Forex Trader's Bill of Rights

OANDA

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Introduction

In any convention of economic interest, buyers and sellers are connected at one point: the price that defines the transaction. Whenever pricing mechanisms are obscured, monopolized or manipulated by a minority of market participants, the majority pays a cost. Not necessarily willingly, or even knowingly. But economic advantage will pass to those who set the rules.

The demand for currency--while sporadic and unpredictable at any given moment--has no pre-defined limit. It is expressed as a function of the number of buyers or sellers who declare their intention to deal within a specified price range. Supply is also potentially unlimited, in an efficient marketplace--except when price movement is manipulated for reasons extraneous to natural market forces.

Inefficiencies in the pricing process prohibit the market from maintaining a natural equilibrium between supply and demand.

In an unregulated, global marketplace--such as the forex market--conventional market makers have been granted tacit permission to set prices, do deals, and dictate the protocols of the trading environment --- but NO LONGER.

A combination of three new realities has already moved the market:

1. **Technology** - that facilitates broader market participation and the potential for greater efficiency;
2. **Diversity of participants** - that broadens the trading base to include non-speculative interest, retail trading, and occasional as well as deeply committed professional traders; and
3. **The emergence of a new class of market makers** - who reject antiquated processes that discriminate against traders, offer a new way of trading, and are paving the way for new efficiencies.

The implication of these new realities? Demand for new trading practices that not only address issues of fairness but have the power to remove the displacements between buyers and sellers to realize vastly improved market efficiency.

Why does a Forex Trader's Bill of Rights matter?

1. To make the forex market fair.
2. To realize prices created by natural market forces uncensored by the arbitrary intervention of middlemen.

The problem with forex pricing today is that there is no fixed point of reference. Bid and ask prices creep from point to point for no good reason. Leading to an overshooting effect--in either direction--that adds unnecessary risk, can diminish liquidity, and jeopardizes best execution.

For the forex market to be effective, it has to be efficient, transparent and fair. In the days of open-outcry trading, it was. Now modernization gives the illusion of efficiency, but the process is clouded by layers of self-interest that favor the select few and discriminate against all other traders.

In an unregulated marketplace, change can come only from the inside out--from the traders who put their assets at risk. Not from entrenched interests who purport to control how this business is done.

Exercising your rights as a trader will reduce your cost, eliminate much of the uncertainty and risk that need not be part of the process, and restore clarity **and fairness to forex trading.**

Understand your rights. Then insist on them.

The slippery slope of arbitrary pricing

The overshooting effect is the first step down a slippery slope. Prices move too far in one direction, and then they move too far again. The result is a massive disruption in pricing that makes trading very risky and much more difficult.

For traders, the absence of a fixed reference point undercuts the viability of a trading strategy: pricing snowballs away from market-driven valuation of a currency and toward prices that are arbitrary.

For the global economy, arbitrary pricing makes it impossible for the market to capture meaningful relationships among currencies. Massive pricing disruptions undercut central banks, ability to maintain a legitimate valuation for their currencies based on economic realities.

Call to Action

Recognize that there is a difference between standard operating procedure and best execution.

Challenge your market maker: ask the questions that appear in the Bill of Rights.

If your market maker doesn't come up with satisfying answers, make your next trade with one who can.

1. Wagging the dog

THE RIGHT TO IMMEDIATE, UNCENSORED ACCESS TO THE MARKETPLACE

Who's minding the store?

Given the volume, tempo and apparent liquidity of the forex market, you'd expect it to be an open and efficient place to trade.

Until you stop to ask:

- Why was my trade delayed?
- Why did my price move so far away from what I expected?
- What is my market maker not telling me?

And there's really one answer to all three of these questions.

> *Access to the forex market is overwhelmingly controlled by a handful of market makers whose intervention does not act in the best interest of traders.*

Could we trade without them? Of course not. But the real problem is how they exercise control: with little or no regard for efficiency, fairness or transparency.

First, there are no uniform standards. Pricing, execution and accountability are subjective: how your trade is handled depends on the size of your order, your current position, the size of your account, your trading habits and history, and your personal relationship with the market maker.

Outcome: execution and price are a function of who you are. [privileged access: lack of fairness]

Second is a more anonymous form of censorship: price and execution may have nothing to do with you, but on how your order fits--or doesn't fit--the market maker's trading agenda at any given moment.

