

**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:** Final rules.

**SUMMARY:** The Commodity Futures Trading Commission (“Commission” or “CFTC”) is adopting a comprehensive regulatory scheme to implement the provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (“Wall Street Reform Act”) <sup>1</sup> and the CFTC Reauthorization Act of 2008 (“CRA”) <sup>2</sup> with respect to off-exchange transactions in foreign currency with members of the retail public (*i.e.*, “retail forex transactions”). The new regulations and amendments to existing regulations published today establish requirements for, among other things, registration, disclosure, recordkeeping, financial reporting, minimum capital, and other operational standards.

**DATES:** *Effective Date:* October 18, 2010.

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**SUPPLEMENTARY INFORMATION:****I. Background**

On January 20, 2010, the Commission published in the **Federal Register** proposed new regulations and amendments to existing regulations in response to the CRA (the “Proposing Release”).<sup>3</sup> The Proposing Release set forth in detail the historical background of the regulation of retail forex transactions, and the events, legislative and otherwise, that led up to the enactment of the CRA.<sup>4</sup> The Commission explained that its proposed regulations were drawn up with the aim of applying the same principles that have guided the regulation of on-exchange instruments, while taking into account the real differences between the trading of futures contracts on designated contract markets (“DCMs”) that are cleared through Commission-registered derivatives clearing organizations (“DCOs”) on the one hand, and off-exchange transactions between forex firms and retail customers on the other hand.<sup>5</sup>

The proposed rule changes were of two general sorts. The first group included amendments to existing regulations to accommodate regulation of retail forex transactions and the new registration categories created under the CRA. The second group comprised a new part 5 of the Commission’s regulations, encompassing, to the extent practicable, the regulations pertaining specifically to persons engaging in retail forex transactions. For example, many of the operational or registration requirements in part 1 or part 3, respectively, of the Commission’s regulations referring to futures commission merchants (“FCMs”) would, as a result of the CRA, now apply also to retail foreign exchange dealers (“RFEDs”). Some of the disclosure, reporting and recordkeeping requirements in part 4 had to be modified to apply to operators of pooled investment vehicles and advisors that

engage in retail forex transactions, as called for under the CRA. Other parts of the Commission’s regulations required their own adaptations in order to extend customer protection, privacy and procedural requirements to retail forex transactions.

The Commission also noted in its Proposing Release that in addition to the regulations expressly called for by the CRA, it was proposing certain additional requirements prompted both by the essential differences between on-exchange transactions and retail forex transactions, and by the history of fraudulent practices in the retail forex market.<sup>6</sup> The proposed regulatory changes were discussed, section by section.<sup>7</sup>

Following the publication of the Proposing Release, the Wall Street Reform Act was enacted which, in relevant part, requires that specified Federal regulatory agencies, including the CFTC, promulgate rules regarding retail forex transactions. Consistent with the CRA, the Wall Street Reform Act directs that such rules prescribe appropriate requirements with respect to disclosure, recordkeeping, capital and margin, reporting, business conduct, and such other standards or requirements as the Federal regulatory agencies determine to be necessary.<sup>8</sup>

Thus, pursuant to the broad authority granted by the Wall Street Reform Act and the CRA, the Commission is implementing requirements for, among other things: Registration, disclosure, recordkeeping, financial reporting, minimum capital, and other operational standards, based on existing CFTC regulations for commodity interest transactions and commodity interest intermediaries, and on existing National Futures Association (“NFA”) rules with respect to retail forex transactions offered by NFA’s members. With certain exceptions, the Commission is adopting the rule changes delineated in the Proposing Release as proposed.

Except for certain otherwise-regulated financial intermediaries excluded by the CRA from the Commission’s jurisdiction, persons offering to be or acting as counterparties to retail forex transactions, but not primarily or substantially engaged in the exchange-traded futures business, are required to register with the CFTC as RFEDs. Registered FCMs that are “primarily or substantially” (as defined in the new regulations) engaged in the activities set forth in the definition in the Commodity

<sup>1</sup> Dodd-Frank Wall Street Reform and Consumer Protection Act, Public Law 111-203 (2010).

<sup>2</sup> Food, Conservation, and Energy Act of 2008, Public Law 110-246, 122 Stat. 1651, 2189-2204 (2008).

<sup>3</sup> Regulation of Off-Exchange Retail Foreign Exchange Transactions and Intermediaries, 75 FR 3282 (Jan. 20, 2010).

<sup>4</sup> See 75 FR 3282, 3283-3285.

<sup>5</sup> See 75 FR 3282, 3285.

<sup>6</sup> See 75 FR 3282, 3286.

<sup>7</sup> See 75 FR 3282, 3286-3293.

<sup>8</sup> See Wall Street Reform Act, Sec. 742.

Exchange Act (the “Act”) of an FCM<sup>9</sup> are permitted to engage in retail forex transactions without also registering as RFEDs. Also, the \$20 million minimum net capital standard established in the CRA for registering as an RFED or offering retail forex transactions as an FCM is incorporated in the new regulations.

The new regulations also 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.

