



# Federal Register

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Wednesday,  
January 20, 2010

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## Part II

# Commodity Futures Trading Commission

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17 CFR Parts 1, 3, 4, et al.  
**Regulation of Off-Exchange Retail Foreign  
Exchange Transactions and  
Intermediaries; Proposed Rule**

## COMMODITY FUTURES TRADING COMMISSION

17 CFR Parts 1, 3, 4, 5, 10, 140, 145, 147, 160, and 166

RIN 3038-AC61

### Regulation of Off-Exchange Retail Foreign Exchange Transactions and Intermediaries

**AGENCY:** Commodity Futures Trading Commission.

**ACTION:** Proposed rules.

**SUMMARY:** The Commodity Futures Trading Commission (“Commission” or “CFTC”) is proposing to adopt a comprehensive regulatory scheme (“Proposal”) to implement the CFTC Reauthorization Act of 2008 (“CRA”) <sup>1</sup> with respect to off-exchange transactions in foreign currency with members of the retail public (*i.e.*, “retail forex transactions”). The Commodity Exchange Act, as amended by the CRA, generally provides that the Commission’s jurisdiction extends to contracts of sale of a commodity for future delivery (or an option on such a contract) or an option (other than an option executed or traded on a national securities exchange), and to certain leveraged or margined contracts in foreign currency that are offered to or entered into with retail customers. The Commission is proposing a scheme that would put in place requirements for, among other things, registration, disclosure, recordkeeping, financial reporting, minimum capital, and other operational standards, based on both the CFTC’s existing regulations for commodity interest transactions and commodity interest intermediaries, as well as rules of the National Futures Association (“NFA”) that are already existing with respect to retail forex transactions offered by NFA’s members. Additionally, the Proposal would amend existing regulations as needed to clarify their application to, and inclusion in, the new regulatory scheme for retail forex.

**DATES:** Comments must be received on or before March 22, 2010.

**ADDRESSES:** You may submit comments, identified by RIN 3038-AC61, by any of the following methods:

- *Federal eRulemaking Portal:* <http://www.regulations.gov/search/index.jsp>. Follow the instructions for submitting comments.

- *E-mail:* [secretary@cftc.gov](mailto:secretary@cftc.gov). Include “Regulation of Retail Forex” in the subject line of the message.

- *Fax:* (202) 418-5521.
- *Mail:* Send to David Stawick, Secretary, Commodity Futures Trading Commission, 1155 21st Street, NW., Washington, DC 20581.

- *Courier:* Same as Mail above.

All comments received will be posted without change to <http://www.cftc.gov>, including any personal information provided.

**FOR FURTHER INFORMATION CONTACT:** For information regarding financial and related reporting requirements, contact: Thomas Smith, Chief Accountant and Deputy Director, Division of Clearing and Intermediary Oversight, 1155 21st Street, NW., Washington, DC 20581. *Telephone number:* 202-418-5495; *facsimile number:* 202-418-5547; and *electronic mail:* [tsmith@cftc.gov](mailto:tsmith@cftc.gov). Jennifer Bauer, Special Counsel, Division of Clearing and Intermediary Oversight, Division of Clearing and Intermediary Oversight, 1155 21st Street, NW., Washington, DC 20581. *Telephone number:* 202-418-5472; *facsimile number:* 202-418-5547; and *electronic mail:* [jbauer@cftc.gov](mailto:jbauer@cftc.gov).

For all other information contact: William Penner, Deputy Director, Division of Clearing and Intermediary Oversight, 1155 21st Street, NW., Washington, DC 20581. *Telephone number:* 202-418-5450; *facsimile number:* 202-418-5547; and *electronic mail:* [wpenner@cftc.gov](mailto:wpenner@cftc.gov). Christopher Cummings, Special Counsel, Division of Clearing and Intermediary Oversight, 1155 21st Street, NW., Washington, DC 20581. *Telephone number:* (202) 418-5547; *facsimile number:* 202-418-5547; and *electronic mail:* [ccummings@cftc.gov](mailto:ccummings@cftc.gov).

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**SUPPLEMENTARY INFORMATION:** The CRA provides the Commission with broad authority to “make, promulgate and enforce such rules and regulations as, in the judgment of the Commission, are reasonably necessary to effectuate any of the provisions of [the Commodity Exchange] Act” in connection with off-exchange foreign currency futures, options, and options on futures, as well as leveraged off-exchange contracts offered to or entered into with retail customers.<sup>2</sup> The Commission is given similarly broad authority to promulgate and enforce rules regarding registration

of persons who solicit, exercise discretionary trading authority or operate or solicit funds in connection with any of these types of transactions.<sup>3</sup>

Pursuant to this authority, the Commission is proposing a scheme that would put in place requirements for, among other things, registration, disclosure, recordkeeping, financial reporting, minimum capital, and other operational standards, based on both the CFTC’s existing regulations for commodity interest transactions and commodity interest intermediaries, as well as rules of the National Futures Association (“NFA”) that are already existing with respect to retail forex transactions offered by NFA’s members.

Subject to certain exceptions (*e.g.*, for certain regulated financial intermediaries not under the Commission’s jurisdiction as established in the CRA), the Proposal would require persons offering to be or acting as counterparties to retail forex transactions but not primarily or substantially engaged in the exchange traded futures business, to register as retail foreign exchange dealers (“RFEDs”) with the CFTC. Registered futures commission merchants (“FCMs”) that are “primarily or substantially” (as defined in the Proposal) engaged in the activities set forth in the Act’s definition of an FCM would be permitted to engage in retail forex transactions without also registering as RFEDs.

The Proposal would further require certain entities other than RFEDs and FCMs that intermediate retail forex transactions to register with the Commission as introducing brokers (“IBs”), commodity trading advisors (“CTAs”), commodity pool operators (“CPOs”), or associated persons (“APs”) of such entities, as appropriate, and to be subject to the Act and regulations applicable to that registrant category. In addition, the Proposal would require any IB that introduces retail forex transactions to an RFED or FCM to be guaranteed by that RFED or FCM.

The Proposal would also implement the \$20 million minimum net capital standard established in the CRA for registering as an RFED or offering retail forex transactions as an FCM; propose an additional volume-based minimum capital threshold calculated on the amount an FCM or RFED owes as counterparty to retail forex transactions; and require RFEDs or FCMs engaging in retail forex transactions to collect security deposits in a minimum amount in order to prudentially limit the leverage available to their retail

<sup>1</sup> Food, Conservation, and Energy Act of 2008, Pub. L. 110-246, 122 Stat. 1651, 2189-2204 (2008).

<sup>2</sup> See, 7 U.S.C. 2(c)(2)(B)(v) and 7 U.S.C. 2(c)(2)(C)(ii)(III).

<sup>3</sup> See, 7 U.S.C. 2(c)(2)(B)(iv)(III) and 7 U.S.C. 2(c)(2)(C)(iii)(III).

customers on such transactions at 10 to 1.

## I. Background

### A. The Commodity Futures Trading Commission Act of 1974

Congress created the Commission in 1974 as an independent agency with the mandate to regulate commodity futures and option markets in the United States by the enactment of the Commodity Futures Trading Commission Act of 1974.<sup>4</sup> While the bill was being considered, the Department of the Treasury ("Treasury") sent a letter to the Senate Committee with jurisdiction over the bill, expressing concerns that Treasury had regarding the effect that passage would have on the off-exchange foreign currency ("forex") market that existed at the time between large, institutional customers.<sup>5</sup> The letter contained proposed language for the bill which would have maintained the *status quo* for institutional off-exchange forex trading, leaving jurisdiction over on-exchange trading in futures and options contracts on forex with the newly-created Commission. The bill was subsequently amended to add the suggested language contained in Treasury's letter, which was intended to give the Commission jurisdiction over retail forex transactions and to exclude from the Commission's jurisdiction the off-exchange, institutional "interbank" market in foreign currencies. This language, which has come to be known as the "Treasury Amendment," provided that:

Nothing in this Act shall be deemed to govern or in any way be applicable to transactions in foreign currency \* \* \* unless such transactions involve the sale thereof for future delivery conducted on a board of trade.<sup>6</sup>

As is discussed below, over time, and on numerous occasions, the Commission and the courts have opined on the proper boundaries of this exclusion.

The Commission first addressed the possible scope of the Treasury Amendment with regard to off-exchange transactions in securities issued by the Government National Mortgage Association ("GNMA"). In an interpretive letter issued by the Commission's Office of General Counsel, Commission staff stated that the remarks by the Senate Committee were

an expression that regulation by the Commission is unnecessary where there exists an informal market among institutional participants in transactions for future delivery in the specified financial instruments only so long as it is supervised by those agencies having regulatory responsibility over those participants. However, where that market is not supervised and where those transactions are conducted with participation by members of the general public, we do not understand the Committee to have intended that a regulatory gap should exist. In these circumstances, we believe the Commodity Exchange Act should be construed broadly to assure that the public interest will be protected by Commission regulation of those transactions.<sup>7</sup>

The scope of the exclusion, again with regard to off-exchange transactions in GNMA securities, was addressed by the U.S. Court of Appeals for the Seventh Circuit ("Seventh Circuit") when it determined that the Treasury Amendment did not exclude options on government securities from the Commission's authority.<sup>8</sup> Specifically, the court determined that although trading in GNMA securities was excluded from the Commission's jurisdiction, trading in options on such instruments was within the Commission's authority. As the court stated:

From the legislative history, it is quite clear that the Treasury Amendment was adopted by Congress only to prevent dual regulation by the CFTC and bank regulatory agencies of the banks and other sophisticated institutions that ordinarily trade in financial instruments.<sup>9</sup>

Following that discussion, in 1985, the Commission issued a Statutory Interpretation concerning the Treasury Amendment that specifically dealt with forex.<sup>10</sup> Responding to reports that forex futures contracts were being offered to retail customers on an off-exchange basis, under the assumption that such transactions were excluded from the Commission's jurisdiction, the Commission reaffirmed and republished its views, as follows:

[T]he Commission wishes to make very clear that any marketing to the general public of futures transactions in foreign currencies conducted outside the facilities of a contract market is strictly outside the scope of the [Treasury] Amendment. As a result, such an off-exchange offer or sale of futures contracts involving foreign currencies is unlawful

<sup>7</sup> *Dealers in GNMA Certificates as a Board of Trade*, CFTC Staff Interpretive Letter No. 77-12, [1977-1980 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 20,467 (Aug. 17, 1977).

<sup>8</sup> *Board of Trade of Chicago v. SEC*, 677 F. 2d 1137, 1154 (7th Cir. 1982), *vacated as moot*, 459 U.S. 1026 (1982).

<sup>9</sup> *Id.* at 1154.

<sup>10</sup> *Trading in Foreign Currencies for Future Delivery*, 50 FR 42983 (Oct. 23, 1985).

under section 4(a) of the Act, 7 U.S.C. 6(a) (1982).<sup>11</sup>

The boundaries of the Treasury Amendment were again tested in *Salomon Forex v. Tauber*,<sup>12</sup> where a sophisticated investor sought to invalidate a multi-million dollar trading debt by claiming that the Treasury Amendment only excluded spot or forward forex transactions from the Commission's jurisdiction, and that trading in off-exchange futures and options were within the Commission's regulatory authority. If such transactions were deemed to be within the Commission's authority, then the transactions could only occur legally on an approved exchange. The Court determined that the Treasury Amendment excluded off-exchange trading in futures and options as well as "spot" and "forward" transactions from the Commission's authority, if it involved "sophisticated, large-scale foreign currency traders."<sup>13</sup> Although this holding has sometimes been misinterpreted to imply that off-exchange forex transactions with the general public were outside the Commission's jurisdiction, this holding concerned only large-scale traders and banks that made up the informal network of the foreign currency "interbank" market. Indeed, the Court itself noted that: "[t]his case does not involve mass marketing to small investors, which would appear to require trading through an exchange and our holding in no way implies that such marketing is exempt from the CEA."<sup>14</sup>

### B. The Futures Trading Practices Act of 1992

The Futures Trading Practices Act of 1992 reorganized certain sections of the Commodity Exchange Act, 7 U.S.C. 1, *et seq.* (2000) (the "Act") and gave the Commission significant exemptive authority over the activities of a wide variety of persons, including FCMs, CTAs, and CPOs.

It was pursuant to this exemptive authority that the Commission addressed some aspects of the over-the-counter ("OTC") markets by adopting Part 35 of its regulations, which provides an exemption from regulation for certain swap agreements.<sup>15</sup> However, the Commission did not use its newly-

<sup>11</sup> *Id.* at 42985.

<sup>12</sup> 795 F. Supp. 768 (E.D. Va. 1992), *aff'd*, 8 F.3d 966 (4th Cir. 1993).

<sup>13</sup> *Id.* at 978.

<sup>14</sup> *Id.*

<sup>15</sup> *See, Exemption for Certain Swap Agreements*, 58 FR 5587 (Jan. 22, 1993).

<sup>4</sup> Public Law 93-643, 88 Stat. 1389 (1974).

<sup>5</sup> *See*, Letter from Donald L.E. Ritger, Acting General Counsel, Department of the Treasury, to the Hon. Herman E. Talmadge (July 30, 1974), *reprinted* at 1974 U.S.C.A.N. 5843, 5887-89.

<sup>6</sup> *Id.* at 51.

granted exemptive authority in the context of retail forex.<sup>16</sup>

Rather, the Commission's efforts were directed to combating forex fraud activities through increased enforcement and public awareness. In response to increased fraud activity in the forex markets, the CFTC issued a fraud advisory to the public on March 30, 1998.<sup>17</sup> Notwithstanding the Commission's guidance and the legislative history, the ambiguity of the Treasury Amendment continued to present opportunities for defendants to challenge the Commission's jurisdiction in the courts, which consumed much of the Commission staff's time and resources.<sup>18</sup> Unfortunately, these challenges would persist until the adoption of the Commodity Futures Modernization Act of 2000 ("CFMA").<sup>19</sup>

Under the Treasury Amendment, retail forex transactions were excluded from the Commission's jurisdiction unless they were conducted on a "board of trade." This broad phrase caused further confusion when courts tried to interpret its meaning in order to delineate where the Commission's jurisdiction ended. The U.S. Court of Appeals for the Ninth Circuit ("Ninth Circuit") relied on the language in the Senate Committee report to interpret the clause and believed that a proper reading of the Treasury Amendment excluded all off-exchange forex transactions—even with retail customers—from the Commission's jurisdiction and that the Commission only had jurisdiction over forex transactions traded on organized exchanges.<sup>20</sup> Other courts interpreting the same clause came to the conclusion that retail off-exchange forex transactions were within the Commission's jurisdiction and that the

legislative history indicates that only large institutional trades were intended to be excluded from the Commission's oversight.<sup>21</sup>

### C. The Commodity Futures Modernization Act of 2000

The CFMA amended the Act to clarify the jurisdiction of the Commission in the area of forex futures and options trading. For the first time, off-exchange retail forex transactions were expressly permitted, provided the counterparty was one of certain enumerated, regulated entities listed in the Act—*e.g.*, a registered FCM.<sup>22</sup> Transactions between certain institutional entities (eligible contract participants, or "ECPs"<sup>23</sup>) remained outside the Commission's jurisdiction altogether, based on several provisions of the Act and the Commission's regulations.<sup>24</sup> Shortly after the adoption of the CFMA, however, the Commission and the National Futures Association ("NFA")<sup>25</sup> noted that firms were registering as FCMs but not engaging in any exchange-traded activities. Rather, they were limiting their activities solely to retail forex. Additionally, the Commission noted that firms were registering as FCMs but conducting retail forex transactions through unregistered affiliates. Nothing in the Act or CFMA's amendments to the Act prohibited these "shell FCMs" from conducting business through their unregistered affiliates.

Although the CFMA provided some additional clarity for off-exchange retail forex transactions, it did not provide the Commission with rulemaking authority, and the Commission was thus required

to provide guidance to allow participants to navigate the statute. For instance, Advisory 06–01 made clear that the Commission had jurisdiction over retail forex and only certain financial institutions that are enumerated in the Act could act as counterparties for retail customers in that regard. Similarly, Commission staff issued an Advisory in 2002 which sets out parameters for unlicensed intermediaries, such as pool operators, account managers and introducers, in retail forex transactions.<sup>26</sup> Most recently, in August 2007, Commission staff issued an Advisory that addressed the following areas: registration of associated persons ("APs") of FCMs, CPOs and introducing brokers ("IBs"); permissible unregistered forex affiliates; segregated funds; guaranteed IBs; combined account statements for forex and exchange-traded futures; and forex trading platforms.<sup>27</sup>

Following passage of the CFMA, legal challenges to the Commission's jurisdiction persisted and certain courts began to analyze the elements of a futures contract—the basis of the Commission's jurisdiction over off-exchange retail forex transactions—using new criteria. Some firms began offering to retail customers transactions that had the elements of futures contracts, but that were marketed as "spot" transactions. However, unlike true spot transactions where delivery is contemplated, these transactions were "rolled over" at expiration (generally within a few days) and carried forward indefinitely. These "rolling spot" or "look-alike" contracts were the basis of many forex fraud cases brought by the Commission. However, the Commission's ability to pursue fraud in this area was put in doubt by the decision of the Seventh Circuit in *CFTC v. Zelener*.<sup>28</sup> The *Zelener* case

<sup>16</sup> See, *e.g.*, Sections 4(c) and 4(d) of the Act, 7 U.S.C. 6(c) and 6(d).

<sup>17</sup> *Fraud Advisory from the CFTC: Foreign Currency Trading (Forex) Fraud*, available at: [http://www.cftc.gov/customerprotection/fraudawarenessandprevention/fraudadvisories/fraudadv\\_forex.html](http://www.cftc.gov/customerprotection/fraudawarenessandprevention/fraudadvisories/fraudadv_forex.html). The Commission also issued brochures to alert customers to the possible scams involving forex fraud. See *CFTC Brochure on Forex Fraud*, available at: <http://www.cftc.gov/enf/enf-forex.htm> and <http://www.cftc.gov/stellent/groups/public/@cpfraudawarenessandprotection/documents/file/enfforexbrochure.pdf> (last visited Oct. 15, 2009).

<sup>18</sup> For instance, in *Dunn & Delta Consultants, Inc. v. CFTC*, 519 U.S. 465, 469 (1997), the U.S. Supreme Court held that foreign currency options were "transactions in foreign currency" within the meaning of the Treasury Amendment.

<sup>19</sup> Consolidated Appropriations Act of 2001, Public Law 106–554, App. E, 114 Stat. 2763 (2000), available at Commodity Futures Modernization Act of 2000, [2000–2002 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 28,433 (Dec. 21, 2000).

<sup>20</sup> *CFTC v. Frankwell Bullion Ltd.*, 99 F. 3d 299 (9th Cir. 1996).

<sup>21</sup> See, *CFTC v. Baragosh*, 278 F.3d 319 (4th Cir. 2002), which relied on the Conference Committee Report, not mentioned in *Frankwell Bullion*, to arrive at the opposite conclusion from the Ninth Circuit; See also, *CFTC v. Standard Forex*, No. CV–93–0088 (CPS), 1993 WL 809966 (E.D.N.Y. Aug. 9, 1993).

<sup>22</sup> See, 7 U.S.C. 2(c)(2)(B). Broadly stated, these entities included: (1) A financial institution; (2) a registered broker/dealer ("B–D") or FCM; (3) an insurance company; (4) a financial holding company; and (5) an investment bank holding company.

<sup>23</sup> Section 1(c)(12) of the Act defines the term "eligible contract participant." Entities classified as ECPs include financial institutions, insurance companies, certain commodity pools and individuals who meet certain asset thresholds. Non-ECPs, generally speaking, are retail customers.

<sup>24</sup> For example, Section 2(d) provides that most sections of the Act do not apply to derivative transactions between ECPs; Section 2(g) provides that most sections of the Act do not apply to swap transactions between ECPs; and the Part 35 safe harbor for swap agreements, which pre-dates the CFMA, provides another basis for excluding jurisdiction.

<sup>25</sup> NFA is a registered futures association, pursuant to Section 17(b) of the Act. It is an industry-wide, self-regulatory organization for the U.S. futures industry.

<sup>26</sup> *Division of Trading and Markets Advisory Concerning Foreign Currency Trading by Retail Customers*, available at: [http://www.cftc.gov/stellent/groups/public/@cpfraudawarenessandprotection/documents/file/forex\\_advisoryretailcustomers.pdf](http://www.cftc.gov/stellent/groups/public/@cpfraudawarenessandprotection/documents/file/forex_advisoryretailcustomers.pdf) (last visited Oct. 13, 2009).

<sup>27</sup> *Division of Clearing and Intermediary Oversight Advisory Concerning Retail Off-Exchange Foreign Currency Trading*, available at: [http://www.cftc.gov/stellent/groups/public/@cpfraudawarenessandprotection/documents/file/forex\\_advertailcustomers2007.pdf](http://www.cftc.gov/stellent/groups/public/@cpfraudawarenessandprotection/documents/file/forex_advertailcustomers2007.pdf) (last updated August 30, 2007).

<sup>28</sup> *CFTC v. Zelener*, 373 F.3d 861 (7th Cir. 2004), *reh'g and reh'g en banc denied*, *CFTC v. Zelener*, 387 F.3d 624 (7th Cir. 2004). The U.S. Court of Appeals for the Sixth Circuit relied on *Zelener* when it issued its opinion in *CFTC v. Erskine*, 512 F.3d 309 (6th Cir. 2008), determining that the foreign currency contracts at issue were not futures contracts and upholding the district court's summary judgment against the Commission for lack of jurisdiction.

introduced a different framework for analyzing what constitutes a “spot” transaction and created confusion about the applicability of the CFMA to certain retail forex transactions. This departed from a line of previous non-forex cases that distinguished between futures and spot or forward contracts based on a multi-factor analysis of the economic elements in the contract.<sup>29</sup>

The court in *Zelener* determined that the contracts at issue were not off-exchange futures contracts, but rather contracts in the commodity itself, and thus excluded from the Commission’s jurisdiction. The Seventh Circuit declined to rehear the case *en banc* and a split of authority among the circuits was created. Some courts continued to follow the traditional multifactor test while others followed the *Zelener* approach and only considered the language within the four corners of the contract.<sup>30</sup>

#### D. The Commodity Futures Trading Commission Reauthorization Act of 2008

The CRA<sup>31</sup> was intended, among other things, to further clarify the Commission’s jurisdiction in the area of retail forex, particularly in light of the proliferation of look-alike forex transactions such as those in the *Zelener* and *Erskine* cases, and to give the Commission additional authority to regulate retail forex transactions and to register persons involved in intermediating these products with members of the public. To remedy the large number of fraud cases where jurisdiction had been questioned, the CRA gave the Commission jurisdiction over certain leveraged retail foreign exchange contracts without regard to whether it could prove the contracts were off-exchange futures contracts.<sup>32</sup> The CRA thus grants the Commission anti-fraud authority in leveraged retail forex transactions even if the transactions at issue are not futures or options. This allows the Commission to protect the public from fraud and provides a workable solution to the split in the decisions in the Federal appellate courts regarding when a so-called “spot” contract is a futures contract.

The CRA also created a new category of registrant, the retail foreign exchange dealer, or “RFED,” and gave the

Commission rulemaking authority over, and required registration of, intermediaries engaging in retail forex.<sup>33</sup> The CRA provided that RFEDs and these other intermediaries must be NFA members and must register with the Commission subject to such terms as the Commission may prescribe.<sup>34</sup> Among other requirements, the CRA established a \$20 million minimum capital requirement for RFEDs and FCMs that offer retail forex.<sup>35</sup>

The grant of authority over look-alike forex contracts is very broad and is intended to encompass transactions that do not result in actual delivery, or for which no legitimate business purpose exists for the customer to enter into the transaction. It is not intended to interfere with the large, sophisticated interbank market or to place additional requirements on businesses with a need to engage in forex transactions in connection with their legitimate business activities.

The CRA further provides that look-alike forex contracts are subject to the CFTC’s authority if they are offered on a leveraged or margined basis, or financed by the offeror, counterparty, or someone acting with the offeror or counterparty.<sup>36</sup> The Commission’s authority, however, does not extend to securities, or to contracts that result in actual delivery within two days or that create an enforceable obligation to deliver between buyer and seller that have the ability to deliver or accept delivery in connection with their line of business.<sup>37</sup> Thus, the CRA charges the Commission with regulating speculative forms of retail forex trading, but excludes from the Commission’s purview true spot transactions that have a legitimate business purpose or that result in actual delivery.

The Commission is proposing these regulations pursuant to separate authority provisions of the CRA with respect to the participants in the forex market and with respect to the transactions themselves. Off-exchange forex futures and options transactions are subject to numerous provisions of the Act including sections 4(b), 4b,

4c(b), 4o, 6(c) and 6(d),<sup>38</sup> 6c, 6d, 8(a), 13(a), 13(b), if they are offered or entered into by an FCM, an RFED, or an affiliate of an FCM that is not one of the otherwise regulated entities specified in the Act.<sup>39</sup> The same provisions apply to look-alike forex transactions.<sup>40</sup>

Notwithstanding the grant of authority with regard to certain sections of the Act specified above, the Commission has full rulemaking authority over the agreements, contracts or transactions in retail forex where “reasonably necessary to effectuate any of the provisions or to accomplish any of the purposes of [the] Act.”<sup>41</sup> The Commission has full rulemaking authority over the futures and options transactions where such transactions are offered or entered into by FCMs, their affiliates or RFEDs;<sup>42</sup> and retains rulemaking authority with regard to look-alike transactions only where such transactions are offered or entered into by RFEDs.<sup>43</sup>

#### E. The Commission’s Proposed Rules

In proposing the following rules, the Commission has endeavored, wherever possible, to apply the principles that have guided it in the regulation of on-exchange instruments. Thus, many of the concepts in the proposed rules will be familiar to industry participants and practitioners. There are, however, essential differences between the trading of futures contracts on designated contract markets (“DCMs”) that are cleared through Commission registered derivatives clearing organizations (“DCOs”) and off-exchange transactions between forex firms and retail customers. Many of the statutory and regulatory safeguards that are a critical feature of the trading and clearance of transactions in futures and options on futures on DCMs and DCOs, respectively, simply are not present in off-exchange retail forex transactions.

The Commission’s proposed regulations are designed to deal with those differences, including the principal-to-principal nature of the transactions and the inherent conflicts of interest between the retail customer and the marketmaker/counterparty. In

<sup>29</sup> See, e.g., *CFTC v. Co Petro Mktg. Group, Inc.*, 680 F.2d 573 (9th Cir. 1982).

<sup>30</sup> See, e.g., *CFTC v. UForex Consulting, LLC*, 551 F.Supp.2d 513 (W.D.La. 2008); *CFTC v. Erskine*, 512 F.3d 309 (6th Cir. 2008).

<sup>31</sup> Food, Conservation, and Energy Act of 2008, Public Law 110–246, 122 Stat. 1651, 2189–2204 (2008).

<sup>32</sup> See, 7 U.S.C. 2(c)(2)(C)(iv).

<sup>33</sup> Previously, firms serving as counterparties to retail forex typically registered as FCMs (if they were not included in any of the other permissible categories), even though they did not engage in exchange-traded futures business, and thus did not meet the statutory definition of an FCM.

<sup>34</sup> See, 7 U.S.C. (2)(c)(2)(B)(i)(II)(gg). The Commission plans on delegating the registration function for RFEDs to NFA, as is the case with the registration of FCMs, IBs, CTAs, CPOs and APs.

<sup>35</sup> See, 7 U.S.C. (2)(c)(2)(B)(ii).

<sup>36</sup> See, 7 U.S.C. 2(c)(2)(C)(i)(I)(bb).

<sup>37</sup> See, 7 U.S.C. 2(c)(2)(C)(i)(II)(bb)(AA); H.R. Rep. No. 110–627, at 979 (2008) (Conf. Rep.).

<sup>38</sup> Although the Commission had jurisdiction with regard to market manipulation in prior versions of the Act, the CRA removed that authority with regard to sections 6(c) and 6(d). All other cited sections remain in full effect.

<sup>39</sup> See, 7 U.S.C. (2)(c)(2)(B)(iii). In addition to the sections included in the CFMA for forex futures and options transactions, the CRA adds sections 4(b), 4o, 13(a), and 13(b).

<sup>40</sup> See, 7 U.S.C. (2)(c)(2)(C)(ii)(III).

<sup>41</sup> See, 7 U.S.C. 2(c)(2)(B)(iv)(III); 2(c)(2)(B)(v); 2(c)(2)(C)(i)(III); 2(c)(2)(C)(iii)(III).

<sup>42</sup> See, 7 U.S.C. (2)(c)(2)(B)(v).

<sup>43</sup> See, 7 U.S.C. (2)(c)(2)(C)(ii)(III).

the nine years since the passage of the CFMA, the Commission has observed a number of improper practices that have raised concern, among them solicitation fraud, a lack of transparency in the pricing and execution of transactions, unresponsiveness to customer complaints, and the targeting of unsophisticated, elderly, low net worth and other vulnerable individuals.<sup>44</sup>

In addition to the regulations explicitly mandated by the CRA—including new registration requirements<sup>45</sup> and enhanced financial requirements—the proposed regulations will require forex registrants to maintain records of customer complaints; require forex counterparties to guarantee the performance of all persons who introduce accounts to the counterparty; require counterparties to disclose, with the Risk Disclosure Statement, the percentage of profitable nondiscretionary forex customer accounts; and require forex counterparties to designate a chief compliance officer to be responsible for development and implementation of customer protection policies and procedures.

As noted above, the Commission believes that these additional requirements are militated both by the essential differences between on-exchange transactions and off-exchange retail forex transactions, and the history

of fraudulent practices in this sector of the forex market.

## II. Section-by-Section Analysis

### A. Structure and Approach

The CRA requires the Commission to register and regulate specified persons who intermediate off-exchange retail forex transactions. In order to comply with this mandate, the Commission must adopt regulations providing for the registration of RFEDs and other off-exchange retail forex intermediaries not excluded from Commission jurisdiction, and must specify the financial, operational and other requirements applicable to persons so registered. To the extent practicable, the Commission has endeavored to assemble the new off-exchange retail forex provisions in a single new part of the Commission's regulations, proposed to be designated part 5.<sup>46</sup> The goal is to provide a single convenient location for regulations applicable to off-exchange retail forex transactions and intermediaries. Unfortunately, developing a completely self-contained part of the Commission's regulations that would contain all of the off-exchange retail forex regulations is not practicable because it has also been necessary to draft amendments to various provisions of existing regulations maintained in other parts of 17 CFR Chapter 1. Among the reasons for these proposed additional amendments are the following: (1) Some regulatory provisions of general application name the specific registration categories they affect, and do not presently refer to RFEDs; (2) persons registered under certain existing registration categories (*e.g.*, FCMs) will be able to engage in off-exchange retail forex transactions under those existing registrations, subject to additional requirements, and restating the requirements pertaining to those registration categories in part 5 would be unwieldy;<sup>47</sup> and (3) certain existing regulatory provisions that should apply to off-exchange retail forex transactions and to the persons engaging in them are worded in terms of on-exchange futures and commodity options transactions, and not in a way that would encompass off-exchange retail forex transactions.

<sup>46</sup> Former part 5 (Designation of and Continuing Compliance by Contract Markets) was removed and reserved. 66 FR 42256 (Aug. 10, 2001).

<sup>47</sup> For example, essentially replicating the text of part 4 (which concerns CPOs and CTAs) within the new part 5 in order to cover providers of forex trading advice and operators of pooled forex trading vehicles would have needlessly increased the volume of the Commission's regulations, when a simple incorporation of the same requirements by reference accomplishes the same purpose.

### B. Proposed Amendments to Existing Regulations

Many of the proposed amendments to regulations outside of proposed part 5 amount to merely adding references to off-exchange retail forex transactions, off-exchange retail forex customers and/or RFEDs to existing regulations.<sup>48</sup> Accordingly, those proposed amendments will not be separately discussed. Other proposed amendments, however, involve a substantive change to the existing regulation because the existing regulation must operate differently in the context of off-exchange retail forex trading.<sup>49</sup> These substantive changes are discussed below.

#### 1. Part 1 of the Commission's Regulations—General Regulations

a. Regulation 1.1—Fraud in or in connection with transactions in foreign currency subject to the Commodity Exchange Act.

This existing provision is specific to off-exchange retail forex transactions. Consistent with the concept of a self-contained off-exchange retail forex part of the regulations, existing Regulation 1.1 is proposed to be deleted and its content to be incorporated into Regulation 5.2 of proposed part 5.

#### b. Regulation 1.3—Definitions.

The definition of "guarantee agreement" is proposed to be amended to take account of IBs who may be guaranteed by RFEDs.<sup>50</sup> The definition of "commodity interest" is proposed to be amended to include off-exchange retail forex transactions over which the Commission has jurisdiction by virtue of the CRA.<sup>51</sup> Including off-exchange retail forex transactions within the "commodity interest" definition permits a wide range of provisions, especially within part 4 of the Commission's regulations, to apply to such transactions without the need to separately revise each provision to expressly address off-exchange retail forex, as well as futures contracts and commodity options.<sup>52</sup>

<sup>48</sup> See, proposed amendments to Regulations 1.4, 1.35, 1.36, 1.37, 1.40, 1.52, 1.65, 3.1, 3.4, 3.10, 3.12, 3.21, 3.30, 3.31, 3.33, 3.44, 3.45, 3.50, 3.60, 4.23, 4.25, 4.30, 4.33, 10.1, 160.1, 160.3, 160.4, 160.30 and 166.2.

<sup>49</sup> See, proposed amendments to Regulations 1.1, 1.3, 1.10, 1.46, 3.1, 4.7, 4.12, 4.13, 4.14, 4.24, 4.34 and 166.5. In several instances, staff took the opportunity of this review and proposed rulemaking to propose deletion of obsolete material that either refers to already deleted regulatory provisions or has become outdated due to the passage of time. See proposed amendments to Regulations 1.52, 3.12, 3.31 and 160.18.

<sup>50</sup> Regulation 1.3(nn).

<sup>51</sup> Regulation 1.3(yy).

<sup>52</sup> See, *e.g.*, Regulation 4.6 as well as various provisions of Regulations 4.22 (reporting to pool

<sup>44</sup> Between December 2000 and September 2009, the Commission has filed 114 forex-related enforcement actions on behalf of more than 26,000 customers. Those efforts have thus far resulted in the award of approximately \$476 million in restitution and disgorgement, and \$576 million in civil monetary penalties. An overwhelming majority of these cases have involved solicitation fraud.

<sup>45</sup> The Commission's proposed regulations include registration requirements for all persons engaged in the solicitation or acceptance of orders for retail forex transactions involving non-ECPs, the exercise of discretionary trading authority in such transactions, or the operation or solicitation of funds for pooled investment vehicles in connection with such transactions. Accordingly, the proposed rules include requirements that such persons become registered as CTAs, CPOs or IBs, as appropriate. The Commission is aware that the statutory definitions of these entities do not anticipate persons engaged in off-exchange activities. The Commission has determined, however, that pursuant to its plenary power to regulate such off-exchange retail forex transactions in section 2(c) of the Act, it will entrust such transactions only to persons registered as CTAs, CPOs and IBs, inasmuch as these are categories of registrants with which the Commission and the public are already familiar. This will allow the Commission to regulate off-exchange retail forex transactions efficiently and effectively. For example, the proposed regulations would make use of the established standards for registration and denial of registration contained in the Act as well as the Commission's previous interpretations of these standards. See 41 FR 44560 at 44561-62 (Oct. 6, 1976).

c. Regulation 1.10—Financial reports of futures commission merchants and introducing brokers.