Outcome: execution and price are a function of the market maker's greed. [biased access: lack of transparency]

How do they do it? The largest market makers execute with dealer intervention, using subjective information or net positions to manage their own book of business.

Outcome: execution and price may be bad or good, but manual intervention ensures that the process won't be efficient. [delayed/inefficient access: lack of efficiency]

If these practices are so obviously bad, why are they still so common?

Because predominant market makers continue to rely on systems introduced more than 50 years ago, before modern technology enabled spot execution and immediate settlement. And before the Internet had created a global community of traders. **Before demand and competition insisted on a better way.**

In an unregulated, international, over-the-counter market, no one's minding the store. And any abuses are likely to get lost in the dust cloud of volume. And even without overt abuse, round-about execution and settlement increase cost and create unnecessary risk. Because they slow the trading process and throw up a barrier between the trader and the trade. For no good reason.

What is your market maker not telling you?

Anything that would allow you to compare what you're getting now to what you should be getting. Anything that might jeopardize the market maker's ability to exploit his lop-sided advantage.

A call for transparency

The business of market making should promote the existence of one market with no price discrimination, not a labyrinth of sub-markets controlled by a few big players.

A call for fairness

The one market should produce one price for every trade-regardless of the trader's identity-and that trade should be executed immediately.

A call for efficiency

Market makers should step up and embrace technology that enables them to counter-party trades at the market, not at their own convenience and advantage.

One market for all

Every market exists to create prices for traded assets. For the pricing mechanism to be effective, traders must not be segregated into special groups with special prices. The stability of the process depends on including the greatest possible number of buyers and sellers, whose actions spontaneously and immediately determine supply and demand-and, therefore, pricing equilibrium.

As long as one group of traders exercises disproportionate influence in the pricing process, there can be no equilibrium; and trading will be riskier and costlier for the majority.

Until market makers are held accountable for the price of each trade, there will be multiple markets, multiple prices for the same trade, and greater overall instability.

2. What you see is not what you get

THE RIGHT TO TRADE REAL SPOT

When your spot trade becomes a two-day contract.

In forex trading any delay is more than an inconvenience: your trading strategy is interrupted, you make fewer trades, costs go up, there's unnecessary risk. It's a waste of your time.

With most market makers today, every trade you make is a forward contract--not a spot trade. What does that mean?

Say you've made a successful intra-day trade and you'd like to close out your position and collect the proceeds. Don't hold your breath... Absent the immediate settlement of a real spot trade, you'll wait two business days until you get your money. (And in the meantime, your funds are a hidden asset for the institution processing your trade.)

What if you'd like to keep your position open? Most market makers require you to do a rollover swap: close out and re-open your position simultaneously, with a new settlement date one day further in the future. (Whom does the swap benefit? Who do you think pays for this antiquated housekeeping detail? And why is it even necessary?)

Two-day settlement restricts your flow of capital, penalizes traders who depend on equity to fund their next trade (which might be in an hour... or in five minutes), and gives unfair advantage to the market maker who provides no value in return. It's just old-fashioned processing.

The **Continuous Linked Settlement (CLS)** network is a global system for settling FX trades. Begun in 1997 by central banks and major institutional traders worldwide, the goal of CLS is to guarantee intra-day settlement for its member firms and their customers. Its higher purpose is to eliminate settlement risk and maintain market liquidity.

As a counter party to every trade, the market maker is responsible for maintaining transaction flow. Two-day settlement invites myriad opportunities for disruption:

- through defaults or delays in the transaction stream;
- through the need to reconcile inconsistencies; and consequently
- having to make up for time lost in restoring the flow.

Read the fine print in your contract: your trade will close; but when it settles is at the discretion of your market maker.

In a world of increasingly short-term trading (90% of forex trading is intra-day), the system is out of sync with practical reality.

Think it's not a serious problem? Then why have the big banks invested years of time and money making this particular pill a little easier to swallow? (By enabling "netting" through a prime broker or daily settlement through the **CLS network**.)

3. A little knowledge is a dangerous thing

THE RIGHT TO KNOW

What do market makers know that you don't? And how are they using that information?

How well do you know your market maker?

