act of 2008 (Reauthorization Act; Pub. L. No. 110-246, 122 Stat. 1651 (2008)).
[5] Authorized party could be only bank or organization, registered at the CTFC.

- traditional forex market – interbank OTC “market” where only banks and their brokers could deal (system present quotes from different clients; client must have credit relationship);
- electronic platforms:[6]
  - with one market maker;[7]
  - with several market makers;[8]
  - with access to different participating banks via one market maker.[9]

3 TYPES OF FOREX TRADING

There are following types of forex trading:

- spot currency trading;
- currency forwards;
- currency futures;
- currency options;
- currency swaps;
- currency swaptions.

Spot currency trading on interbank currency market means exchange of one currency for another. It’s a classical foreign exchange banking service. It’s executed on the spot and cleared within two business days.

A forward contract is an agreement between two parties (most often, one of the parties is a bank) to exchange one currency for another at a specified rate and time in the future. Forward contracts can be thought of much like spot market transactions except that forwards are settled at some point in the future. A very important feature of forward contracts is that they are not traded on exchanges, rather they are private agreements between two parties. Since forward contracts are for the future delivery of a currency there is a risk that between the initial agreement date and the delivery date one of the parties may go into default and be unable fulfill its obligations (Cooper 2009, 2).

[6] Most of them use straight-through processing that cares for settlement and delivery. It could offer only spot trade not futures or options. They have upper and lower trading limits.
[7] Banks or big brokerage houses.
[8] Could be also big international exporting and importing companies.
[9] It's open system with unlimited currency pairs.

Currency Futures are conceptually very similar to forward contracts; however, instead of being customized contracts arranged directly between the dealer and the purchaser, futures are traded on exchanges and are standardized. More importantly, however, while forwards are contracts between two parties, futures are contracts between the exchange and one of the parties only (Cooper 2009, 3).

Generally an option is a contract written by a seller giving the holder the right of buying or selling a particular asset at a certain price by a certain date in the future. The option that gives the holder the right to buy the underlying asset is called a call option and the one that gives the holder the right to sell is called a put option. The price specified in the contract is known as the strike or exercise price, and the specified date is known as the maturity date. In the case of currency options, the underlying asset of the options is a particular amount of a currency and the strike price is a prearranged exchange rate. Currency options are flexible instruments and are used for hedging purposes or for speculating on exchange-rate variations (Zeinali 2007, 1-2).

A swap is an agreement between two parties that lets them exchange cash flows in the future under a set of predetermined conditions. A swap contract that is arranged on an exchange of cash flows in different currencies is known as currency swap. Generally, the parties involved in a currency swap, which are usually central banks or well-known companies, try to decrease their financing costs by exchanging their cash flows (Zeinali 2007, 2-3). Giddy distinct between "foreign-exchange swaps" and "currency swaps”. In a currency swap, interest and principal in different currencies are exchanged. The foreign exchange swap consists of a combination of a spot purchase of one currency against another and there purchase of the currency sold, at a certain date in the future (Giddy 1994, 18).

A swaption is an option granting its owner the right but not the obligation to enter into an underlying swap. Currency swaption is the over-the-counter option contract to enter into a currency swap contract.

4 INTERNET FOREX TRADING

As it’s told at the beginning of this submission, within internet forex trading we can find different types of transactions. Different systems have different names: from spot contracts to rolling spot contracts. The main question is, whether such contracts are within Directive

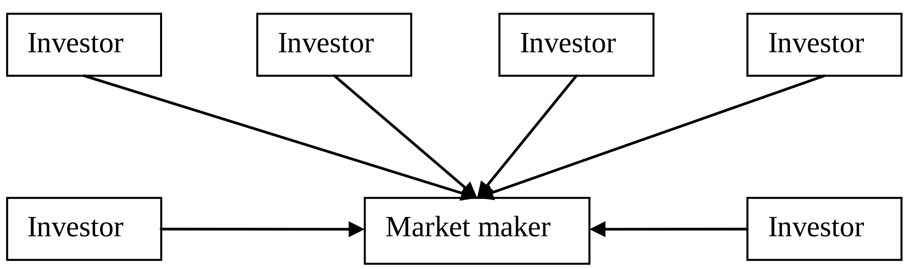
2004/39/EC of the European Parliament and of the Council on market in financial instruments[10] or not. To answer this question, we should look to the following facts:

- who is the counterparty in such contracts;
- which are the rights and obligations form such contracts;
- which is national law's legal definition of money (is it commodity or only measurement of value).