Proposed new provisions would require all IBs and all applicants for registration as IBs in connection with retail off-exchange forex transactions to enter into a guarantee agreement with an RFED or an FCM.<sup>53</sup> To date, those persons who have introduced off-exchange retail forex customers to counterparties have not been required to register as IBs, and fraudulent solicitation and sales practices have been commonplace. *See supra* note 46. The Commission believes that by requiring guarantee agreements between all off-exchange retail forex IBs and the FCM/RFED counterparties to which they introduce off-exchange retail forex customers, the counterparties will be forced to more carefully vet the persons who solicit business on their behalf and the practices those persons employ.

The Commission will be preparing a new Part C guarantee agreement to the Form 1-FR-IB, modeled on the guarantee agreement existing in Part B of Form 1-FR-IB, that will provide that FCMs and RFEDs that guarantee performance by an introducing broker that introduces off-exchange retail forex transactions will be jointly and severally liable for all obligations of the introducing broker under the Act and Commission regulations with respect to the solicitation of, and transactions involving, all retail forex customer accounts of the introducing broker entered into on or after the effective date of the guarantee agreement. The Commission believes that the guarantee requirement serves the public's interest in a marketplace where improper practices by IBs are discouraged while still permitting FCMs and RFEDs to make use of outside salespeople. An IB that is guaranteed by an FCM or RFED will not be subject to the minimum capital requirements set forth in Regulation 1.17(a)(1)(iii).

d. Regulation 1.46—Application and closing out of offsetting long and short positions.

Like FCMs engaging in on-exchange futures and option transactions under the existing regulation, RFEDs and FCMs engaging in off-exchange retail forex transactions would be required to close out offsetting long and short positions in an off-exchange retail forex customer's account. But unlike existing Regulation 1.46, the requirement on

participants), 4.23 and 4.33 (recordkeeping), and 4.24 and 4.34 (required disclosures).

<sup>53</sup> Regulations 1.10(a)(4), 1.10(j)(3), 1.10(j)(9)(i)(A)(2) and 1.10(j)(9)(i)(B)(2). *See also*, Proposed Regulation 5.18(h).

RFEDs and FCMs engaging in off-exchange retail forex transactions to close out offsetting positions would apply regardless of whether the off-exchange retail forex customer has instructed otherwise.<sup>54</sup> Also, unlike the existing provision for transactions in on-exchange futures and option contracts, no exception is proposed for omnibus accounts because they are not used in off-exchange retail forex trading. An RFED or FCM could, if permitted by the rules of a self-regulatory organization ("SRO") of which the RFED or FCM is a member, offset at the retail forex customer's request off-exchange retail forex transactions of the same size, if the retail forex customer holds other transactions of a different size, but the RFED or FCM would be required to offset a transaction against the oldest transaction of the same size.<sup>55</sup>

2. Part 4 of the Commission's Regulations—CPOs and CTAs

a. Regulation 4.7—Exemption from certain part 4 requirements for commodity pool operators with respect to offerings to qualified eligible persons and for commodity trading advisors with respect to advising qualified eligible persons.

As proposed, in determining whether a person is a "qualified eligible person" ("QEP") the NFA-specified minimum security deposit for off-exchange retail forex transactions would be included in the calculation of the portfolio requirement.<sup>56</sup> Such amounts are roughly equivalent to exchange-specified initial margin and option premium. In addition, in order to treat RFEDs and FCMs comparably, RFEDs would be included among the persons that do not have to meet the portfolio requirement to be QEPs.<sup>57</sup>

b. Regulation 4.12—Exemption from provisions of part 4.

As proposed, the NFA-specified minimum security deposit for off-exchange retail forex transactions would be included among the amounts that cannot exceed 10 percent of the fair market value of a pool's assets in order for the operator to claim exemption under Regulation 4.12(b). Again, such amounts are roughly equivalent to on-exchange initial margin and option premiums.<sup>58</sup>

<sup>54</sup> NFA's experience supports the conclusion that keeping open long and short positions in a retail forex customer's account removes the opportunity for the customer to profit on the transactions, increases the fees paid by the customer and invites abuse.

<sup>55</sup> Regulation 1.46(a)(2).

<sup>56</sup> Regulation 4.7(a)(1)(v)(B).

<sup>57</sup> Regulation 4.7(a)(2)(i)(B).

<sup>58</sup> Regulation 4.12(b)(i)(C).

c. Regulation 4.13—Exemption from registration as a commodity pool operator.

As proposed, the NFA-specified minimum security deposit for off-exchange retail forex transactions would be included among the amounts that cannot exceed 5 percent of the liquidation value of the pool's portfolio in order for the operator to claim exemption from registration under Regulation 4.13(a)(3). Again, such amounts are roughly equivalent to initial margin and option premiums.<sup>59</sup>

d. Regulation 4.14—Exemption from registration as a commodity trading advisor.

As proposed, an RFED that provided trading advice solely in connection with its business as an RFED would be exempt from registration as a CTA. This is consistent with treating FCMs and RFEDs comparably, where appropriate.<sup>60</sup>

e. Regulations 4.24 and 4.34—General disclosures required for CPO and CTA Disclosure Documents.

As proposed, the prescribed risk disclosure language for the front of the Disclosure Document would be required to include language warning that off-exchange retail forex transactions may not be given the same preferential treatment as commodity customer claims under the Bankruptcy Code.<sup>61</sup> This warning is necessary because definitions for such terms as "commodity contract," "customer" and "customer property" in Subchapter IV of Chapter 7 of the Bankruptcy Code do not include or refer to off-exchange transactions, generally, or to off-exchange retail forex transactions or customers engaged in such transaction, specifically.<sup>62</sup>

3. Part 166 of the Commission's Regulations—Customer Protection Rules

a. Section 166.5—Dispute settlement procedures.

As proposed, the section of the Commission's customer protection regulations dealing with dispute settlement procedures would be amended to expressly apply where a claim or grievance arises out of a retail forex transaction and the defined term customer would be amended to include

<sup>59</sup> Regulation 4.13(a)(3)(ii).

<sup>60</sup> Regulation 4.14(a)(7)(ii). As noted in the Conference Report that accompanied the CRA, "To the extent their risk profiles are similar, the managers intend for FCMs and RFEDs to be regulated substantially equivalently in terms of their off-exchange retail foreign currency business." H.R. Rep. No. 110-627, at 980 (2008) (Conf. Rep.). The Conference Report is available via the Internet on the CFTC's website.

<sup>61</sup> Regulations 4.24(b) and 4.34(b).

<sup>62</sup> 11 U.S.C. 761 *et seq.*



a retail forex customer.<sup>63</sup> The existing text could be read to exclude customer claims arising out of retail forex transactions from coverage under Regulation 166.5.

### C. New Part 5

As noted earlier, the proposed new part 5 to the Commission's regulations is intended to permit, as much as possible, reference to a single portion of the regulations for matters concerning off-exchange retail forex. Although it has been necessary to make changes to provisions elsewhere in the regulations, the Commission believes that in most cases, initial reference to part 5 should be sufficient to resolve questions (or to direct the reader by cross-reference to the appropriate provision elsewhere).

#### 1. Proposed Regulation 5.1—Definitions

Proposed part 5 begins with a set of definitions of terms specific to off-exchange retail forex and to the regulatory requirements that apply to off-exchange retail forex. "Retail forex transaction" is defined by reference to the description in sections 2(c)(2)(B) and 2(c)(2)(C) of the Act. The proposed definition expressly excludes futures and commodity option contracts traded on a designated contract market or derivatives transaction execution facility.<sup>64</sup> "Retail foreign exchange dealer" is defined as anyone who offers to be or who is a counterparty to a retail forex transaction, except for those persons excluded from the definition by the CRA.<sup>65</sup> In order to apply the IB, CPO, CTA and AP registration and other requirements to analogous retail forex market participants, notwithstanding that statutory and regulatory definitions of the identifying terms do not necessarily comprehend involvement in retail forex trading, the terms are separately defined for the purposes of part 5.<sup>66</sup> "Affiliated person of a futures commission merchant" (a term not previously defined in the Commission's regulations) and an AP of such a person are defined by reference to section 2(c)(2)(B)(i)(II)(cc)(BB) of the Act.<sup>67</sup> "Primarily or substantially" is defined for use in determining whether a registered FCM is primarily or substantially engaged in FCM activities, such that it need not also register as an RFED in order to conduct retail forex business.<sup>68</sup> Certain terms used in determining the financial and reporting

requirements applicable to persons engaged in retail forex business are also defined in Regulation 5.1 to clarify their use elsewhere in part 5.<sup>69</sup>

#### 2. Proposed Regulation 5.2—Prohibited Transactions: Antifraud

As noted above, under the proposal, existing Regulation 1.1 prohibiting fraud in connection with foreign currency transactions would be removed and replaced with new Regulation 5.2, which, in addition to prohibiting fraudulent conduct in connection with retail forex transactions, now prohibits anyone from acting as the counterparty for a retail forex transaction in an account for which that person has discretionary trading authority.

#### 3. Proposed Regulation 5.3—Registration

The CRA amends the Act to require that certain intermediaries for forex futures and options and for look-alike contracts (*i.e.*, those at issue in *Zelener*) register in such capacity as the Commission shall determine and become members of a registered futures association.<sup>70</sup> The Commission has determined that the appropriate registration categories for those intermediaries are as follows. Persons who solicit or accept orders for an RFED, an FCM, or an affiliate of an FCM should be registered as IBs. Persons who exercise discretionary trading authority over accounts should be registered as CTAs. Persons who operate or solicit funds or property for a pooled investment vehicle should be registered as CPOs. Finally, associated persons of the foregoing should be registered as APs. The proposed regulations include provisions to implement this part of the CRA.

Prior to the passage of the CRA, many entities registered as FCMs solely to engage in retail forex transactions. The CRA provides that registered FCMs who currently trade retail forex may continue to do so as FCMs, or may be required to register as RFEDs, depending on their circumstances. A traditional FCM that is primarily or substantially engaged in exchange-traded futures business may continue to engage in retail forex as an FCM, and need not register as an RFED.<sup>71</sup> Currently registered FCMs who solely trade in retail forex, or FCMs who are not primarily or substantially

dealing in exchange-traded futures, will be required to register as RFEDs.

Because there will be two categories of registrants competing for these customers, the stated Congressional intent is that an entity should not be advantaged or disadvantaged as a result of registering as an RFED instead of an FCM.<sup>72</sup> The Commission has therefore endeavored to draft regulations that provide equivalent treatment of FCMs and RFEDs wherever possible.

The enactment of the CFMA permitted registered FCMs and certain of their unregistered affiliates to act as counterparties to retail forex transactions, but it did not specifically require that intermediaries such as introducing brokers, account managers or pool operators be registered in order to engage in forex transactions with retail participants. This created problems when unregistered entities began soliciting retail customers. The lack of vetting by a regulatory agency or an SRO created a situation where members of the general public were being solicited by entities and persons regarding whom they were unable to obtain any background information. In some cases, persons banned from registering in the futures industry as a result of past misconduct were operating as unregistered intermediaries in retail forex transactions because of the lack of minimum requirements to operate in the forex business. Pursuant to the CRA, certain affiliates of FCMs may continue to be proper forex counterparties if the affiliated FCM makes and keeps the risk assessment records required in Section 4f(c)(2)(B) of the Act and the affiliate has at least \$20 million in adjusted net capital.<sup>73</sup> However, under the proposed regulations, the affiliates will have to register in the appropriate capacity in order to serve as a counterparty.

Proposed Regulation 5.3 imposes the registration requirements called for by the CRA upon specified categories of persons intermediating retail forex transactions. RFEDs are required to register as such.<sup>74</sup> FCMs not "primarily or substantially" engaged in FCM business are required to register as RFEDs,<sup>75</sup> and FCM-affiliated persons that serve as retail forex counterparties are also required to register as RFEDs.<sup>76</sup> Persons introducing forex accounts are required to register as IBs.<sup>77</sup> Operators

<sup>63</sup> See, proposed Regulations 5.1(b), (i), (j), (k) and (l).

<sup>64</sup> See, 7 U.S.C. 2(c)(2)(B)(iv) and 2(c)(2)(C)(iii).

<sup>65</sup> The Commission is directed to determine, through notice and comment rulemaking such as this, what "primarily or substantially" means in this context. H.R. Rep. No. 110-627, at 980 (2008) (Conf. Rep.); see also, Proposed Regulation 5.1(g).

<sup>72</sup> See, H.R. Rep. No. 110-627, at 980 (2008) (Conf. Rep.).

<sup>73</sup> See, 7 U.S.C. 2(c)(2)(B)(i)(II)(cc)(BB).

<sup>74</sup> See, proposed Regulation 5.3(a)(6).

<sup>75</sup> See, proposed Regulation 5.3(a)(4).

<sup>76</sup> See, proposed Regulation 5.3(a)(1).

<sup>77</sup> See, proposed Regulation 5.3(a)(5).

<sup>63</sup> Regulations 166.5(a)(1) and (a)(2).

<sup>64</sup> See, proposed Regulation 5.1(m).

<sup>65</sup> See, proposed Regulation 5.1(h).

<sup>66</sup> See, proposed Regulations 5.1(d), (e) and (f).

<sup>67</sup> See, proposed Regulations 5.1(a) and (c).

<sup>68</sup> See, proposed Regulation 5.1(g).



of pooled investment vehicles that engage in retail forex transactions are required to register as CPOs, and persons providing forex trading advice are required to register as CTAs.<sup>78</sup> Finally, associated persons of all of the foregoing are required to register as APs.

The CRA's registration requirements do not apply to certain otherwise regulated entities (e.g., broker-dealers), their associated persons, or persons who would be exempt from registration if they were engaging in such transactions on or subject to the rules of a contract market with regard to forex futures or options<sup>79</sup> or look-alike contracts.<sup>80</sup> This is consistent with the original intent of the Treasury Amendment that entities engaging in forex transactions should not be subject to regulation by multiple regulators concerning the same activity. Proposed Regulation 5.3 excludes from the registration requirement the persons specified in the CRA.

#### 4. Proposed Regulation 5.4—Operative Requirements for CPOs and CTAs

Proposed Regulation 5.4 applies all of the disclosure, recordkeeping, reporting and other existing requirements currently applicable to CPOs and CTAs in the context of on-exchange futures and commodity option contracts to persons defined as, and required to register as, CPOs and CTAs because those persons operate pooled investment vehicles that engage in retail forex transactions or because they provide retail forex trading advice.

#### 5. Proposed Regulation 5.5—Risk Disclosure by FCMs, RFEDs and IBs

Proposed Regulation 5.5 requires RFEDs, FCMs and IBs to provide retail forex customers with a risk disclosure statement similar to that currently required by Regulation 1.55, but tailored to address the risks, conflicts of interest and unique characteristics of retail forex trading. For example, the required risk disclosure statement would also be required to disclose the number of non-discretionary retail forex accounts maintained by an RFED or FCM, the percentage of such accounts that were profitable for each of the four most recent quarters, and a statement that past performance is not necessarily indicative of future results.<sup>81</sup>

Under Section 2(c) of the Act, the Commission's jurisdiction with regard to off-exchange forex transactions extends to transactions involving

entities that are not eligible contract participants as defined in Section 1a of the Act (i.e., retail customers). These transactions serve no broad price discovery function, and the Commission believes both that the vast majority of retail customers who enter these transactions do so solely for speculative purposes, and that relatively few of these participants trade profitably. Whether or not this is actually the case, the Commission believes that disclosure of the percentage of profitable accounts maintained by RFEDs and FCMs engaging in off-exchange retail forex will provide the retail customer with vital information when deciding whether or not to engage in such transactions.

#### 6. Proposed Regulations 5.6 and 5.7—Minimum Financial Requirements

Under proposed Regulation 5.7, RFEDs and FCMs engaging in retail forex trading are required to meet the minimum net capital requirements prescribed in the CRA.<sup>82</sup> Proposed Regulation 5.6 sets forth the "early warning" notification requirements pursuant to which RFEDs and FCMs engaging in retail forex trading are required to notify SROs and the Commission if an RFED or an FCM engaging in retail forex trading has experienced declines in capital, has discovered a material inadequacy in internal controls or has become undercapitalized.<sup>83</sup> Because there is no equivalent to the futures regime of strict segregation of customer funds in off-exchange retail foreign currency dealing, the notice requirement for RFEDs with respect to undersegregation is not included in the proposed regulation. However, a requirement has been proposed that an RFED or FCM engaging in off-exchange retail forex transactions give notice if it is holding liquid assets less than the aggregate retail forex obligation (as defined). The aggregate retail forex obligation is proposed to be the net obligation to all off-exchange retail foreign currency customers at all times (excluding deficit accounts).

The minimum net capital regulation for RFEDs and FCMs offering off-exchange retail forex is proposed based on the significantly higher minimum net capital level for RFEDs and FCMs offering retail forex established in the CRA. The Commission believes that the higher level of \$20 million reflects

Congressional intent to ensure that substantially undercapitalized "shell" FCM off-exchange retail forex dealers and their affiliates, from whom it may be impossible to recover funds in the event of customer claims, do not engage in off-exchange retail forex activity. The existing regulation for the calculation of FCM net capital has been proposed for the calculation of net capital for RFEDs and FCMs offering off-exchange retail forex, with the intent that an FCM offering retail forex should only have one calculation of its adjusted net capital. However, the CRA's higher dollar threshold of minimum capital required, \$20 million, will apply, as well as an additional early warning requirement of 110%, resulting in a notice reporting net capital level of \$22 million. The proposed early warning level of 110% is lower than the FCM early warning level of 150% due to the substantially higher minimum dollar threshold established in the CRA, which results in an adequate minimum early warning "buffer" of no less than \$2 million.

An amount of minimum net capital in addition to the minimum \$20 million is proposed to the extent that an FCM or RFED has a total retail forex obligation in excess of \$10,000,000. After that threshold, as proposed the FCM or RFED must have net capital of no less than \$20,000,000 plus five percent of the total retail forex obligation in excess of \$10,000,000. This proposal is intended to address concerns that, although the capital level contained in the CRA is believed to be high at \$20,000,000, at particularly high levels of retail customer obligations there should be commensurate increases in an entity's minimum required net capital. The NFA has enacted a similar requirement applicable to all its forex dealer members except those that only provide "straight through processing." The Commission's proposal has no exceptions for FCMs engaging in off-exchange retail forex or for RFEDs.

Under the existing net capital regulation for FCMs contained in Commission Regulation 1.17, an FCM that becomes undercapitalized must immediately cease business and transfer its customers' positions to another FCM, unless the Commission believes that it will be able to quickly remedy the situation, in which case the Commission may provide up to an additional 10 business days to return to compliance before ceasing business. Because the retail forex contracts at issue are not exchange-traded, and therefore, positions are not fungible among retail forex FCMs and RFEDs, should an RFED become undercapitalized, the

<sup>78</sup> See, proposed Regulations 5.3(a)(2) and 5.3(a)(3).

<sup>79</sup> See, 7 U.S.C. 2(c)(2)(B)(iv)(II).

<sup>80</sup> See, 7 U.S.C. 2(c)(2)(C)(iii)(II).

<sup>81</sup> See, proposed Regulation 5.5(e).

<sup>82</sup> Analogous to Regulation 1.17 for FCMs trading only futures and commodity options.

<sup>83</sup> The proposed requirement is analogous to existing Regulation 1.12 for FCMs that trade only on-exchange futures and commodity option contracts.

Commission proposes that it either liquidate or transfer all off-exchange retail forex accounts (with a transfer envisioned as a full novation of the retail forex contracts for such accounts by assignment and assumption of the contracts by another RFED or FCM) under the direction and supervision of the Commission or the entity's designated self-regulatory organization ("DSRO"). The same 10 business day period has been proposed for the Commission or DSRO to delay such liquidation or transfer if determined appropriate. The proposal requires the refund or transfer of all funds associated with off-exchange retail forex accounts contemporaneous with the liquidation or transfer. The possibility of an entity needing to refund all customers' accounts and liquidate all positions in such circumstances makes it necessary to include a proposal to require such entity to maintain liquid assets available equal to the amount owed to off-exchange retail forex customers.

Although not permissible to be counted as a liquid asset for fulfilling the requirement of Regulation 5.8, under the proposed net capital regulation, the unsecured receivable resulting from an RFED or FCM offsetting currency exposure with one of several enumerated parties (regulated financial intermediaries or foreign equivalents approved by NFA) will be treated as a current asset. The Commission proposes this, with the counterparty limitation, to balance an RFED's or FCM's need to hedge its net position from offering off-exchange retail forex with the concern that such receivables are collectible for net capital purposes. Without this proposed addition to the net capital calculation, RFEDs and FCMs would have to take a 100% capital charge for such unrealized gains. The Commission understands that NFA, under subparagraph (c) of its Section 11 Financial Requirements for Forex Dealer Members, has been permitting existing forex dealer members to not take such a charge to the extent the counterparty has been considered regulated and approved by NFA, and is not an affiliate of the Forex Dealer Member. Thus, the Commission proposes that a DSRO be afforded the continuing ability to assess the appropriateness of counterparties for this purpose going forward, while making explicit the ability of an entity to cover the net exposure without the burden of a 100% net capital charge being applied. Also, the existing net capital charge with respect to options has been applied to off-exchange retail forex transactions that are options. This net capital charge, with respect to the

existing net capital regulation for FCMs, is derived from the SEC's net capital charges for options that are not options on futures. Because these retail forex transactions are, by nature, off-exchange transactions, the resulting charge under the SEC rule would be the charge for "unlisted" options. This charge is based on the notional transactional size of the option which may result in a very significant capital implication for retail forex transactions which are options. However, this result is consistent with the existing requirements for all off-exchange or unlisted foreign exchange options for existing FCMs and broker-dealers.

#### 7. Proposed Regulation 5.8—Aggregate Retail Forex Assets

Proposed Regulation 5.8 requires RFEDs and FCMs engaging in retail forex transactions to compute the net credit balance resulting from combining all money, securities and property deposited by retail forex customers into their accounts, adjusted for realized and unrealized net profit or loss, and not including any accounts that contain net liquidating balances (the "retail forex obligation" of the RFED or FCM).<sup>84</sup> Under proposed Regulation 5.8(a) each RFED or FCM engaging in retail forex transactions is required to hold assets of the type permitted under Regulation 1.25 equal to the retail forex obligation. Such assets would have to be maintained at one or more qualifying institutions in the U.S., or in money center countries (as defined in Regulation 1.49) where such countries have agreements acceptable to NFA that authorize sharing account information with NFA.

The requirement to hold assets equal to the retail forex obligation is separate from the adjusted net capital requirement. In computing their adjusted net capital, pursuant to proposed Regulation 5.8(d), RFEDs and FCMs could not include assets held for purposes of complying with proposed Regulation 5.8(a) as current assets, or otherwise recording any property received from retail forex customers as an asset without recording a corresponding liability to such customers.

The requirement to maintain assets equal to or in excess of the retail forex obligation is intended to provide some degree of protection for customers in the absence of the protections afforded by the segregation of customer funds that is required in the context of futures and

commodity options trading.<sup>85</sup> The Commission recognizes that the retail forex obligation is not an equivalent substitute for the segregated funds regime, which cannot be replicated in the context of off-exchange retail forex trading. Unlike segregation of customer funds deposited for futures trading, such amounts would not be provided any preferential treatment to unsecured creditors in a bankruptcy, and would not be held in separately titled accounts under the CEA. Because of the lack of bankruptcy preference with respect to the funds of retail forex customers held at FCMs or RFEDs, the Commission does not intend to propose a separation of funds requirement which may be misconstrued as being similar to the protections that are afforded to customers engaged in exchange-traded futures and options. As previously discussed, Regulation 5.8 has been proposed to ensure that RFEDs and FCMs hold liquid assets in appropriate jurisdictions should they be required to be refunded to customers or seized to compensate customers. NFA first established under Section 14 of its Financial Requirements its version of this requirement, due to its difficulty in ultimately obtaining any funds for restitution with respect to failures of forex dealers and cases of fraud. The proposal follows the NFA's rule in this regard while further requiring that the types of assets held to meet the requirement must also be of the kind and character permitted for the investments of futures customer funds under existing Commission Regulation 1.25. These types of assets are limited to generally liquid financial instruments, which the Commission believes to be an appropriate limitation, should it become necessary to liquidate retail forex accounts, transfer funds, or seize or freeze funds in the event of fraud.

#### 8. Proposed Regulation 5.9—Security Deposits for Retail Forex Transactions

Proposed Regulation 5.9(a) would require each RFED and each FCM that engages in retail forex transactions, in advance of any such transaction, to collect from the retail forex customer a security deposit (in cash or in financial instruments that meet the requirements of Regulation 1.25) equal to ten percent of the notional value of the retail forex transaction, ten percent of the notional value of short retail forex options in addition to the premium received, or the full premium received for long options,

<sup>85</sup> The retail forex obligation is also a factor in one of the options for computation of the RFED's or FCM's net capital requirement. See, proposed Regulation 5.7(a)(1)(i)(B).

<sup>84</sup> Defined in proposed Regulation 5.1(l).

as the case may be. Pursuant to proposed Regulation 5.9(b), the RFED or FCM would be required to collect additional security deposit or to liquidate the retail forex customer's position if the amount of security deposit collected fails to meet the requirements of paragraph (a).

The extreme volatility of the foreign currency markets exposes retail forex customers to substantial risk. Forex dealers currently extend leverage to their customers at ratios of between 25:1 to 400:1 or higher, which allows customers to control contracts worth significantly more than their cash investment. Given these high leverage ratios, even minor fluctuations in currency rates can exponentially increase a customer's losses and gains. Even a small move against a customer's position can result in a significant loss. Under current practices, customer positions are usually closed out once the losses in an account exceed the initial investment. However, if, for any reason, the positions are not closed out at a zero balance, the customer could be liable for additional losses.

Customers also face counterparty risk, as there is no central counterparty for forex transactions. Customers may not know that customer funds held by a forex counterparty do not receive the bankruptcy protections applicable to funds held by an FCM engaged in on-exchange trading on the customers behalf.<sup>86</sup> Given the risks that inhere in the trading of off-exchange forex contracts by retail customers, the only funds that should be invested in the off-exchange retail forex market are those that the investor can afford to lose. The Commission's proposed regulation regarding security deposits is intended both to mitigate the risk to which customers are exposed and to provide some capital to cover customer funds held by a failing firm (albeit without the bankruptcy preference applicable to funds held in segregation for exchange-traded contracts). In determining the appropriate leverage or security deposit level to propose, the Commission considered current industry practices, as well as NFA's current leverage restrictions of 100 to 1 on major currencies and 25 to 1 on non-major

<sup>86</sup> As discussed above, an FCM holding customer funds for trading on-exchange futures contracts is required to have, at all times, in its possession and control, segregated property sufficient to pay all customers with credit balances, without deduction for customer debit balances (which must be made up from the FCM's own capital). In an FCM bankruptcy, customers share the segregated property pro rata in proportion to their claims, without any support from a compensation fund. See, generally, Part 190 of the Commission's Regulations, 17 CFR Part 190 (2009).

currencies, and the proposal by the Financial Industry Regulatory Authority ("FINRA") to limit the maximum leverage on certain retail forex transactions offered by broker-dealers to 4 to 1.<sup>87</sup>

#### 9. Proposed Regulations 5.10 and 5.11—Risk Assessment

Proposed Regulation 5.10 imposes risk assessment recordkeeping requirements, and Regulation 5.11 establishes risk assessment reporting requirements, for RFEDs. These sections are patterned on the corresponding existing requirements for FCMs in existing Regulations 1.14 and 1.15, because the same rationale behind risk assessment procedures for FCMs applies equally to RFEDs.

#### 10. Proposed Regulation 5.12—Financial Reporting to Regulators

Proposed Regulation 5.12 requires applicants for registration as RFEDs to submit their applications for registration with a Form 1-FR-FCM, the same financial reporting form that FCMs are required to file, certified by an independent public accountant.<sup>88</sup> Registered RFEDs would be required to file Form 1-FR-FCM monthly and annually. In addition, RFEDs, like FCMs, when notified in writing by NFA or the Commission, would have to file Form 1-FR-FCM or such other financial information as NFA or the Commission may request at such other times as may be specified in the notice.<sup>89</sup> The proposed regulation for RFED financial reporting is intended to require the substantial equivalent of independent IB and FCM financial reporting to the Commission and DSROs, with certified financial reports required from independent auditors qualified under existing Commission Regulation 1.16 and similar reports on material inadequacies by such auditors. The existing reporting requirements as separately proposed to be amended for FCMs, including methods of receiving reports, determining fiscal year ends

<sup>87</sup> NFA leverage rules are set forth in Section 12, "Security Deposits for Forex Transactions with FDMs", of the NFA rules. On June 4, 2009, FINRA submitted to the U.S. Securities and Exchange Commission a proposed rule change to adopt FINRA Rule 2380 to limit the leverage ratio offered by broker-dealers for certain forex transactions to be a maximum of 1.5:1. 74 FR 32022 (July 6, 2009). FINRA subsequently adopted 2 amendments to this proposal, the second of which revised the maximum leverage ratio from 1.5:1 to 4:1. See SR-FINRA-2009-40 available on FINRA's website at <http://www.finra.org/Industry/Regulation/RuleFilings/2009/P118864>.

<sup>88</sup> See, Regulation 1.10.

<sup>89</sup> See, Regulation 1.10(b)(4).

and permitting extensions of time to file, have been proposed for RFEDs.

#### 11. Proposed Regulation 5.13—Reporting to Customers

RFEDs and FCMs engaging in retail forex transactions are required by proposed Regulation 5.13 to furnish each retail forex customer with monthly statements and confirmation statements in a manner comparable to that required of FCMs under Regulation 1.33. The Commission believes that proposed Regulation 5.13 has been drafted in such a manner as to make the required statements meaningful and useful to customers in light of the distinctive characteristics of retail forex transactions relative to exchange-traded futures and commodity option transactions. FCMs could combine their forex monthly and/or confirmation statements with statements they may otherwise be required by Regulation 1.33 to furnish, so long as the futures and commodity options information and the retail forex information are each properly identified as such. The proposed section also provides that the required statements can be furnished electronically with the customer's (revocable) consent, and RFEDs are required to keep copies of monthly and confirmation statements in accordance with the requirements of Regulation 1.31.

#### 12. Proposed Regulation 5.14—Financial Recordkeeping

Proposed Regulation 5.14(a) requires RFEDs to keep the same ledgers or similar records as FCMs are required to keep under Regulation 1.18, showing transactions affecting assets, liabilities, income, expense and capital accounts, classified in the manner set forth in Form 1-FR-FCM, or in categories consistent with generally accepted accounting principles. Proposed Regulation 5.14(b) requires recordkeeping regarding net capital computations, comparable to existing Regulation 1.18(b) for FCMs.

#### 13. Proposed Regulations 5.15 and 5.16—Unlawful Representations and Prohibitions of Guarantees Against Loss

As with CPOs and CTAs dealing only in futures and commodity options, RFEDs, FCMs, IBs, CPOs and CTAs subject to Part 5, as well as their principals and those who solicit for them, are prohibited by proposed Regulation 5.15 from representing that the Commission or the Federal government has sponsored, recommended or approved them in any

way.<sup>90</sup> RFEDs, FCMs and IBs are prohibited under proposed Regulation 5.16 from guaranteeing against or limiting customer losses, from failing to collect margin or security deposits, or from representing that they will do any of those things.<sup>91</sup> This prohibition does not prevent an RFED, FCM or IB from sharing in a loss resulting from error or mishandling of an order, and guarantees entered into prior to effectiveness of the prohibition will only be affected if an attempt is made to extend, modify or renew them.

#### 14. Proposed Regulation 5.17— Authorization to Trade

Proposed Regulation 5.17 requires RFEDs, FCMs, IBs and their APs to have specific authorization by the customer before effecting a retail forex transaction. For the most part, proposed Regulation 5.17 follows existing Regulation 166.2 for on-exchange futures and commodity option transactions. The Commission believes that registrants acting as off-exchange retail forex counterparties should have to obtain authorization for each transaction like other registrants.

#### 15. Proposed Regulation 5.18—Trading Standards

Proposed Regulation 5.18 contains provisions specific to retail forex transactions that were developed to prevent some of the deceptive or unfair practices identified by the Commission and NFA in recent years. Each retail forex counterparty<sup>92</sup> would be required to establish and enforce internal rules, procedures and controls: (1) To prevent “front running,” where transactions in accounts of the retail forex counterparty or its related persons<sup>93</sup> are executed before a like customer order; (2) to establish settlement prices fairly and objectively; and (3) to record and

maintain transaction records and make them available to customers (including time and price information, account records, trading platform price changes and volume, and any algorithm used to determine bid and ask prices). Paragraph (c) of the proposed Regulation prohibits a retail forex counterparty from disclosing that it holds another person’s order unless disclosure is necessary for execution. Paragraphs (d) and (e) ensure that related persons of retail forex counterparties do not open accounts with other retail forex counterparties without the knowledge and authorization of the account surveillance personnel of the retail forex counterparties with which they are related. Paragraph (f) prohibits retail forex counterparties from: (1) Entering a retail forex transaction to be executed at a price that is not at or near prices at which other retail forex customers have executed transactions with the retail forex counterparty during the same time period unless done pursuant to NFA rules; (2) changing prices after execution unless pursuant to NFA rules; (3) providing a customer a new bid price that is higher (or lower) than previously without providing a new asked price that is higher (or lower) as well; and (4) establishing a new position for a customer (except to offset an existing position) if the retail forex counterparty holds one or more outstanding orders of other retail forex customers for the same currency pair at a comparable price.

Additionally, paragraph (g) of proposed Regulation 5.18 would require each retail forex counterparty and each CPO, CTA and IB subject to part 5 to maintain records of all communications they receive concerning possible violations of the Act or Commission regulations involving their retail forex business. The required records would include the complainant’s identity (if provided), the date of the transaction or contract at issue, and the name of the person who received the communication. The retail forex counterparty, CPO, CTA or IB would be required to provide copies of such records to the Commission.

The Commission believes that, given the volume of cases it has prosecuted in recent years involving retail forex fraud, requiring the maintenance of detailed records of customer complaints will provide such intermediaries with a comprehensive view of the types and numbers of problems that exist within their operations, and will provide the Commission with ready access to information regarding such problems.

Paragraph (h) of proposed Regulation 5.18 would require each person who

applies for registration as an IB in order to solicit or accept off-exchange retail forex orders, and each person who succeeds to the business of an IB that solicits or accepts retail forex orders to enter into a guarantee agreement with an FCM or an RFED. As discussed above in relation to revisions to Commission Regulation 1.10, the Commission believes that the requirement that RFEDs and FCMs enter a guarantee agreement with the IBs that solicit business on their behalf serves the public’s interest by discouraging FCMs and RFEDs from associating with IBs without regard to the sales practices they employ.