For each item, check one:

INSIDE INFORMATION	MY MARKET MAKER: DISCLOSES	DOES NOT DISCLOSE
Summary of client positions	☐	☐
Net position of all open trades	☐	☐
Spreads that were applied (real-time and historical)	☐	☐
Spreads that were applied (in relation to trade size)	☐	☐
Prices at which deals were done	☐	☐
Market flows	☐	☐
Order-book statistics	☐	☐

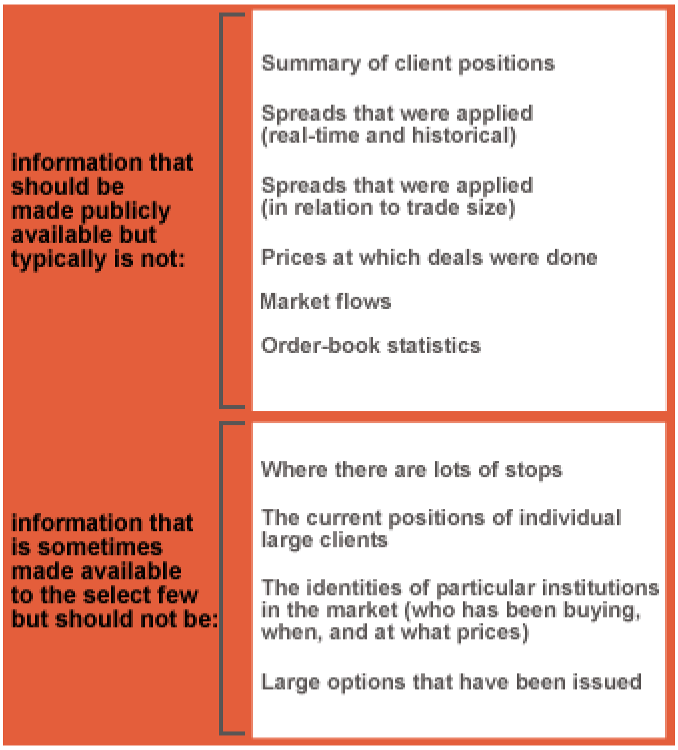
If you made even one check in the left column, your market maker is the rarest of exceptions. Why is that?

Market makers know everything that's worth knowing about their customers, but they're highly selective about how and with whom they share this information. If it's valuable to some traders, why not routinely disclose it to everyone? Withholding valuable information is simply another form of manipulation by market makers.

Someone is benefiting from this knowledge. If not you, why not?

It's not that any of the items in the checklist constitutes an absolute “signal.” It's just that these statistics paint a comprehensive picture of the state of the market; and they can also tell traders something about the market maker's way of working. You can't be expected to “trade the market” if you're forced to fly blind.

In the recent, traumatic cleansing of the accounting industry it became trendy to talk about transparency. But beyond the cliché, transparency has a real purpose: to ensure undiluted fiduciary responsibility. Why should the global currency markets be immune from such fundamental common sense?



Of course trading styles vary. But occasional traders- as well as active professionals- deserve to know the lat of the land at any given moment

This kind of disclosure is another important component of uncensored execution: Providing me with more, not less, information about the likely cost and risk of committing to a position.
Traders are ultimately responsible for their own decisions, but withholding important information market makers determine who stands a better chance of winning or losing. This represents an arbitrary advantage that should not be tolerated.

4. Timing your trade, or trading your time

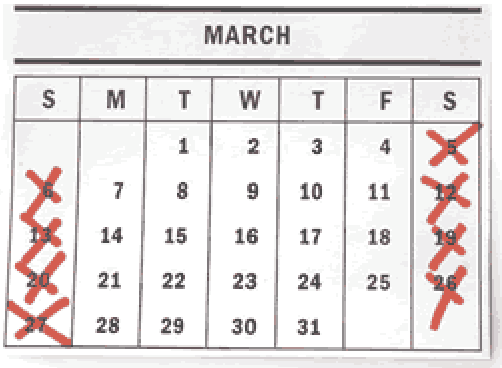
THE RIGHT TO TRADE WHENEVER YOU WANT

Common knowledge among equity investors says that time in the market trumps market timing. Try that strategy in the forex market and see how long you last.

In currency trading the strategic value of a position is calculated more often in seconds or minutes than in days or weeks. Opportunity is defined as locking in your trade when you're ready, not your market maker.

Many market makers advertise round-the-clock trading and 24/7 customer service. But virtually all of them close the trading book on Friday afternoon. Which is fine until it's Sunday morning and you've just fine-tuned your strategy, but you can't place your order.