Finally, pursuant to the authority conferred by the CRA,<sup>10</sup> and to address cases where the Commission’s jurisdiction has been challenged, the Commission is adopting the proposed regulatory provisions applicable to certain leveraged, off-exchange retail forex transactions commonly known as “Zelener contracts.”<sup>11</sup>

## II. The Comments on the Proposing Release

The Commission received in excess of 9,100 comments<sup>12</sup> from a range of commenters, including individuals who trade forex, intermediaries, registered FCMs currently serving as counterparties in retail forex transactions, trade associations or coalitions of industry participants, one committee of a county lawyers’ association, a registered futures association, and numerous law firms representing institutional clients. Many commenters offered specific recommendations for clarification or modification of particular rules; other commenters objected generally to particular proposed rules. Overall, the bulk of the comments concerned four of the proposed rules:

- Proposed Regulation 5.9, which would impose a 10 to 1 leverage limitation on retail forex transactions. (“Security Deposit Proposal” or “Leverage Proposal”)
- Proposed Regulation 5.18(h), which would require each IB that solicits or accepts off-exchange retail forex orders to enter into a guarantee agreement with the FCM or RFED to which the IB

introduces the forex transactions. (“Guaranteed IB Proposal”)

- Proposed Regulation 5.18(j), which would require all retail forex counterparties to calculate, on a quarterly basis, the percentage of non-discretionary accounts that were profitable, to include the results of this calculation for the preceding four quarters in required disclosures to customers, and to maintain and make available upon request records reflecting such calculations for five years. (“Disclosure Proposal”)

- Proposed Regulation 5.7, which would establish a minimum capital requirement for FCMs and RFEDs (“Capital Proposal”)

The comments regarding these proposed rules and the Commission’s response are discussed immediately below. The Commission’s response to comments concerning other aspects of the proposed rules follows later.

Given the volume of comments received, the Commission cannot respond to each and every comment or objection. However, the Commission has carefully reviewed and considered each letter and, in the sections that follow, has endeavored to address both the primary themes running throughout multiple letters and significant points raised by individual commenters.

**Security Deposit Proposal.** In general terms, proposed Regulation 5.9 would have required FCMs and RFEDs engaging in retail forex transactions to collect from each retail forex customer a minimum security deposit equal to 10 percent of the notional value of each retail forex transaction. This proposal is often referred to in the comment letters as a 10% or 10:1 leverage requirement (*i.e.*, for every \$10 of notional value, \$1 is required as a security deposit).

The Commission received a significant number of comment letters regarding the Security Deposit Proposal with a substantial majority of the commenters objecting to the proposed level of 10%. Many of the letters submitted with regard to this issue appeared to be submitted by individual traders, were identical or nearly identical, and objected generally to the proposal. Within the large group of comments by such traders, whether in “form” letter objections or otherwise, the most common objections were that the leverage proposal would drive business off-shore, would lead to the loss of jobs in the U.S., was unnecessarily restrictive and would inhibit small traders’ ability to trade profitably, or that the percentage required as a security deposit was arbitrary, capricious and anti-competitive.

Other commenters noted that by increasing the security deposit level, retail forex customers are exposed to greater levels of market and credit risk. Many of these commenters believe that the amplification that is provided by increased leverage is necessary for clients to earn a profit from their positions. Still other commenters urged that NFA’s current levels be retained and asserted that the Commission had already approved these levels by allowing NFA’s proposed rule regarding leverage to become effective.

Finally, one commenter encouraged the Commission to (1) recognize the different market risks and volatility posed by different currencies, (2) adopt requirements reflective of those differences just as contract markets do in establishing their margin levels, and (3) endorse or adopt some mechanism to allow for periodic review and adjustment of the requirements if necessary.

The Commission’s proposed leverage restriction was conservative and was proposed in an effort to provide maximum customer protection. The Commission does not, however, believe it was arbitrary or contrary to previously approved NFA rules.<sup>13</sup> Moreover, the Commission does not believe that most retail foreign exchange customers select a counterparty based solely on the maximum allowable leverage, otherwise these investors would have already migrated to foreign markets, some of which have no limitation on leverage. Nevertheless, after considering the concerns expressed and arguments made in the comments, the Commission has determined to adopt a revised security deposit requirement for FCMs engaging in retail forex transactions and for RFEDs.

In developing the revised Regulation 5.9, the Commission once again

<sup>13</sup> As noted above, several commenters maintained that the proposed Regulation 5.9 was inconsistent with security deposit levels set by NFA and approved by the Commission. In February 2009, NFA proposed and the Commission approved amendments to Section 12 of NFA’s Financial Requirements. (*See* Letter from Thomas W. Sexton to David A. Stawick, dated February 23, 2009, regarding Forex Security Deposits—Proposed Amendments to NFA Financial Requirements Section 12 and Interpretive Notice Regarding Forex Transactions, available on NFA’s website at [nfa.futures.org](http://nfa.futures.org).) NFA’s amendments left in place requirements of a 1% security deposit for major currencies and a 4% deposit for all other currencies, but eliminated an exemption from these requirements for well-capitalized firms. As NFA noted in its proposed amendments, exempted firms had offered leverage of 200:1, 400:1 and even 700:1. NFA’s February 2009 amendments effectively reduced the amount of leverage available to retail forex customers. The Commission approved the amendments, in accordance with the standards set in Section 17(j) of the Act.

<sup>9</sup> 7 U.S.C. 1a(20) (2006).

<sup>10</sup> *See* 7 U.S.C. 2(c)(2)(C)(iv).

<sup>11</sup> *See* 75 FR 3282, 3284–3285.

<sup>12</sup> The Comment letters referred to in this release are available through the Commission’s Web site: <http://www.cftc.gov/LawRegulation/PublicComments/10-001.html>.

reviewed futures exchange margin levels, NFA's current security deposit requirements, and comparable requirements found in other jurisdictions. Final Regulation 5.9 permits the registered futures association ("RFA") of which the FCM or RFED is a member to determine specific security deposit levels within parameters set forth by the Commission in the regulation.<sup>14</sup> The Commission has provided minimum security deposit amounts of 2 percent of the notional value for major currency pairs and 5 percent of the notional value for all other retail forex transactions. The Commission will periodically review the parameters it has set in light of market conditions and adjust them as necessary. Similarly, each RFA (*i.e.*, NFA) will be required to designate which currencies are "major currencies," and must review, no less frequently than annually, major currency designations and security deposit requirements, and must adjust the designations and requirements as necessary in light of changes in the volatility of currencies and other economic and market factors. It is the Commission's view that revised Regulation 5.9 will provide a mechanism for setting security deposit levels that is both anchored in, and adaptable to, market conditions.