Paragraph (i) of proposed Regulation 5.18 would require retail forex counterparties to calculate on a quarterly basis the percentage of non-discretionary accounts that were profitable, and to maintain records of those calculations together with supporting data for five years in accordance with Regulation 1.31. As discussed above, Proposed Regulation 5.5 requires that RFEDs, FCMs and IBs provided retail forex customers with a risk disclosure statement that includes the percentage of accounts that were profitable for each of the four most recent quarters. Proposed Regulation 5.8 buttresses this requirement by directing retail forex counterparties to make such calculations on a quarterly basis and maintain records reflecting the calculation.

Finally, paragraph (j) would require each retail forex counterparty to designate at least one principal to serve as its chief compliance officer, who would be required to certify annually to the Commission and to NFA that the retail forex counterparty had in place policies and procedures reasonably designed to achieve compliance with the Act and the Commission’s regulations. The Commission intends that retail forex counterparties adhere to the highest professional standards and that they take their compliance responsibilities seriously. With the requirement of a high level compliance officer and annual certification, Commission registrants will be expected to meet these standards and required to identify the person within the entity responsible for meeting them.

#### 16. Proposed Regulation 5.19—Pending Legal Proceedings

Proposed Regulation 5.19 requires RFEDs, FCMs CPOs, CTAs and IBs to disclose pending legal matters and specifies the manner in which such matters are to be reported to the Commission, as well as the criteria for determining which proceedings are

<sup>90</sup> Similar prohibitions already apply to CPOs and CTAs (section 4o(b) of the Act) and to leverage transaction merchants (Regulation 31.19). See also NFA Compliance Rule 2–22 which speaks to all NFA members. The Commission believes that a broad statement of the prohibition is appropriate here to ensure that customers do not misapprehend the implications of registration as previously unregistered off-exchange retail forex market participants come into compliance with the registration requirements imposed on them by the CRA.

<sup>91</sup> See, Regulation 1.56 for the existing prohibition affecting FCMs and IBs engaged in futures and commodity option transactions.

<sup>92</sup> “Retail forex counterparty” is defined for purposes of Regulation 5.18 to include RFEDs, FCMs and affiliated persons of FCMs.

<sup>93</sup> “Related person” of a forex counterparty is defined for purposes of Regulation 5.18 as a general partner, officer, director, owner of more than a ten percent interest, associated person, employee, relative or spouse of the foregoing or relative of a spouse who shares the same home.

required to be disclosed. As discussed above, given the high incidence of fraud in connection with retail forex transactions, the Commission desires to monitor legal actions taken against registrants. Requiring reporting of such actions is one of the most direct ways of determining where problems exist and what registrants may have failed to deal fairly with customers.

#### 17. Proposed Regulation 5.20—Special Calls for Information

Proposed Regulation 5.20 is patterned on existing Regulations 21.00 through 21.03. The purpose of proposed Regulation 5.20 is to ensure that the Commission has the authority to obtain information regarding retail forex accounts and transactions when such information is necessary to enable the Commission to carry out its responsibilities under the Act, and to set forth the responsibilities and duties of RFEDs, FCMs, and IBs when a special call is issued.

#### 18. Proposed Regulation 5.21—Supervision of Retail Forex Accounts

Proposed Regulation 5.21 imposes the same supervision requirements set forth in existing Regulation 166.3 upon Commission registrants subject to Part 5. A separate provision for retail forex is included in order to avoid any question whether the same duties apply to persons with supervisory responsibilities in the context of retail forex trading activity.

#### 19. Proposed Regulation 5.22—Registered Futures Association Membership

In addition to registering with the Commission, the CRA provides that RFEDs and persons who provide retail forex trading advice, operate retail forex pools or solicit retail forex customers or accounts must also become members of a registered futures association.<sup>94</sup> Accordingly, proposed Regulation 5.22 requires registered futures association membership for RFEDs, and for each person (1) required to register as an IB because the person accepts orders for retail forex transactions; (2) required to register as a CPO because the person operates, or solicits funds, securities or property for, a pooled investment vehicle that engages in retail forex transactions; or (3) required to register as a CTA because the person exercises discretionary trading authority, or obtains written authority over, an

account in connection with retail forex transactions.

#### 20. Proposed Regulation 5.23—Bulk Transfers and Bulk Liquidations

Proposed Regulation 5.23 is patterned generally upon existing Regulation 1.65, but has been modified to take into account certain rules of the National Futures Association, that have been approved by the Commission, that govern the transfer or liquidation of the accounts of retail forex customers.<sup>95</sup> Proposed Regulation 5.23 permits transfers that are requested by the retail forex customer or expressly consented to by the retail forex customer's prior, specific consent in writing, or those done in accordance with rules adopted by the DSRO of the RFED, FCM or IB, as the case may be, and approved by the Commission that establish notice and other requirements for such assignments and transfers. The proposed regulation also duplicates, for the most part, the requirements applicable to bulk transfer notices to the Commission under Regulation 1.65. However, the draft regulation requires notice not only of bulk transfers, but also bulk liquidations, and effectively defines the term "bulk" to mean the transfer or liquidation of 50 percent or more of the total retail forex customer accounts carried by the RFED, FCM or IB.<sup>96</sup>

#### 21. Proposed Regulation 5.24—Applicability of Other Parts of the Commission's Regulations

Proposed Regulation 5.24 states that, insofar as consistent with the requirements of part 5, the requirements of other parts of the Commission's regulations that apply to a person shall apply to that person as though those provisions were expressly set forth in part 5. For example, Regulation 1.31 sets forth the Commission's generally applicable recordkeeping requirements and speaks in terms of "persons." Proposed Regulation 5.24 is intended to incorporate such provisions by reference to the extent that part 5 does not impose contradictory requirements.

#### 22. Proposed Regulation 5.25—Applicability of Act

Proposed Section 5.25 incorporates various provisions of the Act which apply generally to registrants, specifying that the provisions of those sections are to be read to include the categories of forex registrants identified in proposed Section 5.1, and that the provisions of those sections are to be read to include off-exchange retail forex transactions

and those that engage in them. Specifically, the provisions of Sections 4b, 4c(b), 4f, 4g, 4k, 4m, 4n, 4o, 6(c)–(e), 6b, 6c, 8(a)–(e), 8a, and 12(f) apply to off-exchange retail forex transactions just as they do to exchange-traded transactions.

### III. Related Matters

#### A. Regulatory Flexibility Act

*FCMs and CPOs:* The Regulatory Flexibility Act ("RFA")<sup>97</sup> requires that agencies, in proposing rules, consider the impact of those rules on small businesses.<sup>98</sup> The Commission has already established certain definitions of "small entities" to be used in evaluating the impact of its rules on such small entities in accordance with the RFA.<sup>99</sup> In that statement, the Commission concluded that neither FCMs nor registered CPOs should be considered to be small entities for purposes of the RFA. With respect to FCMs, the Commission's determination was based in part upon their obligation to meet the capital requirement established by the Commission and the purposes of protecting financial integrity.<sup>100</sup>

As for CPOs, the Commission determined that registered CPOs are not small entities based upon its existing regulatory standard for exempting certain small CPOs from the requirement to register under the Act.<sup>101</sup> (A CPO need not register with the Commission if the gross capital contributions for all pools under its management do not exceed \$400,000 and there are not more than fifteen participants in any one of those pools.<sup>102</sup>)

Thus, with respect to FCMs and registered CPOs, the Commission believes that the Proposal will not have a significant economic impact on a substantial number of small entities.

*CTAs:* The Commission has previously decided to evaluate, within the context of a particular rule proposal, whether all or some CTAs should be considered to be small entities, and if so, to then analyze the economic impact on them of any such rule.<sup>103</sup> CTAs

<sup>97</sup> 5 U.S.C. *et seq.*

<sup>98</sup> By its terms, the RFA does not apply to "individuals." See 48 FR 14933, n. 115 (April 6, 1983). Because associated persons must be individuals, (see Commission Regulation 1.3(aa) and proposed Regulations 5.1(c), (d)(2), (e)(2), (g)(2) and (i)(2)), the RFA does not apply to APs and no analysis of the economic impact of this rule proposal on such persons is required.

<sup>99</sup> 47 FR 18618 (April 30, 1982).

<sup>100</sup> *Id.* at 18619.

<sup>101</sup> *Id.* at 18619–20.

<sup>102</sup> 17 CFR 4.13(a)(2) (2009).

<sup>103</sup> 47 FR at 18620.

<sup>94</sup> See, 7 U.S.C. 2(c)(2)(B)(i)(II)(gg); 2(c)(2)(B)(iv); 2(c)(2)(C)(i)(II)(aa); and 2(c)(2)(C)(iii).

<sup>95</sup> See, proposed Regulation 5.23(a)(1).

<sup>96</sup> See, proposed Regulation 5.23(a)(2).

wishing to advise retail forex customers may include both currently registered CTAs and previously unregistered persons who now will be required to register. As to the first group, there should be no significant new economic impact. As to the second group, registration will require the submission of application forms, fingerprinting of principals, and payment of registration fees. To the extent that CTAs can be considered to be small entities, the Commission does not consider either the proposed registration fee or the proposed fingerprinting requirement for newly registered CTAs to have significant economic impact.<sup>104</sup>

*IBs:* In its 1982 policy statement, the Commission proposed that for purposes of the RFA and future rulemakings, the Commission would not consider introducing brokers to be “small entities” for essentially the same reasons that FCMs had previously been determined not to be small entities.<sup>105</sup> However, this determination was based, in part, on the fact that IBs, like FCMs, are required to maintain a specified level of adjusted net capital. Under the proposal, retail forex IBs would not be subject to a capital requirement; rather, they would have to operate pursuant to a guarantee agreement. Nevertheless, as discussed above with regard to CTAs, registration of previously unregistered entities will require the submission of application forms, fingerprinting of principals, and payment of registration fees. To the extent that IBs can be considered to be small entities, the Commission does not consider either the proposed registration fee or the proposed fingerprinting requirement for IBs subject to Part 5 to have significant economic impact.

*RFEDs:* RFEDs are a new category of registrant. Accordingly, the Commission has not addressed the question of whether such persons are, in fact, small entities for purposes of the RFA. The Commission does not believe that there are regulatory alternatives to those being proposed which would be consistent with the statutory mandate to provide protection to the public against irresponsible or fraudulent business practices. For purposes of the RFA and future rulemakings, the Commission is hereby proposing that RFEDs not be considered to be “small entities” for essentially the same reasons that FCMs have previously been determined not to be small entities.<sup>106</sup> As with FCMs, a requirement to maintain a specified level of adjusted net capital would be

imposed upon RFEDs to ensure that they maintain sufficient capital resources to guarantee their financial accountability and to promote responsible and reliable business operations. Moreover, the Commission has sought to fashion its proposed regulatory program for RFEDs in a manner which is responsive to the function, purposes, and size of the entity being regulated consistent with the objective of the RFA. In particular, the minimum capital requirement required by the CRA effectuates the Congressional purpose that RFEDs maintain sufficient reserve of capital to remain economically viable. For the reasons stated above, the Commission hereby proposes not to define RFEDs as small entities for RFA purposes.

#### *B. Paperwork Reduction Act*

The Proposal contains information collection requirements. The Paperwork Reduction Act of 1995 (“PRA”) <sup>107</sup> imposes certain requirements of federal agencies (including the Commission) in conducting or sponsoring any collection of information as defined by the PRA. The Commission has submitted to the Director of the Office of Management and Budget (“OMB”), pursuant to the provisions of the PRA, an explanation and details of the information collection and recordkeeping requirements which would be necessary to implement the Proposal.

##### 1. Collection of Information

If adopted, the Proposal would require existing and new registrants in the FCM, RFED, CTA, CPO and IB categories to submit certain filings to the Commission which had not been previously required; these collections of information are found primarily in the new part 5 of the proposed regulations. To the extent industry participants are currently registered as CTAs, CPOs, IBs or FCMs, and intend to engage in retail forex transactions, the obligations imposed by the proposed rules would not be significantly altered, but the existing collections will be amended to reflect additional, new registrants within these categories, and the part 5 collection will include any additional information collections not captured in existing collections. The estimated numbers of respondents, annual responses by each, average hours per response and annual reporting burden reflected in section 2 immediately below represent estimates from the last update of the collection plus new respondents, responses and a new calculation of associated burdens. Since

several of the proposals contained herein consist of proposed amendments to rules which have already been assigned OMB control numbers, the Commission assumes that the amended rules will be assigned the same OMB control number. Similarly, the Commission is proposing that the new registrants use amendments to existing forms in order to comply with registration and financial reporting requirements, those forms, as amended, will in all likelihood retain the same OMB control number which they have at present. Finally, as to RFEDs, a new category of registrant, new OMB control numbers will be assigned to new collections; to the extent existing regulations have been amended to include RFEDs, the collections associated with those regulations will be amended to reflect the new category of registrant. Each effected collection and the new part 5 collection are discussed separately below.

##### 2. Existing Collections

###### a. Collection 3038–0024 (Part 1 of the Regulations)

Generally speaking, collections occurring by operation of part 1 regulations affect FCMs and IBs. Those entities that will be required to register as RFEDs are currently registered as FCMs, so existing Collection 3038–0024 has been amended, where appropriate, to reflect fewer FCM respondents. The collection has also been amended, where appropriate, to reflect additional IB registrants, who were not previously required to register to conduct off-exchange retail forex business and now will be.

*Estimated number of respondents:* 2,160.

*Annual responses by each respondent:* 38,894.

*Estimated average hours per response:* 1.9.

*Annual reporting burden:* 21,229.

###### b. Collection 3038–0023 (Part 3 of the Regulations)

Part 3 of the Commission’s regulations concern registration requirements. Existing Collection 3038–0023 has been amended to reflect the obligations associated with the registration of new entrants, such as CTAs, CPOs, IBs, and APs, that had not previously been required to register in order to conduct off-exchange retail forex transactions. Since the registration requirements are in all respects the same as for current registrants, the collection has been amended only insofar as it concerns the increased estimated number of respondents and the corresponding estimated annual burden.

<sup>104</sup> 48 FR 35248 at 35276 (August 3, 1983).

<sup>105</sup> 47 FR at 18619.

<sup>106</sup> *Id.*

<sup>107</sup> 44 U.S.C. 3501, *et seq.*

*Estimated number of respondents:* 71,857.

*Annual responses by each respondent:* 73,694.

*Estimated average hours per response:* 0.09.

*Annual reporting burden:* 6,632.

c. Collection 3038–0005 (Part 4 of the Commission's Regulations)

Part 4 of the Commission's regulations concerns the operations of CTAs and CPOs, and the circumstances under which they may be exempted from registration. As discussed above, the estimated average time spent per response has not been altered. However, adjustments have been made to the collection to account for additional CPOs and CTAs: filing for exemptions from the Part 4 rules, developing and distributing required disclosure documents; complying with required reporting requirements.

*Estimated number of respondents:* 9,486.

*Annual responses by each respondent:* 37,930.

*Estimated average hours per response:* 17.

*Annual reporting burden:* 183,700.<sup>108</sup>

d. Collection 3038–0055 (Part 160 of the Regulations)

Part 160 requires financial institutions to provide notice to customers regarding privacy policies and practices. As discussed above, the estimated average time spent per response has not been amended; rather, the collection has been amended to reflect new registrants that will have to comply with the part 160 requirements.

*Estimated number of respondents:* 4,066.

*Annual responses by each respondent:* 96.

*Estimated average hours per response:* 0.24.

*Annual reporting burden:* 6,186.

3. New Collection 3038—NEW (Proposed Part 5 of the Regulations)

Part 5 of the proposed regulations requires various information collections by various registrants. The Commission is seeking a new and separate control number for collections occurring pursuant to part 5. Among the sections requiring information collections in the new part 5 is Regulation 5.5, which

<sup>108</sup> Due to a mathematical error in the previous Collection 3038–0005, the current estimated numbers reflect a large increase in the burden to respondents. The estimated increase in the annual responses to by each respondent is increased by 721 as a result of this rulemaking. The estimated annual increase in the hours of reporting burden is increased by 4,833 as a result of this rulemaking.

would require the development and distribution of risk disclosure documents by RFEDs, FCMs and IBs transacting off-exchange retail forex. Regulation 5.6 would require reporting by RFEDs that fail to meet minimum financial requirements or are otherwise required to provide early warning notices. Regulation 5.11 would require annual risk assessment reporting by RFEDs, and Regulation 5.12 would require financial reports of RFEDs applying for registration. Regulation 5.13 concerns reporting to customers by RFEDs and FCMs. Regulation 5.18 generally concerns trading and operational standards for retail forex counterparties and intermediaries. Among the sections within Regulation 5.18 requiring collections of information are 5.18(g), which requires all counterparties and intermediaries to forward to the Commission records of communications received concerning facts giving rise to possible violations of the Act or Regulations, and 5.18(j), which requires forex counterparties to provide the Commission with an annual compliance certification. Regulation 5.19 would require all forex counterparties and intermediaries to provide the Commission with notice of legal proceedings to which they are parties. Finally, Regulation 5.23 concerns the notices that must be given in the event of bulk transfers or liquidations.

*OMB Control Number 3038—NEW.*

*Estimated number of respondents:* 1,156.

*Annual responses by each respondent:* 4,493.

*Estimated average hours per response:* 1.8.

*Annual reporting burden:* 4,202.

Copies of the information collection submission to OMB are available from the CFT Clearance Officer, 1155 21st Street, NW., Washington, DC 20581, (202) 418–5160. The Commission considers comments by the public on this proposed collection of information in—

Evaluating whether the proposed collections of information are necessary for the proper performance of the functions of the Commission, including whether the information will have a practical use;

Evaluating the accuracy of the Commission's estimate of the burden of the proposed collection of information, including the validity of the methodology and assumptions used;

Enhancing the quality, utility and clarity of the information to be collected; and

Minimizing the burden of the collection of information on those who

are to respond, including through the use of appropriate automated, electronic, mechanical, or other technological collection techniques or other forms of information technology, e.g., permitting electronic submissions of responses.

Organizations and individuals desiring to submit comments on the information collection should contact the Office of Information and Regulatory Affairs, Office of Management and Budget, Room 10235, New Executive Office Building, Washington, DC 20503, ATTN: Desk Officer of the Commodity Futures Trading Commission. OMB is required to make a decision concerning the collection of information contained in the Proposal between 30 and 60 days after publication of his document in the **Federal Register**. Therefore, a comment to OMB is best assured of having its full effect if OMB receives it within 30 days of publication. This does not affect the deadline for the public comment to the Commission on the proposed rules.

C. Cost-Benefit Analysis

Section 15(a) of the Act<sup>109</sup> requires the Commission to consider the costs and benefits of its action before issuing new regulations under the Act. By its terms, section 15(a) does not require the Commission to quantify the costs and benefits of a new regulation or to determine whether the benefits of the regulation outweigh its costs. Rather, section 15(a) simply requires the Commission to "consider the costs and benefits" of its action.

Section 15(a) further specifies that costs and benefits shall be evaluated in light of five broad areas of market and public concern, enumerated below. Accordingly, the Commission could, in its discretion, give greater weight to any one of the five enumerated areas and could, in its discretion, determine that, notwithstanding its costs, a particular rule was necessary or appropriate to protect the public interest or to effectuate any of the provisions or to accomplish any of the purposes of the Act.

As discussed in more detail above, the Proposal would create a comprehensive scheme to implement the requirements of the CRA. It would put in place requirements including registration, disclosure, recordkeeping, financial reporting, minimum capital and other operational standards. This would be achieved through both amendments to existing regulations and the creation of a new, free-standing part to the Commission's regulations. The Commission is considering the costs

<sup>109</sup> 7 U.S.C. 19(a).



and benefits of the Proposal in light of the specific provisions of section 15(a) as follows:

1. Protection of market participants and the public. The Proposal should enhance considerably the protection of market participants and the public because it requires, for the first time, the registration of several categories of market participants and requires adherence to operational standards that had not previously applied. The benefits that inhere in the imposition of these requirements to a sector of the off-exchange market that has been largely unregulated to this point, and which is geared towards the retail public, are manifest.

2. Efficiency and competition. In its Conference Report, Congress indicated that the Commission should avoid creating two different regulatory regimes for similar business models with respect to FCMs or RFEDs engaging in off-exchange retail forex transactions.<sup>110</sup> Accordingly, the Commission has endeavored to ensure that these entities be treated in comparable fashion relative to one another. Moreover, the Commission has endeavored, wherever possible, to propose regulations in the proposed part 5 that are analogous to regulations imposed upon intermediaries engaged in on-exchange transactions. Accordingly, the Commission believes that it has provided an evenhanded regulatory scheme that will be familiar to industry participants.

3. Financial integrity of futures markets and price discovery. The Proposal's regulations concern retail, off-exchange markets. These markets serve primarily as a vehicle for members of the retail public to engage in speculative transactions. Accordingly, the Commission does not perceive a significant intersection between the operations of these markets and the financial integrity or price discovery functions of the markets generally.

4. Sound risk management practices. The Proposal includes requirements regarding capital, financial reporting, risk assessment recordkeeping, and risk assessment reporting that are comparable to those required of entities engaged in on-exchange trading. The Commission believes that the benefits of these risk management requirements—which strive to ensure the financial

soundness of firms—have been borne out on the exchange-traded side and will be of significant benefit with regard to its oversight of retail forex counterparties.

5. Other public interest considerations. The retail, off-exchange forex market has been largely unregulated until now. The Commission believes that the Proposal is beneficial in that will provide needed protections for members of the public engaging in these transactions. The Proposal will also bring much needed oversight to the forex counterparties and intermediaries that interact with the public.

After considering these factors, the Commission has determined to issue the Proposal. The Commission invites public comment on its application of the cost-benefit provision. Commenters also are invited to submit any data that they may have quantifying the costs and benefits of the Proposal with their comment letters.

#### List of Subjects

##### 17 CFR Part 1

Definitions, Minimum financial and reporting requirements. Recordkeeping requirements, Prohibited transactions in commodity options, Miscellaneous.

##### 17 CFR Part 3

Definitions, Customer protection, Licensing, Registration.

##### 17 CFR Part 4

Advertising, Brokers, Commodity futures, Commodity pool operators, Commodity trading advisors, Consumer protection, Exemption from registration, Reporting and recordkeeping requirements.

##### 17 CFR Part 5

Bulk transfers, Commodity pool operators, Commodity trading advisors, Consumer protection, Customer's money, securities and property, Definitions, Foreign exchange, Minimum financial and reporting requirements, Prohibited transactions in retail foreign exchange, Recordkeeping requirements, Retail foreign exchange dealers, Risk assessment, Special calls, Trading practices.

##### 17 CFR Part 10

Adjudicatory proceedings, Rules of practice.

##### 17 CFR Part 140

Authority delegations (Government agencies), Conflict of interests, Organization and functions (Government agencies).

##### 17 CFR Part 145

Confidential business information, Freedom of information.

##### 17 CFR Part 147

Sunshine Act.

##### 17 CFR Part 160

Consumer financial information, Definitions, Nonpublic personal information, Privacy.

##### 17 CFR Part 166

Arbitration, Authorization to trade, Customer protection, Definitions, Dispute settlement; Litigation; Reparations.

For the reasons presented above, the Commission hereby proposes to amend Chapter I of Title 17 of the Code of Federal Regulations as follows:

### PART 1—GENERAL REGULATIONS UNDER THE COMMODITY EXCHANGE ACT

1. The authority citation for part 1 continues to read as follows:

**Authority:** 7 U.S.C. 1a, 2, 2a, 4, 4a, 6, 6a, 6b, 6c, 6d, 6e, 6f, 6h, 6i, 6j, 6k, 6l, 6m, 6n, 6o, 6p, 7, 7a, 7b, 8, 9, 12, 12c, 13a, 13a-1, 16, 16a, 19, 21, 23 and 24.

#### § 1.1 [Removed and Reserved]

2. Section 1.1 is removed and reserved.

3. Section 1.3 is amended by revising paragraphs (nn) and (yy) to read as follows:

#### § 1.3 Definitions.

\* \* \* \* \*

(nn) *Guarantee agreement*. This term means an agreement of guaranty in the form set forth in part B or C of Form 1-FR, executed by a registered futures commission merchant or retail foreign exchange dealer, as appropriate, and by an introducing broker or applicant for registration as an introducing broker on behalf of an introducing broker or applicant for registration as an introducing broker in satisfaction of the alternative adjusted net capital requirement set forth in § 1.17(a)(1)(iii).

\* \* \* \* \*

(yy) *Commodity Interest*. This term means:

(1) Any contract for the purchase or sale of a commodity for future delivery;

(2) Any contract, agreement or transaction subject to Commission regulation under section 4c or 19 of the Act; and

(3) Any contract, agreement or transaction subject to Commission jurisdiction under section 2(c)(2) of the Act.

4. Section 1.4 is revised to read as follows:

<sup>110</sup> As noted in the Conference Report that accompanied the CRA, "To the extent their risk profiles are similar, the managers intend for FCMs and RFEDs to be regulated substantially equivalently in terms of their off-exchange retail foreign currency business." H.R. Rep. No. 110-627, at 980 (2008) (Conf. Rep.). The Conference Report is available via the Internet on the CFTC's Web site.

**§ 1.4 Use of electronic signatures.**

For purposes of complying with any provision in the Commodity Exchange Act or the rules or regulations in this Chapter I that requires a document to be signed by a customer of a futures commission merchant or introducing broker, a retail forex customer of a retail foreign exchange dealer or futures commission merchant, a pool participant or a client of a commodity trading advisor, an electronic signature executed by the customer, participant or client will be sufficient, if the futures commission merchant, retail foreign exchange dealer, introducing broker, commodity pool operator or commodity trading advisor elects generally to accept electronic signatures; *Provided, however,* That the electronic signature must comply with applicable Federal laws and other Commission rules; *And, Provided further,* That the futures commission merchant, retail foreign exchange dealer, introducing broker, commodity pool operator or commodity trading advisor must adopt and utilize reasonable safeguards regarding the use of electronic signatures, including at a minimum safeguards employed to prevent alteration of the electronic record with which the electronic signature is associated, after such record has been electronically signed.

5. Section 1.10 is amended by revising paragraph (j) to read as follows:

**§ 1.10 Financial reports of futures commission merchants and introducing brokers.**

\* \* \* \* \*

(j) *Requirements for guarantee agreement.* (1) A guarantee agreement filed pursuant to this section must be signed in a manner sufficient to be a binding guarantee under local law by an appropriate person on behalf of the futures commission merchant or retail foreign exchange dealer and the introducing broker, and each signature must be accompanied by evidence that the signatory is authorized to enter the agreement on behalf of the futures commission merchant, retail foreign exchange dealer, or introducing broker and is such an appropriate person. For purposes of this paragraph (j), an appropriate person shall be the proprietor, if the firm is a sole proprietorship; a general partner, if the firm is a partnership; and either the chief executive officer or the chief financial officer, if the firm is a corporation; and, if the firm is a limited liability company or limited liability partnership, either the chief executive officer, the chief financial officer, the manager, the managing member, or those members vested with the

management authority for the limited liability company or limited liability partnership.

(2) No futures commission merchant or retail foreign exchange dealer may enter into a guarantee agreement if:

(i) It knows or should have known that its adjusted net capital is less than the amount set forth in § 1.12(b) of this part or § 5.6(b) of this chapter, as applicable; or

(ii) There is filed against the futures commission merchant or retail foreign exchange dealer an adjudicatory proceeding brought by or before the Commission pursuant to the provisions of sections 6(c), 6(d), 6c, 6d, 8a or 9 of the Act or §§ 3.55, 3.56 or 3.60 of this chapter.

(3) A retail foreign exchange dealer may enter into a guarantee agreement only with an introducing broker as defined in § 5.1(f)(1). A retail foreign exchange dealer may not enter into a guarantee agreement with an introducing broker as defined in § 1.3(mm) of this part.

(4) A guarantee agreement filed in connection with an application for initial registration as an introducing broker in accordance with the provisions of § 3.10(a) of this chapter shall become effective upon the granting of registration or, if appropriate, a temporary license, to the introducing broker. A guarantee agreement filed other than in connection with an application for initial registration as an introducing broker shall become effective as of the date agreed to by the parties.

(5)(i) If the registration of the introducing broker is suspended, revoked, or withdrawn in accordance with the provisions of this chapter, the guarantee agreement shall expire as of the date of such suspension, revocation or withdrawal.

(ii) If the registration of the futures commission merchant or retail foreign exchange dealer is suspended or revoked, the guarantee agreement shall expire 30 days after such suspension or revocation, or at such earlier time as may be approved by the Commission, the introducing broker, and the introducing broker's designated self-regulatory organization.

(6) A guarantee agreement may be terminated at any time during the term thereof:

(i) By mutual written consent of the parties, signed by an appropriate person on behalf of each party, with prompt written notice thereof, signed by an appropriate person on behalf of each party, to the Commission and to the designated self-regulatory organizations of the futures commission merchant or

retail foreign exchange dealer and the introducing broker;

(ii) For good cause shown, by either party giving written notice of its intention to terminate the agreement, signed by an appropriate person, to the other party to the agreement, to the Commission, and to the designated self-regulatory organizations of the futures commission merchant or retail foreign exchange dealer and the introducing broker; or

(iii) By either party giving written notice of its intention to terminate the agreement, signed by an appropriate person, at least 30 days prior to the proposed termination date, to the other party to the agreement, to the Commission, and to the designated self-regulatory organizations of the futures commission merchant or retail foreign exchange dealer and the introducing broker.

(7) The termination of a guarantee agreement by a futures commission merchant, retail foreign exchange dealer or an introducing broker, or the expiration of such an agreement, shall not relieve any party from any liability or obligation arising from acts or omissions which occurred during the term of the agreement.

(8) An introducing broker may not simultaneously be a party to more than one guarantee agreement: *Provided, however,* That the provisions of this paragraph (j)(8) shall not be deemed to preclude an introducing broker from entering into a guarantee agreement with another futures commission merchant or retail foreign exchange dealer if the introducing broker, futures commission merchant or retail foreign exchange dealer which is a party to the existing agreement has provided notice of termination of the existing agreement in accordance with the provisions of paragraph (j)(6) of this section, and the new guarantee agreement does not become effective until the day following the date of termination of the existing agreement: *And, provided further,* That the provisions of this paragraph (j)(8) shall not be deemed to preclude an introducing broker from entering into a guarantee agreement with another futures commission merchant or retail foreign exchange dealer if the futures commission merchant or retail foreign exchange dealer which is a party to the existing agreement ceases to remain registered and the existing agreement would therefore expire in accordance with the provisions of paragraph (j)(6)(ii) of this section.

(9)(i)(A) An introducing broker that is a party to a guarantee agreement that has been terminated in accordance with the provisions of paragraph (j)(6) of this

section, or that is due to expire in accordance with the provisions of paragraph (j)(5)(ii) of this section, must cease doing business as an introducing broker on or before the effective date of such termination or expiration unless, on or before 10 days prior to the effective date of such termination or expiration or such other period of time as the Commission or the designated self-regulatory organization may allow for good cause shown, the introducing broker files with its designated self-regulatory organization either a new guarantee agreement effective as of the day following the date of termination of the existing agreement, or, in the case of a guarantee agreement that is due to expire in accordance with the provisions of paragraph (j)(4)(ii) of this section, a new guarantee agreement effective on or before such expiration, or either:

(1) A Form 1-FR-IB certified by an independent public accountant in accordance with § 1.16 as of a date not more than 45 days prior to the date on which the report is filed; or

(2) A Form 1-FR-IB as of a date not more than 17 business days prior to the date on which the report is filed and a Form 1-FR-IB certified by an independent public accountant in accordance with § 1.16 as of a date not more than one year prior to the date on which the report is filed: *Provided, however*, that an introducing broker as defined in § 5.1(f)(1) of this chapter that is party to a guarantee agreement that has been terminated or that has expired must cease doing business as an introducing broker on or before the effective date of such termination or expiration unless, on or before 10 days prior to the effective date of such termination or expiration or such other period of time as the Commission or the designated self-regulatory organization may allow for good cause shown, the introducing broker files with its designated self-regulatory organization a new guarantee agreement effective on or before the termination or expiration date of the terminating or expiring guarantee agreement.

(B) Each person filing a Form 1-FR-IB in accordance with this section must include with the financial report a statement describing the source of his current assets and representing that his capital has been contributed for the purpose of operating his business and will continue to be used for such purpose.

(ii)(A) Notwithstanding the provisions of paragraph (j)(9)(i) of this section or of § 1.17(a), an introducing broker that is a party to a guarantee agreement that has been terminated in accordance with the

provisions of paragraph (j)(6)(ii) of this section shall not be deemed to be in violation of the minimum adjusted net capital requirement of § 1.17(a)(1)(iii) or (a)(2) for 30 days following such termination. Such an introducing broker must cease doing business as an introducing broker on or after the effective date of such termination, and may not resume doing business as an introducing broker unless and until it files a new agreement or either:

(1) A Form 1-FR-IB certified by an independent public accountant in accordance with § 1.16 as of a date not more than 45 days prior to the date on which the report is filed; or

(2) A Form 1-FR-IB as of a date not more than 17 business days prior to the date on which the report is filed and a Form 1-FR-IB certified by an independent public accountant in accordance with § 1.16 as of a date not more than one year prior to the date on which the report is filed: *Provided, however*, that an introducing broker as defined in § 5.1(f)(1) of this chapter that is party to a guarantee agreement that has been terminated must cease doing business as an introducing broker from and after the effective date of such termination, and may not resume doing business as an introducing broker as defined in § 5.1(f)(1) of this chapter unless and until it files a new guarantee agreement.

(B) Each person filing a Form 1-FR-IB in accordance with this section must include with the financial report a statement describing the source of his current assets and representing that his capital has been contributed for the purpose of operating his business and will continue to be used for such purpose.

\* \* \* \* \*

6. Section 1.35 is amended by revising paragraphs (a), (a-1) and (b) to read as follows:

**§ 1.35 Records of cash commodity, futures, and option transactions.**

(a) *Futures commission merchants, retail foreign exchange dealers, introducing brokers, and members of contract markets.* Each futures commission merchant, retail foreign exchange dealer, introducing broker, and member of a contract market shall keep full, complete, and systematic records, together with all pertinent data and memoranda, of all transactions relating to its business of dealing in commodity futures, retail forex transactions, commodity options, and cash commodities (including currencies). Each futures commission merchant, retail foreign exchange dealer, introducing broker, and member

of a contract market shall retain the required records, data, and memoranda in accordance with the requirements of § 1.31, and produce them for inspection and furnish true and correct information and reports as to the contents or the meaning thereof, when and as requested by an authorized representative of the Commission or the United States Department of Justice. Included among such records shall be all orders (filled, unfilled, or canceled), trading cards, signature cards, street books, journals, ledgers, canceled checks, copies of confirmations, copies of statements of purchase and sale, and all other records, data and memoranda, which have been prepared in the course of its business of dealing in commodity futures, retail forex transactions, commodity options, and cash commodities. Among such records each member of a contract market must retain and produce for inspection are all documents on which trade information is originally recorded, whether or not such documents must be prepared pursuant to the rules or regulations of either the Commission or the contract market. For purposes of this section, such documents are referred to as "original source documents."

(a-1) *Futures commission merchants, retail foreign exchange dealers, introducing brokers, and members of contract markets: Recording of customers' and option customers' orders.* (1) Each futures commission merchant, each retail foreign exchange dealer and each introducing broker receiving a customer's, retail forex customer's or option customer's order, as applicable, shall immediately upon receipt thereof prepare a written record of the order including the account identification, except as provided in paragraph (a-1)(5) of this section, and order number, and shall record thereon, by timestamp or other timing device, the date and time, to the nearest minute, the order is received, and in addition, for option customers' orders, the time, to the nearest minute, the order is transmitted for execution.