The hallmark of the forex market is volatility: it's a direct reflection of trading activity, momentary liquidity, and breaking news that can move prices in whole numbers, not just pips. You can't control volatility, but you won't profit by watching from the sidelines.



While much of the industrial world has come to celebrate the weekend, events that drive currency prices have a way of ignoring the calendar. For example:

- political and economic summit meetings
- national elections
- acts of terror
- military confrontations and attacks
- natural disasters
- unnatural disasters—like assassinations, coups and hostage-taking
- the fact that many countries don't take off on Saturday and Sunday

For traders in a global market fueled by 24/7 news coverage, the sometimes market maker represents a tangible threat.

5. The fallacy of best execution

THE RIGHT TO EQUAL TREATMENT

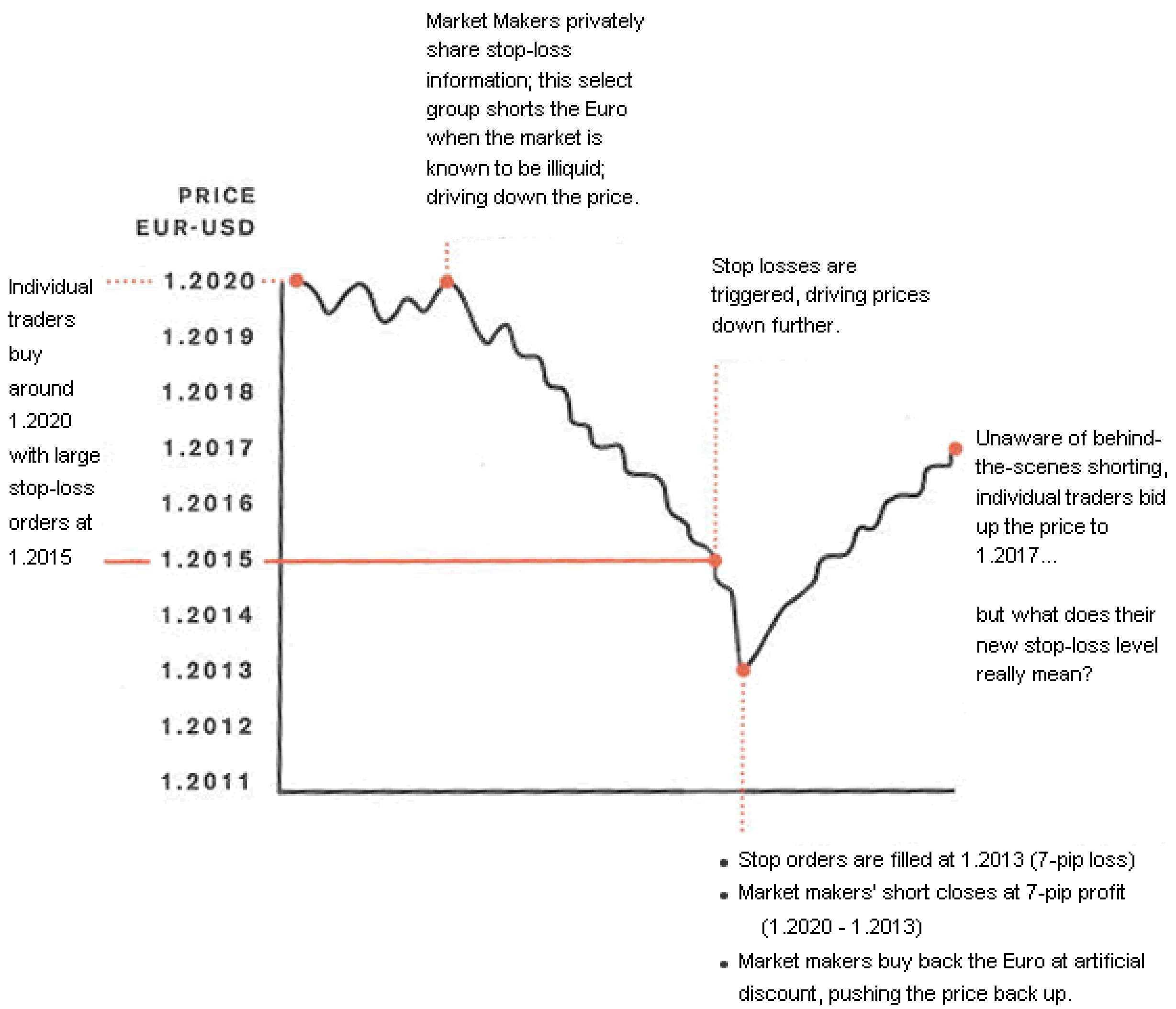
Market makers are more concerned with making deals than making trades