*Disclosure of Profitable vs. Non-Profitable Accounts.* As proposed, Regulation 5.5(e) required that the risk disclosure statement provided to every retail forex customer include disclosure of the number of non-discretionary accounts maintained by the FCM or RFED that were profitable and those that were not, during the four most recent calendar quarters. Commenters called the provision anti-competitive and doubted that measurement of profitable accounts could be done in a way that would permit comparison. Proposed Regulation 5.18(i) required that each retail forex counterparty 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.

Some commenters asserted that the Commission did not provide adequate guidance or a standard methodology for calculating "winners" and "losers." Commenters stated that the proposal was ambiguous and that the reported percentages may not be comparable across the industry. In addition,

commenters thought that there was too much subjectivity in determining "winners" and "losers" and that, therefore, the resulting disclosure would not be helpful for customers. Other commenters stated that by requiring retail forex firms to disclose the percentage of profitable accounts quarterly, the Commission would be unfairly singling out retail forex dealers, as this information is not required on the futures side or for broker-dealers.

As noted in the Proposing Release, there are significant differences between trading futures contracts on an exchange and entering into off-exchange transactions between forex firms and retail customers.<sup>15</sup> The Commission believes that as a result of the inherent conflicts embedded in the operations of the retail over-the-counter forex industry, such disclosure is necessary. To illustrate potential conflicts of interests in the off-exchange retail forex industry, the Commission in its Proposing Release pointed out that the retail forex counterparty: (i) Is the counterparty to the customer, which sets up a "zero-sum game" between the customer and the retail forex dealer; (ii) provides quotes to their customers, which may not be the best quote at the time and may not even be a competitive quote; and (iii) enters into a principal-to-principal transaction with the non-discretionary retail forex accountholder. At each stage of the transaction, the retail forex counterparty has an inherent conflict with its non-discretionary retail forex accountholders. By contrast, in exchange-traded futures markets, accountholders do not encounter the same level of conflicts that retail forex customers face, and, therefore, a requirement to disclose the percentage of non-discretionary retail accounts that were profitable and not profitable is appropriate in retail forex markets, while it may not be elsewhere. As a result of the industry structure and operational conflicts, the Commission believes that this disclosure is necessary to protect the non-discretionary retail forex accountholder.

So while the Commission continues to believe in the value and effectiveness of such disclosures, it is adopting Regulation 5.5(e) and Regulation 5.18(i) with certain amendments, in order to address concerns regarding the implementation of the rule. As proposed, the calculation for determining whether a retail forex account was profitable or not during a quarter would be net of fees, commissions, any other expenses, trading results, customer funds

deposited, and customer funds withdrawn. The regulation as adopted provides further guidance in response to commenters' concerns. The final rule clarifies that a retail forex account will be considered either "profitable" or "not profitable," with "not profitable" including accounts that break-even.

The Commission is also clarifying the required time periods for which the required calculations in Regulation 5.5(e)(1) and 5.5(e)(2) must be made and records maintained and made available. Regulation 5.5(e)(1) requires that information regarding profitable and not profitable accounts for the four most recent quarters be included in disclosure documents; Regulation 5.5(e)(2) requires that similar quarterly information be maintained for five years and provided to requesting customers or potential customers. As to the 5.5(e)(1) information, once these regulations are effective, FCMs and RFEDs must provide the required information for the past four quarters. FCMs and RFEDs also must update this information going forward on a quarterly basis and disclose the most current four quarters in disclosure documents provided to potential customers.

Regulation 5.5(e)(2) requires an RFED or FCM to provide to a customer or potential customer the same account information as set out in Regulation 5.5(e)(1) for the most recent five-year period during which the RFED or FCM maintained non-discretionary retail forex customer accounts, but only at the request of the customer or potential customer. The Commission intends that this requirement to keep and make available five years worth of profitable and non-profitable account information be prospective; following the adoption of these rules, FCMs and RFEDs are required to keep and maintain such data going forward on a quarterly basis until such time as they have amassed five years worth of information, at which point they will have to keep and make available the information for the five most recent years. Furthermore, prior to amassing five years of performance information, an FCM or RFED is obligated to provide, upon request by a customer or prospective customer, the historical quarterly performance information for as many quarters as the FCM or RFED has available.

In addition, to provide clarity regarding the type of accounts that must be used in making the calculation of profitable and unprofitable accounts, FCMs and RFEDs must use those retail forex accounts, as defined in Regulation 5.1(i), that are non-discretionary accounts; *Provided*, that the retail forex account is not a proprietary account, as

<sup>14</sup> NFA is currently the only futures association registered with the Commission.

<sup>15</sup> See 75 FR 3282, 3285.

defined in Regulation 5.18(i)(3). The Commission believes that excluding proprietary accounts will help minimize the possibility of skewed results stemming from differing methods of calculation. The Commission is also requiring that the data be calculated on a calendar year basis for all counterparties.

**Guarantee Requirement for IBs Who Introduce Retail Forex Business.** The Commission proposed in Regulation 5.18(h) to require that any person within the definition of an IB under Regulation 5.1(f)(1) (or applicant for registration as such, or successor to the business of such) enter into a guarantee agreement with an FCM or an RFED. The IB would be permitted to enter such an agreement with only one FCM or RFED. The rationale behind this requirement was to make FCMs and RFEDs exercise care with regard to entities with which they do business by making them jointly and severally liable for all obligations of the IB under the Act and Commission Regulations with respect to the solicitation of retail forex transactions. This would, in turn, discourage them from associating with IBs without regard to the sales practices employed by those IBs.