(2)(i) Each member of a contract market who on the floor of such contract market receives a customer's or option customer's order which is not in the form of a written record including the account identification, order number, and the date and time, to the nearest minute, the order was transmitted or received on the floor of such contract market, shall immediately upon receipt thereof prepare a written record of the order in nonerasable ink, including the account identification, except as provided in paragraph (a-1)(5) of this section or appendix C to this part, and order number and shall record thereon,

by timestamp or other timing device, the date and time, to the nearest minute, the order is received.

(ii) Except as provided in paragraph (a-1)(3) of this section:

(A) Each contract market member who on the floor of such contract market receives an order from another member present on the floor which is not in the form of a written record shall, immediately upon receipt of such order, prepare a written record of the order or obtain from the member who placed the order a written record of the order, in non-erasable ink including the account identification and order number and shall record thereon, by time-stamp or other timing device, the date and time, to the nearest minute, the order is received; or

(B) When a contract market member present on the floor places an order, which is not in the form of a written record, for his own account or an account over which he has control, with another member of such contract market for execution:

(1) The member placing such order immediately upon placement of the order shall record the order and time of placement to the nearest minute on a sequentially-numbered trading card maintained in accordance with the requirements of paragraph (d) of this section;

(2) The member receiving and executing such order immediately upon execution of the order shall record the time of execution to the nearest minute on a trading card or other record maintained pursuant to the requirements of paragraph (d) of this section; and

(3) The member receiving and executing the order shall return such trading card or other record to the member placing the order. The member placing the order then must submit together both of the trading cards or other records documenting such trade to contract market personnel or the clearing member, in accordance with contract market rules adopted pursuant to paragraph (j)(1) of this section.

(iii) Each contract market may adopt rules, which must be submitted to the Commission pursuant to section 5a(a)(12)(A) of the Act and Commission Regulation 1.41, that provide alternative requirements to those contained in paragraph (a-1)(2)(ii) of this section. Such rules shall, at a minimum, require that the contemporaneous written records:

(A) Contain the terms of the order;

(B) Include reliable timing data for the initiation and execution of the order which would permit complete and

effective reconstruction of the order placement and execution; and

(C) Be submitted to contract market personnel or clearing members in accordance with contract market rules adopted pursuant to paragraph (j)(1) of this section.

(3)(i) The requirements of paragraph (a-1)(2)(ii) of this section will not apply if a contract market maintains in effect rules which have been submitted to the Commission pursuant to section 5a(a)(12)(A) of the Act and Commission Regulation 1.41, which provide for an exemption where:

(A) A contract market member places with another member of such contract market an order that is part of a spread transaction;

(B) The member placing the order personally executes one or more legs of the spread; and

(C) The member receiving and executing such order immediately upon execution of the order records the time of execution to the nearest minute on his trading card or other record maintained in accordance with the requirements of paragraph (d) of this section.

(ii) Each contract market shall, as part of its trade practice surveillance program, conduct surveillance for compliance with the recordkeeping and other requirements under paragraphs (a-1)(2) and (3) of this section, and for trading abuses related to the execution of orders for members present on the floor of the contract market.

(4) Each member of a contract market reporting the execution from the floor of the contract market of a customer's or option customer's order or the order of another member of the contract market received in accordance with paragraphs (a-1)(2)(i) or (a-1)(2)(ii)(A) of this section, shall record on a written record of the order, including the account identification, except as provided in paragraph (a-1)(5) of this section, and order number, by timestamp or other timing device, the date and time to the nearest minute such report of execution is made. Each member of a contract market shall submit the written records of customer orders or orders from other contract market members to contract market personnel or to the clearing member responsible for the collection of orders prepared pursuant to this paragraph as required by contract market rules adopted in accordance with paragraph (j)(1) of this section. The execution price and other information reported on the order tickets must be written in nonerasable ink.

(5) *Post-execution allocation of bunched orders.* Specific customer account identifiers for accounts

included in bunched orders need not be recorded at time of order placement or upon report of execution if the requirements of paragraphs (a-1)(5)(i)-(iv) of this section are met.

(i) *Eligible account managers.* The person placing and directing the allocation of an order eligible for post-execution allocation must have been granted written investment discretion with regard to participating customer accounts. The following persons shall qualify as eligible account managers:

(A) A commodity trading advisor registered with the Commission pursuant to the Act or excluded or exempt from registration under the Act or the Commission's rules, except for entities exempt under § 4.14(a)(3) or § 4.14(a)(6) of this chapter;

(B) An investment adviser registered with the Securities and Exchange Commission pursuant to the Investment Advisers Act of 1940 or with a state pursuant to applicable state law or excluded or exempt from registration under such Act or applicable state law or rule;

(C) A bank, insurance company, trust company, or savings and loan association subject to federal or state regulation; or

(D) A foreign adviser that exercises discretionary trading authority solely over the accounts of non-U.S. persons, as defined in § 4.7(a)(1)(iv) of this chapter.

(ii) *Information.* Eligible account managers shall make the following information available to customers upon request:

(A) The general nature of the allocation methodology the account manager will use;

(B) Whether accounts in which the account manager may have any interest may be included with customer accounts in bunched orders eligible for post-execution allocation; and

(C) Summary or composite data sufficient for that customer to compare its results with those of other comparable customers and, if applicable, any account in which the account manager has an interest.

(iii) *Allocation.* Orders eligible for post-execution allocation must be allocated by an eligible account manager in accordance with the following:

(A) Allocations must be made as soon as practicable after the entire transaction is executed, but in any event account managers must provide allocation information to futures commission merchants no later than a time sufficiently before the end of the day the order is executed to ensure that clearing records identify the ultimate customer for each trade.

(B) Allocations must be fair and equitable. No account or group of accounts may receive consistently favorable or unfavorable treatment.

(C) The allocation methodology must be sufficiently objective and specific to permit independent verification of the fairness of the allocations using that methodology by appropriate regulatory and self-regulatory authorities and by outside auditors.

(iv) *Records.* (A) Eligible account managers shall keep and must make available upon request of any representative of the Commission, the United States Department of Justice, or other appropriate regulatory agency, the information specified in paragraph (a-1)(5)(ii) of this section.

(B) Eligible account managers shall keep and must make available upon request of any representative of the Commission, the United States Department of Justice, or other appropriate regulatory agency, records sufficient to demonstrate that all allocations meet the standards of paragraph (a-1)(5)(iii) of this section and to permit the reconstruction of the handling of the order from the time of placement by the account manager to the allocation to individual accounts.

(C) Futures commission merchants that execute orders or that carry accounts eligible for post-execution allocation, and members of contract markets that execute such orders, must maintain records that, as applicable, identify each order subject to post-execution allocation and the accounts to which contracts executed for such order are allocated.

(D) In addition to any other remedies that may be available under the Act or otherwise, if the Commission has reason to believe that an account manager has failed to provide information requested pursuant to paragraph (a-1)(5)(iv)(A) or (a-1)(5)(iv)(B) of this section, the Commission may inform in writing any designated contract market or derivatives transaction execution facility and that designated contract market or derivatives transaction execution facility shall prohibit the account manager from submitting orders for execution except for liquidation of open positions and no futures commission merchants shall accept orders for execution on any designated contract market or derivatives transaction execution facility from the account manager except for liquidation of open positions.

(E) Any account manager that believes he or she is or may be adversely affected or aggrieved by action taken by the Commission under paragraph (a-1)(5)(iv)(D) of this section shall have the

opportunity for a prompt hearing in accordance with the provisions of § 21.03(g) of this chapter.

\* \* \* \* \*

(b) *Futures commission merchants, retail foreign exchange dealers, introducing brokers, and clearing members of contract markets.* Each futures commission merchant, each retail foreign exchange dealer, and each clearing member of a contract market and, for purposes of paragraph (b)(3) of this section, each introducing broker, shall, as a minimum requirement, prepare regularly and promptly, and keep systematically and in permanent form, the following:

(1) A financial ledger record which will show separately for each customer or retail forex customer or option customer all charges against and credits to such customer's or retail forex customer's or option customer's account, including but not limited to customer or retail forex customer funds deposited, withdrawn, or transferred, and charges or credits resulting from losses or gains on closed transactions;

(2) A record of transactions which will show separately for each account (including proprietary accounts):

(i) All commodity futures transactions executed for such account, including the date, price, quantity, market, commodity and future;

(ii) All retail forex transactions executed for such account, including the date, price, quantity, and currency; and

(iii) All commodity option transactions executed for such account, including the date, whether the transaction involved a put or call, expiration date, quantity, underlying contract for future delivery or underlying physical, strike price, and details of the purchase price of the option, including premium, mark-up, commission and fees; and

(3) A record or journal which will separately show for each business day complete details of:

(i) All commodity futures transactions executed on that day, including the date, price, quantity, market, commodity, future and the person for whom such transaction was made;

(ii) All retail forex transactions executed on that day for such account, including the date, price, quantity, currency and the person for whom such transaction was made; and

(iii) All commodity option transactions executed on that day, including the date, whether the transaction involved a put or call, the expiration date, quantity, underlying contract for future delivery, or

underlying physical, strike price, details of the purchase price of the option, including premium, mark-up, commission and fees and the person for whom the transaction was made; and

(iv) In the case of an introducing broker, the record or journal required by this paragraph (b)(3) shall also include the futures commission merchant or retail foreign exchange dealer carrying the account for which each commodity futures, retail forex and commodity option transaction was executed on that day. Provided, however, that where reproductions on microfilm, microfiche or optical disk are substituted for hard copy in accordance with the provisions of § 1.31(b) of this part, the requirements of paragraphs (b)(1) and (b)(2) of this section will be considered met if the person required to keep such records is ready at all times to provide, and immediately provides in the same city as that in which such person's commodity retail forex or commodity option books and records are maintained, at the expense of such person, reproduced copies which show the records as specified in paragraphs (b)(1) and (b)(2) of this section, on request of any representatives of the Commission or the U.S. Department of Justice.

\* \* \* \* \*

7. Section 1.36 is amended by revising paragraph (a) to read as follows:

**§ 1.36 Record of securities and property received from customers and option customers.**

(a) Each futures commission merchant and each retail foreign exchange dealer shall maintain, as provided in § 1.31, a record of all securities and property received from customers, retail forex customers or option customers in lieu of money to margin, purchase, guarantee, or secure the commodity, retail forex or commodity option transactions of such customers, retail forex customers or option customers. Such record shall show separately for each customer, retail forex customer or option customer: a description of the securities or property received; the name and address of such customer, retail forex customer or option customer; the dates when the securities or property were received; the identity of the depositories or other places where such securities or property are segregated or held; the dates of deposits and withdrawals from such depositories; and the dates of return of such securities or property to such customer, retail forex customer or option customer, or other disposition thereof, together with the facts and circumstances of such other disposition. In the event any futures commission

merchant deposits with the clearing organization of a contract market, directly or with a bank or trust company acting as custodian for such clearing organization, securities and/or property which belong to a particular customer or option customer, such futures commission merchant shall obtain written acknowledgment from such clearing organization that it was informed that such securities or property belong to customers or option customers of the futures commission merchant making the deposit. Such acknowledgment shall be retained as provided in § 1.31.

\* \* \* \* \*

8. Section 1.37 is amended by revising paragraph (a)(1) to read as follows:

**§ 1.37 Customer's or option customer's name, address, and occupation recorded; record of guarantor or controller of account.**

(a)(1) Each futures commission merchant, retail foreign exchange dealer, introducing broker, and member of a contract market shall keep a record in permanent form which shall show for each commodity futures, retail forex or option account carried or introduced by it the true name and address of the person for whom such account is carried or introduced and the principal occupation or business of such person as well as the name of any other person guaranteeing such account or exercising any trading control with respect to such account. For each such commodity option account, the records kept by such futures commission merchant, introducing broker, and member of a contract market must also show the name of the person who has solicited and is responsible for each option customer's account or assign account numbers in such a manner to identify that person.

\* \* \* \* \*

9. Section 1.40 is revised to read as follows:

**§ 1.40 Crop, market information letters, reports; copies required.**

Each futures commission merchant, each retail foreign exchange dealer, each introducing broker and each member of a contract market shall, upon request, furnish or cause to be furnished to the Commission a true copy of any letter, circular, telegram, or report published or given general circulation by such futures commission merchant, retail foreign exchange dealer, introducing broker or member which concerns crop or market information or conditions that affect or tend to affect the price of any commodity or exchange rate, and the

true source of or authority for the information contained therein.

10. Section 1.46 is amended by revising paragraphs (a) and (b) to read as follows:

**§ 1.46 Application and closing out of offsetting long and short positions.**

(a) *Application of purchases and sales.* (1) Except with respect to purchases or sales which are for omnibus accounts, or where the customer or account controller has instructed otherwise, any futures commission merchant who, on or subject to the rules of a designated contract market or registered derivatives transaction execution facility:

(i) Purchases any commodity for future delivery for the account of any customer when the account of such customer at the time of such purchase has a short position in the same future of the same commodity on the same market;

(ii) Sells any commodity for future delivery for the account of any customer when the account of such customer at the time of such sale has a long position in the same future of the same commodity on the same market;

(iii) Purchases a put or call option for the account of any option customer when the account of such option customer at the time of such purchase has a short put or call option position with the same underlying futures contract or same underlying physical, strike price, expiration date and contract market as that purchased; or

(iv) Sells a put or call option for the account of any option customer when the account of such option customer at the time of such sale has a long put or call option position with the same underlying futures contract or same underlying physical, strike price, expiration date and contract market as that sold—shall on the same day apply such purchase or sale against such previously held short or long futures or option position, as the case may be, and shall, for futures transactions, promptly furnish such customer a statement showing the financial result of the transactions involved and, if applicable, that the account was introduced to the futures commission merchant by an introducing broker and the names of the futures commission merchant and introducing broker.

(2) Any futures commission merchant or retail foreign exchange dealer who:

(i) Engages in a retail forex transaction involving the purchase of any currency for the account of any retail forex customer when the account of such retail forex customer at the time of such purchase has an open retail forex

transaction for the sale of the same currency;

(ii) Engages in a retail forex transaction involving the sale of any currency for the account of any retail forex customer when the account of such retail forex customer at the time of such sale has an open retail forex transaction for the purchase of the same currency;

(iii) Purchases a put or call option involving foreign currency for the account of any option customer when the account of such option customer at the time of such purchase has a short put or call option position with the same underlying currency, strike price, and expiration date as that purchased; or

(iv) Sells a put or call option involving foreign currency for the account of any option customer when the account of such option customer at the time of such sale has a long put or call option position with the same underlying currency, strike price, and expiration date as that sold—shall immediately apply such purchase or sale against such previously held opposite transaction, and shall promptly furnish such retail forex customer a statement showing the financial result of the transactions involved and, if applicable, that the account was introduced to the futures commission merchant or retail foreign exchange dealer by an introducing broker and the names of the futures commission merchant or retail foreign exchange dealer, and the introducing broker.

(b) *Close-out against oldest open position.* In all instances wherein the short or long futures, retail forex transaction or option position in such customer's, retail forex customer's or option customer's account immediately prior to such offsetting purchase or sale is greater than the quantity purchased or sold, the futures commission merchant or retail foreign exchange dealer shall apply such offsetting purchase or sale to the oldest portion of the previously held short or long position: Provided, That upon specific instructions from the customer or option customer the offsetting transaction shall be applied as specified by the customer or option customer without regard to the date of acquisition of the previously held position; and Provided, further, that a futures commission merchant or retail foreign exchange dealer, if permitted by the rules of a registered futures association, may offset, at the customer's request, retail forex transactions of the same size, even if the customer holds other transactions of a different size, but in each case must offset the transaction against the oldest

transaction of the same size. Such instructions may also be accepted from any person who, by power of attorney or otherwise, actually directs trading in the customer's, retail forex customer's or option customer's account unless the person directing the trading is the futures commission merchant or retail foreign exchange dealer (including any partner thereof), or is an officer, employee, or agent of the futures commission merchant or retail foreign exchange dealer. With respect to every such offsetting transaction that, in accordance with such specific instructions, is not applied to the oldest portion of the previously held position, the futures commission merchant or retail foreign exchange dealer shall clearly show on the statement issued to the customer, retail forex customer or option customer in connection with the transaction, that because of the specific instructions given by or on behalf of the customer, retail forex customer or option customer the transaction was not applied in the usual manner, i.e., against the oldest portion of the previously held position. However, no such showing need be made if the futures commission merchant or retail foreign exchange dealer has received such specific instructions in writing from the customer, retail forex customer or option customer for whom such account is carried.

\* \* \* \* \*

- 11. Section 1.52 is amended by:
a. Revising paragraphs (a) and (c);
b. Revising paragraphs (g)(3) and (g)(4); and
c. Revising paragraphs (h), (j), and (k) to read as follows:

§ 1.52 Self-regulatory organization adoption and surveillance of minimum financial requirements.

(a) Each self-regulatory organization must adopt, and submit for Commission approval, rules prescribing minimum financial and related reporting requirements for all its members who are registered futures commission merchants or registered retail foreign exchange dealers. Each self-regulatory organization other than a contract market must adopt, and submit for Commission approval, rules prescribing minimum financial and related reporting requirements for all its members who are registered introducing brokers. Each contract market which elects to have a category of membership for introducing brokers must adopt, and submit for Commission approval, rules prescribing minimum financial and related reporting requirements for all its members who are registered introducing brokers. Each self-regulatory

organization shall submit for Commission approval any modification or other amendments to such rules. Such requirements must be the same as, or more stringent than, those contained in §§ 1.10 and 1.17, for futures commission merchants and introducing brokers, and § 5.7 for retail foreign exchange dealers. The definition of adjusted net capital must be the same as that prescribed in § 1.17(c) for futures commission merchants and introducing brokers, and § 5.7(b)(2) for futures commission merchants offering or engaging in retail forex transactions and for retail foreign exchange dealers: Provided, however, A designated self-regulatory organization may permit its member registrants which are registered with the Securities and Exchange Commission as securities brokers or dealers to file (in accordance with § 1.10(h)) a copy of their Financial and Operational Combined Uniform Single Report under the Securities Exchange Act of 1934, Part II, Part IIA, or Part II CSE, in lieu of Form 1-FR: And, provided further, A designated self-regulatory organization may permit its member introducing brokers to file a Form 1-FR-IB in lieu of a Form 1-FR-FCM.

\* \* \* \* \*

(c) Any two or more self-regulatory organizations may file with the Commission a plan for delegating to a designated self-regulatory organization, for any registered futures commission merchant, any registered retail foreign exchange dealer, or any registered introducing broker which is a member of more than one such self-regulatory organization, the responsibility of:

- (1) Monitoring and auditing for compliance with the minimum financial and related reporting requirements adopted by such self-regulatory organizations in accordance with paragraph (a) of this section; and
(2) Receiving the financial reports necessitated by such minimum financial and related reporting requirements.

\* \* \* \* \*

(g) \* \* \*
(3) Reduces multiple monitoring and auditing for compliance with the minimum financial rules of the self-regulatory organizations submitting the plan for any futures commission merchant, retail foreign exchange dealer, or introducing broker which is a member of more than one self-regulatory organization;

(4) Reduces multiple reporting of the financial information necessitated by such minimum financial and related reporting requirements by any futures commission merchant, retail foreign

exchange dealer, or introducing broker which is a member of more than one self-regulatory organization; \* \* \*

(h) After the Commission has approved a plan or part of one under § 1.52(g), a self-regulatory organization relieved of responsibility must notify each of its members which is subject to such a plan:

- (1) Of the limited nature of its responsibility for such a member's compliance with its minimum financial and related reporting requirements; and
(2) Of the identity of the designated self-regulatory organization which has been delegated responsibility for such a member.

\* \* \* \* \*

(j) Whenever a registered futures commission merchant, a registered retail foreign exchange dealer, or a registered introducing broker holding membership in a self-regulatory organization ceases to be a member in good standing of that self-regulatory organization, such self-regulatory organization must, on the same day that event takes place, give telegraphic notice of that event to the principal office of the Commission in Washington, DC, and send a copy of that notification to such futures commission merchant, retail foreign exchange dealer, or such introducing broker.

(k) Nothing in this section shall preclude the Commission from examining any futures commission merchant, retail foreign exchange dealer, or introducing broker for compliance with the minimum financial and related reporting requirements to which such futures commission merchant, retail foreign exchange dealer, or introducing broker is subject.

\* \* \* \* \*

PART 3—REGISTRATION

12. The authority citation for part 3 continues to read as follows:

Authority: 7 U.S.C. 1a, 2, 6, 6a, 6b, 6c, 6d, 6e, 6f, 6g, 6h, 6i, 6k, 6m, 6n, 6o, 6p, 8, 9, 9a, 12, 12a, 13b, 13c, 16a, 18, 19, 21 and 23.

13. Section 3.1 is amended by revising paragraph (c) to read as follows:

§ 3.1 Definitions.

\* \* \* \* \*

(c) Sponsor. Sponsor means the futures commission merchant, retail foreign exchange dealer, introducing broker, commodity trading advisor, commodity pool operator or leverage transaction merchant which makes the certification required by § 3.12 of this part for the registration of an associated person of such sponsor.

\* \* \* \* \*

14. Section 3.4 is amended by revising paragraph (a) to read as follows:



**§ 3.4 Registration in one capacity not included in registration in any other capacity.**

(a) Except as may be otherwise provided in the Act or in any rule, regulation, or order of the Commission, each futures commission merchant, retail foreign exchange dealer, floor broker, floor trader, associated person, commodity trading advisor, commodity pool operator, introducing broker, and leverage transaction merchant must register as such under the Act.

Registration in one capacity under the Act shall not include registration in any other capacity: *Provided, however,* That a registered floor broker need not also register as a floor trader in order to engage in activity as a floor trader.

\* \* \* \* \*

15. Section 3.10 is amended by:

- a. Revising the heading;
- b. Revising paragraph (a)(1);
- c. Revising paragraph (b); and
- d. Revising paragraph (d) to read as follows:

**§ 3.10 Registration of futures commission merchants, retail foreign exchange dealers, introducing brokers, commodity trading advisors, commodity pool operators and leverage transaction merchants.**

(a) *Application for registration.* (1)(i) Except as provided in paragraph (a)(3) of this section, application for registration as a futures commission merchant, retail foreign exchange dealer, introducing broker, commodity trading advisor, commodity pool operator or leverage transaction merchant must be on Form 7-R, completed and filed with the National Futures Association in accordance with the instructions thereto.

(ii) Applicants for registration as a futures commission merchant, retail foreign exchange dealer or introducing broker must accompany their Form 7-R with a Form 1-FR-FCM or Form 1-FR-IB, respectively, in accordance with the provisions of § 1.10 of this chapter: *Provided, however,* That an applicant for registration as a futures commission merchant or introducing broker which is registered with the Securities and Exchange Commission as a securities broker or dealer may accompany its Form 7-R with a copy of its Financial and Operational Combined Uniform Single Report under the Securities Exchange Act of 1934, Part II or Part II A, in accordance with the provisions of § 1.10(h) of this chapter.

\* \* \* \* \*

(b) *Duration of registration.* (1) A person registered as a futures commission merchant, retail foreign exchange dealer, introducing broker, commodity trading advisor, commodity

pool operator or leverage transaction merchant in accordance with paragraph (a) of this section will continue to be so registered until the effective date of any revocation or withdrawal of such registration. Such person will be prohibited from engaging in activities requiring registration under the Act or from representing himself to be a registrant under the Act or the representative or agent of any registrant during the pendency of any suspension of such registration.

(2) A person registered as an introducing broker who was a party to a guarantee agreement with a futures commission merchant or retail foreign exchange dealer in accordance with § 1.10(j) of this chapter will have its registration cease thirty days after the termination of such guarantee agreement unless the procedures set forth in § 1.10(j)(8) of this chapter are followed.

\* \* \* \* \*

(d) On a date to be established by the National Futures Association, and in accordance with procedures established by the National Futures Association, each registrant as a futures commission merchant, retail foreign exchange dealer, introducing broker, commodity trading advisor, commodity pool operator or leverage transaction merchant shall, on an annual basis, review and update registration information maintained with the National Futures Association. The failure to complete the review and update within thirty days following the date established by the National Futures Association shall be deemed to be a request for withdrawal from registration, which shall be processed in accordance with the provisions of § 3.33(f).

\* \* \* \* \*

16. Section 3.12 is amended by:

- a. Revising the heading;
- b. Revising paragraph (a);
- c. Revising paragraph (f)(1)(iii)(E);
- d. Revising paragraph (f)(4);
- e. Revising paragraph (h)(1)(i) and paragraph (h)(1)(iii); and
- f. Removing paragraph (j)

The revisions read as follows:

**§ 3.12 Registration of associated persons of futures commission merchants, retail foreign exchange dealers, introducing brokers, commodity trading advisors, commodity pool operators and leverage transaction merchants.**

(a) *Registration required.* It shall be unlawful for any person to be associated with a futures commission merchant, retail foreign exchange dealer, introducing broker, commodity trading advisor, commodity pool operator or leverage transaction merchant as an

associated person unless that person shall have registered under the Act as an associated person of that sponsoring futures commission merchant, retail foreign exchange dealer, introducing broker, commodity trading advisor, commodity pool operator or leverage transaction merchant in accordance with the procedures in paragraphs (c), (d), (f), or (i), of this section or is exempt from such registration pursuant to paragraph (h) of this section.

\* \* \* \* \*

(f) \* \* \*

(1) \* \* \*

(iii) \* \* \*

(E) Associated person's supervision of any person or persons engaged in any of the foregoing solicitations or acceptances, with respect to any customers common to it and any other futures commission merchant, retail foreign exchange dealer, introducing broker, commodity trading advisor, commodity pool operator, or leverage transaction merchant with which the associated person is associated.

\* \* \* \* \*

(4) If a person is associated with a futures commission merchant, with a retail foreign exchange dealer, or with an introducing broker and he directs customers seeking a managed account to use the services of a commodity trading advisor(s) approved by the futures commission merchant, retail foreign exchange dealer or introducing broker and all such customers' accounts solicited or accepted by the associated person are carried by the futures commission merchant, retail foreign exchange dealer or introduced by the introducing broker with which the associated person is associated, such a person shall be deemed to be associated solely with the futures commission merchant, retail foreign exchange dealer or introducing broker and may not also register as an associated person of the commodity trading advisor(s).

\* \* \* \* \*

(h) \* \* \*

(1) \* \* \*

(i) Registered under the Act as a futures commission merchant, retail foreign exchange dealer, floor broker, or as an introducing broker;

\* \* \* \* \*

(iii) The chief operating officer, general partner or other person in the supervisory chain-of-command, *provided* the futures commission merchant, retail foreign exchange dealer, introducing broker, commodity trading advisor, commodity pool operator, or leverage transaction merchant engages in commodity interest related activity for customers as no more

than ten percent of its total revenue on an annual basis, the firm is not subject to a pending proceeding brought by the Commission or a self-regulatory organization alleging fraud or failure to supervise, and has not been found in such a proceeding to have committed fraud or failed to supervise, as required by the Act, the rules promulgated thereunder or the rules of a self-regulatory organization, the person for whom exemption is sought and the person designated in accordance with paragraphs (h)(1)(iii)(C) or (h)(1)(iii)(D) of this section are listed as principals of the firm, the fitness examination conducted by the National Futures Association with respect to these persons discloses no derogatory information that would disqualify any of such persons as a principal or as an associated person, and the firm files with the National Futures Association corporate or partnership resolutions stating that:

(A) Such supervisory person is not authorized to:

(1) Solicit or accept customers', retail forex customers', or leverage customers' orders,

(2) Solicit a client's or prospective client's discretionary account,

(3) Solicit funds, securities or property for a participation in a commodity pool, or

(4) Exercise any line supervisory authority over those persons so engaged;

(B) Such supervisory person has no authority with respect to hiring, firing or other personnel matters involving persons engaged in activities subject to regulation under the Act;

(C) Another person (or persons) designated therein, who is registered as an associated person(s) or who has applied for registration as an associated person(s) and is not subject to a pending proceeding brought by the Commission or a self-regulatory organization alleging fraud or failure to supervise, and has not been found in such a proceeding to have committed fraud or failed to supervise, as required by the Act, the rules promulgated thereunder or the rules of a self-regulatory organization, holds and exercises full and final supervisory authority, including authority to hire and fire personnel, over the customer commodity interest related activities of the firm; and

(D) If the person (or persons) so designated in accordance with paragraph (h)(1)(iii)(C) of this section ceases to have the authority referred to therein, the firm will notify the National Futures Association within twenty days of such occurrence by means of a subsequent resolution which resolution must also include the name of another

associated person (or persons) who has been vested with full supervisory authority, including authority to hire and fire personnel, over the customer commodity interest related activities of the firm in the event that all of those previously designated in accordance with paragraph (h)(1)(iii)(C) of this section have been relieved of such authority. Subsequent changes in supervisory authority shall be reported in the same manner; or

\* \* \* \* \*

17. Section 3.21 is amended by:

- a. Revising paragraph (b)(3); and
- b. Revising paragraph (c)(1) through (3) and (c)(4)(i) to read as follows:

**§ 3.21 Exemption from fingerprinting requirement in certain cases.**

\* \* \* \* \*

(b) \* \* \*

(3) *With respect to the fingerprints of a principal.* An officer, if the futures commission merchant, retail foreign exchange dealer, commodity trading advisor, commodity pool operator, introducing broker, or leverage transaction merchant with which the principal will be affiliated is a corporation, a general partner, if a partnership, or the sole proprietor, if a sole proprietorship.

(c) *Outside directors.* Any futures commission merchant, retail foreign exchange dealer, introducing broker, commodity trading advisor, commodity pool operator or leverage transaction merchant that has a principal who is a director but is not also an officer or employee of the firm may, in lieu of submitting a fingerprint card in accordance with the provisions of §§ 3.10(a)(2) and 3.31(a)(2), file a "Notice Pursuant to Rule 3.21(c)" with the National Futures Association. Such notice shall state, if true, that such outside director:

(1) Is not engaged in:

(i) The solicitation or acceptance of customers' orders or retail forex customers' orders,

(ii) The solicitation of funds, securities or property for a participation in a commodity pool,

(iii) The solicitation of a client's or prospective client's discretionary account,

(iv) The solicitation or acceptance of leverage customers' orders for leverage transactions;

(2) Does not regularly have access to the keeping, handling or processing of:

(i) Commodity interest transactions;

(ii) Customer funds, retail forex customer funds, leverage customer funds, foreign futures or foreign options secured amount, or adjusted net capital; or

(3) Does not have direct supervisory responsibility over persons engaged in the activities referred to in paragraphs (c)(1) and (c)(2) of this section; and

(4) \* \* \*;

(i) The name of the futures commission merchant, retail foreign exchange dealer, introducing broker, commodity trading advisor, commodity pool operator, leverage transaction merchant, or applicant for registration in any of these capacities of which the person is an outside director;

\* \* \* \* \*

18. Section 3.30 is amended by revising paragraph (a) to read as follows:

**§ 3.30 Current address for purpose of delivery of communications from the Commission or the National Futures Association.**

(a) The address of each registrant, applicant for registration and principal, as submitted on the application for registration (Form 7-R or Form 8-R) or as submitted on the biographical supplement (Form 8-R) shall be deemed to be the address for delivery to the registrant, applicant or principal for any communications from the Commission or the National Futures Association, including any summons, complaint, reparation claim, order, subpoena, special call, request for information, notice, and other written documents or correspondence, unless the registrant, applicant or principal specifies another address for this purpose: *Provided*, That the Commission or the National Futures Association may address any correspondence relating to a biographical supplement submitted for or on behalf of a principal to the futures commission merchant, retail foreign exchange dealer, commodity trading advisor, commodity pool operator, introducing broker, or leverage transaction merchant with which the principal is affiliated and may address any correspondence relating to the registration of an associated person to the futures commission merchant, retail foreign exchange dealer, commodity trading advisor, commodity pool operator, introducing broker, or leverage transaction merchant with which the associated person or the applicant for registration is or will be associated as an associated person.

\* \* \* \* \*

19. Section 3.31 is amended by revising paragraphs (a)(1), (b), (c), and (d) to read as follows:

**§ 3.31 Deficiencies, inaccuracies, and changes, to be reported.**

(a)(1) Each applicant or registrant as a futures commission merchant, retail foreign exchange dealer, commodity

trading advisor, commodity pool operator, introducing broker, or leverage transaction merchant shall, in accordance with the instructions thereto, promptly correct any deficiency or inaccuracy in Form 7-R or Form 8-R which no longer renders accurate and current the information contained therein. Each such correction shall be made on Form 3-R and shall be prepared and filed in accordance with the instructions thereto. *Provided, however,* that where a registrant is reporting a change in the form of organization from or to a sole proprietorship, the registrant must file a Form 7-W regarding the pre-existing organization and a Form 7-R regarding the newly formed organization.

\* \* \* \* \*

(b) Each applicant or registrant as a floor broker, floor trader or associated person, and each principal of a futures commission merchant, retail foreign exchange dealer, commodity trading advisor, commodity pool operator, introducing broker, or leverage transaction merchant must, in accordance with the instructions thereto, promptly correct any deficiency or inaccuracy in the Form 8-R or supplemental statement thereto which renders no longer accurate and current the information contained in the Form 8-R or supplemental statement. Each such correction must be made on Form 3-R and must be prepared and filed in accordance with the instructions thereto.

(c)(1) After the filing of a Form 8-R or a Form 3-R by or on behalf of any person for the purpose of permitting that person to be an associated person of a futures commission merchant, retail foreign exchange dealer, commodity trading advisor, commodity pool operator, introducing broker, or a leverage transaction merchant, that futures commission merchant, retail foreign exchange dealer, commodity trading advisor, commodity pool operator, introducing broker or leverage transaction merchant must, within thirty days after the occurrence of either of the following, file a notice thereof with the National Futures Association indicating:

(i) The failure of that person to become associated with the futures commission merchant, retail foreign exchange dealer, commodity trading advisor, commodity pool operator, introducing broker, or leverage transaction merchant, and the reasons therefor; or

(ii) The termination of the association of the associated person with the futures commission merchant, retail foreign

exchange dealer, commodity trading advisor, commodity pool operator, introducing broker, or leverage transaction merchant, and the reasons therefor.

(2) Each person registered as, or applying for registration as, a futures commission merchant, retail foreign exchange dealer, commodity trading advisor, commodity pool operator, introducing broker or leverage transaction merchant must, within thirty days after the termination of the affiliation of a principal with the registrant or applicant, file a notice thereof with the National Futures Association.

(3) Any notice required by paragraph (c) of this section must be filed on Form 8-T or on a Uniform Termination Notice for Securities Industry Registration.

(d) Each contract market or derivatives transaction execution facility that has granted trading privileges to a person who is registered, has received a temporary license, or has applied for registration as a floor broker or floor trader, must notify the National Futures Association within sixty days after such person has ceased having trading privileges on such contract market or derivatives transaction execution facility.