For any type of trading, best execution comprises three essential factors:

1. **the best price** (least displacement from the quote)
2. **the fastest execution** (to capture the moment of opportunity—without the delay of dealer intervention)
3. **the fastest settlement** (for traders, to maintain the flow of capital; for market makers, to avoid operational and interest-rate risk)

Don't look for any of these in fx trading today, because market makers discriminate among traders and how trades are quoted and executed. Maybe your market maker has got your number: because of your trading style, because you trade in odd or small lots, or because—in the eyes of the market maker—you're on the wrong side of a given trade.

Ask your market maker why identical trades have different spreads and close at different prices. When you're told that "spreads don't matter," be prepared to dig a little deeper. And beware the guaranteed spread. Compare your quote to other spreads for your intended trade that aren't quite so fat. Realize that a guarantee is never free: it's a window of inflated cost to allow for extra margin—but not necessarily yours.



Artificially triggering stops to close out a position is the worst form of discrimination. It kills a trade at the will of the market maker and defuses what could have been a successful strategy.
You'll never know.

The right to equal treatment

Whatever the size of your position, whether you're long or short, no matter where you set your stop-loss, and regardless of your trading history—every trader should get the same spread and the same price. Instantaneously. No excuses.

Spreads matter. They're the part of the transaction where you can exercise the greatest control: by choosing a market maker with tight spreads up front, who doesn't discriminate, and whose execution—trade after trade—keeps your total cost in line with your real profit.

You have the right to understand your total cost of ownership. Inflated spreads will hide this from you, and your market maker will always defend the price you got as best execution. Instead of just accepting it, figure out for yourself what's really best.

6. Don’t give in or give up

THE RIGHT TO CHOOSE AND MANAGE RISK

Why the inevitable risks of forex trading aren't.

Forex trading has plenty of risk built right in. Why add more if you don’t have to?

Before you give in to “the inevitable costs of doing business,” understand that it doesn't have to be that way. Know what you can control to manage risk (and cost), and choose a market maker that grants you the flexibility to do so.

You do have a choice.

The nirvana of leverage:	Your market maker offers 200:1 leverage, but that doesn't make it right for you. Keep your trading real: know when your market maker is facilitating your trade and when he's likely to become a loan shark. And remember that the margin requirement is designed to protect everyone but you. It is never a reliable barometer of real risk. For example: say you're long and short two highly correlated currencies; you're already managing risk, even though you're required to double up on the margin requirement.
Tyranny of the round lot:	Committing more than you want to a trade robs you of flexibility—and increases your exposure to risk. Choosing a market maker that allows you to trade any amount gives you the option to maintain your position (for example, in the face of a margin call) and manage the opportunity. Isn't that why you made the trade in the first place?
The high cost to limit risk:	Choose a market maker that doesn't charge you for having the wisdom to set stop-loss and take-profit thresholds.
Revolt against price-skewing:	Tired of seeing your positions go up in smoke? Choose a market maker who trades at the market—without discriminating or artificially taking out trades that don't fit his book of business.
The (inflated) cost to play:	Exorbitant minimums are a holdover from the days of paper trading. Why invest $100,000 if that's way above your comfort level? Choose a market maker that lets you control your risk from the outset—by committing only the amount you need to trade or can bear to lose. Then you'll be in a better position to use leverage wisely and get the most out of your investment.
Settle now, not later:	Immediate settlement minimizes counter-party and operational risk. Don't just ask for it. Insist on it.

Keeping your trade alive

Say you have an open position with a large unrealized loss and you're close to a margin call. You don't want to deposit additional funds, but because you think your position will turn around and appreciate you don't want to close it out prematurely.

Some market makers will allow you to avoid the pending margin call by closing out only 5% or 10% of your position. And you can use that same flexibility to take advantage of an unrealized profit.

Take a number

Between the close of your trade and settlement day, your market maker is obliged to settle all the transactions that precede yours.

If everything goes perfectly, you're in luck. If not, be prepared to wait until your market maker has sorted everything out.

