



# Commodity Futures Trading Commission

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## Final Rule Regarding Retail Foreign Exchange Transactions

The Commodity Futures Trading Commission (CFTC) announced the publication in the Federal Register of final regulations concerning off-exchange retail foreign currency transactions. The rules implement provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act as well as the Food, Conservation, and Energy Act of 2008.

**On May 22, 2008, the Congress passed the CFTC Reauthorization Act of 2008 (CRA) as part of the Farm Bill. Among other things, the CRA amended the CEA to:**

- Clarify that the CFTC's anti-fraud authority applies to certain retail off-exchange foreign currency transactions,
- Create a new registration category for retail foreign exchange dealers,
- Require registration with the CFTC for those who solicit orders, exercise discretionary trading authority and operate pools with respect to retail off-exchange foreign currency transactions,
- Impose minimum capital requirements for futures commission merchants and retail foreign exchange dealers that act as counterparties to such transactions, and
- Grant the Commission broad rulemaking authority over off-exchange, retail foreign currency contracts (retail forex) to implement any of the purposes of the CEA.

**On July 21, 2010, the Congress passed the Dodd-Frank Wall Street Reform and Consumer Protection Act. Among other things, the Dodd-Frank Act further amended the CEA to:**

- Require that all off-exchange retail foreign currency transactions be done pursuant to the rules of a Federal regulatory agency.
- Require that Federal regulators prepare rules regarding off-exchange retail forex transactions within specified time periods, or the transactions are prohibited. If any Federal regulatory agency had already proposed such rules, the prohibition is to take effect 90 days following enactment unless such proposed rules are sooner finalized and adopted.
- Require that such rules include appropriate requirements with respect to:
  - Disclosure;
  - Recordkeeping;
  - Capital and margin;
  - Reporting;
  - Business conduct;
  - Documentation; and
  - Such other standards or requirements as the Federal regulatory agency shall determine to be necessary.

**On January 13, 2010, the Commission issued proposed rules to implement the CRA, providing a comprehensive regulatory scheme for the offer and sale of off-exchange retail forex.**

The comment period closed on March 22, 2010, and the Commission received more than 9,100 comments.

## The Commission's proposed rules called for:

- Persons offering to be or acting as a counterparty to retail forex transactions to be registered as retail foreign exchange dealers (RFEDs) or futures commission merchants (FCMs) with the CFTC, unless they are regulated by another Federal regulatory agency.
- Registration for persons who solicit orders, exercise discretionary trading authority and operate pools with respect to off-exchange retail forex.
- All retail forex counterparties and intermediaries to provide risk disclosure statements to retail forex customers comparable to those currently required for on-exchange futures trading.
- Disclosure by FCMs and RFEDs of the number of non-discretionary retail forex accounts maintained by the FCM or RFED and the percentage of such accounts that were profitable for each of the four most recent quarters.
- A minimum capital requirement for FCMs or RFEDs of \$20 million; additionally, FCMs or RFEDs that maintain liabilities to retail forex customers in excess of \$10 million would be required to maintain capital of \$20 million, plus 5% of the amount of the customer liabilities in excess of \$10 million.
- Each FCM or RFED to hold liquid assets equal to or in excess of the total amount of the firm's obligation to retail forex customers in bank accounts or broker accounts.
- A 10-to-1 leverage limitation on retail forex customers.
- All retail forex counterparties and intermediaries to maintain records of all communications they receive concerning possible violations of the Act or regulations involving their retail forex business and report such communications to the Division of Enforcement within prescribed time periods.
- 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 business.
- All retail forex counterparties to designate at least one principal to serve as a chief compliance officer who would be required to certify annually to the Commission and NFA that the firm has in place policies and procedures reasonably designed to achieve compliance with the Act and the Commission's regulations.
- All retail forex counterparties and intermediaries to disclose pending legal matters to the Commission.

## The Commission's final rules implementing the provisions of the CRA and Dodd-Frank Act adopt the proposed rules as proposed with some notable exceptions.

The proposed 10 to 1 leverage restriction has been replaced with a mechanism whereby the Commission sets parameters (the release specifies a minimum 2 percent security deposit in the case of major currencies and 5 percent of the notional value of the transaction for all other currencies) and periodically reviews the appropriateness of those parameters. NFA is authorized to set specific security deposit levels within those parameters, and is required to review periodically and adjust as necessary both the particular security deposit levels and the designation of which currencies are "major" currencies, in light of such factors as changes in volatility.

The proposed requirement that a person who registers as an IB to introduce retail forex accounts must be guaranteed by a registered FCM or RFED (and that the IB could be guaranteed by only one FCM or RFED) has been replaced with the same requirement that currently applies to IBs who introduce futures and commodity interest accounts. A forex IB may choose either to meet the minimum net capital requirements applicable to futures and commodity options IBs, or to enter into a guarantee agreement with an FCM or an RFED.

The final rules retain the requirement for RFEDs and FCMs that engage in retail forex transactions to disclose on a quarterly basis the percentage of non-discretionary accounts that realized a profit and to keep and make available records of that calculation. The final rule, however, clarifies that a retail forex account will be considered either "profitable" or "not profitable," with "not profitable" including accounts that break-even. Further, only non-discretionary accounts that are not proprietary are to be considered. Finally, the recordkeeping requirement is prospective and will not require reconstruction of transactions pre-dating the effectiveness of the final rules except insofar as necessary to comply with the requirement that disclosure documents include a statement of profitable and not-profitable accounts for the preceding four quarters.