4.1 COUNTERPARTIES

Electronic trading platforms offer two different trading systems. In first system there is one market maker with bid and offers. Manager of trading system or sponsors give their own funds for trading with forex investors. In such system managers fix type of currency crosses, bid/ask spreads, bid/ask publishing delays of Reuters data, trading conditions, "protective measures" etc. Investor (or retail investor) has only the right to accept such rules. Such system is a trading system and clearing system. This system prevails in the internet forex trading. Next figure represents such system.

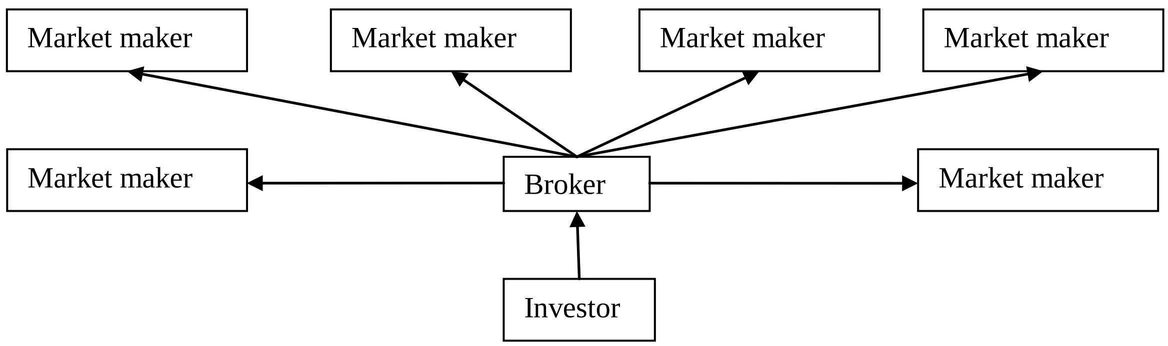
Fig. 1: One market maker



In second system there is a broker between market maker and investor. Broker has access to different market makers and searches for the best deal for his client – investor. In this system broker chooses the best offer or bid between different market makers in the best interest of his client. Such system is the case of big investors whose orders are placed through banks or brokerage houses to the interbank forex market.[11] Next figure represents such system.

[10] OJ L. 145, from 30.4.2004 (hereinafter MiFID Directive)
[11] Some similarity with this system could be found in Daukascopy.Bank SA.

Fig. 2: System with multiple market makers



Specific structure was introduced in the States after the modernization of derivative contracts' legislation in 2000. Dealing with foreign exchange contracts was released to all subjects under condition that one of the parties is "authorized party".[12] Due to the supervisory problems, legislation defined currency as commodity and so currency contracts felt into CFTC jurisdiction. The side effect of such solution was the invention of spot forex trade – spot trading with currency crosses on electronic platforms. Electronic trading platforms became an OTC currency contracts market for retail investors with the logic taken from interbank forex market. It's a market on which retail investors can decide about the amount of investment.

4.2 WHAT IS FOREX SPOT CONTRACT?

Big question what's the instrument trading on the forex spot market. Different explanations on different web pages show, that the essence of the spot forex trade is unclear. All web pages offer explanation about the logic of interbank forex trading. All web pages offer explanation about the currency pairs and what are the factors, which have influence on the pairs.[13] So is spot forex trading really trading with some instrument or is just an expensive lottery in which investors choose the game and the amount to gamble? This part will examine the different explanations of forex, given to retail investors and try to make a definition of spot forex trading.

John Forman on the webpage of tradingmarkets.com (Forman 2010) defines following characteristics of forex trading;

[12] Bank or insurance company, registered securities broker-dealer, futures commission merchant or other financial institution, or is an individual or entity with a high net worth

[13] And about the amount of trade on forex market (what is a main magnet for naïve investors).

- it's 24 hour trading;
- it's a deal between investor and broker;
- there is no exchange;
- it's margin based;
- it's trading with futures (trading a two day forward);
- trade consisted of borrowing one currency, exchanging in other currency ant depositing it (rollover);
- transaction is closed by selling the owned currency for the home currency.

Bart Mallon on the webpage of forexregistration.com (Mallon, no date) defines spot forex as over leveraged off-exchange foreign transactions where one party is a retail customer.

Term SPOT indicates also Single Payment Option Trading. SPOT automatically converts option to cash when option trade is successful, giving a payout. SPOT options can't be cancelled by selling. The underlying is specific Forex spot contract.

In 2009, the Canadian Securities Administrators (CSA) introduced harmonized registration requirements for financial industry participants across all CSA jurisdictions. Separately, securities regulators in Quebec and Ontario addressed the registration requirements of dealers and advisors trading in Contracts for Difference (CFDs) and forex contracts. On February 1st 2009 the Derivatives Act (QDA)[14] came into force in Quebec. Under the Act, a broad definition of "derivative" captures online forex trading as trading in over-the-counter (OTC) derivatives.