7. Feeding time at the spread trough

THE RIGHT TO UNDERSTAND COST

You know what you're making, but how much do you get to keep?

Spreads matter: see the Profitability Calculator at the end of this chapter for the difference one pip can make.

Opaque spreads and hidden processes make it hard to know what kind of deal you're really getting. You know your absolute cost, but how many intermediaries took a piece of that? And what—if anything—did they do to contribute to best execution?

Pricing in the forex market is highly subjective. Even when your market maker guarantees the spread, if it's inflated you should know why.

Because intermediaries build into the trading process a secret franchise of participants. Maybe they're part of your market maker's organization, maybe they're not. But each is guaranteed a piece of the action on every trade. Who are they? And what, exactly, do they do?

You have the right to know.

Such bureaucratic layering can only add to your total cost, with not much to show for it. Meanwhile, the market keeps moving, and there goes your ability to seize momentary opportunity.

In forex trading today, none of this constitutes criminal behavior. For traders it's just bad business; for the market maker & associates it's the proven path to riches. Worst of all, traders' acceptance of bad practices just perpetuates them.

Inside a regulated, national economy, enforcement agencies might be expected to step in and ensure or, at least, encourage fair practices. But the global forex market is not regulated.

Change is way overdue. And for this market the only agent of change will be the individual trader. So, what can you do?

The right **to** understand cost

Know what you're getting for the excess spread you're paying. If intermediaries are adding value, how can you quantify that? And have you taken the trouble to do so?

Know what you're giving away. Use the Spread Cost calculator to figure your profitability at your current spread; then see how much difference a one-pip reduction could make.

Use your new-found perspective to reexamine your trading relationship. Challenge your market maker. Listen carefully to the answers you get. Be prepared to make a change—or settle for the tradeoff between what you're paying and what you're not getting for that excess cost.

8. Learning by burning

THE RIGHT TO LEARN—ON YOUR OWN, OR THROUGH FREE EXCHANGE WITH OTHER TRADERS

The high cost of trial and error

Breaking news: online market makers breathe fresh air into the smoke-filled back rooms of forex trading…billions of dollars enter the market each day…everybody's getting rich quick (or so they claim).

The good news is that there are more ways into forex than ever before, and it costs much less to trade.

The bad news is that it's as hard as ever to know whom to trust.

How do you find out what you need to know about a market maker?

1. **From what the market maker tells you**

   In the old days you placed your order and took your chances. Everything happened behind the scenes—no learning curve, no second chances.

   Online market makers today make trading a little more obvious. They entice traders with demo accounts and trading games. Sure, they're a come-on, but there are some good ones—and they're not just for novices. The best ones are a risk-free way to learn the ropes or test a trading strategy before you commit.

   But take care:

   - Does the demo platform offer the same spreads and prices as the real platform? If not, keep shopping.
   - Is the demo a “limited-time offer”? Many are, so they won't be useful for serious traders who like to test as they go.
   - No matter how realistic the demo, it's still make-believe. The stakes suddenly change when you're investing real money.

2. **From what your fellow traders have to say**

   As an asset to trade, currency is hot. And as more investors enter the arena the information industry is not far behind.

   You want a sure-thing trading strategy? The Internet is happy to oblige. But keep one hand on your wallet at all times.

   As expected, the big banks and institutional traders have kept quiet. Maybe they've owned all the important information for so long they're not afraid that 10 million traders might actually compare notes.

   Meanwhile, the bulletin boards and chat rooms and trader forums are all abuzz. No surprise: most of the talk is self-congratulation from sudden experts. But there's also some good information—and, for the first time—traders have access to other people's experience.

   Be sure of two things:

   - Market makers are listening to what traders say. They will shape their trading practices around serious demands that rise above the noise. Why?
   - Because in a newly public marketplace the individual trader's experience finally matters. When an active trader who does a billion a year complains online about execution or inflated spreads, his market maker will care. Especially when that trader can click over to a more competitive, more responsive market maker for about $25.

The right to learn -- on your own, or through free exchange with other traders

Learn before you burn. Because of its lack of regulation and global customer base, forex has a unique opportunity to escape the narrow control of information by a few big players.

Look for demo platforms that are true-to-life, and use them to do some comparison shopping. The best ones not only let you compare costs—they reveal the market maker's attitude toward you as an investor.