Commenters called the banning of independent IBs in the retail forex business harsh and said it could lead to less customer choice and poorer service. Others said that requiring a guarantee agreement was anticompetitive and unnecessary, as most enforcement activity concerns unregistered industry participants, and that guarantee agreements have been a substitute for minimum capital for as long as the IB registration category has existed.

After considering the comments, the Commission has determined to permit IBs who register in order to transact retail forex business (like IBs who register to transact futures and commodity options business), to choose between entering into a guarantee agreement with an FCM or RFED, and maintaining the existing IB minimum net capital requirement. Accordingly, IBs, whether they register to do retail forex business, futures business, or both, must comply with the provisions in the Commission's regulations that apply to IBs; *Provided*, that any IB that operates pursuant to a guarantee agreement meeting the requirements of Regulation 1.10(j) need not meet the minimum net capital requirements set forth in Regulations 1.10, 1.12 and 1.17.

**Net Capital Requirements for FCMs and RFEDs.** As proposed, Regulation 5.7 implements the \$20 million minimum net capital requirement for FCMs engaging in retail forex transactions and

for RFEDs (as set forth in the CRA), and to the extent that the FCM's or RFED's total retail forex obligation to its customers exceeds \$10 million, the regulation requires an additional five percent of that excess. Several comments urged the Commission to revise proposed Regulation 5.7 to include an exemption from the additional net capital requirement when the FCM or RFED uses "straight-through processing."<sup>16</sup> Referring to the costs imposed by additional capital requirements, the commenters argued that such costs, in addition to the limits imposed by several of the other proposed regulatory requirements, would cause much of the retail forex business to be transferred to offshore jurisdictions without (or with substantially reduced) regulatory protections.<sup>17</sup>

The Commission considered but did not adopt NFA's straight-through processing exemption in its proposal, specifically because the proposed additional capital requirement was intended to provide a capital requirement that directly relates to the size of a firm's liability to retail forex customers. Some firms offering retail forex transactions have liabilities to their retail customers exceeding \$10 million. Straight-through processing, although mitigating market exposure for a firm, does not reduce in any way the total liability to retail forex customers who are direct counterparties to the firm and therefore exposed to the credit risk of such firm. Therefore, the Commission is adopting the capital provisions in Section 5.7 as originally proposed.

Separately, a comment letter was received significantly after the comment period was closed objecting to the net capital charges applicable to retail foreign currency options set forth in proposed Regulation 5.7(b)(2)(v)(B). The Commission has determined to adopt that provision as proposed, and to clarify that for both FCMs and RFEDs unlisted retail forex options are subject to the existing net capital charges that are applicable to an FCM for any other unlisted foreign currency option that is entered into with any eligible contract participant (which treatment is also consistent with the treatment of all unlisted options, including foreign

currency options, for securities broker-dealers).

**Requirement To Appoint a Chief Compliance Officer.** Proposed Regulation 5.18(j) calls for each retail forex counterparty (defined to include a retail foreign exchange dealer, an FCM or an affiliated person of an FCM) to designate a Chief Compliance Officer. In proposing this requirement, the Commission sought to promote customer protection by focusing responsibility for an entity's regulatory compliance. This requirement was criticized on the basis that potential personal liability for a Chief Compliance Officer would discourage individuals from assuming that position, and because no comparable requirement exists for firms engaging in on-exchange transactions.

The Commission continues to believe that, given the history of fraudulent and improper behavior in the retail forex business, requiring a Chief Compliance Officer is a reasonable way to ensure that retail forex counterparties observe the highest professional standards and take their compliance obligations seriously. Accordingly, this requirement is retained in final Regulation 5.18.

**Prohibition of Guarantees Against Customer Loss.** Proposed Regulation 5.16 would prohibit, among other things, the making of guarantees against loss to retail foreign exchange customers by FCMs, RFEDs and IBs. One currently registered FCM commented that firms should be allowed to guarantee that clients will not lose more than their account balance because technology allows for automatic liquidation of positions if the account balance falls below margin requirements.

The Commission notes that not all retail forex counterparties have comparable capabilities to deal with events such as extremely volatile markets. Moreover, proposed regulation 5.16 is based on Commission Regulation 1.56, which prohibits FCMs and IBs engaged in futures and commodity option transactions from making similar guarantees. At the time the Commission proposed Regulation 1.56, it specifically noted that the use of limited-risk and guarantee-against-loss agreements had "often been associated with patterns of allegedly unlawful conduct by FCMs or other registrants or with the financial instability of such persons."<sup>18</sup> The Commission does not view these dual concerns—rooted in consumer protection and the financial stability of firms—as any less compelling today and

<sup>16</sup> NFA's Financial Requirement Section 11 currently contains such an exemption from an additional capital requirement for member firms using straight-through-processing for all customer transactions.

<sup>17</sup> This argument is diminished by the recent enactment of the Wall Street Reform Act, which clearly indicates the intent of Congress that retail forex transactions in the United States either be comprehensively regulated or be prohibited outright. See Wall Street Reform Act, Sec. 742.

<sup>18</sup> See 46 Fed. Reg. 62841 (Dec. 29, 1981).

has determined to issue the regulation as proposed.

*Specific Authorization for Trades.*

Two commenters expressed a concern regarding proposed Regulation 5.17, which requires RFEDs, FCMs, IBs, and their APs to have specific authorization by the customer before effecting a retail forex transaction. The concerns centered on the use of automated systems that generate orders based on the trader's specifications. According to the commenters, both IBs and forex counterparties may run such software on their servers for traders.