FSA defines rolling spot forex contract either of the following:
(a) a future, other than a future traded or expressed to be as traded on a recognised investment exchange, where the property which is to be sold under the contract is foreign exchange or sterling; or
(b) a contract for differences where the profit is to be secured or loss avoided by reference to fluctuations in foreign exchange; and

in either case where the contract is entered into for the purpose of speculation (FSA handbook; http://fsahandbook.info/FSA/glossary-html/handbook/Glossary/R?definition=G1035).

Para 2(2) of Commodity Exchange Act states (amendments from 2008), that Commission has jurisdiction agreements, contracts and transactions in retail foreign currency. Same act mandates minimum capital requirements for entities serving as counterparties to such transactions.

[14] Bill 77.

In USA was in October 1999 granted patent for system and method for trading having the principal market maker (patent no. 5963923). Rolling Spot Currency contract tries to copy the idea of foreign exchange spot cash market.[15] Chicago Mercantile Exchange's (hereinafter CME) Rolling Spot Currency contracts have some exceptions in comparison with spot cash market (Garber 1999, 11):

- exchange makes an automatic daily adjustment for the "roll" via a cash debit/credit;
- trading goes through CME Clearing House – easy solving problems with clearing;
- Rolling Spot Currency contracts have standard size.

For quick access to cash the Rolling Spot Currency contracts are combined with currency forwards to produce forward swap positions (Garber 1999, 11). Rolling Spot Currency contracts are futures contracts, which, in almost all aspects, replicate spot currencies in the forex market (Garber 1999, 12).[16]

Rolling spot currency contracts gained popularity after the case CTFC vs. Zelener in 2004.[17] In this judgment court decided that speculative transactions in foreign currency aren't contracts of sale of commodity for future delivery. Rolling spot currency contracts as a spot trade was in

[15] In this "market" the actual currency transfer generally occurs two business days following the transaction date (SWIFT system rules). At the close of business of each trading day, market participants roll or swap their open spot positions forward one business day. There is a possibility to net future spot positions against existing positions.

[16] There should be the distinction between spot (current date transaction) and the short duration (1-14 days) currency market derivative products (Garber 1999, 11).

[17] Judgment of US Court of Appeals For the Seventh Circuit Commodity Futures Trading Commission v. Michael Zelener, No. 03-4245. Case was as follows. AlaronFX deals in foreign currency. Two corporations doing business as "British Capital Group" or BCG solicited customers' orders for foreign currency. (Michael Zelener, the first-named defendant, is the principal owner and manager of these two firms.) Each customer opened an account with BCG and another with AlaronFX; the documents made it clear that AlaronFX would be the source of all currency bought or sold through BCG in this program, and that AlaronFX would act as a principal. A customer could purchase (go long) or sell (short) any currency; for simplicity we limit our illustrations to long positions. The customer specified the desired quantity, with a minimum order size of $5,000; the contract called for settlement within 48 hours. It is agreed, however, that few of BCG's customers paid in full within that time, and that none took delivery. AlaronFX could have reversed the transactions and charged (or credited) customers with the difference in price across those two days. Instead, however, AlaronFX rolled the transactions forward two days at a time—as the AlaronFX contract permits, and as BCG told the customers would occur. Successive extensions meant that a customer had an open position in foreign currency. If the dollar appreciated relative to that currency, the customer could close the position and reap the profit in one of two ways: take delivery of the currency (AlaronFX promised to make a wire transfer on demand), or sell an equal amount of currency back to AlaronFX. If, however, the dollar fell relative to the other currency, then the client suffered a loss when the position was closed by selling currency back to AlaronFX.

USA prohibited in May 2009 for the members of National Futures Association (hereinafter NFA) with the change of NFA regulations.[18]

CME group offers different currency contracts (either with psychical or cash delivery). In 2007 the CME developed also the Rolling Spot Currency contract, to evade problems associated with spot/futures basis. In fact Rolling Spot Currency contract is a futures contract with a daily adjustment at swap rate.

Even more interesting situation is with definition of spot forex within the banking sector. Saxo bank on its page advertises FX crosses, FX forward outrights and FX options (source: Saxo bank webpage). It's interesting that FX forward outrights and FX options. Funny thing is that there is no definition of FX crosses. Even more funny thing is, that bank in the same page talks about currency trading (what's effectively buying and selling foreign currency) and FX trading[19] as trading with derivatives (source: Saxo bank webpage). Spreads are given by the bank (what shows that the counterparty is bank) but under certain conditions trades must be approved by a dealer (who is employee of the bank).