Choose a market maker who's not afraid to let his customers tell it like they see it. Insist on uncensored public forums that let you tell what you know and learn what you don't.

Take your responsibility seriously. Sharing critical experience will help weed out second-class or dubious operators and hold the survivors to a higher standard.

9. Getting beyond fairness to true accountability

THE RIGHT TO FULL DISCLOSURE

Real spreads and real prices should be a matter of public record.

The risk of currency trading is exaggerated by a lack of transparency at three stages:

1. **pricing** (why is the quote what it is?)
2. **execution** (why was my position closed at point A instead of point B or C?) and
3. **after the fact of the trade** (what were the real spreads and real prices while my position was alive?)

Just as market makers use their knowledge of traders' positions and habits, traders should have the information to characterize and judge the habits of their market makers. Today, that's barely possible. You take what they give you, and 'better luck next time.'

So a major component of the cost of ownership is simple uncertainty—about your cost, what you left on the table, and the true validity of your trading strategy (which may have been derailed by the secret franchise of intermediaries).

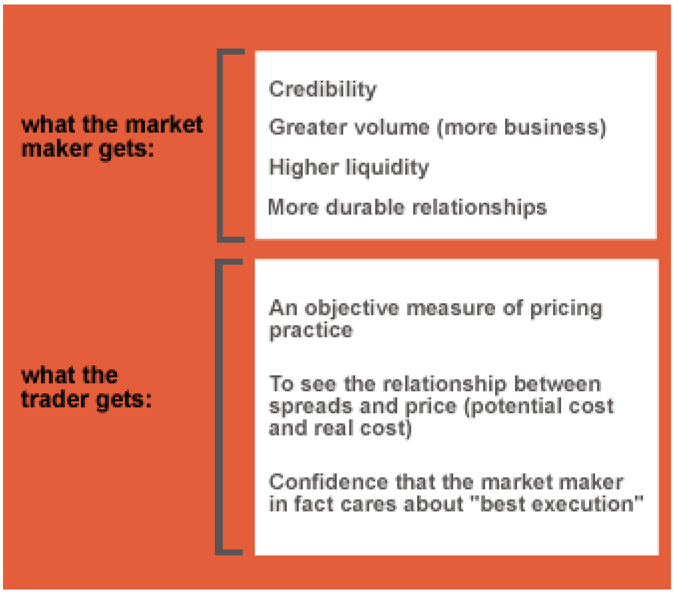
The absence of accountability gives market makers permission to:

- give different prices for the same trade at the same time, hoping that no one will notice;
- claim that spreads don't matter and then hope traders won't connect the dots between spread cost and profitability;
- execute at prices that are in someone's best interest, but not necessarily yours.

Currency markets are unique in that individual traders are closer (than with other traded assets) to ***building the product and determining its value***. Unlike coffee beans, currency has no presumptive value; the market forces that determine its worth have less to do with external factors such as the weather, local labor practices, or public taste. Everything else being equal, the value of currency is what the market will bid and ask for it.

Hard knowledge of real spreads and real prices is a direct measure of the market maker's efficiency. Use your power as a trader to demand to see how, when and where value is determined.

Until every market maker publishes these statistics, you're taking a huge leap of faith about best execution. And about how you are valued as a customer.



The right to full disclosure

Accountability is an acknowledgment of high and consistent standards. For institutional market makers, then, why is accountability such a bitter pill?

Choose market makers who make full disclosure part of their way of working. It benefits them; it benefits you.

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Understand your market maker's pricing practice. Pip by pip. Otherwise you're accepting unnecessary risk and paying up for value that can't be defined.

10. An appeal to your self-interest

THE RIGHT TO PAY AND RECEIVE INTEREST

How on earth is the obligation to pay for anything a "right"?

Of all the rights you should insist on, this is a very important one ABOUT WHICH YOU CAN DO ABSOLUTELY NOTHING. Because banks and market makers refuse to recognize this issue. Because it flies in the face of yet another antiquated tradition. And because—for traders who never or only rarely keep a position open overnight (that's some 90% of you)—it just doesn't seem to matter.

Standard practice today is that the interest rate attached to any currency only matters if you keep your position open from one day to the next. Your market maker will require you to do a rollover swap, and part of the cost of that (unnecessary) transaction is the difference in interest rates between the currency you're buying and the one you're selling. No matter how your position may have changed during the day.