(Approved by the Office of Management and Budget under control number 3038-0023)

20. Section 3.33 is amended by revising paragraphs (a) introductory text, (b) introductory text, (b)(6), and (e) to read as follows:

**§ 3.33 Withdrawal from registration.**

(a) A futures commission merchant, retail foreign exchange dealer, introducing broker, commodity trading advisor, commodity pool operator, leverage transaction merchant, floor broker or floor trader may request that its registration be withdrawn in accordance with the requirements of this section if:

\* \* \* \* \*

(b) A request for withdrawal from registration as a futures commission merchant, retail foreign exchange dealer, introducing broker, commodity trading advisor, commodity pool operator, or leverage transaction merchant must be made on Form 7-W, and a request for withdrawal from registration as a floor broker or floor trader must be made on Form 8-W, completed and filed with National Futures Association in accordance with the instructions thereto. The request for withdrawal must be made by a person

duly authorized by the registrant and must specify:

\* \* \* \* \*

(6) If a basis for withdrawal from registration under paragraph (a)(1) of this section is that the registrant has ceased engaging in activities requiring registration, then, with respect to each capacity for which the registrant has ceased such activities:

(i) That all customer, retail forex customer or option customer agreements, if any, have been terminated;

(ii) That all customer, retail forex customer or option customer positions, if any, have been transferred on behalf of customers or option customers or closed;

(iii) That all customer, retail forex customer or option customer cash balances, securities, or other property, if any, have been transferred on behalf of customers, retail forex customers or option customers or returned, and that there are no obligations to customers, retail forex customers or option customers outstanding;

(iv) In the case of a commodity pool operator, that all interests in, and assets of, any commodity pool have been redeemed, distributed, or transferred, on behalf of the participants therein, and that there are no obligations to such participants outstanding;

(v) In the case of a leverage transaction merchant:

(A) Either that all leverage customer agreements, if any, and all leverage contracts have been terminated, and that all leverage customer cash balances, securities or other property, if any, have been returned, or

(B) Alternatively, that pursuant to Commission approval, the leverage contract obligations of the leverage transaction merchant have been assumed by another leverage transaction merchant and all leverage customer cash balances, securities or other property, if any, have been transferred to such leverage transaction merchant on behalf of leverage customers or returned, and that there are no obligations to leverage customers outstanding;

(vi) The nature and extent of any pending customer, retail forex customer, option customer, leverage customer, or commodity pool participant claims against the registrant, and, to the best of the registrant's knowledge and belief, the nature and extent of any anticipated or threatened customer, option customer, leverage customer, or commodity pool participant claims against the registrant; and

(vii) In the case of a futures commission merchant or a retail foreign

exchange dealer which is a party to a guarantee agreement, that all such agreements have been or will be terminated in accordance with the provisions of § 1.10(j) of this chapter not more than thirty days after the filing of the request for withdrawal from registration.

\* \* \* \* \*

(e) A request for withdrawal from registration as a futures commission merchant, retail foreign exchange dealer, introducing broker, commodity trading advisor, commodity pool operator, leverage transaction merchant on Form 7-W, and a request for withdrawal from registration as a floor broker or floor trader on Form 8-W, must be filed with the National Futures Association and a copy of such request must be sent by the National Futures Association within three business days of the receipt of such withdrawal request to the Commodity Futures Trading Commission, Division of Clearing and Intermediary Oversight, Three Lafayette Centre, 1155 21st Street, NW., Washington, DC 20581. In addition, any floor broker or floor trader requesting withdrawal from registration must file a copy of his Form 8-W with each contract market that has granted him trading privileges. Within three business days of any determination by the National Futures Association under § 3.10(d) to treat the failure by a registrant to file an annual Form 7-R as a request for withdrawal, the National Futures Association shall send the Commission notice of that determination.

\* \* \* \* \*

21. Section 3.44 is amended by revising paragraphs (a)(1) through (5) to read as follows:

**§ 3.44 Temporary licensing of applicants for guaranteed introducing broker registration.**

(a) \* \* \*

(1) A properly completed guarantee agreement (Form 1-FR part B) from a futures commission merchant or retail foreign exchange dealer which is eligible to enter into such an agreement pursuant to § 1.10(j)(2) of this chapter;

(2) A Form 7-R properly completed in accordance with the instructions thereto;

(3) A Form 8-R for the applicant, if a sole proprietor, and each principal (including each branch office manager) thereof, properly completed in accordance with the instructions thereto, all of whom would be eligible for a temporary license if they had applied as associated persons.

(4) A certification executed by a person duly authorized by the futures

commission merchant or retail foreign exchange dealer that has executed the guarantee agreement required by paragraph (a)(1) of this section, stating that:

(i) The futures commission merchant or retail foreign exchange dealer has verified the information on the Forms 8-R filed pursuant to paragraph (a)(3) of this section which relate to education and employment history of the applicant's principals (including each branch office manager) thereof during the preceding three years; and

(ii) To the best of the futures commission merchant's or retail foreign exchange dealer's knowledge, information, and belief, all of the publicly available information supplied by the applicant and its principals and each branch office manager of the applicant on the Form 7-R and Forms 8-R, as appropriate, is accurate and complete; and

(5) The fingerprints of the applicant, if a sole proprietor, and of each principal (including each branch office manager) thereof on fingerprint cards provided by the National Futures Association for that purpose: *Provided*, that a principal who has a current Form 8-R on file with the National Futures Association or the Commission is not required to submit a fingerprint card.

\* \* \* \* \*

22. Section 3.45 is amended by revising paragraph (b) to read as follows:

**§ 3.45 Restrictions upon activities.**

\* \* \* \* \*

(b) An applicant for registration as an introducing broker who has received a temporary license may be guaranteed by a futures commission merchant or retail foreign exchange dealer other than the futures commission merchant or retail foreign exchange dealer which provided the initial guarantee agreement described in § 3.44(a)(1) of this subpart: *Provided*, That, at least 10 days prior to the effective date of the termination of the existing guarantee agreement in accordance with the provisions of § 1.10(j)(4)(ii) or (j)(5) of this chapter, or such other period of time as the National Futures Association may allow for good cause shown, the applicant files with the National Futures Association—

(1) Written notice of such termination and

(2) A new guarantee agreement with another futures commission merchant or retail foreign exchange dealer effective the day following the last effective date of the existing guarantee agreement.

23. Section 3.50 is amended by revising paragraph (b)(2) to read as follows:

**§ 3.50 Service.**

\* \* \* \* \*

(b) \* \* \*  
(2) Any futures commission merchant or retail foreign exchange dealer which has entered into a guarantee agreement in accordance with § 1.10(j) of this chapter, if the applicant or registrant is registered as or applying for registration as an introducing broker.

\* \* \* \* \*

24. Section 3.60 is amended by revising paragraph (b)(2)(i)(B) to read as follows:

**§ 3.60 Procedure to deny, condition, suspend, revoke or place restrictions upon registration pursuant to sections 8a(2), 8a(3) and 8a(4) of the Act.**

\* \* \* \* \*

(b) \* \* \*  
(2)(i) \* \* \*

(B) In the case of a sponsor which is a futures commission merchant, a retail foreign exchange dealer or a leverage transaction merchant, the sponsor is not subject to the reporting requirements of § 1.12(b), § 5.6(b) or § 31.7(b) of this chapter, respectively; and

\* \* \* \* \*

**PART 4—COMMODITY POOL OPERATORS AND COMMODITY TRADING ADVISORS**

25. The authority citation for part 4 continues to read as follows:

**Authority:** 7 U.S.C. 1a, 2, 4, 6b, 6c, 6l, 6m, 6n, 6o, 12a and 23.

26. Section 4.7 is amended by:  
a. Revising paragraph (a)(1)(v)(B); and  
b. Revising paragraph (a)(2)(i) to read as follows:

**§ 4.7 Exemption from certain part 4 requirements for commodity pool operators with respect to offerings to qualified eligible persons and for commodity trading advisors with respect to advising qualified eligible persons.**

\* \* \* \* \*

(a) \* \* \*  
(1) \* \* \*  
(v) \* \* \*

(B) Has had on deposit with a futures commission merchant, for its own account at any time during the six-month period preceding either the date of sale to that person of a pool participation in the exempt pool or the date that the person opens an exempt account with the commodity trading advisor, at least \$200,000 in exchange-specified initial margin and option premiums, together with NFA-specified minimum security deposit for retail forex transactions (as defined in section 5.1(m) of this chapter) for commodity interest transactions; or

\* \* \* \* \*

(2) \* \* \*

(i)(A) A futures commission merchant registered pursuant to section 4d of the Act, or a principal thereof;

(B) A retail foreign exchange dealer registered pursuant to section 2(c)(2)(B)(i)(II)(gg) of the Act, or a principal thereof;

\* \* \* \* \*

27. Section 4.12 is amended by revising paragraph (b)(1)(i)(C) to read as follows:

**§ 4.12 Exemption from provisions of part 4.**

\* \* \* \* \*

(b) \* \* \*

(1) \* \* \*

(i) \* \* \*

(C) Will not enter into commodity interest transactions for which the aggregate initial margin and premiums, and NFA-specified minimum security deposit for retail forex transactions (as defined in § 5.1(m) of this chapter) exceed 10 percent of the fair market value of the pool's assets, after taking into account unrealized profits and unrealized losses on any such contracts it has entered into; *Provided, however*, That in the case of an option that is in-the-money at the time of purchase, the in-the-money amount as defined in § 190.01(x) may be excluded in computing such 10 percent; and

\* \* \* \* \*

28. Section 4.13 is amended by:

a. Revising paragraph (a)(3)(ii)(A); and  
b. Revising paragraph (a)(3)(ii)(B)(1) to read as follows:

**§ 4.13 Exemption from registration as a commodity pool operator.**

\* \* \* \* \*

(a) \* \* \*

(3) \* \* \*

(ii) \* \* \*

(A) The aggregate initial margin, premiums, and NFA-specified minimum security deposit for retail forex transactions (as defined in section 5.1(m) of this chapter) required to establish such positions, determined at the time the most recent position was established, will not exceed 5 percent of the liquidation value of the pool's portfolio, after taking into account unrealized profits and unrealized losses on any such positions it has entered into; *Provided*, That in the case of an option that is in-the-money at the time of purchase, the in-the-money amount as defined in § 190.01(x) of this chapter may be excluded in computing such 5 percent; or

(B) \* \* \*

(1) The term "notional value" shall be calculated for each such futures position by multiplying the number of contracts

by the size of the contract, in contract units (taking into account any multiplier specified in the contract), by the current market price per unit, and for each such option position by multiplying the number of contracts by the size of the contract, adjusted by its delta, in contract units (taking into account any multiplier specified in the contract), by the strike price per unit, and for each such retail forex transaction, by calculating the value in U.S. Dollars of such transaction, at the time the transaction was established, excluding for this purpose the value in U.S. Dollars of offsetting long and short transactions, if any; and

\* \* \* \* \*

29. Section 4.14 is amended by revising paragraph (a)(7) to read as follows:

**§ 4.14 Exemption from registration as a commodity trading advisor.**

\* \* \* \* \*

(a) \* \* \*

(7)(i) It is registered under the Act as a leverage transaction merchant and the person's trading advice is solely in connection with its business as a leverage transaction merchant;

(ii) It is registered under the Act as a retail foreign exchange dealer and the person's trading advice is solely in connection with its business as a retail foreign exchange dealer.

\* \* \* \* \*

30. Section 4.23 is amended by:

a. Revising paragraph (a)(1);  
b. Revising paragraph (a)(7); and  
c. Revising paragraph (b)(1) and (2) to read as follows:

**§ 4.23 Recordkeeping.**

(a) *Concerning the commodity pool:*  
(1) An itemized daily record of each commodity interest transaction of the pool, showing the transaction date, quantity, commodity interest, and, as applicable, price or premium, delivery month or expiration date, whether a put or a call, strike price, underlying contract for future delivery or underlying physical, the futures commission merchant and/or retail foreign exchange dealer carrying the account and the introducing broker, if any, whether the commodity interest was purchased, sold (including, in the case of a retail forex transaction, offset), exercised, expired (including, in the case of a retail forex transaction, whether it was rolled forward), and the gain or loss realized.

\* \* \* \* \*

(7) Copies of each confirmation of a commodity interest transaction of the pool, each purchase and sale statement and each monthly statement for the pool

received from a futures commission merchant or retail foreign exchange dealer.

\* \* \* \* \*

(b) *Concerning the commodity pool operator:* (1) An itemized daily record of each commodity interest transaction of the commodity pool operator and each principal thereof, showing the transaction date, quantity, commodity interest, and, as applicable, price or premium, delivery month or expiration date, whether a put or a call, strike price, underlying contract for future delivery or underlying physical, the futures commission merchant or retail foreign exchange dealer carrying the account and the introducing broker, if any whether the commodity interest was purchased, sold, exercised, or expired, and the gain or loss realized.

(2) Each confirmation of a commodity interest transaction, each purchase and sale statement and each monthly statement furnished by a futures commission merchant or retail foreign exchange dealer to:

(i) The commodity pool operator relating to a personal account of the pool operator; and

(ii) Each principal of the pool operator relating to a personal account of such principal.

\* \* \* \* \*

31. Section 4.24 is amended by:

a. Revising paragraph (b)(1) introductory text and the first three sentences of the Risk Disclosure Statement in paragraph (b)(1);  
b. Adding paragraph (b)(4);  
c. Revising paragraph (e)(6);  
d. Revising paragraph (g);  
e. Revising paragraphs (h)(2) and (h)(4)(iii);

f. Revising paragraph (i)(2)(ii);  
g. Redesignating paragraph (i)(2)(xii) as paragraph (i)(2)(xiii) and adding new paragraph (i)(2)(xii);

h. Revising paragraphs (j)(1)(vi) and (j)(3); and

i. Revising paragraphs (l)(1)(iii), (l)(2) introductory text and (l)(2)(i).

The addition and revisions to read as follows:

**§ 4.24 General disclosures required.**

\* \* \* \* \*

(b) *Risk Disclosure Statement.* (1) The following Risk Disclosure Statement must be prominently displayed immediately following any disclosures required to appear on the cover page of the Disclosure Document as provided by the Commission, by any applicable federal or state securities laws and regulations or by any applicable laws of non-United States jurisdictions.

RISK DISCLOSURE STATEMENT

YOU SHOULD CAREFULLY CONSIDER WHETHER YOUR FINANCIAL CONDITION PERMITS YOU TO PARTICIPATE IN A COMMODITY POOL. IN SO DOING, YOU SHOULD BE AWARE THAT COMMODITY INTEREST TRADING CAN QUICKLY LEAD TO LARGE LOSSES AS WELL AS GAINS. SUCH TRADING LOSSES CAN SHARPLY REDUCE THE NET ASSET VALUE OF THE POOL AND CONSEQUENTLY THE VALUE OF YOUR INTEREST IN THE POOL. IN ADDITION, RESTRICTIONS ON REDEMPTIONS MAY AFFECT YOUR ABILITY TO WITHDRAW YOUR PARTICIPATION IN THE POOL. \* \* \*

(4) If the pool may engage in retail Forex transactions, the Risk Disclosure Statement must further state:

YOU SHOULD ALSO BE AWARE THAT THIS COMMODITY POOL MAY ENGAGE IN OFF-EXCHANGE FOREIGN CURRENCY TRADING. SUCH TRADING IS NOT CONDUCTED IN THE INTERBANK MARKET. THE FUNDS THAT THE POOL USES FOR OFF-EXCHANGE FOREIGN CURRENCY TRADING WILL NOT RECEIVE THE SAME PROTECTIONS AS FUNDS USED TO MARGIN OR GUARANTEE EXCHANGE-TRADED FUTURES AND OPTION CONTRACTS. IF THE POOL DEPOSITS SUCH FUNDS WITH A COUNTERPARTY AND THAT COUNTERPARTY BECOMES INSOLVENT, THE POOL'S CLAIM FOR AMOUNTS DEPOSITED OR PROFITS EARNED ON TRANSACTIONS WITH THE COUNTERPARTY MAY NOT BE TREATED AS A COMMODITY CUSTOMER CLAIM FOR PURPOSES OF SUBCHAPTER IV OF CHAPTER 7 OF THE BANKRUPTCY CODE AND THE REGULATIONS THEREUNDER. THE POOL MAY BE A GENERAL CREDITOR AND ITS CLAIM MAY BE PAID, ALONG WITH THE CLAIMS OF OTHER GENERAL CREDITORS, FROM ANY MONIES STILL AVAILABLE AFTER PRIORITY CLAIMS ARE PAID. EVEN POOL FUNDS THAT THE COUNTERPARTY KEEPS SEPARATE FROM ITS OWN FUNDS MAY NOT BE SAFE FROM THE CLAIMS OF PRIORITY AND OTHER GENERAL CREDITORS.

\* \* \* \* \*

(e) \* \* \*

(6) If known, the futures commission merchant and/or retail foreign exchange dealer through which the pool will execute its trades, and, if applicable, the introducing broker through which the pool will introduce its trades to the

futures commission merchant and/or retail foreign exchange dealer.

\* \* \* \* \*

(g) Principal risk factors. A discussion of the principal risk factors of participation in the offered pool. This discussion must include, without limitation, risks relating to volatility, leverage, liquidity, counterparty creditworthiness, as applicable to the types of trading programs to be followed, trading structures to be employed and investment activity (including retail forex transactions) expected to be engaged in by the offered pool.

(h) \* \* \* (2) A description of the trading and investment programs and policies that will be followed by the offered pool, including the method chosen by the pool operator concerning how futures commission merchants and/or retail foreign exchange dealers carrying the pool's accounts shall treat offsetting positions pursuant to § 1.46 of this chapter, if the method is other than to close out all offsetting positions or to close out offsetting positions on other than a first-in, first-out basis, and any material restrictions or limitations on trading required by the pool's organizational documents or otherwise. This description must include, if applicable, an explanation of the systems used to select commodity trading advisors, investee pools and types of investment activity to which pool assets will be committed;

\* \* \* \* \*

(4) \* \* \*

(iii) If assets deposited by the pool as margin or as security deposit generate income, to whom that income will be paid.

(i) \* \* \*

(2) \* \* \*

(ii) Brokerage fees and commissions, including interest income paid to futures commission merchants, and any fees incurred to maintain an open position in retail forex transactions;

\* \* \* \* \*

(xii) Any costs or fees included in the spread between bid and asked prices for retail forex transactions; and

\* \* \* \* \*

(j) \* \* \*

(1) \* \* \*

(vi) Any other person providing services to the pool or soliciting participants for the pool, or acting as a counterparty to the pool's retail forex transactions (as defined in section 5.1(m) of this chapter).

\* \* \* \* \*

(3) Included in the description of such conflicts must be any arrangement

whereby a person may benefit, directly or indirectly, from the maintenance of the pool's account with the futures commission merchant and/or retail foreign exchange dealer, or from the introduction of the pool's account to a futures commission merchant and/or retail foreign exchange dealer by an introducing broker (such as payment for order flow or soft dollar arrangements) or from an investment of pool assets in investee pools or funds or other investments.

\* \* \* \* \*

(1) \* \* \*

(1) \* \* \*

(iii) The pool's futures commission merchants and/or retail foreign exchange dealers and its introducing brokers, if any.

(2) With respect to a futures commission merchant and/or retail foreign exchange dealer or an introducing broker, an action will be considered material if:

(i) The action would be required to be disclosed in the notes to the futures commission merchant's, retail foreign exchange dealer's or introducing broker's financial statements prepared pursuant to generally accepted accounting principles;

\* \* \* \* \*

32. Section 4.25 is amended by revising paragraph (c)(3)(ii) to read as follows:

§ 4.25 Performance disclosures.

\* \* \* \* \*

(c) \* \* \*

(3) \* \* \*

(ii) If a major commodity trading advisor has not previously traded accounts, the pool operator must prominently display the following statement:

(Name of the major commodity trading advisor), A COMMODITY TRADING ADVISOR THAT HAS DISCRETIONARY TRADING AUTHORITY OVER (percentage of the pool's funds available for commodity interest trading allocated to that trading advisor) PERCENT OF THE POOL'S COMMODITY INTEREST TRADING HAS NOT PREVIOUSLY DIRECTED ANY ACCOUNTS.

\* \* \* \* \*

Subpart C—Commodity Trading Advisors

33. Section 4.30 is revised to read as follows:

§ 4.30 Prohibited activities.

No commodity trading advisor may solicit, accept or receive from an existing or prospective client funds,

securities or other property in the trading advisor's name (or extend credit in lieu thereof) to purchase, margin, guarantee or secure any commodity interest of the client; *Provided, however*, That this section shall not apply to a future commission merchant that is registered as such under the Act or to a leverage transaction merchant that is registered as a commodity trading advisor under the Act or to a retail foreign exchange dealer that is registered as such under the Act.

34. Section 4.33 is amended by:

- a. Revising paragraph (a)(6); and
- b. Revising paragraphs (b)(1) and (2)

to read as follows:

**§ 4.33 Recordkeeping.**

\* \* \* \* \*

(a) \* \* \*

(6) Copies of each confirmation of a commodity interest transaction, each purchase and sale statement and each monthly statement received from a futures commission merchant or a retail foreign exchange dealer.

\* \* \* \* \*

(b) Concerning the commodity trading advisor:

(1) An itemized daily record of each commodity interest transaction of the commodity trading advisor, showing the transaction date, quantity, commodity interest, and, as applicable, price or premium, delivery month or expiration date, whether a put or a call, strike price, underlying contract for future delivery or underlying physical, the futures commission merchant and/or retail foreign exchange dealer carrying the account and the introducing broker, if any, whether the commodity interest was purchased, sold (including, in the case of a retail forex transaction, offset), exercised, expired (including, in the case of a retail forex transaction, whether it was rolled forward), and the gain or loss realized.

(2) Each confirmation of a commodity interest transaction, each purchase and sale statement and each monthly statement furnished by a futures commission merchant or retail foreign exchange dealer to:

(i) The commodity trading advisor relating to a personal account of the trading advisor; and

(ii) Each principal of the trading advisor relating to a personal account of such principal.

\* \* \* \* \*

35. Section 4.34 is amended by:

- a. Revising paragraph (b);
- b. Revising paragraph (e)(2);
- c. Revising paragraphs (g) and (h);
- d. Revising paragraph (i)(2);
- e. Revising paragraphs (j)(1) and (j)(3);

f. Revising paragraphs (k)(1)(ii), (k)(1)(iii), (k)(2) introductory text, and (k)(2)(i) to read as follows:

**§ 4.34 General disclosures required.**

\* \* \* \* \*

(b) *Risk Disclosure Statement.* (1) The following Risk Disclosure Statement must be prominently displayed immediately following any disclosures required to appear on the cover page of the Disclosure Document as provided by the Commission, by any applicable federal or state securities laws and regulations or by any applicable laws of non-United States jurisdictions:

**RISK DISCLOSURE STATEMENT**

THE RISK OF LOSS IN TRADING COMMODITY INTERESTS CAN BE SUBSTANTIAL. YOU SHOULD THEREFORE CAREFULLY CONSIDER WHETHER SUCH TRADING IS SUITABLE FOR YOU IN LIGHT OF YOUR FINANCIAL CONDITION. IN CONSIDERING WHETHER TO TRADE OR TO AUTHORIZE SOMEONE ELSE TO TRADE FOR YOU, YOU SHOULD BE AWARE OF THE FOLLOWING:

IF YOU PURCHASE A COMMODITY OPTION YOU MAY SUSTAIN A TOTAL LOSS OF THE PREMIUM AND OF ALL TRANSACTION COSTS.

IF YOU PURCHASE OR SELL A COMMODITY FUTURES CONTRACT OR SELL A COMMODITY OPTION OR ENGAGE IN OFF-EXCHANGE FOREIGN CURRENCY TRADING YOU MAY SUSTAIN A TOTAL LOSS OF THE INITIAL MARGIN FUNDS OR SECURITY DEPOSIT AND ANY ADDITIONAL FUNDS THAT YOU DEPOSIT WITH YOUR BROKER TO ESTABLISH OR MAINTAIN YOUR POSITION. IF THE MARKET MOVES AGAINST YOUR POSITION, YOU MAY BE CALLED UPON BY YOUR BROKER TO DEPOSIT A SUBSTANTIAL AMOUNT OF ADDITIONAL MARGIN FUNDS, ON SHORT NOTICE, IN ORDER TO MAINTAIN YOUR POSITION. IF YOU DO NOT PROVIDE THE REQUESTED FUNDS WITHIN THE PRESCRIBED TIME, YOUR POSITION MAY BE LIQUIDATED AT A LOSS, AND YOU WILL BE LIABLE FOR ANY RESULTING DEFICIT IN YOUR ACCOUNT.

UNDER CERTAIN MARKET CONDITIONS, YOU MAY FIND IT DIFFICULT OR IMPOSSIBLE TO LIQUIDATE A POSITION. THIS CAN OCCUR, FOR EXAMPLE, WHEN THE MARKET MAKES A "LIMIT MOVE."

THE PLACEMENT OF CONTINGENT ORDERS BY YOU OR YOUR TRADING ADVISOR, SUCH AS A "STOP-LOSS" OR "STOP-LIMIT" ORDER, WILL NOT NECESSARILY LIMIT YOUR LOSSES

TO THE INTENDED AMOUNTS, SINCE MARKET CONDITIONS MAY MAKE IT IMPOSSIBLE TO EXECUTE SUCH ORDERS.

A "SPREAD" POSITION MAY NOT BE LESS RISKY THAN A SIMPLE "LONG" OR "SHORT" POSITION.

THE HIGH DEGREE OF LEVERAGE THAT IS OFTEN OBTAINABLE IN COMMODITY INTEREST TRADING CAN WORK AGAINST YOU AS WELL AS FOR YOU. THE USE OF LEVERAGE CAN LEAD TO LARGE LOSSES AS WELL AS GAINS.

IN SOME CASES, MANAGED COMMODITY ACCOUNTS ARE SUBJECT TO SUBSTANTIAL CHARGES FOR MANAGEMENT AND ADVISORY FEES. IT MAY BE NECESSARY FOR THOSE ACCOUNTS THAT ARE SUBJECT TO THESE CHARGES TO MAKE SUBSTANTIAL TRADING PROFITS TO AVOID DEPLETION OR EXHAUSTION OF THEIR ASSETS. THIS DISCLOSURE DOCUMENT CONTAINS, AT PAGE (insert page number), A COMPLETE DESCRIPTION OF EACH FEE TO BE CHARGED TO YOUR ACCOUNT BY THE COMMODITY TRADING ADVISOR.

THIS BRIEF STATEMENT CANNOT DISCLOSE ALL THE RISKS AND OTHER SIGNIFICANT ASPECTS OF THE COMMODITY INTEREST MARKETS. YOU SHOULD THEREFORE CAREFULLY STUDY THIS DISCLOSURE DOCUMENT AND COMMODITY INTEREST TRADING BEFORE YOU TRADE, INCLUDING THE DESCRIPTION OF THE PRINCIPAL RISK FACTORS OF THIS INVESTMENT, AT PAGE (insert page number).

(2)(i) If the commodity trading advisor may trade foreign futures or options contracts pursuant to the offered trading program, the Risk Disclosure Statement must further state the following:

YOU SHOULD ALSO BE AWARE THAT THIS COMMODITY TRADING ADVISOR MAY ENGAGE IN TRADING FOREIGN FUTURES OR OPTIONS CONTRACTS. TRANSACTIONS ON MARKETS LOCATED OUTSIDE THE UNITED STATES, INCLUDING MARKETS FORMALLY LINKED TO A UNITED STATES MARKET MAY BE SUBJECT TO REGULATIONS WHICH OFFER DIFFERENT OR DIMINISHED PROTECTION. FURTHER, UNITED STATES REGULATORY AUTHORITIES MAY BE UNABLE TO COMPEL THE ENFORCEMENT OF THE RULES OF REGULATORY AUTHORITIES OR MARKETS IN NON-UNITED STATES JURISDICTIONS WHERE YOUR TRANSACTIONS MAY BE EFFECTED. BEFORE YOU TRADE YOU SHOULD



INQUIRE ABOUT ANY RULES RELEVANT TO YOUR PARTICULAR CONTEMPLATED TRANSACTIONS AND ASK THE FIRM WITH WHICH YOU INTEND TO TRADE FOR DETAILS ABOUT THE TYPES OF REDRESS AVAILABLE IN BOTH YOUR LOCAL AND OTHER RELEVANT JURISDICTIONS.

(ii) If the commodity trading advisor may engage in retail forex transactions pursuant to the offered trading program, the Risk Disclosure Statement must further state the following:

YOU SHOULD ALSO BE AWARE THAT THIS COMMODITY TRADING ADVISOR MAY ENGAGE IN OFF-EXCHANGE FOREIGN CURRENCY TRADING. SUCH TRADING IS NOT CONDUCTED IN THE INTERBANK MARKET. THE FUNDS DEPOSITED WITH A COUNTERPARTY FOR SUCH TRANSACTIONS WILL NOT RECEIVE THE SAME PROTECTIONS AS FUNDS USED TO MARGIN OR GUARANTEE EXCHANGE-TRADED FUTURES AND OPTION CONTRACTS. IF THE COUNTERPARTY BECOMES INSOLVENT AND YOU HAVE A CLAIM FOR AMOUNTS DEPOSITED OR PROFITS EARNED ON TRANSACTIONS WITH THE COUNTERPARTY, YOUR CLAIM MAY NOT BE TREATED AS A COMMODITY CUSTOMER CLAIM FOR PURPOSES OF SUBCHAPTER IV OF CHAPTER 7 OF THE BANKRUPTCY CODE AND REGULATIONS THEREUNDER. YOU MAY BE A GENERAL CREDITOR AND YOUR CLAIM MAY BE PAID, ALONG WITH THE CLAIMS OF OTHER GENERAL CREDITORS, FROM ANY MONIES STILL AVAILABLE AFTER PRIORITY CLAIMS ARE PAID. EVEN FUNDS THAT THE COUNTERPARTY KEEPS SEPARATE FROM ITS OWN FUNDS MAY NOT BE SAFE FROM THE CLAIMS OF PRIORITY AND OTHER GENERAL CREDITORS.

FURTHER, YOU SHOULD CAREFULLY REVIEW THE INFORMATION CONTAINED IN THE RISK DISCLOSURE STATEMENT OF THE FUTURES COMMISSION MERCHANT OR RETAIL FOREIGN EXCHANGE DEALER THAT YOU SELECT TO CARRY YOUR ACCOUNT.

(3) If the commodity trading advisor is not also a registered futures commission merchant or a registered retail foreign exchange dealer, the trading advisor must make the additional following statement in the Risk Disclosure Statement, to be included as the last paragraph thereof:

THIS COMMODITY TRADING ADVISOR IS PROHIBITED BY LAW FROM ACCEPTING FUNDS IN THE TRADING ADVISOR'S NAME FROM A

CLIENT FOR TRADING COMMODITY INTERESTS. YOU MUST PLACE ALL FUNDS FOR TRADING IN THIS TRADING PROGRAM DIRECTLY WITH A FUTURES COMMISSION MERCHANT OR RETAIL FOREIGN EXCHANGE DEALER, AS APPLICABLE.

\* \* \* \* \*

(e) \* \* \*

(2) The futures commission merchant and/or retail foreign exchange dealer with which the commodity trading advisor will require the client to maintain its account or, if the client is free to choose the futures commission merchant or retail foreign exchange dealer with which it will maintain its account, the trading advisor must make a statement to that effect; and

\* \* \* \* \*

(g) *Principal risk factors.* A discussion of the principal risk factors of this trading program. This discussion must include, without limitation, risks due to volatility, leverage, liquidity, and counterparty creditworthiness, as applicable to the trading program and the types of transactions and investment activity expected to be engaged in pursuant to such program (including retail forex transactions, if any).

(h) *Trading program.* A description of the trading program, which must include the method chosen by the commodity trading advisor concerning how futures commission merchants and/or retail foreign exchange dealers carrying accounts it manages shall treat offsetting positions pursuant to § 1.46 of this chapter, if the method is other than to close out all offsetting positions or to close out offsetting positions on other than a first-in, first-out basis, and the types of commodity interests and other interests the commodity trading advisor intends to trade, with a description of any restrictions or limitations on such trading established by the trading advisor or otherwise.

(i) \* \* \*

(2) Where any fee is determined by reference to a base amount including, but not limited to, "net assets," "gross profits," "net profits," "net gains," "pips" or "bid-asked spread," the trading advisor must explain how such base amount will be calculated. Where any fee is based on the difference between bid and asked prices on retail forex transactions (as defined in § 5.1 of this chapter), the trading advisor must explain how such fee will be calculated;

\* \* \* \* \*

(j) *Conflicts of interest.* (1) A full description of any actual or potential conflicts of interest regarding any aspect of the trading program on the part of:

(i) The commodity trading advisor; (ii) Any futures commission merchant and/or retail foreign exchange dealer with which the client will be required to maintain its commodity interest account;

(iii) Any introducing broker through which the client will be required to introduce its account to a futures commission merchant and/or retail foreign exchange dealer; and (iv) Any principal of the foregoing.

\* \* \* \* \*

(3) Included in the description of any such conflict must be any arrangement whereby the trading advisor or any principal thereof may benefit, directly or indirectly, from the maintenance of the client's commodity interest account with a futures commission merchant and/or retail foreign exchange dealer, or the introduction of such account through an introducing broker (such as payment for order flow or soft dollar arrangements).

(k) \* \* \*

(1) \* \* \*

(ii) Any futures commission merchant or retail foreign exchange dealer with which the client will be required to maintain its commodity interest account; and

(iii) Any introducing broker through which the client will be required to introduce its account to the futures commission merchant and/or retail foreign exchange dealer.

(2) With respect to a futures commission merchant, retail foreign exchange dealer or introducing broker, an action will be considered material if:

(i) The action would be required to be disclosed in the notes to the futures commission merchant's, retail foreign exchange dealer's or introducing broker's financial statements prepared pursuant to generally accepted accounting principles;

\* \* \* \* \*

36. Part 5 is added to read as follows:

**PART 5—OFF-EXCHANGE FOREIGN CURRENCY TRANSACTIONS**

- Sec. 5.1 Definitions.
- 5.2 Prohibited transactions.
- 5.3 Registration of persons engaged in retail forex transactions.
- 5.4 Applicability of part 4 of this chapter to commodity pool operators and commodity trading advisors.
- 5.5 Distribution of "Risk Disclosure Statement" by retail foreign exchange dealers, futures commission merchants and introducing brokers regarding retail forex transactions.
- 5.6 Maintenance of minimum financial requirements by retail foreign exchange dealers and futures commission

- merchants offering or engaging in retail forex transactions.
- 5.7 Minimum financial requirements for retail foreign exchange dealers and futures commission merchants offering or engaging in retail forex transactions.
- 5.8 Aggregate retail forex assets.
- 5.9 Security deposits for retail forex transactions.
- 5.10 Risk assessment recordkeeping requirements for retail foreign exchange dealers.
- 5.11 Risk assessment reporting requirements for retail foreign exchange dealers.
- 5.12 Financial reports of retail foreign exchange dealers.
- 5.13 Reporting to customers of retail foreign exchange dealers and futures commission merchants; monthly and confirmation statements.
- 5.14 Records to be kept by retail foreign exchange dealers and futures commission Merchants.
- 5.15 Unlawful representations.
- 5.16 Prohibition of guarantees against loss.
- 5.17 Authorization to trade.
- 5.18 Trading and operational standards.
- 5.19 Pending legal proceedings.
- 5.20 Special calls for account and transaction information.
- 5.21 Supervision.
- 5.22 Registered futures association membership.
- 5.23 Notice of bulk transfers and bulk liquidations.
- 5.24 Applicability of other parts of this chapter.
- 5.25 Applicability of the Act.