Deutsche bank offers trading with currency pairs. Although there is no definition what instrument in fact currency pair is. Spreads are defined by bank. The open positions are automatically rolled over.[20] Rollover consists of two simultaneous sell contracts. Client buys for one value date and sells for another value date.[21] (source: Deutsche bank dbFX webpage). By definition from bank's client agreement, bank offers execution-only dealing services in relation to transactions in rolling spot foreign exchange contracts. The counterparty to transactions is

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[18] Such decision was introduced for the reason of consumer protection. In many cases in front of CTFC in 2008 was discovered that rolling spot currency contracts, offered by respective electronic trading platforms, were adjusted to make profits for the managers of such platforms (either by trade algorithms or by delaying of information). Also spreads were greater than on real off exchange market (http://www.nfa.futures.org/nfamanual/manual-updates.html).

[19] Open Spot Forex positions held at the end of a Trading Day will be rolled over to a new Value Date on a Tom/Next basis. As part of the tom next roll over operation, positions are subject to a swap charge or credit.

[20] It must be stated that said it's not true. Paragraph 10 of client agreement states (source: Client Agreement; http://www.dbfx.com/about-dbfx/client-agreement):

10.1 Please note that we will automatically rollover all open positions on your account to the following business day unless you notify us to close your position(s) prior to 4 p.m. (London Time). We will charge you a fee in respect of each such position that is rolled over. The fees that we charge will be specified on the dbFX Trading Platform.

10.2 In the absence of timely instructions from you, we are authorized, at our absolute discretion, to rollover or offset all or any portion of the currency positions in your accounts or to make or receive delivery on your behalf upon such terms and by such methods deemed reasonable by us in our sole discretion.

10.3 For the avoidance of doubt, we will not arrange delivery of currencies unless we deem necessary pursuant to clause 10.2 or if we otherwise agree in writing with you and, accordingly, unless such arrangements have been made by us any currency positions that settle shall do so by credit or debit to your account with us.

[21] Both presumably to the Deutsche bank.

Deutsche Bank AG, London Branch. In fact all main characteristics of deal is in the hand of the bank and can be unilaterally changed or modified by the bank.[22]

Variety of counterparties could be found within Dukascopy. Indeed SWFX Marketplace trading system works on matching client's orders and counterparty's[23] orders. In fact, (non)existence of counterparty has a vital influence on a client's trade.[24] If there is no liquidity, there is no trade.[25] But also Dukascopy has a broad possibility of unilateral actions[26] and limited responsibility.[27]

[22] And obviously in favor of the bank. E.g. Para 1.3 of Client Agreement: "… We reserve the right to modify or discontinue, temporarily or permanently, a service (or any part thereof) with or without notice. You agree that we will not be liable to you or to any third party for any modification, suspension or discontinuance of a service." Para 3.1. of Client Agreement: "…he prices that we quote are determined by us and usually represent a mark-up or markdown of inter-bank dealing rates. Each price shall be effective and may be used in a dealing instruction prior to the earlier of its expiration time and the time, if any, at which it is otherwise withdrawn by us. A price may not be used in a dealing instruction after such time. Each price shall be available for use in a dealing instruction for a transaction with a principal amount not to exceed a maximum determined by us. You acknowledge that these prices and maximum amounts may differ from prices and maximum amounts provided to other customers of ours and may be withdrawn or changed without notice. We may in our sole discretion and without prior notice to you immediately cease the provision of prices in some or all currency pairs and for some or all value dates at any time." Para 15.1. of Client Agreement: "…15.2 We shall not be responsible for any loss or damage caused, directly or indirectly, by any events, actions or omissions beyond our control including, without limitation, loss or damage resulting, directly or indirectly, from any delays or inaccuracies in the transmission of orders and/or information due to a breakdown in or failure of any transmission or communication facilities."

[23] By para. 1.1.e of marketplace trading agreement "Counterparties" shall mean banks and/or brokers and/or marketplaces and/or any client or partner of Dukascopy or Dukascopy itself participating in the transactions executed for the account of the Client in opposite direction (source: http://www.dukascopy.com/swiss/docs/bankForms/Marketplace-Trading-Agreement-in-use.pdf).

[24] By para. 11.i. of marketplace trading agreement "Liquidity" shall mean the existence of a counterparty in the SWFX Marketplace Trading System, willing, at a particular moment, to enter into the transaction of the Client in opposite direction with the same price and with sufficient volume (source: http://www.dukascopy.com/swiss/docs/bankForms/Marketplace-Trading-Agreement-in-use.pdf).

[25] Para 2.1. of marketplace trading agreement Dukascopy executes trading orders of the Client subject to the ability of Dukascopy to find appropriate liquidity and to provide the execution over the SWFX Marketplace Trading System (source: http://www.dukascopy.com/swiss/docs/bankForms/Marketplace-Trading-Agreement-in-use.pdf).