Neither commenter provided a great deal of detail regarding the mechanics of such automated trading programs, and the Commission cannot offer its view of any particular program. However, the Commission believes that if such programs are nothing more than automated order entry platforms, and all relevant trading parameters are set and controlled by the customer—including, for example, the designation of the currency pair to be traded, the amount of currency to be bought or sold, the price at which orders should be placed, and the amount of money to be committed to trading—then trades generated by such programs would originate from the customer and no additional authorization would be required. However, Commission staff will monitor the use of such programs. Any features that would appear to constitute discretion, strategy or advice on the behalf of the sponsoring entity would require a different analysis and, in addition to potentially triggering application of Regulation 5.17, may have additional registration implications.

*Requirement To Close Out Offsetting Positions.* One commenter objected to the Commission's proposed amendment to Regulation 1.46, which would require RFEDs and FCMs engaging in off-exchange retail forex transactions to close out offsetting long and short positions in a retail forex customer's account, regardless of whether a customer instructs otherwise. Citing the prevalence of spread trades in futures trading, the commenter maintained that there is no economic distinction between commodity futures and forex transactions with respect to offsetting long and short positions.

The Commission continues to believe that maintaining open long and short positions in a retail forex customer's account removes the opportunity for the customer to profit on the transaction, increases the fees paid by the customer, and invites abuse. Nothing submitted by any commenter has demonstrated otherwise. Moreover, spread trades

executed on-exchange typically involve the purchase of one futures delivery month against the sale of another futures delivery month of the same commodity, or the purchase of one delivery month of one commodity against the sale of that same delivery month of a different commodity. Because retail forex contracts are not listed by delivery month, spread trades of this sort are not possible in retail forex accounts, and open long and short contracts in the same currency pair are truly offsetting. Accordingly, the Commission has determined to adopt Regulation 1.46 as proposed.

*Re-quoting.* Two comments were received regarding Regulation 5.18(f), which would, among other things, prohibit retail forex counterparties from providing a customer a new bid (or asked) price that is higher (or lower) than a previous price without providing a new asked (or bid) price that is higher (or lower) as well. One commenter maintained that the proposed rule would not take into account that in the forex market, spreads can increase dramatically, which might cause the new bid price to be higher and the new ask price to be lower.

While a fast-moving market may affect the spread, the Commission's proposed rule is intended to apply to those situations where a customer is quoted one bid/asked price, and rather than fill the order, the FCM or RFED provides a second quote. In this situation, the Commission believes that if the forex dealer re-quotes the price, then at a minimum, the spread should remain the same.

A second commenter suggested that the Commission clarify that all "re-quote" practices are required to be objective and evenhanded and that a counterparty that re-quotes a price must do so regardless of the direction the market moves. Further, the commenter suggested that the Commission require counterparties to disclose to customers how orders that reach the platform at a price no longer available are handled.

The Commission believes the intent of proposed Regulation 5.18 is clear. It requires that, when re-quoting prices, forex counterparties are obligated to do so in a symmetrical fashion, so that the re-quoted prices do not represent an increase in the spread from the initially quoted prices, regardless of the direction the market moves. As to the objectiveness of the re-quote, the Commission believes that the requirement that both bid and asked prices be re-quoted symmetrically will encourage objectivity. Moreover, proposed Regulations 5.18(b)(3) and 5.18(b)(iv) require, respectively, that

forex counterparties establish and enforce internal rules, procedures and controls to "[f]airly and objectively establish settlement prices for retail forex transactions" and to maintain records reflecting "any method or algorithm used to determine the bid or asked price for any retail forex transaction or the prices at which the customer orders are executed \* \* \*." The Commission believes that this should provide adequate incentive for firms to deal fairly and objectively with their customers with regard to re-quoting.

Finally, as to the suggested disclosure, as proposed, Regulation 5.5 would require FCMs, RFEDs and IBs engaged in retail forex transactions to distribute to retail forex customers a written disclosure statement containing, among other things, the following statement:

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.

While the proposed disclosure language does not require a statement regarding how re-quoted prices are handled, it does inform the customer that it is within the discretion of the forex dealer to set prices (provided they otherwise comply with the requirements of Regulation 5.18). For this reason, and those cited above, the Commission has determined to issue Regulation 5.18(f) as proposed.

*CFTC Authority To Regulate Zelener Contracts.* One commenter, a law firm, argued that the CRA did not grant the Commission the authority to regulate, other than for fraud, FCMs that are primarily or substantially engaged in trading futures contracts on registered exchanges to the extent they also offer off-exchange *Zelener*, or "futures look-alike" forex, contracts.<sup>19</sup> To the extent legislative history suggests that similarly situated RFEDs and FCMs should be subject to the same regulations, the

<sup>19</sup> See 7 U.S.C. 2(c)(2)(C)(ii) and 2(c)(2)(C)(iii) regarding the scope of the Commission's authority to write rules with regard to leveraged or margined foreign currency contracts offered to non-ECPs.

commenter maintains that this language is restricted to requirements relating to the financial soundness of the forex dealer and nothing else.

The CRA contains several provisions that touch on the scope of the Commission's jurisdiction over retail off-exchange foreign currency contracts, whether futures or look-alike, leveraged contracts. Retail 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), 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>20</sup> The same provisions apply to look-alike forex transactions.<sup>21</sup> The CRA clearly gives the Commission 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>22</sup> On the other hand, however, while the CRA explicitly grants the Commission rulemaking authority over off-exchange retail futures and options transactions where such transactions are offered or entered into by FCMs, their affiliates or RFEDs,<sup>23</sup> its rulemaking authority with regard to look-alike transactions does not explicitly include FCMs. Thus, the commenter concludes that language in Sections 2(c)(2)(C)(ii) and 2(c)(2)(C)(iii) limits the Commission's authority in this area where FCMs are concerned.