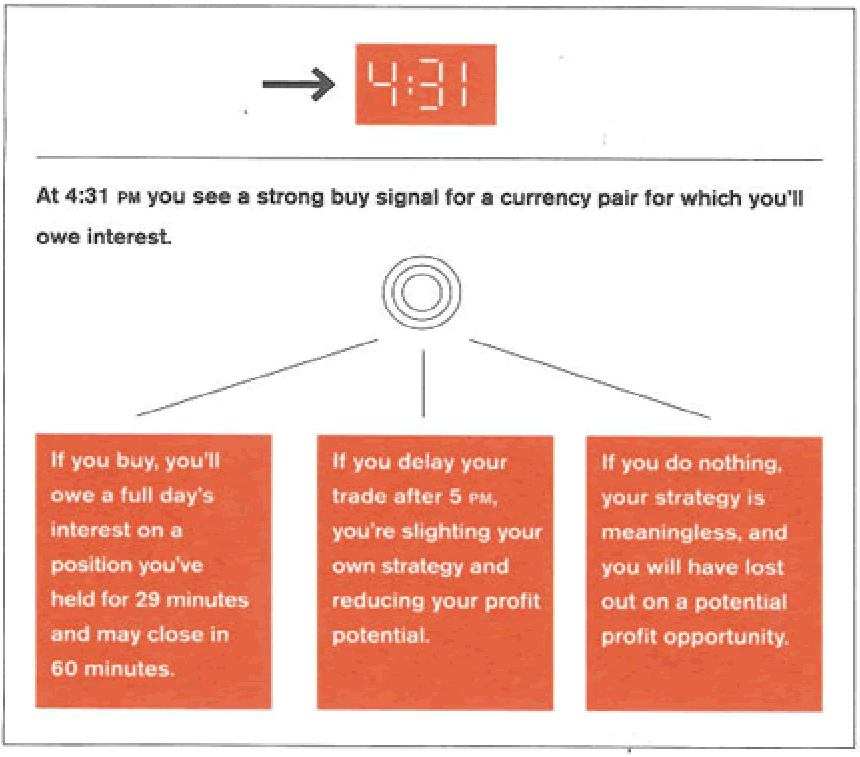
This is like your electric company ignoring your power usage during the day and basing your rate on how much you happen to be using at 8 PM.

Day traders say, So what? Day traders, here's what:

Removing interest rates from the trading decision is just plain foolish. If you pretend that currencies as diverse as the Euro, the U.S. Dollar, the Argentine Peso and the Polish Zloty are all the same, you're ignoring a basic risk that can kill even a short-term trade.

By removing interest from the buying and selling equation, the market creates an artificial bias toward shorting weaker currencies (with higher rates of interest), and, potentially, rewarding buyers of stronger currencies (with lower rates of interest). The result? Distorted pricing flows that upset trends, create valuation havoc, and encourage speculation for its own sake.

Or, what if you just don't get around to closing your position before the end of the day—or you'd like to keep it open without the rigmarole and unnecessary cost of the rollover swap?



Interest rates should have a positive effect on trading flows. But that's not how it works in the forex market. During the day they skew prices by encouraging speculation on weaker currencies. At the end of the day they lead investors to make -- or not to make -- trades for the wrong reasons. However you look at it, discrete interest makes for bad trading decisions. Talk about unnecessary risk.

If day traders are getting a free ride now, why would anybody want to change that?

An appeal to your higher nature:

1. The payment of continuous interest, second by second, recognizes that currencies are different. That assigning appropriate risk is a rational part of forex trading. That ***unnecessary volatility*** (benefiting only speculators and market makers) ***should not be subsidized***.
2. Continuous interest payment enables central banks to intervene during the trading day to manage their currencies a bit at a time, instead of making draconian adjustments in interest rates overnight.
3. Volatility won't disappear, but continuous interest will make pricing flows less erratic and help the market avoid free-falls.

An appeal to your self-interest:

1. Let's face it: if you take a position today for five minutes or two hours, you're looking for the highest possible return at a calculated risk. But the only "calculation" is the number of minutes your position is open.
2. With continuous interest-rate payment, the calculation becomes more interesting: suddenly, there are two components of return—what you make on the trade, and the interest you stand to earn. One is impossible to predict; the other is a certainty. Of course, you may end up ***owing*** interest. But the potential to increase your return is there, and this is the right you are currently denied.