[26] E.g. Para 8.2. of marketplace trading agreement states that Dukascopy shall be entitled to restrict access to, or to impose limits, suspend, stop or cancel trading on the SWFX Marketplace Trading System (including, without limitation, discontinuing the Client's use of the API), either generally or in respect of particular currency pairs, transactions or customers, or to discontinue transmitting any or all information, or to refuse facilitating or proceeding any or all transactions, or to refuse allowing access to and use of the SWFX Marketplace Trading System, in the event that, at Dukascopy's sole discretion, any of the following circumstances occur (source: http://www.dukascopy.com/swiss/docs/bankForms/Marketplace-Trading-Agreement-in-use.pdf):

8.2.1. full or partial failure of the SWFX Marketplace Trading System, including failure of the technology constituting the SWFX Marketplace Trading System or any of the communications linked to the SWFX Marketplace Trading System or between the SWFX Marketplace Trading System and the Client and/or any of the Counterparties, or any other circumstance as a result of which it is not practicable for Dukascopy to use the SWFX Marketplace Trading System;

8.2.4. non-compliance by the Client with any applicable laws;

8.2.5. market conditions generally or conditions with respect to a particular currency pair or a single currency rendering it necessary or desirable, at Dukascopy's sole discretion, to do so;

The strong unilateral position of Dukascopy is seen from para 14.2. of marketplace trading agreement.[28]

As it's seen different legal systems and different providers offers different definitions of rolling spot forex contracts. These definitions range from currency derivatives (which are within MiFID) trough mixture of CDF's and swaps, to real exchange of currencies with obligatory swap at the end of the day to the financial smears.[29] So what this term means depends of the legal system and contractual terms. All this legal uncertainty is the possible trigger for great amount of electronic platforms which are in fact "ponzi schemes". By my opinion, many of rollover spot forex contracts are pure fiction produced form nothing and turning around this nothing to produce money from naïve investors. What's the legal reasoning for such thinking?

Firstly, each manager of platform states that it's an OTC platform. It's not an organized market. These platforms have their internal rules, but these rules could be easily changed unilaterally by platform manager. As counterparty to the retail client is ether platform manager or his partners or other clients. Such structure allows the platform to be outside the registration's obligation (under MiFID rule for the MTF's). And such platform is also out of the supervisor's power of national financial market regulators. To stress this fact out, most contracts has a provision that maganer of a platform only executes given orders (it's not a system of receiving orders; in this system clients only posts their orders).

Secondly, managers of platforms offers trade with currency crosses and with rolling spot FX contracts. With such terminology the managers of platforms try to avoid the control of national central banks, which are responsible for supervision of the currency exchange service. Most of these platforms can't do currency exchange, because they don't have proper license. Terminology is used to cover the real deals.

8.2.6. absence of liquidity on the market

[27] Para 14.3. of marketplace trading system agreement states that the possible liability of Dukascopy, if any, regarding any losses which might arise as a result of the contractual relationship with the Client shall in no event exceed the amount of 10 times the total commission(s) received by Dukascopy for the particular transaction(s) in question (source: http://www.dukascopy.com/swiss/docs/bankForms/Marketplace-Trading-Agreement-in-use.pdf).

[28] Dukascopy assumes no liability towards the Client for the ability of the SWFX Marketplace Trading System to meet the user's requirements, be error-free, or operate without interruption, or that information transmitted through the SWFX Marketplace Trading System (or via phone) shall be accurate or timely. Dukascopy shall also assume no liability for other users of the SWFX Marketplace Trading System or any employees of Dukascopy to perform as expected. The SWFX Marketplace Trading System shall be provided strictly on "AS IS" and "WITH ALL ITS FAULTS" basis (source: http://www.dukascopy.com/swiss/docs/bankForms/Marketplace-Trading-Agreement-in-use.pdf).

[29] With intention to avoid possible controls form regulators and state.

Thirdly, no platform gives what is neither currency cross nor rolling spot FX contract. If these contracts are standardized, than with such contracts should be firstly dealt on the organized market.[30] This means, that for such instruments the issuer should firstly got the accurate permission and only after that, trade with such instruments is possible also on the OTC. Almost all of these "crosses" and "rolling spot" don't have the appropriate permission. On the other hand, you can't trade with (non)standardized contracts on OTC.[31] Managers of platforms try to explain that these instruments aren't financial instruments. But what are they? If we went out that we can trade with:

- money;
- commodities;
- money market's instruments;
- financial market's instruments.

Managers of platforms successfully defy placing currency crosses or rolling spot forex contracts in any of mentioned categories and maintain mystery of their nature. By this they show per se the illegality of such trade.