**Authority:** 7 U.S.C. 1a, 2, 6, 6a, 6b, 6c, 6d, 6e, 6f, 6g, 6h, 6i, 6k, 6m, 6n, 6o, 6p, 8, 9, 9a, 12, 12a, 13b, 13c, 16a, 18, 19, 21, 23.

### § 5.1 Definitions.

- (a) *Affiliated person of a futures commission merchant* means a person described in section 2(c)(2)(B)(i)(II)(cc)(BB) of the Act;
- (b) *Aggregate retail forex assets* means an amount of liquid assets held in accordance with section 5.8 of this part;
- (c) *Associated person of an affiliated person of a futures commission merchant* means any natural person associated with an affiliated person of a futures commission merchant as a partner, officer or employee (or any natural person occupying a similar status or performing similar functions), in any capacity which involves:
- (1) The solicitation or acceptance of retail forex customers' orders (other than in a clerical capacity); or
- (2) The supervision of any person or persons so engaged;
- (d)(1) *Commodity pool operator*, for purposes of this part, means any person who operates or solicits funds, securities, or property for a pooled investment vehicle that is not an eligible contract participant as defined in section 1a(12) of the Act, and that engages in retail forex transactions;

(2) *Associated person of a commodity pool operator*, for purposes of this part, means any natural person associated with a commodity pool operator as defined in paragraph (d)(1) of this section as a partner, officer, employee, consultant or agent (or any natural person occupying a similar status or performing similar functions), in any capacity which involves:

- (i) The solicitation of funds, securities, or property for a participation in a pooled investment vehicle; or
- (ii) The supervision of any person or persons so engaged;

(e)(1) *Commodity trading advisor*, for purposes of this part, means any person who exercises discretionary trading authority or obtains written authorization to exercise discretionary trading authority over any account for or on behalf of any person that is not an eligible contract participant as defined in section 1a(12) of the Act, in connection with retail forex transactions;

(2) *Associated person of a commodity trading advisor*, for purposes of this part, means any natural person associated with a commodity trading advisor as defined in paragraph (e)(1) of this section as a partner, officer, employee, consultant or agent (or any natural person occupying a similar status or performing similar functions), in any capacity which involves:

- (i) The solicitation of a client's or prospective client's discretionary account; or
- (ii) The supervision of any person or persons so engaged;
- (f)(1) *Introducing broker*, for purposes of this part, means any person who solicits or accepts orders from a customer that is not an eligible contract participant as defined in section 1a(12) of the Act, in connection with retail forex transactions;

(2) *Associated person of an introducing broker*, for purposes of this part, means any natural person associated with an introducing broker as defined in paragraph (g)(1) of this section as a partner, officer, employee, or agent (or any natural person occupying a similar status or performing similar functions), in any capacity which involves:

- (i) The solicitation or acceptance of retail forex customers' orders (other than in a clerical capacity); or
- (ii) The supervision of any person or persons so engaged;

(g) *Primarily or substantially* means, when used to describe the extent of a futures commission merchant's engagement in the activities described in section 1a(20) of the Act, that:

(1) Such activities account for more than fifty percent of the futures commission merchant's gross revenues, computed in accordance with generally accepted accounting principles, on an annual basis;

(2) The futures commission merchant receives gross revenues, computed in accordance with generally accepted accounting principles, from such activities in excess of \$500,000 in any twelve month period; or

(3) The futures commission merchant is a clearing member of a registered derivatives clearing organization.

(h)(1) *Retail foreign exchange dealer* means any person that is, or that offers to be, the counterparty to a retail forex transaction, except for a person described in sub-paragraph (aa), (bb), (cc)(AA), (dd), (ee) or (ff) of section 2(c)(2)(B)(i)(II) of the Act;

(2) *Associated person of a retail foreign exchange dealer* means any natural person associated with a retail foreign exchange dealer as defined in paragraph (i)(1) of this section as a partner, officer or employee (or any natural person occupying a similar status or performing similar functions), in any capacity which involves:

- (i) The solicitation or acceptance of retail forex customers' orders (other than in a clerical capacity); or
- (ii) The supervision of any person or persons so engaged;

(i) *Retail forex account* means the account of a person who is not an eligible contract participant as defined in section 1a(12) of the Act, established with a retail foreign exchange dealer or a futures commission merchant, in which account retail forex transactions (including options on contracts for the purchase or sale of foreign currency) with such retail foreign exchange dealer or futures commission merchant as counterparty are undertaken, or which account is established in order to enter into such transactions.

(j) *Retail forex account agreement* means the contractual agreement between a futures commission merchant or retail foreign exchange dealer and any person who is not an eligible contract participant as defined in section 1a(12) of the Act, which agreement contains the terms governing the person's retail forex account with such futures commission merchant or retail foreign exchange dealer.

(k) *Retail forex customer* means a person, other than an eligible contract participant as defined in section 1a(12) of the Act, acting on its own behalf and trading in any account, agreement, contract or transaction described in section 2(c)(2)(B) or 2(c)(2)(C) of the Act.

(l) *Retail forex obligation* means the net credit balance at a retail foreign exchange dealer or futures commission merchant that would be obtained by combining all money, securities and property deposited by a retail forex customer into a retail forex account or accounts, adjusted for the realized and unrealized net profit or loss, if any, accruing on the open trades, contracts or transactions in the retail forex account or accounts, without including any retail forex customers' accounts that contain negative net liquidating balances.

(m) *Retail forex transaction* means any account, agreement, contract or transaction described in section 2(c)(2)(B) or 2(c)(2)(C) of the Act. A retail forex transaction does not include an account, agreement, contract or transaction in foreign currency that is a contract of sale of a commodity for future delivery (or an option thereon) that is executed, traded on or otherwise subject to the rules of a contract market designated pursuant to section 5(a) of the Act or a derivatives transaction execution facility registered pursuant to section 5a(c) of the Act.

#### **§ 5.2 Prohibited transactions.**

(a) *Scope.* The provisions of this section shall be applicable to any retail forex transaction.

(b) *Fraudulent conduct prohibited.* It shall be unlawful for any person, by use of the mails or by any means or instrumentality of interstate commerce, directly or indirectly, in or in connection with any retail forex transaction:

(1) To cheat or defraud or attempt to cheat or defraud any person;

(2) Willfully to make or cause to be made to any person any false report or statement or cause to be entered for any person any false record; or

(3) Willfully to deceive or attempt to deceive any person by any means whatsoever.

(c) *Acting as counterparty and exercising discretion prohibited.* (1) No person who acts as the counterparty for any retail forex transaction may do so for an account for which the person or any affiliate of the person is authorized (by contract, power of attorney or otherwise) to cause transactions to be effected without the client's specific authorization.

(2) For purposes of this paragraph (c), an "affiliate" of a person means a person controlling, controlled by or under common control with, the first person.

#### **§ 5.3 Registration of persons engaged in retail forex transactions.**

(a) Subject to paragraph (b) of this section, each of the following is subject

to the registration provisions under the Act and to part 3 of this chapter:

(1)(i) Any affiliated person of a futures commission merchant, as defined in section 5.1(a) of this part, which affiliated person:

(A) Solicits or accepts orders from any person that is not an eligible contract participant in connection with any retail forex transaction; or

(B) Accepts money, securities, or property (or extends credit in lieu thereof) in connection with such solicitation or acceptance of orders in order to engage in any retail forex transaction, is required to register as a retail foreign exchange dealer; and

(ii) Any associated person of an affiliated person of a futures commission merchant, as defined in § 5.1(c) of this part, is required to register as an associated person of an affiliated person of a futures commission merchant.

(2)(i) Any commodity pool operator, as defined in § 5.1(d)(1) of this part, is required to register as a commodity pool operator;

(ii) Any associated person of a commodity pool operator, as defined in § 5.1(d)(2) of this part, is required to register as an associated person of a commodity pool operator;

(3)(i) Any commodity trading advisor, as defined in § 5.1(e)(1) of this part, is required to register as a commodity trading advisor;

(ii) Any associated person of a commodity trading advisor, as defined in § 5.1(e)(2) of this part, is required to register as an associated person of a commodity trading advisor;

(4)(i) Any person registered as a futures commission merchant:

(A) That is not primarily or substantially engaged in the business activities described in section 1a(20) of the Act;

(B) That solicits or accepts orders from any person that is not an eligible contract participant in connection with any retail forex transaction; and

(C) That accepts money, securities, or property (or extends credit in lieu thereof) in connection with such solicitation or acceptance of orders in order to engage in retail forex transactions, is required to register as a retail foreign exchange dealer;

(ii) Any associated person of a futures commission merchant described in paragraph (a)(4)(i) of this section is required to register as an associated person of a futures commission merchant;

(5)(i) Any introducing broker, as defined in § 5.1(f)(1) of this part, is required to register as an introducing broker;

(ii) Any associated person of an introducing broker, as defined in § 5.1(f)(2) of this part, is required to register as an associated person of an introducing broker;

(6)(i) Any retail foreign exchange dealer, as defined in § 5.1(h)(1) of this part is required to register as a retail foreign exchange dealer;

(ii) Any associated person of a retail foreign exchange dealer, as defined in § 5.1(h)(2) of this part, is required to register as an associated person of a retail foreign exchange dealer;

(b) Any person described in paragraph (a) of this section that is already registered in the required capacity specified in paragraph (a) is not required under this section to register twice in the same capacity; Provided, however, that a person already registered as an associated person of one class of registrant may also be required to register as an associated person of another class of registrant in order to comply with this section.

#### **§ 5.4 Applicability of part 4 of this chapter to commodity pool operators and commodity trading advisors.**

Part 4 of this chapter applies to any person required pursuant to the provisions of this part 5 to register as a commodity pool operator or as a commodity trading advisor. Failure by any such person to comply with the requirements of part 4 will constitute a violation of this section and the relevant section of part 4.

#### **§ 5.5 Distribution of "Risk Disclosure Statement" by retail foreign exchange dealers, futures commission merchants and introducing brokers regarding retail forex transactions.**

(a) Except as provided in § 5.23 of this part, no retail foreign exchange dealer, futures commission merchant, or in the case of an introduced account no introducing broker, may open an account that will engage in retail forex transactions for a retail forex customer, unless the retail foreign exchange dealer, futures commission merchant or introducing broker first:

(1)(i) In the case of a retail foreign exchange dealer or a person required to register as an introducing broker solely by reason of this part, furnishes the retail forex customer with a separate written disclosure statement containing only the language set forth in paragraph (b) of this section and the disclosure required by paragraph (e) of this section;

(ii) In the case of a futures commission merchant or a person required to register as an introducing broker because it engages in the activities described in § 1.3(mm) of this chapter, furnishes the retail forex

customer with a separate written disclosure statement containing only the language set forth in paragraph (b) of this section and the disclosure required by paragraph (e) of this section; *Provided, however*, that the disclosure statement may be attached to other documents as the initial page(s) of such documents and as the only material on such page(s); and

(2) Receives from the retail forex customer an acknowledgment signed and dated by the retail forex customer that he received and understood the disclosure statement.

(b) The language set forth in the written disclosure statement required by paragraph (a) of this section shall be as follows:

#### Risk Disclosure Statement

OFF-EXCHANGE FOREIGN CURRENCY TRANSACTIONS INVOLVE THE LEVERAGED TRADING OF CONTRACTS DENOMINATED IN FOREIGN CURRENCY CONDUCTED WITH A FUTURES COMMISSION MERCHANT OR A RETAIL FOREIGN EXCHANGE DEALER AS YOUR COUNTERPARTY.

BECAUSE OF THE LEVERAGE AND THE OTHER RISKS DISCLOSED HERE, YOU CAN RAPIDLY LOSE ALL OF THE FUNDS YOU DEPOSIT FOR SUCH TRADING AND YOU MAY LOSE MORE THAN YOU DEPOSIT.

YOU SHOULD BE AWARE OF AND CAREFULLY CONSIDER THE FOLLOWING POINTS BEFORE DETERMINING WHETHER SUCH TRADING IS APPROPRIATE FOR YOU.

(1) TRADING IS NOT ON A REGULATED MARKET OR EXCHANGE—YOUR DEALER IS YOUR TRADING PARTNER WHICH IS A DIRECT CONFLICT OF INTEREST. BEFORE YOU ENGAGE IN ANY RETAIL FOREIGN EXCHANGE TRADING, YOU SHOULD CONFIRM THE REGISTRATION STATUS OF YOUR COUNTERPARTY.

The off-exchange foreign currency trading you are entering into is not conducted on an interbank market, nor is it conducted on a futures exchange subject to regulation as a designated contract market by the Commodity Futures Trading Commission. The foreign currency trades you transact are trades with the futures commission merchant or retail foreign exchange dealer as your counterparty. WHEN YOU SELL, THE DEALER IS THE BUYER. WHEN YOU BUY, THE DEALER IS THE SELLER. As a result, when you lose money trading, your dealer is making money on such trades, in addition to any fees, commissions, or spreads the dealer may charge.

(2) AN ELECTRONIC TRADING PLATFORM FOR RETAIL FOREIGN CURRENCY TRANSACTIONS IS NOT AN EXCHANGE. IT IS AN ELECTRONIC CONNECTION FOR ACCESSING YOUR DEALER. THE TERMS OF AVAILABILITY OF SUCH A PLATFORM ARE GOVERNED ONLY BY YOUR CONTRACT WITH YOUR DEALER.

Any trading platform that you may use to enter off-exchange foreign currency transactions is only connected to your futures commission merchant or retail foreign exchange dealer. You are accessing that trading platform only to transact with your dealer. You are not trading with any other entities or customers of the dealer by accessing such platform. The availability and operation of any such platform, including the consequences of the unavailability of the trading platform for any reason, is governed only by the terms of your account agreement with the dealer.

(3) YOUR DEPOSITS WITH THE DEALER HAVE NO REGULATORY PROTECTIONS.

All of your rights associated with your retail forex trading, including the manner and denomination of any payments made to you, are governed by the contract terms established in your account agreement with the futures commission merchant or retail foreign exchange dealer. Funds deposited by you with a futures commission merchant or retail foreign exchange dealer for trading off-exchange foreign currency transactions are not subject to the customer funds protections provided to customers trading on a contract market that is designated by the Commodity Futures Trading Commission. Your dealer may commingle your funds with its own operating funds or use them for other purposes. In the event your dealer becomes bankrupt, any funds the dealer is holding for you in addition to any amounts owed to you resulting from trading, whether or not any assets are maintained in separate deposit accounts by the dealer, may be treated as an unsecured creditor's claim.

(4) YOU ARE LIMITED TO YOUR DEALER TO OFFSET OR LIQUIDATE ANY TRADING POSITIONS SINCE THE TRANSACTIONS ARE NOT MADE ON AN EXCHANGE OR MARKET, AND YOUR DEALER MAY SET ITS OWN PRICES.

Your ability to close your transactions or offset positions is limited to what your dealer will offer to you, as there is no other market for these transactions. Your dealer may offer any prices it wishes, and it may offer prices derived

from outside sources or not in its discretion. Your dealer may establish its prices by offering spreads from third party prices, but it is under no obligation to do so or to continue to do so. Your dealer may offer different prices to different customers at any point in time on its own terms. The terms of your account agreement alone govern the obligations your dealer has to you to offer prices and offer offset or liquidating transactions in your account and make any payments to you. The prices offered by your dealer may or may not reflect prices available elsewhere at any exchange, interbank, or other market for foreign currency.

(5) PAID SOLICITORS MAY HAVE UNDISCLOSED CONFLICTS

The futures commission merchant or retail foreign exchange dealer may compensate introducing brokers for introducing your account in ways which are not disclosed to you. Such paid solicitors are not required to have, and may not have, any special expertise in trading, and may have conflicts of interest based on the method by which they are compensated. Solicitors working on behalf of futures commission merchants and retail foreign exchange dealers are required to register. You should confirm that they are, in fact registered. You should thoroughly investigate the manner in which all such solicitors are compensated and be very cautious in granting any person or entity authority to trade on your behalf. You should always consider obtaining dated written confirmation of any information you are relying on from your dealer or a solicitor in making any trading or account decisions.

FINALLY, YOU SHOULD THOROUGHLY INVESTIGATE ANY STATEMENTS BY ANY DEALERS OR SALES REPRESENTATIVES WHICH MINIMIZE THE IMPORTANCE OF, OR CONTRADICT, ANY OF THE TERMS OF THIS RISK DISCLOSURE. SUCH STATEMENTS MAY INDICATE POTENTIAL SALES FRAUD.

THIS BRIEF STATEMENT CANNOT, OF COURSE, DISCLOSE ALL THE RISKS AND OTHER ASPECTS OF TRADING OFF-EXCHANGE FOREIGN CURRENCY TRANSACTIONS WITH A FUTURES COMMISSION MERCHANT OR RETAIL FOREIGN EXCHANGE DEALER.

I hereby acknowledge that I have received and understood this risk disclosure statement.

Date

Signature of Customer

(c) The acknowledgment required by paragraph (a) of this section must be retained by the retail foreign exchange dealer, futures commission merchant or introducing broker in accordance with § 1.31 of this chapter.

(d) This section does not relieve a retail foreign exchange dealer, futures commission merchant or introducing broker from any other disclosure obligation it may have under applicable law.

(e)(1) Immediately following the language set forth in paragraph (b) of this section, the statement required by paragraph (a) of this section shall include, for each of the most recent four quarters during which the counterparty maintained retail forex accounts:

(i) The total number of non discretionary retail forex accounts maintained by the retail foreign exchange dealer or futures commission merchant;

(ii) The percentage of such accounts that were profitable; and

(iii) the percentage of such accounts that were not profitable.

(2) Identification of retail forex accounts for purposes of this disclosure and calculation of each such account's profit or loss must be made in accordance with § 5.18(i) of this part. Such statement of profitable trades shall include the following legend: PAST PERFORMANCE IS NOT NECESSARILY INDICATIVE OF FUTURE RESULTS. Each retail foreign exchange dealer or futures commission merchant shall provide, upon request, to any retail forex customer or prospective retail forex customer the total number of non discretionary retail forex accounts maintained by such retail foreign exchange dealer or futures commission merchant, the percentage of such accounts that were profitable, and the percentage of such accounts that were unprofitable, calculated in accordance with § 5.18(i) of this part, for each quarter during the most recent five year period during which such retail foreign exchange dealer or futures commission merchant maintained non discretionary retail forex accounts.

**§ 5.6 Maintenance of minimum financial requirements by retail foreign exchange dealers and futures commission merchants offering or engaging in retail forex transactions.**

(a) Each futures commission merchant offering or engaging in retail forex transactions or who files an application for registration as a futures commission merchant that will offer or engage in retail forex transactions and each person registered as a retail foreign exchange dealer or who files an application for

registration as a retail foreign exchange dealer, who knows or should have known that its adjusted net capital at any time is less than the minimum required by § 5.7 of this part or by the capital rule of a registered futures association of which it is a member, must:

(1) Give telephonic notice, to be confirmed in writing by facsimile notice, that the applicant's or registrant's adjusted net capital is less than that required by § 5.7 of this part. The notice must be given immediately after the applicant or registrant knows or should know that its adjusted net capital is less than that required by any of the aforesaid rules to which the applicant or registrant is subject; and

(2) Provide together with such notice documentation in such form as necessary to adequately reflect the applicant's or registrant's capital condition as of any date such person's adjusted net capital is less than the minimum required. The applicant or registrant must provide similar documentation for other days as the Commission may request.

(b) Each applicant or registrant, who knows or should have known that its adjusted net capital at any time is less than the greatest of:

(1) \$22,000,000;

(2) 110 percent of the amount required by § 5.7(a)(1)(i)(B) of this part; or

(3) 110 percent of the amount of adjusted net capital required by a registered futures association of which the futures commission merchant or retail foreign exchange dealer is a member, must file written notice to that effect within 24 hours of such event.

(c) If an applicant or registrant at any time fails to make or keep current the books and records required by these regulations, such applicant or registrant must, on the same day such event occurs, provide facsimile notice of such fact, specifying the books and records which have not been made or which are not current, and within 48 hours after giving such notice file a written report stating what steps have been and are being taken to correct the situation.

(d) Whenever any applicant or registrant discovers or is notified by an independent public accountant, pursuant to § 1.16(e)(2) of this chapter, of the existence of any material inadequacy, as specified in § 1.16(d)(2) of this chapter, such applicant or registrant must give facsimile notice of such material inadequacy within 24 hours, and within 48 hours after giving such notice file a written report stating what steps have been and are being

taken to correct the material inadequacy.

(e) Whenever any self-regulatory organization learns that a member registrant has failed to file a notice or written report as required by § 5.6 of this part, that self-regulatory organization must immediately report this failure by telephone, confirmed in writing immediately by facsimile notice, as provided in paragraph (h) of this section.

(f) A retail foreign exchange dealer or a futures commission merchant offering or engaging in retail forex transactions shall provide written notice of a substantial reduction in capital as compared to that last reported in a financial report filed with the Commission pursuant to § 5.12 of this part. This notice shall be provided as follows:

(1) If any event or series of events, including any withdrawal, advance, loan or loss cause, on a net basis, a reduction in net capital of 20 percent or more, notice must be provided within two business days of the event or series of events causing the reduction; and

(2) If the equity capital of the retail foreign exchange dealer or futures commission merchant offering or engaging in retail forex transactions or the equity capital of a subsidiary or affiliate of the retail foreign exchange dealer or futures commission merchant offering or engaging in retail forex transactions consolidated pursuant to § 1.17(f) of this chapter would be withdrawn by action of a stockholder or a partner or a limited liability company member or by redemption or repurchase of shares of stock by any of the consolidated entities or through the payment of dividends or any similar distribution, or an unsecured advance or loan would be made to a stockholder, partner, sole proprietor, limited liability company member, employee or affiliate, such that the withdrawal, advance or loan would cause, on a net basis, a reduction in excess adjusted net capital of 30 percent or more, notice must be provided at least two business days prior to the withdrawal, advance or loan that would cause the reduction: Provided, however, That the provisions of paragraphs (f)(1) and (f)(2) of this section do not apply to any retail foreign exchange transaction in the ordinary course of business between a retail foreign exchange dealer and any affiliate where the retail foreign exchange dealer makes payment to or on behalf of such affiliate for such transaction and then receives payment from such affiliate for such transaction within two business days from the date of the transaction.

(3) Upon receipt of such notice from a futures commission merchant offering or engaging in retail forex transactions or a retail foreign exchange dealer, the Director of the Division of Clearing and Intermediary Oversight or the Director's designee may require that the futures commission merchant offering or engaging in retail forex transactions or retail foreign exchange dealer provide or cause a Material Affiliated Person (as that term is defined in § 5.10(a)(2) of this part) to provide, within three business days from the date of the request or such shorter period as the Director or designee may specify, such other information as the Director or designee determines to be necessary based upon market conditions, reports provided by the retail foreign exchange dealer or futures commission merchant offering or engaging in retail forex transactions, or other available information.

(g) Whenever a person registered as a futures commission merchant offering or engaging in retail forex transactions or a retail foreign exchange dealer knows or should know that the total amount of its retail forex obligation exceeds the amount of the aggregate retail forex assets the registrant maintains in accordance with the provisions of § 5.8 of this chapter, the registrant must report such deficiency immediately by telephone notice, confirmed immediately in writing by facsimile notice.

(h) Every notice and written report required to be given or filed with the Commission by this section by an applicant must be filed with the regional office of the Commission with jurisdiction over the state in which the applicant's principal place of business is located, and with the National Futures Association. Every notice and written report required to be given or filed with the Commission by this section by a registrant or self-regulatory organization must be filed with the regional office of the Commission with jurisdiction over the state in which the registrant's principal place of business is located, and with the registrant's designated self-regulatory organization. In addition, every notice and written report required to be given by this section must also be filed with the Chief Accountant of the Division of Clearing and Intermediary Oversight at the Commission's principal office in Washington, DC.

(i) In lieu of filing paper copies with the Commission, all filings or other notices prepared by a futures commission merchant or retail foreign exchange dealer pursuant to this section may be submitted to the Commission in

electronic form using a form of user authentication assigned in accordance with procedures established by or approved by the Commission, and otherwise in accordance with instructions issued by or approved by the Commission, if the futures commission merchant, retail foreign exchange dealer or a designated self-regulatory organization has provided the Commission with the means necessary to read and to process the information contained in such report. Any such electronic submission must clearly indicate the registrant or applicant on whose behalf such filing is made and the use of such user authentication in submitting such filing will constitute and become a substitute for the manual signature of the authorized signer.

**§ 5.7 Minimum financial requirements for retail foreign exchange dealers and futures commission merchants offering or engaging in retail forex transactions.**

(a)(1)(i) Each futures commission merchant offering or engaging in retail forex transactions and each retail foreign exchange dealer must maintain adjusted net capital equal to or in excess of the greatest of:

(A) \$20,000,000;

(B) \$20,000,000 plus five percent of the futures commission merchant's or retail foreign exchange dealer's total retail forex obligation in excess of \$10,000,000;

(C) any amount required under § 1.17 of this chapter, as applicable; or

(D) the amount of adjusted net capital required by a registered futures association of which the futures commission merchant or retail foreign exchange dealer is a member.

(ii) Section 1.17 of this chapter shall apply to retail foreign exchange dealers as if such retail foreign exchange dealers were futures commission merchants, or as applicable, applicants or registrants, as stated in § 1.17 for the purpose of determining the adjusted net capital under this section. For the purpose of applying this section, "applicant" or "registrant" shall include retail foreign exchange dealers and futures commission merchants offering or engaging in retail forex transactions and applicants therefore.

(2) No person applying for registration as a retail foreign exchange dealer or a futures commission merchant that will engage in retail forex transactions shall be so registered unless such person affirmatively demonstrates to the satisfaction of a registered futures association that it complies with the financial requirements of this section.

(3) Each registrant must be in compliance with this section at all times

and must be able to demonstrate such compliance to the satisfaction of the Commission or the registrant's designated self-regulatory organization.

(4) A registrant who is not in compliance with this section, or is unable to demonstrate such compliance as required by paragraph (a)(3) of this section, shall, as directed by and under the supervision of the Commission or the registrant's designated self-regulatory organization, either liquidate or transfer all retail forex accounts (including the novation of retail forex contracts) and refund or transfer all funds associated with such retail forex accounts and immediately cease offering or engaging in retail forex transactions until such time as the firm is able to demonstrate to the Commission or the registrant's designated self-regulatory organization such compliance: *Provided, however,* That if such registrant immediately demonstrates to the satisfaction of the Commission or the registrant's designated self-regulatory organization the ability to achieve compliance, the Commission or the registrant's designated self-regulatory organization may in its discretion allow such registrant up to a maximum of 10 business days, or such additional time as determined by the Commission, in which to achieve compliance without having to liquidate positions or transfer accounts and cease doing business as required above. Nothing in this paragraph (a)(4) shall be construed as preventing the Commission or the registrant's designated self-regulatory organization from taking action against a registrant for non-compliance with any of the provisions of this section.

(b) For the purposes of this section:

(1) Where the applicant or registrant has an asset or liability which is defined in Securities Exchange Act Rule 15c3-1 (§ 240.15c3-1 of this title) the inclusion or exclusion of all or part of such asset or liability for the computation of adjusted net capital shall be in accordance with § 240.15c3-1 of this title, unless specifically stated otherwise in this section or in § 1.17 of this chapter.

(2) The adjusted net capital of an applicant or registrant for the purpose of this section shall be determined by the application of § 1.17 pursuant to paragraph (a)(1)(ii) of this section, with the following additions:

(i) All positions in retail forex accounts and other financial positions and instruments of the applicant or registrant must be marked to market and adjusted daily by referencing to current market prices or rates of exchange.

(ii) Current assets must exclude any retail forex account which liquidates to a deficit or contains a debit ledger balance only and is not secured in accordance with § 1.17(c)(3).

(iii) Current assets must exclude any unsecured receivable accrued from any over-the-counter transaction in foreign currency, options on foreign currency or options on contracts for the purchase or sale of foreign currency, or arising from the deposit of collateral or compensating balances with respect to such transactions, unless such unsecured receivable is from a person who is an eligible contract participant that also is:

(A) A bank or trust company regulated by a United States banking regulator;

(B) A broker-dealer registered with the Securities and Exchange Commission and a member of the Financial Industry Regulatory Authority;

(C) A futures commission merchant registered with the Commission and a member of the National Futures Association;

(D) A retail foreign exchange dealer registered with the Commission and a member of the National Futures Association;

(E) An entity regulated as a foreign equivalent of any of the persons listed in paragraphs (b)(2)(iii)(A) through (D) of this section, if such person is regulated in a money center country as defined in § 1.49 of this chapter and recognized by the futures commission merchant's or retail foreign exchange dealer's designated self-regulatory organization as a foreign equivalent;

(F) Any other entity approved by the futures commission merchant's or retail foreign exchange dealer's designated self-regulatory organization.

(iv) The value attributed to any retail forex transaction that is an option shall be the difference between the option's exercise value or striking value and the market value of the underlying. In the case of a call, if the market value of the underlying is less than the exercise value or striking value of such call, it shall be given no value; and, in the case of a put, if the market value of the underlying is more than the exercise value or striking value of the put, it shall be given no value.

(v)(A) In computing adjusted net capital, the capital deductions set forth in § 1.17(c)(5)(ii) of this chapter shall apply to retail forex transactions other than options. The capital deductions which apply are six percent for net positions in Euros, British pounds, Canadian dollars, Japanese yen, or Swiss francs and 20 percent for net positions in all other foreign currencies, *Provided, however*, That there shall be

no capital deductions for retail forex transactions covered (as defined in § 1.17(j) of this chapter) by the applicant or registrant by open futures contracts to the extent such futures contracts are not otherwise designated as cover for any other net capital purposes. For purposes of this paragraph (b)(2)(v)(A), such retail forex transactions shall be treated as if they were inventory and cover were therefore applicable. A retail foreign exchange dealer or futures commission merchant may not use an affiliate (unless approved by the firm's designated self-regulatory organization) or any person that is considered unregulated under the rules of the firm's designated self-regulatory organization to cover its currency positions for purposes of this section.

(B) In computing adjusted net capital, the capital deductions set forth in § 1.17(c)(5)(vi) of this chapter shall apply to all retail forex transactions that are options.

(C) For the purpose of applying capital deductions on open proprietary futures positions under § 1.17(c)(5)(x) of this chapter, net or individual positions in retail forex transactions shall not constitute cover under § 1.17(j) for the purpose of applying such charges.

(c) An applicant or registrant must prepare, and keep current, ledgers or other similar records which show or summarize, with appropriate references to supporting documents, each transaction affecting the applicant's or registrant's asset, liability, income, expense and capital accounts, and in which (except as otherwise permitted in writing by the Commission) all the applicant's or registrant's asset, liability and capital accounts are classified into the account classification subdivisions specified on Form 1-FR-FCM. Each applicant or registrant shall prepare and keep current such records.

(d) An applicant or registrant must make and keep as a record in accordance with § 5.14 of this part formal computations of its adjusted net capital and of its minimum financial requirements pursuant to this section as of the close of business each month and on other such dates called for by the Commission, the National Futures Association, or another self-regulatory organization of which the firm is a member. Such computations must be completed and made available for inspection by any representative of the Commission, the National Futures Association, a self-regulatory organization of which the firm is a member, or the United States Department of Justice commencing the first month-end after the date the application for registration is filed.

#### § 5.8 Aggregate retail forex assets.

(a) Each retail foreign exchange dealer and futures commission merchant offering or engaging in retail forex transactions shall calculate its total retail forex obligation and shall at all times hold assets solely of the type permissible under § 1.25 of this chapter equal to or in excess of the total retail forex obligation at one or more qualifying institutions in the United States or money center countries as defined in § 1.49 of this chapter.

(b) For assets held in the United States, a qualifying institution is:

(1) A bank or trust company regulated by a United States banking regulator;

(2) A broker-dealer registered with the Securities and Exchange Commission and a member of the Financial Industry Regulatory Authority; or

(3) A futures commission merchant registered with the Commission and a member of the National Futures Association.

(c) For assets held in a money center country, a qualifying institution is:

(1) A bank or trust company regulated in a money center country, *Provided* that the bank or trust company has regulatory capital in excess of \$1 billion;

(2) An entity regulated in a money center country as an equivalent of a broker-dealer or futures commission merchant as determined by the retail foreign exchange dealer's or futures commission merchant's designated self-regulatory organization, *Provided* that the entity maintains regulatory capital in excess of \$100 million; or

(3) A futures commission merchant registered with the Commission and a member of the National Futures Association.

(d) Assets held in a money center country are not eligible to meet the requirements of paragraph (a) of this section unless the retail foreign exchange dealer or futures commission merchant has entered into an agreement that is acceptable to the firm's designated self-regulatory organization and that authorizes the qualifying institution to provide account information to the Commission and the firm's designated self-regulatory organization.

(e) In computing its adjusted net capital pursuant to § 5.7 of this part, a retail foreign exchange dealer or futures commission merchant may not include aggregate retail forex assets as current assets or otherwise record any property received from retail forex customers as an asset without recording a corresponding liability to the retail forex customers.



**§ 5.9 Security deposits for retail forex transactions.**

(a) Each futures commission merchant engaging, or offering to engage, in retail forex transactions and each retail foreign exchange dealer must collect from each retail forex customer a minimum security deposit in the form of cash or other financial instruments that comply with the requirements specified in § 1.25 of this chapter for each retail forex transaction equal to:

(1) Ten percent of the notional value of the retail forex transaction;

(2) For short options, ten percent of the notional value of the retail forex transaction, plus the premium received by the futures commission merchant or retail foreign exchange dealer; or

(3) For long options, the full premium charged and received by the futures commission merchant or retail foreign exchange dealer.

(b) A futures commission merchant or retail foreign exchange dealer is required to collect additional security deposits from a retail forex customer or liquidate the retail forex customer's positions if the amount of the retail forex customer's security deposits maintained with the futures commission merchant or retail foreign exchange dealer are not sufficient to meet the requirements in paragraph (a) of this section.