The Commission disagrees. Section 8a(5) of the Act gives the Commission the broadest possible authority to "make and promulgate such rules and regulations as, in the judgment of the Commission, are reasonably necessary to effectuate any of the provisions or to accomplish any of the purposes of this Act[.]"<sup>24</sup> Under this authority, the Commission has promulgated rules covering the full scope of FCM activities generally. Furthermore, the recent Wall Street Reform and Consumer Protection Act of 2010 specifically defines FCMs as any "individual, association, partnership, corporation, or trust \* \* \* that \* \* \* is \* \* \* acting as a counterparty in any agreement, contract or transaction described in Section 2(c)(2)(C)(i) of the Act,"<sup>25</sup> making it clear that the offering of "look-alike" transactions falls within the scope of

regulated FCM activity. Accordingly, the Commission sees no deficiencies in its authority to fully regulate FCMs engaged in "look-alike" forex contracts.<sup>26</sup>

*Definition of Retail Forex Transactions.* One commenter pointed out that the definition of "retail forex transactions" found in proposed Regulation 5.1(m) refers to "any account, agreement, contract or transaction" described in Section 2(c)(2)(B) or 2(c)(2)(C) of the Act and notes that the use of the word "account" in this context is confusing.

Broad language in Section 2(c)(2)(B)(i) of the Act provides the Commission with jurisdiction over "an agreement, contract or transaction in foreign currency" that is a contract of sale of a commodity for future delivery (or an option on such a contract) or an option (other than one traded on a securities exchange). Elsewhere in Section 2(c), the statute states that certain of its provisions apply to "agreements, contracts or transactions \* \* \* and accounts or pooled investment vehicles \* \* \*."<sup>27</sup> In order to accurately reflect the full scope of authority granted it under the Act, the Commission included the word "accounts" within the definition of "retail forex transactions." The Commission does not view this as in any way inconsistent with language in Section 2(c), as amended by the CRA, and has determined to adopt the regulation as proposed.

*Anticompetitiveness.* In addition to similar comments specifically referencing proposed Regulation 5.9 (security deposits) and 5.18(h) (guaranteed IBs)—which are addressed above—the Commission received numerous comments arguing that various other sections of the proposed rules were "anticompetitive" insofar as there is no comparable requirement relative to those engaged in futures transactions on designated contract markets. As the Commission pointed out in its Proposing Release, it has, whenever possible, drawn upon the principles that have guided it in the

regulation of on-exchange instruments. However, the Commission also noted that there are essential differences between the trading futures contracts on designated contract markets that are cleared through designated clearing organizations, on the one hand, and off-exchange transactions between forex firms and retail customers, on the other.<sup>28</sup>

Given the principal-to-principal nature of retail forex transactions and the inherent conflicts of interest in the relationship between the retail customer and the dealer/counterparty, the lack of transparency in the pricing and execution of such transactions, and the volume of fraud the Commission has seen arising from such transactions, the Commission has determined to promulgate some regulations that are unique to, and tailored to, retail forex transactions. By way of example, the Commission's proposed regulations included requirements that forex registrants maintain records of customer complaints; that counterparties disclose, with the Risk Disclosure Statement, the percentage of profitable nondiscretionary forex customer accounts; and that forex counterparties designate a chief compliance officer to be responsible for development and implementation of customer protection policies and procedures. To the extent the final rules published today do not track precisely with rules applicable to on-exchange futures trading, the Commission believes that the differences reflect meaningful differences in the market structure of retail forex transactions and that the rules issued today are no more restrictive or burdensome than necessary to address these differences.

*Scope of Commission's Authority and Application of Other Rules.* Several commenters lodged criticisms or made observations that go to the scope of the Commission's authority, as provided in the Act and CRA, or otherwise. For example, several commenters maintained that the Commission should require segregation of customer funds by counterparties in order to provide some protection in the event of a counterparty insolvency. The Commission's segregation requirements with regard to futures flow from Section 4d of the Act<sup>29</sup> which, generally speaking, requires that customer property for trading commodity contracts be kept apart, or segregated, from the FCM's own funds. However, as noted in the

<sup>20</sup> See 7 U.S.C. 2(c)(2)(B)(iii).

<sup>21</sup> See 7 U.S.C. 2(c)(2)(C)(ii)(I).

<sup>22</sup> See 7 U.S.C. 2(c)(2)(B)(iv)(III); 2(c)(2)(B)(v); 2(c)(2)(C)(ii)(III); 2(c)(2)(C)(iii)(III).

<sup>23</sup> See 7 U.S.C. 2(c)(2)(B)(v).

<sup>24</sup> See 7 U.S.C. 12a(5) (2006).

<sup>25</sup> See Wall Street Reform Act, Sec. 721(a)(13).

<sup>26</sup> The Commission also disagrees with the argument that CRA Conference Report language is inapposite. The Conference Report states that "[t]o 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. The managers do not intend for the Commission to provide either FCMs or RFEDs with a more favorable regulatory environment over the other or to create two significantly different regulatory regimes for similar business models—to the extent the financial risks posed by such operations are similar." See H.R. Rep. No. 110–627 at 980 (Conf. Rep.) (emphasis added).

<sup>27</sup> See, for example, 7 U.S.C. 2(c)(2)(B)(iii).

<sup>28</sup> 75 FR 3282, 3285–86.

<sup>29</sup> 7 U.S.C. 6(c) (2006).

Commission's proposing release,<sup>30</sup> a segregated funds regime cannot be replicated in the context of off-exchange retail forex trading. Unlike segregation of customer funds deposited for futures trading, under the relevant provisions of the Bankruptcy Code,<sup>31</sup> such amounts held in connection with retail forex trading would not receive any preferential treatment to unsecured creditors in bankruptcy.