Fourthly, as it was shown with the contractual terms, the manager of platform has pure discretion to decide how and when to execute the order. They limit their responsibility. They have wide right to change trade algorithms, stop orders etc. In most cases such rights of opposite party rises at least a big question of conflict of interests, if not a question of business fraud.

4.3 (I)LLEGALITY OF ONLINE ROLLOVER SPOT FOREX CONTRACTS?

The answer on this question depends on various factors:

- client's national legislation;
- type of forex trading platform;
- is it a retail market or market for professional clients;
- type of instruments, traded on forex trading platform;
- legislation of the state in which forex trading platform is located.

[30] And only after it, with such instruments could be dealt on the OTC market.
[31] Considering the fact, that every such contract is different from others. So the trade with such contracts on the OTC would be possible just in case, that the buyer or seller would place on platform the whole contract's content he wants to buy or sell.

By my opinion we could differentiate 4 different types of forex trading platforms:

- platform in which the manager of platform is also a counterparty to the retail client;
- platform in which manager of a platform offers only a technical support to the retail clients and market makers;
- platform in which manager of a platform offers only technical support to the clients (either retail or professional) – trade is between clients;
- platform which is mixture of above systems.

Next figures show relation in first three systems.
Fig. 3: Trading platform as a market maker

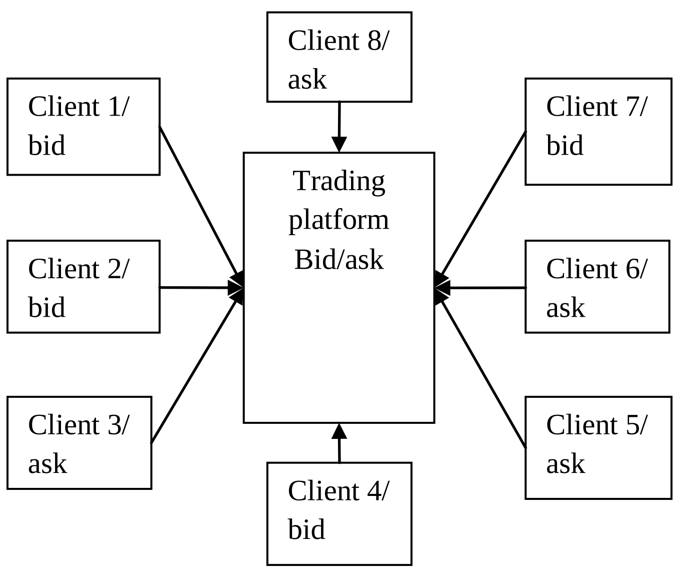


Fig. 4: Trading platform as an intermediator

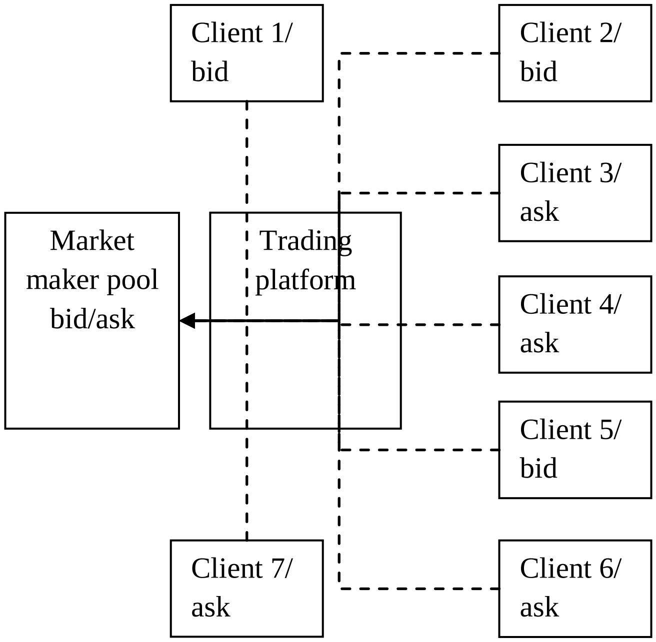
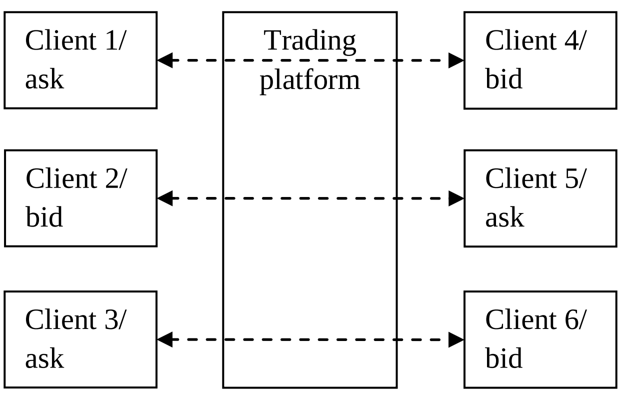