**§ 5.10 Risk assessment recordkeeping requirements for retail foreign exchange dealers.**

(a) *Requirement to maintain and preserve information.* (1) Each retail foreign exchange dealer registered with the Commission pursuant to section 2(c)(2)(B)(i)(II)(gg) of the Act shall prepare, maintain and preserve the following information:

(i) An organizational chart which includes the retail foreign exchange dealer and each of its affiliated persons. Included in the organizational chart shall be a designation of which affiliated persons are "Material Affiliated Persons" as that term is used in paragraph (a)(2) of this section, which Material Affiliated Persons file routine financial or risk exposure reports with the Securities and Exchange Commission, a federal banking agency, an insurance commissioner or other similar official or agency of a state, or a foreign regulatory authority, and which Material Affiliated Persons are dealers in financial instruments with off-balance sheet risk and, if a Material Affiliated Person is such a dealer, whether it is also an end-user of such instruments;

(ii) Written policies, procedures, or systems concerning the retail foreign exchange dealer's:

(A) Method(s) for monitoring and controlling financial and operational risks to it resulting from the activities of any of its affiliated persons;

(B) Financing and capital adequacy, including information regarding sources of funding, together with a narrative discussion by management of the liquidity of the material assets of the retail foreign exchange dealer, the structure of debt capital, and sources of alternative funding;

(C) Establishing and maintaining internal controls with respect to market risk, credit risk, and other risks created by the retail foreign exchange dealer's trading activities, including systems and policies for supervising, monitoring, reporting and reviewing trading activities in forex transactions, securities, futures contracts, commodity options, forward contracts and financial instruments; policies for hedging or managing risks created by trading activities or supervising accounts carried for affiliates, including a description of the types of reviews conducted to monitor positions; and policies relating to restrictions or limitations on trading activities: *Provided, however,* that if the retail foreign exchange dealer has no such written policies, procedures or systems, it must so state in writing;

(iii) Fiscal year-end consolidated and consolidating balance sheets for the highest level Material Affiliated Person within the retail foreign exchange dealer's organizational structure, which shall include the retail foreign exchange dealer and its other Material Affiliated Persons, prepared in accordance with generally accepted accounting principles, which consolidated balance sheets shall be audited by an independent certified public accountant if an annual audit is performed in the ordinary course of business, but which otherwise may be unaudited, and which shall include appropriate explanatory notes. The consolidating balance sheets may be those prepared by the retail foreign exchange dealer's highest level Material Affiliated Person as part of its internal financial reporting process. Any additional information required to be filed under § 5.11(a)(2)(iii) of this part shall also be maintained and preserved; and

(iv) Fiscal year-end consolidated and consolidating income statements and consolidated cash flow statements for the highest level Material Affiliated Person within the retail foreign exchange dealer's organizational structure, which shall include the retail foreign exchange dealer and its other Material Affiliated Persons, prepared in accordance with generally accepted

accounting principles, which consolidated statements shall be audited by an independent certified public accountant if an annual audit is performed in the ordinary course of business, but which otherwise may be unaudited, and which shall include appropriate explanatory notes. The consolidating statements may be those prepared by the retail foreign exchange dealer's highest level Material Affiliated Person as part of its internal financial reporting process. Any additional information required to be filed under § 5.11(a)(2)(iii) shall also be maintained and preserved.

(2) The determination of whether an affiliated person of a retail foreign exchange dealer is a Material Affiliated Person shall involve consideration of all aspects of the activities of, and the relationship between, both entities, including without limitation, the following factors:

(i) The legal relationship between the retail foreign exchange dealer and the affiliated person;

(ii) The overall financing requirements of the retail foreign exchange dealer and the affiliated person, and the degree, if any, to which the retail foreign exchange dealer and the affiliated person are financially dependent on each other;

(iii) The degree to which the retail foreign exchange dealer and the affiliated person directly or indirectly engage in over-the-counter transactions with each other;

(iv) The degree, if any, to which the retail foreign exchange dealer or its customers rely on the affiliated person for operational support or services in connection with the retail foreign exchange dealer's business;

(v) The level of market, credit or other risk present in the activities of the affiliated person; and

(vi) The extent to which the affiliated person has the authority or the ability to cause a withdrawal of capital from the retail foreign exchange dealer.

(3) For purposes of this section and § 5.11 of this part, the term Material Affiliated Person does not include a natural person.

(4) The information, reports and records required by this section shall be maintained and preserved, and made readily available for inspection, in accordance with the provisions of § 1.31 of this chapter.

(b) *Special provisions with respect to Material Affiliated Persons subject to the supervision of certain domestic regulators.* A retail foreign exchange dealer shall be deemed to be in compliance with the recordkeeping requirements of paragraphs (a)(1)(i), (iii)

and (iv) of this section with respect to a Material Affiliated Person if:

(1) The Material Affiliated Person is required to maintain and preserve information pursuant to § 240.17h-1T of this title, or such other risk assessment regulations as the Securities and Exchange Commission may adopt, and the retail foreign exchange dealer maintains and makes available for inspection by the Commission in accordance with the provisions of this section copies of the records and reports maintained and filed on Form 17-H (or such other forms or reports as may be required) by the Material Affiliated Person with the Securities and Exchange Commission pursuant to §§ 240.17h-1T and 240.17h-2T of this title, or such other risk assessment regulations as the Securities and Exchange Commission may adopt;

(2) In the case of a Material Affiliated Person (including a foreign banking organization) that is subject to examination by, or the reporting requirements of, a Federal banking agency, the retail foreign exchange dealer or such Material Affiliated Person maintains and makes available for inspection by the Commission in accordance with the provisions of this section copies of all reports submitted by such Material Associated Person to the Federal banking agency pursuant to section 5211 of the Revised Statutes, section 9 of the Federal Reserve Act, section 7(a) of the Federal Deposit Insurance Act, section 10(b) of the Home Owners' Loan Act, or section 5 of the Bank Holding Company Act of 1956; or

(3) In the case of a Material Affiliated Person that is subject to the supervision of an insurance commissioner or other similar official or agency of a state, the retail foreign exchange dealer or such Material Affiliated Person maintains and makes available for inspection by the Commission in accordance with the provisions of this section copies of the annual statements with schedules and exhibits prepared by the Material Affiliated Person on forms prescribed by the National Association of Insurance Commissioners or by a state insurance commissioner.

(c)(1) *Special provisions with respect to Material Affiliated Persons subject to the supervision of a Foreign Regulatory Authority.* A retail foreign exchange dealer shall be deemed to be in compliance with the recordkeeping requirements of paragraphs (a)(1)(iii) and (iv) of this section with respect to a Material Affiliated Person if such retail foreign exchange dealer maintains and makes available, or causes such Material Affiliated Person to make

available, for inspection by the Commission in accordance with the provisions of this section copies of any financial or risk exposure reports filed by such Material Affiliated Person with a foreign futures authority or other foreign regulatory authority, provided that:

(i) The retail foreign exchange dealer agrees to use its best efforts to obtain from the Material Affiliated Person and to cause the Material Affiliated Person to provide, directly or through its foreign futures authority or other foreign regulatory authority, any supplemental information the Commission may request and there is no statute or other bar in the foreign jurisdiction that would preclude the retail foreign exchange dealer, the Material Affiliated Person, the foreign futures authority or other foreign regulatory authority from providing such information to the Commission; or

(ii) The foreign futures authority or other foreign regulatory authority with whom the Material Affiliated Person files such reports has entered into an information-sharing agreement with the Commission which is in effect as of the retail foreign exchange dealer's fiscal year-end and which will allow the Commission to obtain the type of information required herein.

(2) The retail foreign exchange dealer shall maintain a copy of the original report and a copy translated into the English language. For the purposes of this section, the term "Foreign Futures Authority" shall have the meaning set forth in section 1a(10) of the Act.

(d) *Exemptions.* The Commission may exempt any retail foreign exchange dealer from any provision of this section if it finds that the exemption is not contrary to the public interest and the purposes of the provisions from which the exemption is sought. The Commission may grant the exemption subject to such terms and conditions as it may find appropriate.

(e) *Location of records.* A retail foreign exchange dealer required to maintain records concerning Material Affiliated Persons pursuant to this section may maintain those records either at the principal office of the Material Affiliated Person or at a records storage facility, provided that, except as set forth in paragraph (c) of this section, the records are located within the boundaries of the United States and the records are kept and available for inspection in accordance with § 1.31 of this chapter. If such records are maintained at a place other than the retail foreign exchange dealer's principal place of business, the Material Affiliated Person or other entity

maintaining the records shall file with the Commission a written undertaking, in a form acceptable to the Commission, signed by a duly authorized person, to the effect that the records will be treated as if the retail foreign exchange dealer were maintaining the records pursuant to this section and that the entity maintaining the records will permit examination of such records at any time, or from time to time during business hours, by representatives or designees of the Commission and promptly furnish the Commission representative or its designee true, correct, complete and current hard copy of all or any part of such records. The election to maintain records at the principal place of business of the Material Affiliated Person or at a records storage facility pursuant to the provisions of this paragraph shall not relieve the retail foreign exchange dealer required to maintain and preserve such records from any of its responsibilities under this section or § 5.11 of this part.

(f) *Confidentiality.* All information obtained by the Commission pursuant to the provisions of this section from a retail foreign exchange dealer concerning a Material Affiliated Person shall be deemed confidential information for the purposes of section 8 of the Act.

(g) *Implementation schedule.* Each retail foreign exchange dealer who is subject to the requirements of this section shall maintain and preserve the information required by paragraphs (a)(1)(i) and (ii) of this section commencing 60 calendar days after registration becomes effective and the information required by paragraphs (a)(1)(iii) and (iv) of this section commencing 105 calendar days following the first fiscal year-end occurring after registration becomes effective.

#### **§ 5.11 Risk assessment reporting requirements for retail foreign exchange dealers.**

(a) *Reporting requirements with respect to information required to be maintained by section 5.10 of this part.*

(1) Each retail foreign exchange dealer registered with the Commission pursuant to Section 2(c)(2)(B)(i)(II)(gg) of the Act shall file the following with the regional office of the Commission with which it files periodic financial reports within 60 calendar days after the effective date of such registration:

(i) A copy of the organizational chart maintained by the retail foreign exchange dealer pursuant to § 5.10(a)(1)(i) of this part. Where there is a material change in information provided, an updated organizational

chart shall be filed within sixty calendar days after the end of the fiscal quarter in which the change has occurred; and

(ii) Copies of the financial, operational, and risk management policies, procedures and systems maintained by the retail foreign exchange dealer pursuant to § 5.10(a)(1)(ii) of this part. If the retail foreign exchange dealer has no such written policies, procedures or systems, it must file a statement so indicating. Where there is a material change in information provided, such change shall be reported within sixty calendar days after the end of the fiscal quarter in which the change has occurred.

(2) Each retail foreign exchange dealer registered with the Commission pursuant to section 2(c)(2)(B)(i)(II)(gg) of the Act shall file the following with the regional office with which it files periodic financial reports within 105 calendar days after the end of each fiscal year or, if a filing is made pursuant to a written notice issued under paragraph (a)(2)(iii) of this section, within the time period specified in the written notice:

(i) Fiscal year-end consolidated and consolidating balance sheets for the highest level Material Affiliated Person within the retail foreign exchange dealer's organizational structure, which shall include the retail foreign exchange dealer and its other Material Affiliated Persons, prepared in accordance with generally accepted accounting principles, which consolidated balance sheets shall be audited by an independent certified public accountant if an annual audit is performed in the ordinary course of business, but which otherwise may be unaudited, and which consolidated balance sheets shall include appropriate explanatory notes. The consolidating balance sheets may be those prepared by the retail foreign exchange dealer's highest level Material Affiliated Person as part of its internal financial reporting process;

(ii) Fiscal year-end annual consolidated and consolidating income statements and consolidated cash flow statements for the highest level Material Affiliated Person within the retail foreign exchange dealer's organizational structure, which shall include the retail foreign exchange dealer and its other Material Affiliated Persons, prepared in accordance with generally accepted accounting principles, which consolidated statements shall be audited by an independent certified public accountant if an annual audit is performed in the ordinary course of business, but which otherwise may be unaudited, and which consolidated statements shall include appropriate explanatory notes. The consolidating

statements may be those prepared by the retail foreign exchange dealer's highest level Material Affiliated Person as part of its internal financial reporting process; and

(iii) Upon receiving written notice from any representative of the Commission and within the time period specified in the written notice, such additional information which the Commission determines is necessary for a complete understanding of a particular affiliate's financial impact on the retail foreign exchange dealer's organizational structure.

(3) For the purposes of this section, the term Material Affiliated Person shall have the meaning used in § 5.10 of this part.

(4) The reports required to be filed pursuant to paragraphs (a)(1) and (2) of this section shall be considered filed when received by the regional office of the Commission with whom the retail foreign exchange dealer files financial reports pursuant to § 5.12 of this part.

(b) *Exemptions.* The Commission may exempt any retail foreign exchange dealer from any provision of this section if it finds that the exemption is not contrary to the public interest and the purposes of the provisions from which the exemption is sought. The Commission may grant the exemption subject to such terms and conditions as it may find appropriate.

(c) *Special provisions with respect to Material Affiliated Persons subject to the supervision of certain domestic regulators.* (1) In the case of a Material Affiliated Person that is required to maintain and preserve information pursuant to section 240.17h-1T of this title, or such other risk assessment regulations as the Securities and Exchange Commission may adopt, the retail foreign exchange dealer shall be deemed to be in compliance with the reporting requirements of paragraph (a)(2) of this section with respect to such Material Affiliated Person if the retail foreign exchange dealer maintains and makes available for inspection by the Commission in accordance with the provisions of this section copies of the records and reports maintained and filed on Form 17-H (or such other forms or reports as may be required) by the Material Affiliated Person with the Securities and Exchange Commission pursuant to §§ 240.17h-1T and 240.17h-2T of this title, or such other risk assessment regulations as the Securities and Exchange Commission may adopt;

(2) In the case of a Material Affiliated Person (including a foreign banking organization) that is subject to examination by, or the reporting

requirements of, a Federal banking agency, the retail foreign exchange dealer shall be deemed to be in compliance with the reporting requirements of paragraph (a)(2) of this section with respect to such Material Affiliated Person if the retail foreign exchange dealer or such Material Affiliated Person maintains in accordance with § 5.10 of this part copies of all reports filed by the Material Affiliated Person with the Federal banking agency pursuant to section 5211 of the Revised Statutes, section 9 of the Federal Reserve Act, section 7(a) of the Federal Deposit Insurance Act, section 10(b) of the Home Owners' Loan Act, or section 5 of the Bank Holding Company Act of 1956.

(3) In the case of a retail foreign exchange dealer that has a Material Affiliated Person that is subject to the supervision of an insurance commissioner or other similar official or agency of a state, such retail foreign exchange dealer shall be deemed to be in compliance with the reporting requirements of paragraph (a)(2) of this section with respect to the Material Affiliated Person if:

(i) With respect to a Material Affiliated Person organized as a mutual insurance company or a non-public stock company, the retail foreign exchange dealer or such Material Affiliated Person maintains in accordance with § 5.14 of this part copies of the annual statements with schedules and exhibits prepared by the Material Affiliated Person on forms prescribed by the National Association of Insurance Commissioners or by a state insurance commissioner; and

(ii) With respect to a Material Affiliated Person organized as a public stock company, the retail foreign exchange dealer or such Material Affiliated Person maintains, in addition to the annual statements with schedules and exhibits required to be maintained pursuant to § 1.14 of this chapter, copies of the filings made by the Material Affiliated Person pursuant to sections 13 or 15 of the Securities Exchange Act of 1934 and the Investment Company Act of 1940.

(4) No retail foreign exchange dealer shall be required to furnish to the Commission any examination report of any Federal banking agency or any supervisory recommendations or analyses contained therein with respect to a Material Affiliated Person that is subject to the regulation of a Federal banking agency. All information received by the Commission pursuant to this section concerning a Material Affiliated Person that is subject to examination by or the reporting

requirements of a Federal banking agency shall be deemed confidential for the purposes of section 8 of the Act.

(5) The furnishing of any information or documents by a retail foreign exchange dealer pursuant to this section shall not constitute an admission for any purpose that a Material Affiliated Person is otherwise subject to the Act.

(d) *Special provisions with respect to Material Affiliated Persons subject to the supervision of a Foreign Regulatory Authority.* A retail foreign exchange dealer shall be deemed to be in compliance with the reporting requirements of paragraph (a)(2) of this section with respect to a Material Affiliated Person if such retail foreign exchange dealer furnishes, or causes such Material Affiliated Person to make available, in accordance with the provisions of this section, copies of any financial or risk exposure reports filed by such Material Affiliated Person with a foreign futures authority or other foreign regulatory authority, provided that:

(1) The retail foreign exchange dealer agrees to use its best efforts to obtain from the Material Affiliated Person and to cause the Material Affiliated Person to provide, directly or through its foreign futures authority or other foreign regulatory authority, any supplemental information the Commission may request and there is no statute or other bar in the foreign jurisdiction that would preclude the retail foreign exchange dealer, the Material Affiliated Person, the foreign futures authority or other foreign regulatory authority from providing such information to the Commission; or

(2) The foreign futures authority or other foreign regulatory authority with whom the Material Affiliated Person files such reports has entered into an information sharing agreement with the Commission which is in effect as of the retail foreign exchange dealer's fiscal year-end and which will allow the Commission to obtain the type of information required herein. The retail foreign exchange dealer shall file a copy of the original report and a copy translated into the English language. For the purposes of this section, the term "Foreign Futures Authority" shall have the meaning set forth in section 1a(10) of the Act.

(e) *Confidentiality.* All information obtained by the Commission pursuant to the provisions of this section from a retail foreign exchange dealer concerning a Material Associated Person shall be deemed confidential information for the purposes of section 8 of the Act.

(f) *Implementation schedule.* Each retail foreign exchange dealer who is subject to the requirements of this section shall file the information required by paragraph (a)(1) of this section within 60 calendar days after registration is granted, and the information required by paragraph (a)(2) of this section within 105 calendar days after registration is granted.

#### **§ 5.12 Financial reports of retail foreign exchange dealers.**

(a)(1) Each person who files an application for registration as a retail foreign exchange dealer with the National Futures Association shall submit, concurrently with the filing of such application, either:

(i) A Form 1-FR-FCM certified by an independent public accountant as of a date not more than 45 days prior to the date on which such report is filed; or

(ii) A Form 1-FR-FCM as of a date not more than 17 business days prior to the date on which such report is filed and a Form 1-FR-FCM certified by an independent public accountant as of a date not more than one year prior to the date on which such report is filed.

(2) Each such person must include with such financial report a statement describing the source of his current assets and representing that his capital has been contributed for the purpose of operating his business and will continue to be used for such purpose.

(3) The provisions of paragraph (a)(1) of this section do not apply to any person succeeding to and continuing the business of another retail foreign exchange dealer.

(b)(1) Each person registered as a retail foreign exchange dealer must file a Form 1-FR-FCM as of the close of business each month. Each Form 1-FR must be filed no later than 17 business days after the date for which the report is made.

(2) In addition to the monthly financial reports required by paragraph (b)(1) of this section, each person registered as a retail foreign exchange dealer must file a Form 1-FR-FCM as of the close of its fiscal year, which must be certified by an independent public accountant and must be filed no later than 90 days after the close of the retail foreign exchange dealer's fiscal year.

(3) A Form 1-FR-FCM required to be certified by an independent public accountant which is filed by a retail foreign exchange dealer must be filed in paper form and may not be filed electronically with the Commission. A Form 1-FR-FCM required to be certified by an independent public accountant which is filed by an applicant for registration as a retail foreign exchange

dealer with the National Futures Association must be filed electronically in accordance with electronic filing procedures established by the National Futures Association, however a paper copy of any such filing with the original manually signed certification must be maintained by the applicant for registration as a retail foreign exchange dealer in accordance with § 1.31.

(c) Each Form 1-FR-FCM required by the provisions of paragraphs (a)(1) and (b)(2) of this section to be certified by an independent public accountant must be certified in accordance with § 1.16 of this chapter, and must be accompanied by the accountant's report on material inadequacies in accordance with the provisions of § 1.16(c)(5) of this chapter. In all other respects, the independent public accountant shall act in accordance with the provisions of § 1.16 (except paragraph (f)) of this chapter: Provided, however, that the term "§ 5.7" shall be substituted for the term "§ 1.17," and the term "retail foreign exchange dealer" shall be substituted for the term "futures commission merchant."

(d) Upon receiving written notice from any representative of the Commission, National Futures Association, or any self-regulatory organization of which the firm is a member, a retail foreign exchange dealer or applicant for such registration, must, monthly or at such times as specified, furnish the Commission, National Futures Association, or self-regulatory organization a Form 1-FR-FCM or such other financial information requested in the written notice. Each such Form 1-FR-FCM or such other information must be furnished within the time period specified in the written notice, and in accordance with the provisions of paragraph (i) of this section.

(e)(1) Each Form 1-FR-FCM filed pursuant to this § 5.12 which is not required to be certified by an independent public accountant must be completed in accordance with the instructions to the form and contain:

(i) A statement of financial condition as of the date for which the report is made;

(ii) A statement of income (loss) for the period between the date of the most recent statement of financial condition filed with the Commission and the date for which the report is made;

(iii) A statement of changes in ownership equity for the period between the date of the most recent statement of financial condition filed with the Commission and the date for which the report is made;

(iv) A statement of changes in liabilities subordinated to claims of general creditors for the period between

the date of the most recent statement of financial condition filed with the Commission and the date for which the report is made;

(v) A statement of the computation of the minimum capital requirements pursuant to § 5.7 of this part as of the date for which the report is made; and

(vi) In addition to the information expressly required, such further material information as may be necessary to make the required statements and schedules not misleading.

(2) Each Form 1-FR-FCM filed pursuant to this § 5.12 which is required to be certified by an independent public accountant must be completed in accordance with the instructions to the form and contain:

(i) A statement of financial condition as of the date for which the report is made;

(ii) Statements of income (loss), cash flows, changes in ownership equity, and changes in liabilities subordinated to claims of general creditors, for the period between the date of the most recent certified statement of financial condition filed with the Commission and the date for which the report is made: Provided, That for an applicant filing pursuant to paragraph (a) of this section the period must be the year ending as of the date of the statement of financial condition;

(iii) A statement of the computation of the minimum capital requirements pursuant to § 5.7 of this part as of the date for which the report is made;

(iv) Appropriate footnote disclosures;

(v) A reconciliation, including appropriate explanations, of the statement of the computation of the minimum capital requirements pursuant to § 5.7 of this part, in the certified Form 1-FR-FCM with the applicant's or registrant's corresponding uncertified most recent Form 1-FR-FCM filing when material differences exist or, if no material differences exist, a statement so indicating; and

(vi) In addition to the information expressly required, such further material information as may be necessary to make the required statements not misleading.

(3) The statements required by paragraphs (e)(2)(i) and (ii) of this section may be presented in accordance with generally accepted accounting principles in the certified reports filed as of the close of the registrant's fiscal year pursuant to paragraph (b)(2) of this section or accompanying the application for registration pursuant to paragraph (a)(1) of this section, rather than in the format specifically prescribed by these regulations: Provided, the statement of

financial condition is presented in a format as consistent as possible with the Form 1-FR-FCM and a reconciliation is provided reconciling such statement of financial condition to the statement of the computation of the minimum capital requirements pursuant to § 5.7 of this part. Such reconciliation must be certified by an independent public accountant in accordance with § 1.16 of this chapter.

(4) Attached to each Form 1-FR-FCM filed pursuant to this section must be an oath or affirmation that to the best knowledge and belief of the individual making such oath or affirmation the information contained in the Form 1-FR-FCM is true and correct. The individual making such oath or affirmation must be: If the registrant or applicant is a sole proprietorship, the proprietor; if a partnership, any general partner; if a corporation, the chief executive officer or chief financial officer; and, if a limited liability company or limited liability partnership, the chief executive officer, the chief financial officer, the manager, the managing member, or those members vested with the management authority for the limited liability company or limited liability partnership.

(f) *Election of fiscal year.* (1) An applicant wishing to establish a fiscal year other than the calendar year may do so by notifying the National Futures Association of its election of such fiscal year, in writing, concurrently with the filing of the Form 1-FR-FCM pursuant to paragraph (a)(1) of this section, but in no event may such fiscal year end more than one year from the date of the Form 1-FR-FCM filed pursuant to paragraph (a)(1) of this section. An applicant that does not so notify the National Futures Association will be deemed to have elected the calendar year as its fiscal year.

(2)(i) A registrant must continue to use its elected fiscal year, calendar or otherwise, unless a change in such fiscal year has been approved pursuant to this paragraph (f)(2).

(ii) A registrant may file with its designated self-regulatory organization an application to change its fiscal year, a copy of which the registrant must file with the Commission. The application shall be approved or denied in writing by the registrant's designated self-regulatory organization. The registrant must file immediately with the Commission a copy of any notice it receives from its designated self-regulatory organization to approve or deny the registrant's application to change its fiscal year. A written notice of approval shall become effective upon

the filing by the registrant of a copy with the Commission, and a written notice of denial shall be effective as of the date of the notice.

(g) In the event a retail foreign exchange dealer or applicant for registration as a retail foreign exchange dealer finds that it cannot file its Form 1-FR-FCM for any period within the time specified in paragraph (b)(1) or (2) of this section without substantial undue hardship, it may request approval for an extension of time by filing an application for an extension of time with, in the case of a registrant, its designated self-regulatory organization, or, in the case of an applicant, the National Futures Association. The registrant or applicant also must file a copy of its application for an extension of time with the Commission. The application shall be approved or denied in writing by the National Futures Association or designated self-regulatory organization, as applicable. The registrant or applicant must file immediately with the Commission a copy of any notice it receives approving or denying the request for extension of time. A written notice of approval shall become effective upon the filing by the registrant or applicant of a copy with the Commission, and a written notice of denial shall be effective as of the date of the notice.

(h) *Public availability of reports.* (1) Forms 1-FR-FCM filed pursuant to this section will be treated as exempt from mandatory public disclosure for purposes of the Freedom of Information Act and the Government in the Sunshine Act and parts 145 and 147 of this chapter, except for the information described in paragraph (i)(2) of this section.

(2) The following information in Forms 1-FR-FCM will be publicly available:

(i) The amount of the applicant's or registrant's adjusted net capital; the amount of its minimum net capital requirement under § 5.7 of this chapter; the amount of its adjusted net capital in excess of its minimum net capital requirement; and the amount of the retail forex obligation owed to its retail forex customers; and

(ii) The Statement of Financial Condition and the opinion of the independent public accountant in the certified annual financial reports of retail foreign exchange dealers.

(3) All information that is exempt from mandatory public disclosure under paragraph (h)(1) of this section will, however, be available for official use by any official or employee of the United States or any State, by the National Futures Association or any other self-

regulatory organization of which the person filing such report is a member, and by any other person to whom the Commission believes disclosure of such information is in the public interest. Nothing in this paragraph (h) will limit the authority of any self-regulatory organization to request or receive any information relative to its members' financial condition.

(i)(1) In the case of an applicant, all filings or other notices provided for in this section will be considered filed when received by the regional office of the Commission with jurisdiction over the state in which the applicant's principal place of business is located and by the National Futures Association. In the case of a registrant, all filings or other notices provided for in this section will be considered filed when received by the regional office of the Commission with jurisdiction over the state in which the registrant's principal place of business is located and by the registrant's designated self-regulatory organization. Any copy that under paragraph (f)(2) or (g) is required to be filed with the Commission shall be filed with the regional office of the Commission with jurisdiction over the state in which the registrant's principal place of business is located.

(2) All filings or other notices filed pursuant to this section which need not be certified in accordance with § 1.16 may be submitted to the Commission in electronic form using a form of user authentication assigned in accordance with procedures established by or approved by the Commission, and otherwise in accordance with instructions issued by or approved by the Commission, if the retail foreign exchange dealer or a designated self-regulatory organization has provided the Commission with the means necessary to read and to process the information contained in such report. Any such electronic submission must clearly indicate the registrant or applicant on whose behalf such filing is made and the use of such user authentication in submitting such filing will constitute and become a substitute for the manual signature of the authorized signer. In the case of a Form 1-FR filed via electronic transmission in accordance with procedures established by or approved by the Commission, such transmission must be accompanied by the user authentication assigned to the authorized signer under such procedures, and the use of such user authentication will constitute and become a substitute for the manual signature of the authorized signer for the purpose of making the oath or

affirmation referred to in paragraph (e)(4) of this section.

*§ 5.13 Reporting to customers of retail foreign exchange dealers and futures commission merchants; monthly and confirmation statements.*

(a) *Monthly statements.* Each retail foreign exchange dealer or futures commission merchant must promptly furnish in writing to each retail forex customer, as of the close of the last business day of each month or as of any regular monthly date selected, except for accounts in which there are neither open positions at the end of the statement period nor any changes to the account balance since the prior statement period, but in any event not less frequently than once every three months, a statement which clearly shows:

- (1) For each retail forex customer:
  - (i) The open retail forex transactions with prices at which acquired;
  - (ii) The net unrealized profits or losses in all open retail forex transactions marked to the market; and
  - (iii) Any money, securities or other property carried with the retail foreign exchange dealer or futures commission merchant; and
  - (iv) A detailed accounting of all financial charges and credits to such retail forex accounts during the monthly reporting period, including money, securities or property received from or disbursed to such customer and realized profits and losses; and
- (2) For each retail forex customer engaging in forex option transactions:
  - (i) All forex options purchased, sold, exercised, or expired during the monthly reporting period, identified by underlying retail forex transaction or underlying currency, strike price, transaction date, and expiration date;
  - (ii) The open forex option positions carried for such customer as of the end of the monthly reporting period, identified by underlying retail forex transaction or underlying currency, strike price, transaction date, and expiration date;
  - (iii) All open forex option positions marked to the market and the amount each position is in the money, if any;
  - (iv) Any money, securities or other property carried with the retail foreign exchange dealer or futures commission merchant; and
  - (v) A detailed accounting of all financial charges and credits to such retail forex account(s) during the monthly reporting period, including money, securities and property received from or disbursed to such customer, premiums charged and received, and realized profits and losses.

(b) *Confirmation statement.* Each retail foreign exchange dealer or futures commission merchant must, not later than the next business day after any retail forex or forex option transaction, furnish:

(1) To each retail forex customer, a written confirmation of each retail forex transaction caused to be executed by it for the customer, including offsetting transactions executed during the same business day and the rollover of an open retail forex transaction to the next business day.

(2) To each retail forex customer engaging in forex option transactions, a written confirmation of each forex option transaction, containing at least the following information:

(i) The retail forex customer's account identification number;

(ii) A separate listing of the actual amount of the premium, as well as each mark-up thereon, if applicable, and all other commissions, costs, fees and other charges incurred in connection with the forex option transaction;

(iii) The strike price;

(iv) The underlying retail forex transaction or underlying currency;

(v) The final exercise date of the forex option purchased or sold; and

(vi) The date the forex option transaction was executed.

(3) To each retail forex customer engaging in forex option transactions, upon the expiration or exercise of any forex option, a written confirmation statement thereof, which statement shall include the date of such occurrence, a description of the forex option involved, and, in the case of exercise, the details of the retail forex or physical currency position which resulted therefrom including, if applicable, the final trading date of the retail forex transaction underlying the option.

(4) Notwithstanding the provisions of paragraphs (b)(1) through (3) of this section, a retail forex transaction or forex option transaction that is caused to be executed for a pooled investment vehicle that engages in retail forex transactions need be confirmed only to the operator of such pooled investment vehicle.

(c) *Controlled accounts.* With respect to any account controlled by any person other than the retail forex customer or forex option customer for whom such account is carried, each retail foreign exchange dealer or futures commission merchant shall promptly furnish in writing to such other person the information required by paragraphs (a) and (b) of this section.

(d) *Recordkeeping.* Each retail foreign exchange dealer or futures commission merchant shall retain, in accordance

with § 1.31 of this chapter, a copy of each monthly statement and confirmation required by this section.

(e) *Introduced accounts.* Each statement provided pursuant to the provisions of this section must, if applicable, show that the account for which the retail foreign exchange dealer or futures commission merchant is providing the statement was introduced by an introducing broker and the names of the retail foreign exchange dealer or futures commission merchant and introducing broker.

(g) *Electronic transmission of statements.* (1) The statements required by this section may be furnished to a retail forex customer by means of electronic media if the retail forex customer so consents, *Provided, however,* that a retail foreign exchange dealer or futures commission merchant must, prior to the transmission of any statement by means of electronic media, disclose the electronic medium or source through which statements will be delivered, the duration, whether indefinite or not, of the period during which consent will be effective, any charges for such service, the information that will be delivered by such means, and that consent to electronic delivery may be revoked at any time, and provided, further, that a retail foreign exchange dealer or futures commission merchant must obtain the retail forex customer's signed consent acknowledging such disclosure prior to the transmission of any statement by means of electronic media.

(2) Any statement required to be furnished to a person other than a retail forex customer in accordance with paragraph (g) of this section may be furnished by electronic media.

(3) A retail foreign exchange dealer or futures commission merchant who furnishes statements to a retail forex customer by means of electronic media must retain a daily confirmation statement for such retail forex customer as of the end of the trading session, reflecting all transactions made during that session for the customer, in accordance with § 1.31 of this chapter.

(h) *Combination with other statements.* Any futures commission merchant required to deliver statements to retail forex customers in accordance with § 1.33 of this chapter may combine into one monthly statement or confirmation statement, as the case may be, the information required by this section and the information required by § 1.33, provided that retail forex account information is separately identified from any other trading or account activity of the retail forex customer.

#### **§ 5.14 Records to be kept by retail foreign exchange dealers and futures commission merchants.**

(a) No person shall be registered as a retail foreign exchange dealer under the Act unless, commencing on the date his application for such registration is filed, he prepares and keeps current ledgers or other similar records which show or summarize, with appropriate references to supporting documents, each transaction affecting his asset, liability, income, expense and capital accounts, and in which (except as otherwise permitted in writing by the Commission) all his asset, liability and capital accounts are classified into either the account classification subdivisions specified on Form 1-FR-FCM or categories that are in accord with generally accepted accounting principles as applicable. Each person so registered shall prepare and keep current such records.

(b) Each applicant or registrant must make and keep as a record in accordance with § 1.31 of this chapter formal computations of its adjusted net capital and of its minimum financial requirements pursuant to § 1.17 or § 5.7 of this chapter, or the requirements of the designated self-regulatory organization to which it is subject, as applicable, as of the close of business each month. Such computations must be completed and made available for inspection by any representative of the National Futures Association, in the case of an applicant, or of the Commission or designated self-regulatory organization, if any, in the case of a registrant, within 17 business days after the date for which the computations are made, commencing the first month end after the date the application for registration is filed.

#### **§ 5.15 Unlawful representations.**

It shall be unlawful for any person registered pursuant to the requirements of this part to represent or imply in any manner whatsoever that such person has been sponsored, recommended or approved, or that its abilities or qualifications have been reviewed or evaluated, by the Commission, the Federal government or any agency thereof.

#### **§ 5.16 Prohibition of guarantees against loss.**

(a) No retail foreign exchange dealer, futures commission merchant or introducing broker may in any way represent that it will, with respect to any retail foreign exchange transaction in any account carried by a retail foreign exchange dealer or futures commission merchant for or on behalf of any person:

- (1) Guarantee such person against loss;
- (2) Limit the loss of such person; or
- (3) Not call for or attempt to collect security deposits, margin, or other deposits as established for retail forex customers.

(b) No person may in any way represent that a retail foreign exchange dealer, futures commission merchant or introducing broker will engage in any of the acts or practices described in paragraph (a) of this section.

(c) This section shall not be construed to prevent a retail foreign exchange dealer, futures commission merchant or introducing broker from assuming or sharing in the losses resulting from an error or mishandling of an order.

(d) This section shall not affect any guarantee entered into prior to [effective date of final rule], but this section shall apply to any extension, modification or renewal thereof entered into after such date.

#### **§ 5.17 Authorization to trade.**

No retail foreign exchange dealer, futures commission merchant, introducing broker or any of their associated persons may directly or indirectly effect a retail forex transaction for the account of any customer unless before the transaction the customer, or person designated by the customer to control the account specifically authorized the retail foreign exchange dealer, futures commission merchant, introducing broker or any of their associated persons to effect the transaction. A transaction is "specifically authorized" if the customer or person designated by the customer to control the account specifies:

- (a) The precise retail forex transaction to be effected;
- (b) The exact amount of the foreign currency to be purchased or sold; and
- (c) In the case of an option, the identity of the foreign currency or contract that underlies the option.