Similarly, some commenters took issue with the definitions of certain intermediaries and the capital requirements, found in the Proposing Release. Here again, the Commission is bound by statutory language that defines the scope of its authority.<sup>32</sup> While the Commission appreciates the concerns expressed by these commenters and the time they have taken to express them, it can do no more than its statutory authority permits.

### III. Related Matters

#### A. Regulatory Flexibility Act

*FCMs and CPOs:* The Regulatory Flexibility Act ("RFA")<sup>33</sup> requires that agencies, in proposing rules, consider the impact of those rules on small businesses.<sup>34</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>35</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>36</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>37</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>38</sup>)

Thus, with respect to FCMs and registered CPOs, the Commission believes that these final rules 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>39</sup> CTAs 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>40</sup>

*IBs:* In 1983, the Commission proposed that for purposes of the RFA and future rulemakings, it 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>41</sup> This was based, in part, on the fact that IBs, like FCMs, are required to maintain a specified level of adjusted net capital. In the Proposing Release, retail forex IBs would not have been subject to a capital requirement; rather, they would have had to operate pursuant to a guarantee agreement. Under the final rules, retail forex IBs will be treated no differently than futures IBs. Accordingly, and in keeping with past Commission determinations, the Commission believes that the final rules with respect to IBs will not have a significant impact on a substantial number of small entities.

*RFEDs:* RFEDs are a new category of registrant. 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. In the Proposing Release, the Commission proposed 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>42</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 will not define RFEDs as small entities for RFA purposes.

#### B. Paperwork Reduction Act

Under the Paperwork Reduction Act of 1995 ("PRA")<sup>43</sup> an agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a currently valid control number. The Commission's final rules regarding retail forex transactions result in information collection requirements within the meaning of the PRA. The Commission submitted the proposing release along with supporting documentation to the Office of Management and Budget ("OMB") for review in accordance with 44 U.S.C. 3507(d) and 5 CFR 1320.11. The Commission requested that OMB approve, and with respect to the collections required under the new part 5 of the Commission's regulations, assign a new control number for, the collections of information required by the proposing release. The information collection burdens created by the Commission's proposed rules, which were discussed in detail in the proposing release, are identical to the collective information collection burdens of the final rules.

The Commission invited the public and other Federal agencies to comment on any aspect of the information

<sup>30</sup> 75 FR 3281, 3287 and 3290 (Jan. 20, 2010).

<sup>31</sup> 11 U.S.C. 761, *et seq.*

<sup>32</sup> See, for example, Section 2(c)(2)(B)(iv)(I) of the Act, 7 U.S.C. 2(c)(2)(B)(iv)(I), which provides the Commission with the authority to register and promulgate rules regarding specifically defined persons or entities. See also Section 2(c)(2)(B)(ii) of the Act which explicitly provides for a \$20 million minimum capital requirement.

<sup>33</sup> 5 U.S.C. 601, *et seq.*

<sup>34</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>35</sup> 47 FR 18618 (April 30, 1982).

<sup>36</sup> *Id.* at 18619.

<sup>37</sup> *Id.* at 18619–20.

<sup>38</sup> 17 CFR 4.13(a)(2) (2009).

<sup>39</sup> 47 FR 18618, 18620.

<sup>40</sup> 48 FR 35248, 35276 (August 3, 1983)

<sup>41</sup> 48 FR 14933, 14955 (Apr. 6, 1983). See also 47 FR 18618, 18619.

<sup>42</sup> *Id.*

<sup>43</sup> 44 U.S.C. 3501, *et seq.*



collection requirements discussed above. The Commission received no comment on its burden estimates or on any other aspect of the information collection requirements contained in its proposing release. The affected collections are as follows:

- Existing Collection 3038–0024 (part 1 of the Commission's regulations);
- Existing Collection 3038–0023 (part 3 of the Commission's regulations);
- Existing Collection 3038–0005 (part 4 of the Commission's regulations);
- Existing Collection 3038–0055 (part 160 of the Commission's regulations); and
- New Collection 3038–0062 (part 5 of the Commission's regulations).

### C. Cost-Benefit Analysis

Section 15(a) of the Act<sup>44</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, these amendments are intended to create a comprehensive scheme to implement the requirements of the CRA, and to put in place requirements including registration, disclosure, recordkeeping, financial reporting, minimum capital and other operational standards. This is to 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 and benefits of the amendments in light of the specific provisions of section 15(a) as follows:

1. Protection of market participants and the public. The amendments should enhance considerably the protection of market participants and the public because they require, for the first time,

the registration of several categories of market participants and require adherence to operational standards that have 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>45</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 part 5 that are analogous to regulations imposed upon intermediaries engaged in on-exchange transactions. Accordingly, the Commission believes that it has provided an even handed regulatory scheme that will be familiar to industry participants.

3. Financial integrity of futures markets and price discovery. The amendments 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 amendments include 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 amendments are beneficial in that they will provide needed protections for members of the public engaging in these transactions. The amendments 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 adopt the proposed rule changes. The Commission did not receive any comments relative to its analysis of the cost-benefit provision.

### 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.

<sup>44</sup> 7 U.S.C. 19(a).

<sup>45</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.



## 17 CFR Part 166

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

■ For the reasons presented above, the Commission hereby amends 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:

### § 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) of this chapter. 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) introductory text, (c)(1), and (c)(2);

■ 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 of this chapter 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) of this chapter 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 paragraphs (c)

introductory text, (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.

\* \* \* \* \*

■ 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)(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 required minimum security deposit for retail forex transactions (as defined in § 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 required 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) of this chapter 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 required minimum security deposit for retail forex transactions (as defined in § 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);
- g. Revising paragraphs (j)(1)(vi) and (j)(3); and
- h. Revising paragraphs (l)(1)(iii), (l)(2) introductory text and (l)(2)(i).

The addition and revisions 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 § 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.