Fig. 5: Trading platform as a bulletin board



First type of platforms poses question of their legality because of possible conflicts of interests. If the owner of a platform is also market maker who earns on the bid/ask spreads, than such platforms, declared as OTC (so outside every supervision), can't play an honest game.[32] Only the platform's manager knows the trading algorithms and the platform's manager has a right to

[32] In fact in should be against every economic law if the platform's manager wouldn't like to maximize his profits. This is even truer in environments, which are not regulated at all.

change “rules of the game”. No one, except platform’s manager, knows whether trading algorithm treats every client equally. Such platforms are, by my opinion, internet casinos with the adjusted roulette balls and fake playing cards, adapted in favor of platform’s manager. So such platforms should be treated as an in line gambling rooms and should be regulated or supervised under gambling laws.[33]

Second type of platforms also poses a question of their legality in case of connection between trading platform’s manager and pool of market makers. There could be a serious question of conflict of interests even on the case of not so many bindings between manager and pool of market makers. For this part is valid what is said in the above paragraph. How is with legality of such platforms in the case of no connection between their mangers and pool of market makers? Answer depends on the type of instruments they’re trading with. When they are trading with standardized financial instruments (in accordance with their national legislation) such trading is legal. Otherwise is illegal.

Third type of platform is a type of notice board. In the case of automatic order routing, clients could trade only with standardized financial instruments. In the case of trading with nonstandardized instruments we could talk only about legality of the trade and not of the trading system.

Dealing with legality of the instruments in the retail forex market we could talks about:

- pure currency exchange;
- FX options;
- FX outright forwards;
- FX swaps;
- FX futures;
- Currency crosses.

There is no question of legality with the first five instruments. Greater problem posts the last one.[34] By my opinion currency crosses could be treated as:

- pure currency exchange;
- trading with standardized foreign currency contracts;
- trading with foreign currency futures with different date of maturity.

[33] Managers of these platforms can't be treated as market makers, because mostly their role as market maker is just factious. Mostly they just aggregate bids and asks and show this aggregated bids and asks as their bid/ask.
[34] Which is also mostly offered product of the FX platforms.