#### **§ 5.18 Trading and operational standards.**

- (a) For purposes of this section:
  - (1) The term *retail forex counterparty* includes, as appropriate:
    - (i) A retail foreign exchange dealer as defined in § 5.1 of this part;
    - (ii) A futures commission merchant as defined in section 1a(20) of the Act; and
    - (iii) An affiliated person of a futures commission merchant as defined in § 5.1 of this part.
  - (2) The term *related person* when used in reference to a retail forex counterparty means any general partner, officer, director, owner of more than ten percent of the equity interest, associated person or employee of the retail forex



counterparty, and any relative or spouse of any of the foregoing persons, or any relative of such spouse, who shares the same home as any of the foregoing persons.

(b) Prior to engaging in a retail forex transaction, each retail forex counterparty shall, at a minimum, establish and enforce internal rules, procedures and controls to:

(1) Ensure, to the extent possible, that each order received from a retail forex customer which order is executable at or near the price that the retail forex counterparty has quoted to the customer is entered for execution before any order in any retail forex transaction for any proprietary account, any other account in which a related person of the retail forex counterparty has an interest, or any account for which such a related person may originate orders without the prior specific consent of the account owner (if such related person has gained knowledge of the retail forex customer's order prior to the transmission of an order for a proprietary account), an account in which such a related person has an interest, or an account in which such a related person may originate orders without the prior specific consent of the account owner; and

(2) Prevent related persons of forex counterparties from placing orders, directly or indirectly, with another person in a manner designed to circumvent the provisions of paragraph (b)(1) of this section;

(3) Fairly and objectively establish settlement prices for retail forex transactions; and

(4) Record and maintain essential information regarding customer orders and account activity, and to provide such information to customers upon request. Such information shall include:

(i) Transaction records for the customer's account, including:

(A) The date and time each order is received by the retail forex counterparty;

(B) The price at which each order is placed, or, in the case of an option, the premium paid;

(C) If the transaction was entered into by means of a trading platform, the price quoted on the trading platform when the order was placed, or, in the case of an option, the premium quoted;

(D) The customer account identification information;

(E) The currency pair;

(F) The size of the transaction;

(G) Whether the order was a buy or sell order;

(H) The type of order, if the order was not a market order;

(I) If a trading platform is used, the date and time the order is transmitted to the trading platform;

(J) If a trading platform is used, the date and time the order is executed;

(K) The size and price at which the order is executed, or in the case of an option, the amount of the premium paid for each option purchased, or the amount credited for each option sold; and

(L) For options, whether the option is a put or call, the strike price, and expiration date.

(ii) Account records that contain the following information:

(A) The funds in the account, net of any commissions and fees;

(B) The net profits and losses on open trades; and

(C) The funds in the account plus or minus the net profits and losses on open trades. (In the case of open option positions, the account balance should be adjusted for the net option value);

(iii) If a trading platform is used, daily logs showing each price change on the platform, the time of the change to the nearest second, and the trading volume at that time and price; and

(iv) Any method or algorithm used to determine the bid or asked price for any retail forex transaction or the prices at which customer orders are executed, including, but not limited to, any markups, fees, commissions or other items which affect the profitability or risk of loss of a retail forex customer's transaction.

(c) No retail forex counterparty shall disclose that an order of another person is being held by the retail forex counterparty, unless such disclosure is necessary to the effective execution of such order or is made at the request of an authorized representative of the Commission, or a futures association registered with the Commission pursuant to section 17 of the Act.

(d) No retail forex counterparty shall knowingly handle the account of any related person of another retail forex counterparty unless it:

(1) Receives written authorization from a person designated by such other retail forex counterparty with responsibility for the surveillance over such account pursuant to paragraph (b)(2) of this section;

(2) Prepares immediately upon receipt of an order for such account a written record of such order, including the account identification and order number, and records thereon to the nearest minute, by time-stamp or other timing device, the date and time the order is received; and

(3) Transmits on a regular basis to such other retail forex counterparty

copies of all statements for such account and of all written records prepared upon the receipt of orders for such account pursuant to paragraph (b)(2) of this section.

(e) No related person of a retail forex counterparty shall have an account, directly or indirectly, with another retail forex counterparty unless:

(1) It receives written authorization to maintain such an account from a person designated by the retail forex counterparty of which it is a related person with responsibility for the surveillance over such account pursuant to paragraph (b)(2) of this section; and

(2) Copies of all statements for such account and of all written records prepared by such other retail forex counterparty upon receipt of orders for such account pursuant to paragraph (d)(2) of this section are transmitted on a regular basis to the retail forex counterparty of which it is a related person.

(f) No retail forex counterparty shall:

(1) Enter into a retail forex transaction, to be executed pursuant to a market or limit order at a price that is not at or near the price at which other retail forex customers, during that same time period, have executed retail forex transactions with the retail forex counterparty; *Provided, however*, that this paragraph (f)(1) shall not prohibit such practice if done in accordance with the rules of a registered futures association, and of which such retail foreign exchange dealer, futures commission merchant or affiliated person of a futures commission merchant is a member;

(2) Adjust or alter prices for a retail forex transaction after the transaction has been confirmed to the retail forex customer; *Provided, however*, that this paragraph (f)(2) shall not prohibit such practice if in accordance with the rules of a registered futures association, and of which such retail foreign exchange dealer, futures commission merchant or affiliated person of a futures commission merchant is a member;

(3)(i) Provide a retail forex customer a new bid price for a retail forex transaction that is higher than its previous bid without providing a new asked price that is also higher than its previous asked price by a similar amount;

(ii) Provide a retail forex customer a new bid price for a retail forex transaction that is lower than its previous bid without providing a new asked price that is also lower than its previous asked price by a similar amount; or

(4) Establish a new position for a retail forex customer (except one that

offsets an existing position for that retail forex customer) where the retail forex counterparty holds outstanding orders of other retail forex customers for the same currency pair at a comparable price.

(g)(1) Each retail forex counterparty and each CPO, CTA and IB subject to this Part 5 shall maintain a record of all communications received by such person concerning facts giving rise to possible violations of the Act, rules, regulations or orders thereunder, related to their retail forex business. The record shall contain the name of the complainant, if provided, the date of the communication, the agreement, contract or transaction, the substance of the communication, and the name of the person who received the communication.

(2) Each retail forex counterparty and each CPO, CTA and IB subject to this Part 5 shall provide to the Division of Enforcement of the Commission, electronically, a copy of the record of each communication received pursuant to paragraph (g)(1) of this section. Such copy shall be provided to the Division of Enforcement of the Commission no later than 30 calendar days after the communication is received: *Provided, however*, that in the case of a communication concerning facts giving rise to possible fraud under the Act or Commission regulations, such copy shall be provided to the Division of Enforcement of the Commission within three business days after the communication is received.

(h) An introducing broker as defined in § 5.11(a)(1) of this part, or an applicant for registration as an introducing broker as defined in § 5.1(f)(1) of this part, or any person succeeding to and continuing the business of another introducing broker as defined in § 5.1(f)(1) of this part, must enter into a guarantee agreement with a retail foreign exchange dealer or futures commission merchant.

(i) Each retail forex counterparty shall prepare and maintain on a quarterly basis a calculation of the percentage of non discretionary retail forex accounts open for any period of time during the quarter that earned a profit, and the percentage of such accounts that experienced a loss. The calculation of profit or loss for each retail forex account must be net of fees, commissions, any other expenses, trading losses, customer funds deposited, and customer funds withdrawn. Retail forex counterparties shall maintain such calculations along with all data supporting such calculations for five years in accordance with § 1.31.

(j) Each retail forex counterparty shall designate one or more principals to serve as a chief compliance officer(s). The chief compliance officer(s) shall certify to the Commission and a registered national futures association annually that the retail forex counterparty has in place processes to establish, maintain, review, modify and test policies and procedures reasonably designed to achieve compliance with the Act, rules, regulations and orders thereunder. The certification shall include a statement that the counterparty has in place compliance processes, and that the chief compliance officer(s) has apprised the chief executive officer of the compliance efforts to date and identify and address significant compliance problems and plans to address those problems.

#### § 5.19 Pending legal proceedings.

(a) Every retail foreign exchange dealer or futures commission merchant and each CPO, CTA or IB subject to this Part 5 shall submit to the Commission copies of any dispositive or partially dispositive decision for which a notice of appeal has been filed, the notice of appeal and such further documents as the Commission may thereafter request filed in any material legal proceeding to which the retail foreign exchange dealer, futures commission merchant, CPO, CTA or IB is a party or to which its property or assets is subject with respect to retail forex transactions.

(b) Every retail foreign exchange dealer or futures commission merchant and each CPO, CTA or IB subject to this Part 5 shall submit to the Commission copies of any dispositive or partially dispositive decision concerning which a notice of appeal has been filed, the notice of appeal, and such further documents as the Commission may thereafter request filed in any material legal proceeding instituted against any person who is a principal of the retail foreign exchange dealer, futures commission merchant, CPO, CTA or IB (as the term "principal" is defined in § 3.1(a) of this chapter) arising from conduct in such person's capacity as a principal of the retail foreign exchange dealer, futures commission merchant, CPO, CTA or IB and alleging violations, with regard to retail forex transactions, of:

(1) The Act or any rule, regulation, or order thereunder; or

(2) Provisions of state law relating to a duty or obligation owed by such a principal.

(c) All documents required by this section to be submitted to the Commission shall be mailed via first-class or submitted by other more

expeditious means to the Commission's headquarters office in Washington, DC, Attention: Director, Division of Enforcement. All documents required by this section to be submitted to the Commission as to matters pending on [effective date of final rule] shall be mailed to the Commission within 45 days of that effective date. Thereafter, all decisions and notices of appeal required to be submitted by retail foreign exchange dealers, futures commission merchants, CPOs, CTAs or IBs shall be mailed within 10 days of the filing or receipt by the retail foreign exchange dealer or futures commission merchant of the relevant notice of appeal. For purposes of paragraph (a) and (b) of this section, a "material legal proceeding" includes but is not limited to actions involving alleged violations of the Commodity Exchange Act or the Commission's regulations. However, a legal proceeding is not "material" for the purposes of this rule if the proceeding is not in a federal or state court or if the Commission is a party.

#### § 5.20 Special calls for account and transaction information.

(a) *Preparation and transmission of information upon special call.* All information required upon special call shall be prepared in such form and manner and in accordance with such instructions, and shall be transmitted at such time and to such office of the Commission, as may be specified in the call.

(b) *Special calls for information on controlled accounts from retail foreign exchange dealers, futures commission merchants and introducing brokers.* Upon call by the Commission, each retail foreign exchange dealer, futures commission merchant and introducing broker shall file with the Commission the names and addresses of all persons who, by power of attorney or otherwise, exercise trading control over any customer's account in retail forex transactions.

(c) *Special calls for information on open transactions in accounts carried or introduced by retail foreign exchange dealers, futures commission merchants, and introducing brokers.* Upon special call by the Commission for information relating to retail forex transactions held or introduced on the dates specified in the call, each retail foreign exchange dealer, futures commission merchant, or introducing broker shall furnish to the Commission the following information concerning accounts of traders owning or controlling such retail forex transaction positions, as may be specified in the call:

(1) The name, address, and telephone number of the person for whom each account is carried;

(2) The principal business or occupation of the person for whom each account is introduced or carried, as specified in the call;

(3) The name, address and principal business or occupation of any person who controls the trading of each account;

(4) The name and address of any person having a financial interest of ten percent or more in each account;

(5) The number of open retail forex transaction positions introduced or carried in each account, as specified in the call; and

(6) The total number of retail forex transactions against which delivery has been made.

(d) *Delegation of authority to the Director of the Division of Clearing and Intermediary Oversight and the Director of the Division of Market Oversight.* The Commission hereby delegates, until the Commission orders otherwise, to the Director of the Division of Clearing and Intermediary Oversight and the Director of the Division of Market Oversight, or to the respective Director's designees, the authority set forth in this section to make special calls for information on controlled accounts from retail foreign exchange dealers, futures commission merchants and from introducing brokers, and to make special calls for information on open contracts in accounts carried or introduced by futures commission merchants, introducing brokers, and foreign brokers. Either Director may submit to the Commission for its consideration any matter that has been delegated pursuant to this section. Nothing in this section shall be deemed to prohibit the Commission, at its election, from exercising the authority delegated in this section to the Directors.

#### **§ 5.21 Supervision.**

Each Commission registrant subject to this Part 5, except an associated person who has no supervisory duties, must diligently supervise the handling by its partners, officers, employees and agents (or persons occupying a similar status or performing a similar function) of all retail forex accounts carried, operated, advised or introduced by the registrant and all other activities of its partners, officers, employees and agents (or persons occupying a similar status or performing a similar function) relating to its business as a Commission registrant.

#### **§ 5.22 Registered futures association membership.**

(a) Each person registered as a retail foreign exchange dealer must become and remain a member of at least one futures association that is registered under section 17 of the Act and that provides for the membership therein of such retail foreign exchange dealer.

(b) Each person required to register as:

(1) An introducing broker, because the person solicits or accepts orders for retail forex transactions;

(2) A commodity pool operator because the person operates, or solicits funds, securities, or property for, a pooled investment vehicle that engages in retail forex transactions; or

(3) A commodity trading advisor because the person exercises discretionary trading authority, or obtains written authorization to exercise discretionary trading authority over, an account in connection with retail forex transactions, must become and remain a member of at least one futures association that is registered under section 17 of the Act and that provides for the membership therein of such person.

#### **§ 5.23 Notice of bulk transfers and bulk liquidations.**

(a) *Notice and Disclosure to Retail Forex Customers of a Bulk Transfer.* (1) A retail foreign exchange dealer, futures commission merchant or introducing broker must obtain the written prior and specific consent of its retail forex customer to the assignment of any position or transfer of any account of the retail forex customer to another retail foreign exchange dealer, futures commission merchant or introducing broker, unless made at the retail forex customer's request.

(2) Absent a request of the retail forex customer or the consent described in paragraph (a)(1) of this section, assignments of positions and transfers of accounts of retail forex customers may be permitted under rules of the retail forex dealer's, futures commission merchant's, or introducing broker's designated self-regulatory organization that establish notice and other requirements with respect to the assignment of positions and transfers of accounts of retail forex customers. If such rules permit implied consent as a result of the failure of the retail forex customer to object after having received notice of the proposed assignment or transfer, such rules must provide that the notice must include a statement that the retail forex customer is not required to accept the proposed assignment or transfer and may direct the transferor firm to liquidate the positions of the

retail forex customer or transfer the account to a firm of the retail forex customer's selection.

(3) For assignments and transfers made under this section, other than at the retail forex customer's request, the transferee retail foreign exchange dealer, futures commission merchant or introducing broker must provide to the retail forex customer the risk disclosure statements and forms of acknowledgment required by Part 5 of this chapter and receive the required signed acknowledgments within sixty days of such assignments or transfers. This requirement shall not apply:

(i) If the transferee retail foreign exchange dealer, futures commission merchant or introducing broker has clear written evidence that the retail forex customer has received and acknowledged receipt of the required disclosure statements; or

(ii) If the transfer of accounts is made from one introducing broker to another introducing broker guaranteed by the same retail foreign exchange dealer or futures commission merchant pursuant to a guarantee agreement in accordance with the requirements of § 1.10(j) of this chapter and such retail foreign exchange dealer or futures commission merchant maintains the relevant acknowledgments required by Part 5 of this chapter.

(b) *Notice to the Commission.* Each retail foreign exchange dealer, futures commission merchant or introducing broker shall file with the Commission prior notice of any transfer of accounts of any retail forex customer that is not initiated at the request of the customer, where the transfer involves 50 percent or more of the transferor's total number of retail forex customer accounts.

(c) *Contents of Notice to the Commission.* The notice required by paragraph (b) of this section shall include:

(1) The name, principal business address and telephone number of the transferor futures retail foreign exchange dealer, futures commission merchant or introducing broker;

(2) The name, principal business address and telephone number of each transferee retail foreign exchange dealer, futures commission merchant or introducing broker;

(3) The designated self-regulatory organization for the transferor and transferee firms;

(4) A brief statement as to the reasons for the transfer;

(5) A copy of any notices to customers regarding the transfers; and

(6) A statement of the number of accounts to be transferred.

(d) *Notice of the Bulk Liquidation of Retail Forex Transactions.* A retail foreign exchange dealer or futures commission merchant may not initiate the bulk liquidation of properly margined retail forex transactions unless such liquidation complies with the rules and procedures of the retail forex dealer's or futures commission merchant's designated self-regulatory organization and the retail forex dealer or futures commission merchant provides the Commission with prior written notice of the liquidation.

(e) *Contents of Notice of Bulk Liquidation.* The notice required by paragraph (d) of this section shall include:

- (1) The name, principal business address and telephone number of the initiating retail foreign exchange dealer or futures commission merchant;
- (2) A brief statement of the reasons for the liquidation;
- (3) A copy of any notices to customers regarding the liquidation; and
- (4) A statement of the number of accounts to be liquidated.

(f) *Filing of Notices.* The notice required by paragraph (b) and (d) of this section shall be filed five business days prior to the transfer or liquidation of the retail forex transaction with the Deputy Director, Compliance and Registration Section, Division of Clearing and Intermediary Oversight, Commodity Futures Trading Commission, Three Lafayette Centre, 1155 21st Street, NW., Washington, DC 20581; the National Futures Association Attn: Vice President-Compliance; and the designated self-regulatory organization for the transferor firm.

(g) *No effect on other obligations.* The requirements of this section shall not affect the obligations of a retail foreign exchange dealer, futures commission merchant or introducing broker under the rules of a self-regulatory organization or applicable customer account agreement with respect to assignments of positions or transfers of accounts or liquidation of positions.

(h) *Corrective notice.* If a proposed transfer is not completed in accordance with the notice required to be filed by paragraph (b) of this section, a corrective notice shall be filed within five business days of the date such proposed transfer was to occur explaining why the proposed transfer was not completed.

#### **§ 5.24 Applicability of other parts of this chapter.**

Insofar as it is consistent with the requirements of this part, all other provisions of this chapter that apply to a person shall apply to such person as

though such provisions were expressly set forth in this part.

#### **§ 5.25 Applicability of the Act.**

Except as otherwise specified in this part and unless the context otherwise requires, the provisions of Sections 4b, 4c(b), 4f, 4g, 4k, 4m, 4n, 4o, 6(c)–(e), 6b, 6c, 8(a)–(e), 8a and 12(f) of the Act shall apply to retail forex transactions that are subject to the requirements of this part as though such provisions were set forth herein and included specific references to retail forex transactions and the persons defined in § 5.1 of this part.

### **PART 10—RULES OF PRACTICE**

37. The authority citation for part 10 continues to read as follows:

**Authority:** Pub. L. 93–463, sec. 101(a)(11), 88 Stat. 1391; 7 U.S.C. 2a(12).

38. Section 10.1 is amended by revising paragraph (a) to read as follows:

#### **§ 10.1 Scope and applicability of rules of practice.**

\* \* \* \* \*

(a) Denial, suspension, revocation, conditioning, restricting or modifying of registration as a futures commission merchant, retail foreign exchange dealer, introducing broker, or associated person, floor broker, floor trader, commodity pool operator, commodity trading advisor or leverage transaction merchant pursuant to sections 6(c), 8a(2), 8a(3), 8a(4) and 8a(11) of the Act, 7 U.S.C. 9 and 15, 12a(2), 12a(3), 12a(4) and 12(a)(11), or denial, suspension, or revocation of designation as a contract market pursuant to sections 6(a) and 6(b) of the Act, 7 U.S.C. 8;

\* \* \* \* \*

### **PART 140—ORGANIZATION, FUNCTIONS, AND PROCEEDINGS OF THE COMMISSION**

39. The authority citation for part 140 continues to read as follows:

**Authority:** 7 U.S.C. 2 and 12a.

40. Section 140.94 is amended by adding to read as follows:

#### **§ 140.94 Delegation of authority to the Director of the Division of Clearing and Intermediary Oversight.**

(a) The Commission hereby delegates, until such time as the Commission orders otherwise, the following functions to the Director of the Division of Clearing and Intermediary Oversight and to such members of the Commission's staff acting under his direction as he may designate from time to time:

(1) All functions reserved to the Commission in § 5.7 of this chapter;

(2) All functions reserved to the Commission in § 5.10 of this chapter;

(3) All functions reserved to the Commission in § 5.11 of this chapter;

(4) All functions reserved to the Commission in § 5.12 of this chapter, except for those relating to nonpublic treatment of reports set forth in § 5.12(i) of this chapter; and

(5) All functions reserved to the Commission in § 5.14 of this chapter.

(b) The Director of the Division of Clearing and Intermediary Oversight may submit any matter which has been delegated to him under paragraph (a) of this section to the Commission for its consideration.

(c) Nothing in this section may prohibit the Commission, at its election, from exercising the authority delegated to the Director of the Division of Clearing and Intermediary Oversight under paragraph (a) of this section.

### **PART 145—COMMISSION RECORDS AND INFORMATION**

41. The authority citation for part 145 continues to read as follows:

**Authority:** Pub. L. 99–570, 100 Stat. 3207; Pub. L. 89–554, 80 Stat. 383; Pub. L. 90–23, 81 Stat. 54; Pub. L. 98–502, 88 Stat. 1561–1564 (5 U.S.C. 552); Sec. 101(a), Pub. L. 93–463, 88 Stat. 1389 (5 U.S.C. 4a(j)); unless otherwise noted.

42. Section 145.5 is amended by revising paragraphs (d)(1)(viii) and (h) to read as follows:

#### **§ 145.5 Disclosure of nonpublic records.**

\* \* \* \* \*

(d) \* \* \*

(1) \* \* \*

(viii) The following reports and statements that are also set forth in paragraph (h) of this section, except as specified in 17 CFR 1.10(g)(2), 17 CFR 31.13(m), or 17 CFR 5.12(h): Forms 1–FR required to be filed pursuant to 17 CFR 1.10 or 17 CFR 5.12; FOCUS reports that are filed in lieu of Forms 1–FR pursuant to 17 CFR 1.10(h); Forms 2–FR required to be filed pursuant to 17 CFR 31.13; the accountant's report on material inadequacies filed in accordance with 17 CFR 1.16(c)(5); and all reports and statements required to be filed pursuant to 17 CFR 1.17(c)(6);

\* \* \* \* \*

(h) Contained in or related to examinations, operating, or condition reports prepared by, on behalf of, or for the use of the Commission or any other agency responsible for the regulation or supervision of financial institutions, including, but not limited to the following reports and statements that are also set forth in paragraph (d)(1)(viii) of this section, except as specified in 17

CFR 1.10(g)(2), 17 CFR 5.12(h) or 17 CFR 31.13(m): Forms 1–FR required to be filed pursuant to 17 CFR 1.10 or 17 CFR 5.12; FOCUS reports that are filed in lieu of Forms 1–FR pursuant to 17 CFR 1.10(h); Forms 2–FR required to be filed pursuant to 17 CFR 31.13; the accountant’s report on material inadequacies filed in accordance with 17 CFR 1.16(c)(5); and all reports and statements required to be filed pursuant to 17 CFR 1.17(c)(6); and

\* \* \* \* \*

**PART 147—OPEN COMMISSION MEETINGS**

43. The authority citation for part 147 continues to read as follows:

**Authority:** Sec. 3(a), Pub. L. 94–409, 90 Stat. 1241 (5 U.S.C. 552b); sec. 101(a)(11), Pub. L. 93–463, 88 Stat. 1391 (7 U.S.C. 4a(j) (Supp. V, 1975)), unless otherwise noted.

44. Section 147.3 is amended by revising paragraphs (b)(4)(i)(H) and (b)(8) to read as follows:

**§ 147.3 General requirement of open meetings; grounds upon which meetings may be closed.**

\* \* \* \* \*

- (b) \* \* \*
- (4) \* \* \*
- (i) \* \* \*

(H) The following reports and statements that are also set forth in paragraph (b)(8) of this section, except as specified in 17 CFR 1.10(g)(2), 17 CFR 5.12, or 17 CFR 31.13(m): Forms 1–FR required to be filed pursuant to 17 CFR 1.10, 17 CFR 5.12(h)(2), or 17 CFR 31.13(m); FOCUS reports that are filed in lieu of Forms 1–FR pursuant to 17 CFR 1.10(h); Forms 2–FR required to be filed pursuant to 17 CFR 31.13; the accountant’s report on material inadequacies filed in accordance with 17 CFR 1.16(c)(5); and all reports and statements required to be filed pursuant to 17 CFR 1.17(c)(6);

\* \* \* \* \*

(8) Disclose information contained in or related to examination, operating, or condition reports prepared by, on behalf of, or for the use of the Commission or any other agency responsible for the regulation or supervision of financial institutions, including, but not limited to the following reports and statements that are also set forth in paragraph (b)(4)(i)(H) of this section, except as specified in 17 CFR 1.10(g)(2), 17 CFR 5.12, or 17 CFR 31.13(m): Forms 1–FR required to be filed pursuant to 17 CFR 1.10, 17 CFR 5.12(h)(2), or 17 CFR 31.12(m); FOCUS reports that are filed in lieu of Forms 1–FR pursuant to 17 CFR 1.10(h); Forms 2–FR required to be filed pursuant to 17 CFR 31.13; the

accountant’s report on material inadequacies filed in accordance with 17 CFR 1.16(c)(5); and all reports and statements required to be filed pursuant to 17 CFR 1.17(c)(6);

\* \* \* \* \*

**PART 160—PRIVACY OF CONSUMER FINANCIAL INFORMATION**

45. The authority citation for part 160 continues to read as follows:

**Authority:** 7 U.S.C. 7b–2 and 12a(5); 15 U.S.C. 6801, *et seq.*

46. Section 160.1 is amended by revising paragraph (b) to read as follows:

**§ 160.1 Purpose and scope.**

\* \* \* \* \*

(b) *Scope.* This part applies only to nonpublic personal information about individuals who obtain financial products or services primarily for personal, family, or household purposes from the institutions listed below. This part does not apply to information about companies or about individuals who obtain financial products or services primarily for business, commercial, or agricultural purposes. This part applies to all futures commission merchants, retail foreign exchange dealers, commodity trading advisors, commodity pool operators and introducing brokers that are subject to the jurisdiction of the Commission, regardless whether they are required to register with the Commission. These entities are hereinafter referred to in this part as “you.” This part does not apply to foreign (non-resident) futures commission merchants, retail foreign exchange dealers, commodity trading advisors, commodity pool operators and introducing brokers that are not registered with the Commission. Nothing in this part modifies, limits or supersedes the standards governing individually identifiable health information promulgated by the Secretary of Health and Human Services under the authority of sections 262 and 264 of the Health Insurance Portability and Accountability Act of 1996, 42 U.S.C. 1320d–1320d–8.

- 47. Section 160.3 is amended by:
  - a. Revising paragraph (a) introductory text and paragraph (a)(2);
  - b. Redesignating paragraphs (k)(2)(i)(B) through (F) as paragraphs (k)(2)(i)(C) through (G) and republishing them, and adding new paragraph (k)(2)(i)(B);
  - c. Revising paragraphs (n)(1)(i) and (n)(2)(i);
  - d. Revising paragraph (o)(1)(i);
  - e. Revising paragraph (u)(2)(i)(A);
  - f. Redesignating paragraphs (w)(2) through (4) as paragraphs (w)(3) through

(5) and adding new paragraph (w)(2); and  
g. Adding new paragraph (x) to read as follows:

**§ 160.3 Definitions.**

\* \* \* \* \*

(a) *Affiliate* of a futures commission merchant, retail foreign exchange dealer, commodity trading advisor, commodity pool operator or introducing broker means any company that controls, is controlled by, or is under common control with a futures commission merchant, retail foreign exchange dealer, commodity trading advisor, commodity pool operator or introducing broker that is subject to the jurisdiction of the Commission. In addition, a futures commission merchant, retail foreign exchange dealer, commodity trading advisor, commodity pool operator or introducing broker subject to the jurisdiction of the Commission will be deemed an affiliate of a company for purposes of this part if:

\* \* \* \* \*

(2) Rules adopted by the Federal Trade Commission or another federal functional regulator under Title V of the GLB Act treat the futures commission merchant, retail foreign exchange dealer, commodity trading advisor, commodity pool operator or introducing broker as an affiliate of that company.

\* \* \* \* \*

- (k) \* \* \*
- (2) \* \* \*
- (i) \* \* \*

(B) You are a retail foreign exchange dealer with whom a consumer has opened an account, or that effects or engages in retail forex transactions with or for a consumer, even if you do not hold any assets of the consumer.

(C) You are an introducing broker that solicits or accepts specific orders for trades;

(D) You are a commodity trading advisor with whom a consumer has a contract or subscription, either written or oral, regardless of whether the advice is standardized, or is based on, or tailored to, the commodity interest or cash market positions or other circumstances or characteristics of the particular consumer;

(E) You are a commodity pool operator, and you accept or receive from the consumer, funds, securities, or property for the purpose of purchasing an interest in a commodity pool;

(F) You hold securities or other assets as collateral for a loan made to the consumer, even if you did not make the loan or do not effect any transactions on behalf of the consumer; or

(G) You regularly effect or engage in commodity interest transactions with or for a consumer even if you do not hold any assets of the consumer.

\* \* \* \* \*

(n)(1) \* \* \*

(i) Any futures commission merchant, retail foreign exchange dealer, commodity trading advisor, commodity pool operator or introducing broker that is registered with the Commission as such or is otherwise subject to the Commission's jurisdiction; and

\* \* \* \* \*

(2) \* \* \*

(i) Any person or entity, other than a futures commission merchant, retail foreign exchange dealer, commodity trading advisor, commodity pool operator or introducing broker that, with respect to any financial activity, is subject to the jurisdiction of the Commission under the Act.

\* \* \* \* \*

(o)(1) \* \* \*

(i) Any product or service that a futures commission merchant, retail foreign exchange dealer, commodity trading advisor, commodity pool operator, or introducing broker could offer that is subject to the Commission's jurisdiction; and

\* \* \* \* \*

(u) \* \* \*

(2) \* \* \*

(i) \* \* \*

(A) Information a consumer provides to you on an application to open a commodity interest trading account, to invest in a commodity pool, or to obtain another financial product or service;

\* \* \* \* \*

(w) \* \* \*

(2) Any retail foreign exchange dealer;

(x) *Retail foreign exchange dealer* has the same meaning as in § 5.3(i)(1) of this chapter.

48. Section 160.4 is amended by:

a. Revising paragraph (c)(2)(ii); and  
b. Revising paragraph (e)(1)(iv) to read as follows:

**§ 160.4 Initial privacy notice to consumers required.**

\* \* \* \* \*

(c) \* \* \*

(2) \* \* \*

(ii) Opens a retail forex account, or opens a commodity interest account through an introducing broker or with a futures commission merchant that clears transactions for its customers through you on a fully-disclosed basis;

\* \* \* \* \*

(e) \* \* \*

(1) \* \* \*

(iv) You have established a customer relationship with a customer in a bulk

transfer in accordance with § 1.65, if you are a transferee futures commission merchant, retail foreign exchange dealer or introducing broker.

\* \* \* \* \*

49. Section 160.30 is amended by revising the introductory text to read as follows:

**§ 160.30 Procedures to safeguard customer records and information.**

Every futures commission merchant, retail foreign exchange dealer, commodity trading advisor, commodity pool operator and introducing broker subject to the jurisdiction of the Commission must adopt policies and procedures that address administrative, technical and physical safeguards for the protection of customer records and information. These policies and procedures must be reasonably designed to:

\* \* \* \* \*

**PART 166—CUSTOMER PROTECTION RULES**

50. The authority citation for part 166 remains as follows:

**Authority:** 7 U.S.C. 1a, 2, 6b, 6c, 6d, 6g, 6h, 6k, 6l, 6o, 7, 12a and 23, as amended by the Commodity Futures Modernization Act of 2000, Appendix E of Pub. L. 106-554, 114 Stat. 2763 (2000).

51. Section 166.2 is revised as follows:

**§ 166.2 Authorization to trade.**

No futures commission merchant, retail foreign exchange dealer, introducing broker or any of their associated persons may directly or indirectly effect a transaction in a commodity interest for the account of any customer unless before the transaction the customer, or person designated by the customer to control the account:

(a) With respect to any commodity interest as defined in § 1.3(yy)(1) through (3) of this chapter, specifically authorized the futures commission merchant, retail foreign exchange dealer, introducing broker or any of their associated persons to effect the transaction (a transaction is "specifically authorized" if the customer or person designated by the customer to control the account specifies—

(1) The precise commodity interest to be purchased or sold and

(2) The exact amount of the commodity interest to be purchased or sold); or

(b) With respect to any commodity interest as defined in § 1.3(yy)(1) or (2) of this chapter, authorized in writing the futures commission merchant,

introducing broker or any of their associated persons to effect transactions in commodity interests for the account without the customer's specific authorization; Provided, however, That if any such futures commission merchant, introducing broker or any of their associated persons is also authorized to effect transactions in foreign futures or foreign options without the customer's specific authorization, such authorization must be expressly documented.

52. Section 166.5 is amended by:

a. Removing paragraph (a)(1)(iv), redesignating paragraphs (a)(1)(i) through (a)(1)(iii) as paragraphs (a)(1)(i)(A) through (a)(1)(i)(C), and adding new paragraph (a)(1)(ii);

b. Revising paragraphs (a)(2) and (a)(3);

c. Revising paragraphs (c)(5)(i)(A) and (c)(5)(i)(C) to read as follows:

**§ 166.5 Dispute settlement procedures.**

(a) \* \* \*

(ii) Arises out of any retail forex transaction (as defined in § 5.1(m) of this chapter).

(2) The term customer as used in this section includes an option customer (as defined in § 1.3(jj) of this chapter), a retail forex customer (as defined in § 5.1(k) of this chapter) and any person for or on behalf of whom a member of a designated contract market, or a participant transacting on or through such designated contract market, effects a transaction on such contract market, except another member of or participant in such designated contract market; *Provided, however*, a person who is an "eligible contract participant" as defined in section 1a(12) of the Act shall not be deemed to be a customer within the meaning of this section.

(3) The term *Commission registrant* as used in this section means a person registered under the Act as a futures commission merchant, retail foreign exchange dealer, introducing broker, floor broker, commodity pool operator, commodity trading advisor, or associated person.

\* \* \* \* \*

(c) \* \* \*

(5) \* \* \*

(i) \* \* \*

(A) The designated contract market, if applicable and if available, upon which the transaction giving rise to the dispute was executed or could have been executed;

\* \* \* \* \*

(C) At least one other organization that will provide the customer with the opportunity to select the location of the arbitration proceeding from among

several major cities in diverse geographic regions and that will provide the customer with the choice of a panel or other decision-maker composed of at least one or more persons, of which at least a majority are not members or associated with a member of the designated contract market, if applicable, or employee thereof, and

that are not otherwise associated with the designated contract market (mixed panel), if applicable: Provided, however, that the list of qualified organizations provided by a Commission registrant that is a floor broker need not include a registered futures association unless a registered futures association has been

authorized to act as a decision-maker in such matters.

\* \* \* \* \*

Issued in Washington, DC, on January 7, 2010, by the Commission.

**David A. Stawick,**

*Secretary of the Commission.*

[FR Doc. 2010-456 Filed 1-19-10; 8:45 am]

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