\* \* \* \* \*

(l) \* \* \*

(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) \* \* \*

(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(m) 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 § 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 § 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 calendar quarters during which the counterparty maintained retail forex customer accounts:

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

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

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

(2) Identification of retail forex customer accounts for the purpose of this disclosure and the calculation in determining whether each such account was profitable or not profitable 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 foreign exchange dealer or futures commission merchant, the percentage of such accounts that were profitable and the percentage of such accounts that were not profitable, calculated in accordance with § 5.18(i) of this part, for each calendar quarter during the most recent five year period during which such retail foreign exchange dealer or futures commission merchant maintained non discretionary retail forex customer 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 for each retail forex transaction equal to the applicable percentage as set by the registered futures association of which they are a member; *Provided*, that the registered futures association's security deposit requirement cannot be less than:

(1) 2% of the notional value of the retail forex transaction for major currency pairs and 5% of the notional value of the retail forex transaction for all other currency pairs;

(2) For short options, 2% for major currency pairs and 5% for all other currency pairs of the notional value of the retail forex transaction, plus the premium received by the retail forex customer; or

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

(b) Security deposits must be made in the form of cash or other financial instruments that comply with the requirements specified in § 1.25 of this chapter.

(c) 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 of this section.

(d) A major currency pair security deposit percentage is only applicable when both sides of a retail over-the-counter foreign exchange transaction involve major currencies.

(e) Any registered futures association whose members serve as counterparties to retail forex transaction shall designate which currencies are "major currencies", and shall review, no less frequently than annually, major currency designations and security deposit requirements, and shall adjust the designations and requirements as necessary.

#### **§ 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 § 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 § 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) of this section 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 options 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.

(f) *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 (f) 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.

(g) *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 October 18, 2010, 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 § 5.1(f)(1) of this part, applicant for registration as an introducing broker as defined in § 5.1(f)(1) of this part, or person succeeding to and continuing the business of another introducing broker as defined in § 5.1(f)(1) of this part must comply with all provisions applicable to an introducing broker under this chapter; *Provided, however*, that an introducing broker operating pursuant to, or an applicant for registration as an introducing broker who has filed concurrently with its application for registration, a guarantee agreement meeting the requirements of § 1.10(j) of this chapter is not subject to the minimum capital and related financial reporting requirements of §§ 1.10, 1.12 and 1.17 of this chapter.

(i)(1) Each retail forex counterparty shall prepare and maintain on a quarterly basis (calendar quarter) a calculation of the percentage of nondiscretionary retail forex customer accounts open for any period of time during the quarter that were profitable, and the percentage of such accounts that were not profitable. In calculating whether a retail forex account was profitable or not profitable during the quarter, the FCM or RFED must compute the realized and unrealized gains and/or losses on all retail forex transactions carried in the retail forex account at any time during the quarter, and subtract all fees, commissions, and any other charges posted to the retail forex account during the quarter, and add any interest income and other income or rebates credited to the retail forex account during the quarter. All deposits and/or withdrawals of funds made by a retail forex customer during the quarter must be excluded from the computation of whether the retail forex account was profitable or not profitable during the quarter. Computations that result in a zero or negative number shall be considered a retail forex account that was not profitable. Computations that result in a positive number shall be considered a retail forex account that was profitable. RFEDs and FCMs shall maintain such calculations along with data supporting such calculations for five years in accordance with § 1.31.

(2) In calculating its percentages of nondiscretionary retail forex customer accounts that were profitable or not profitable, the retail forex counterparty may only use those retail forex accounts, as defined in § 5.1(i) of this part, that are nondiscretionary accounts; provided, that the retail forex account is not a proprietary account, as defined in paragraph (i)(3) of this section.

(3) Proprietary account for this section means a retail forex account carried on

the books of a retail foreign exchange dealer or a futures commission merchant for one of the following persons, or of which ten percent or more is owned by one of the following persons, or of which an aggregate of ten percent or more of which is owned by more than one of the following persons:

(i) Such retail foreign exchange dealer or futures commission merchant itself;

(ii) If the retail foreign exchange dealer or futures commission merchant is a partnership, a general partner in such partnership;

(iii) If the retail foreign exchange dealer or futures commission merchant is a limited partnership, a limited or special partner in such partnership whose duties include:

(A) The management of the partnership business or any part thereof,

(B) The handling of retail forex transactions of such partnership,

(C) The keeping of records pertaining to retail forex transactions, or

(D) The signing or co-signing of checks or drafts on behalf of such partnership;

(iv) If the retail foreign exchange dealer or futures commission merchant is a corporation or association, an officer, director or owner of ten percent or more of the capital stock, of such organization;

(v) An employee of such retail foreign exchange dealer or futures commission merchant whose duties include:

(A) The management of the business of such retail foreign exchange dealer or futures commission merchant or any part thereof,

(B) The handling of retail forex transactions of such retail foreign exchange dealer or futures commission merchant,

(C) The keeping of records pertaining to retail forex transactions of such retail foreign exchange dealer or futures commission merchant, or

(D) The signing or co-signing of checks or drafts on behalf of such retail foreign exchange dealer or futures commission merchant;

(vi) A spouse or minor dependent living in the same household of any of the foregoing persons;

(vii) A business affiliate that directly or indirectly controls such retail foreign exchange dealer or futures commission merchant; or

(viii) A business affiliate that, directly or indirectly is controlled by or is under common control with, such retail foreign exchange dealer or futures commission merchant.

(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 October 18, 2010 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 positions 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 PROCEDURES 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 added 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 31.13(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);

\* \* \* \* \*

#### 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 continues to read 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 to read 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) \* \* \* (1) \* \* \*

(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.

\* \* \* \* \*

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**David A. Stawick,**  
*Secretary of the Commission.*

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