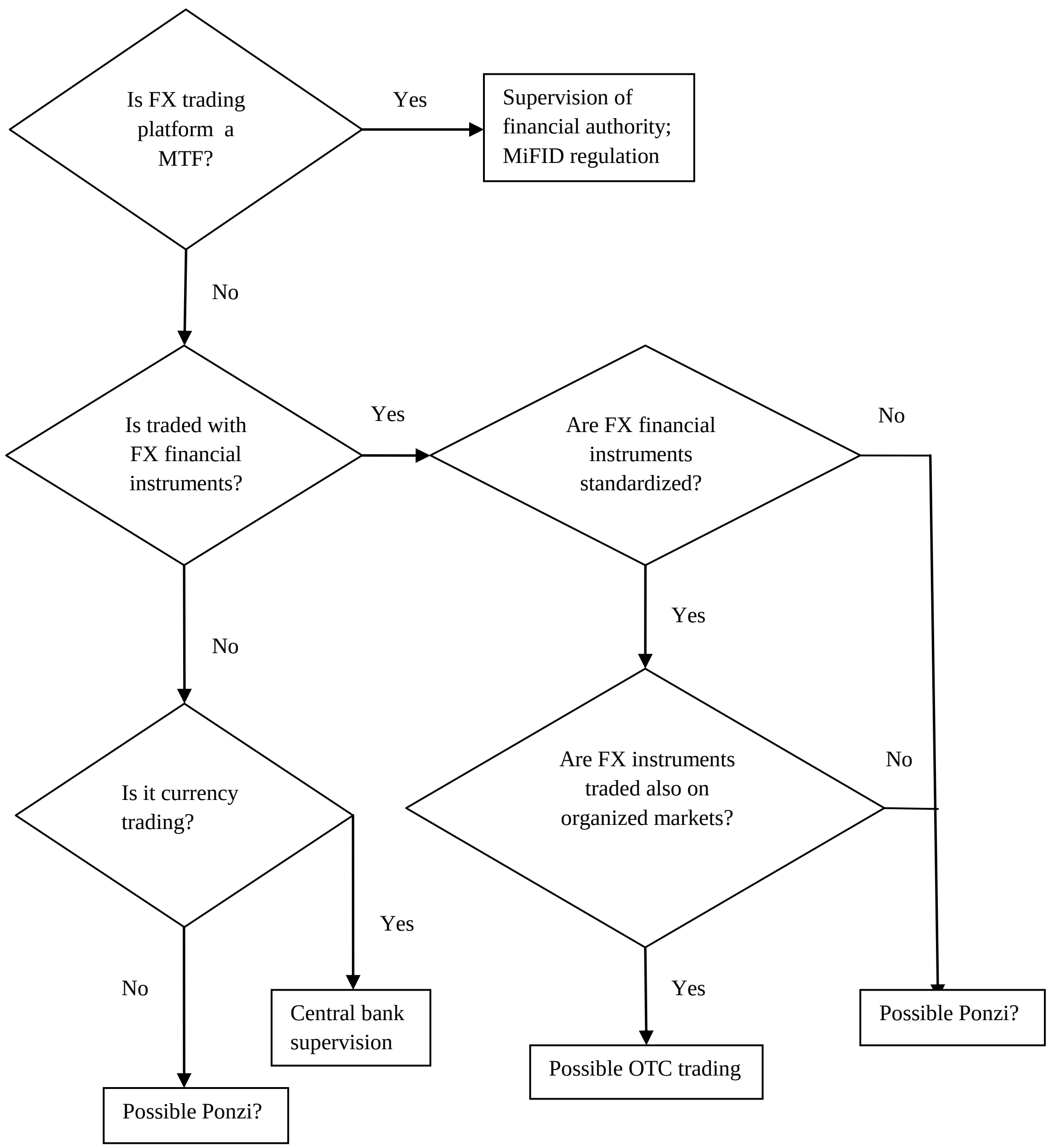
In the first case we can talk about banking service. In second and third case such instruments should be traded also on organized exchange (otherwise we can't talk about standardized contracts and can't be simply traded via electronic trading platforms) and should get appropriate permission before their emission. In abovementioned group I intentionally didn't include quasi contracts for difference. The main problem of the last one is the illegal production of fiction money in the case of mere speculation. If we take into account a fiction case of retail contract for difference at forex platform.[35] In most cases the platform's manager gives a retail client factious loan of 500.000 EUR against payment of margin even though the manager doesn't have this amount and the retail client doesn't have enough wealth to return such loan.[36] So platforms are in fact creating new money without any limit.[37]

We can't expect the uniform definition of rolling spot forex contract. We can't even expect that all countries would prohibit such contract. Taking into account a big number of ponzi schemes and real economic benefits of such contracts, my opinion is that EU should prohibit rolling spot forex contracts. The main intention of rolling spot forex contracts is mere speculation (and not hedging) – if not gambling. On the other hand, rolling spot forex contract hides a margin contract. As is seen such scheme produces new amounts of fiction money, which gives additional fuel on the fire of people's greed.[38] How should be treaded rolling spot forex contracts concluded by European subject outside EU? If the subject can prove, that such trade is a trade with instrument listed on an organized exchange, than such trade shall be treated as trade with financial instruments. Otherwise such trade should be treated as a gambling contract with all consequences. The access to all on line forex trading platforms should be blocked. Regulators should avoid general approach that rolling spot forex contracts are per se derivatives, which fall inside MiFID.

Next diagram tries to define a decision making procedure to decide whether the FX trading platform works legally or is a ponzi scheme.

[35] Although I think that currency derivatives are contradictio in adiecto and were great generators of the last financial crisis.
[36] If we talk about rollover contracts in which rollover cost of a contract is cost of interest rate.
[37] And with no legal base. There is also a question whether platform's managers are registered for loan service.
[38] And gives to the people the deceptive feeling of richness. You pay 20.000 EURO to play with 1 mio EUR just in a second.

Fig. 6: Decision making procedure



5 CONCLUSION

Rolling spot forex contracts are product of rapid grooving business of forex trading platforms. In fact there is no uniform definition, what is rolling spot forex contracts. Some markets or legal systems offer a definition of mentioned contract. Mostly the forex trading platforms only offer trading with such contracts with no legal explanation of traded “instrument”.

Such environment with no clear regulation gives a fertile floor for different Ponzi schemes and also greedy operators of forex trading platforms. As it’s seen form contract terms, operators of such platforms have a lot of rights and almost no obligations. With margin trading they produce huge amounts of virtual money which disappears in “virtual black holes” after the investor is drained.

Because of mentioned the uniform action of EU should be done in direction of paneuropean prohibition of rolling spot forex contracts. On the other hand all access to internet trading platforms which offer such trading, should be blocked.[39] In case of concluded contracts, such deals should be treated as illegal gambling.

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[39] With such action there would be a big decrease of different ponzi scams.

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