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PART 1—GENERAL REGULATIONS UNDER THE COMMODITY EXCHANGE ACT

DEFINITIONS

Sec.
1.1 Fraud in or in connection with transactions in foreign currency subject to the Commodity Exchange Act.
1.2 Liability of principal for act of agent.
1.3 Definitions.
1.4 Use of electronic signatures.

MINIMUM FINANCIAL AND RELATED REPORTING REQUIREMENTS

1.10 Financial reports of futures commission merchants and introducing brokers.
1.11 [Reserved]
1.12 Maintenance of minimum financial requirements by futures commission merchants and introducing brokers.
1.13 [Reserved]
1.14 Risk assessment recordkeeping requirements for futures commission merchants.
1.15 Risk assessment reporting requirements for futures commission merchants.
1.16 Qualifications and reports of accountants.
1.17 Minimum financial requirements for futures commission merchants and introducing brokers.
1.18 Records for and relating to financial reporting and monthly computation by futures commission merchants and introducing brokers.

PROHIBITED TRADING IN COMMODITY OPTIONS

1.19 Prohibited trading in certain ''puts'' and ''calls''.

CUSTOMERS' MONEY, SECURITIES, AND PROPERTY

1.20 Customer funds to be segregated and separately accounted for.
1.21 Care of money and equities accruing to customers.
1.22 Use of customer funds restricted.
1.23 Interest of futures commission merchant in segregated funds; additions and withdrawals.
1.24 Segregated funds; exclusions therefrom.
1.25 Investment of customer funds.
1.26 Deposit of instruments purchased with customer funds.
1.27 Record of investments.
1.28 Appraisal of instruments purchased with customer funds.
1.29 Increment or interest resulting from investment of customer funds.
1.30 Loans by futures commission merchants; treatment of proceeds.

RECORDKEEPING

1.31 Books and records; keeping and inspection.
1.32 Segregated account; daily computation and record.
1.33 Monthly and confirmation statements.
1.34 Monthly record, ''point balance''.
1.35 Records of cash commodity, futures, and option transactions.
1.36 Record of securities and property received from customers and option customers.
1.37 Customer's or option customer's name, address, and occupation recorded; record of guarantor or controller of account.
1.38 Execution of transactions.
1.39 Simultaneous buying and selling orders of different principals; execution of, for and between principals.

MISCELLANEOUS

1.40 Crop, market information letters, reports; copies required.
1.41 [Reserved]
1.41a–1.41c [Reserved]
1.42–1.43 [Reserved]
1.44 Records and reports of warehouses, depositories, and other similar entities; visitation of premises.
1.45 [Reserved]
1.46 Application and closing out of offsetting long and short positions.
1.47 Requirements for classification of purchases or sales of contracts for future delivery as bona fide hedging under §1.3(z)(3) of the regulations.
1.48 Requirements for classification of sales or purchases for future delivery as bona fide hedging of unsold anticipated production or unfilled anticipated requirements under §1.3(z)(2) (i)(B) or (ii)(C) of the regulations.
1.49 Denomination of customer funds and location of depositories.
1.50–1.51 [Reserved]
1.52 Self-regulatory organization adoption and surveillance of minimum financial requirements.
1.53 Enforcement of contract market bylaws, rules, regulations, and resolutions.
1.54 Contract market rules submitted to and approved or not disapproved by the Secretary of Agriculture.
1.55 Distribution of ''Risk Disclosure Statement'' by futures commission merchants and introducing brokers.
1.56 Prohibition of guarantees against loss.
1.57 Operations and activities of introducing brokers.
1.58 Gross collection of exchange-set margins.
1.59 Activities of self-regulatory organization employees, governing board members, committee members, and consultants.
1.60 Pending legal proceedings.

1.61 [Reserved]
1.62 Contract market requirement for floor broker and floor trader registration.
1.63 Service on self-regulatory organization governing boards or committees by persons with disciplinary histories.
1.64 Composition of various self-regulatory organization governing boards and major disciplinary committees.
1.65 Notice of bulk transfers and disclosure obligations to customers.
1.66 No-action positions with respect to floor traders.
1.67 Notification of final disciplinary action involving financial harm to a customer.
1.68 Customer election not to have funds, carried by a futures commission merchant for trading on a registered derivatives transaction execution facility, separately accounted for and segregated.
1.69 Voting by interested members of self-regulatory organization governing boards and various committees.
1.70 Notification of State enforcement actions brought under the Commodity Exchange Act.

APPENDIX A TO PART 1 [RESERVED]
APPENDIX B TO PART 1—FEES FOR CONTRACT MARKET RULE ENFORCEMENT REVIEWS AND FINANCIAL REVIEWS

AUTHORITY: 7 U.S.C. 1a, 2, 5, 6, 6a, 6b, 6c, 6d, 6e, 6f, 6g, 6h, 6i, 6j, 6k, 6l, 6m, 6n, 6o, 6p, 7, 7a, 7b, 8, 9, 12, 12a, 12c, 13a, 13a–1, 16, 16a, 19, 21, 23, and 24, as amended by the Commodity Futures Modernization Act of 2000, Appendix E of Pub. L. 106–554, 114 Stat. 2763 (2000).

SOURCE: 41 FR 3194, Jan. 21, 1976, unless otherwise noted.

DEFINITIONS

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

(a) *Scope.* The provisions of this section shall be applicable to accounts, agreements, contracts, or transactions described in section 2(c)(1) of the Act, to the extent that the Commission exercises jurisdiction over such accounts, agreements, contracts and transactions as provided in section 2(c)(2)(B) of the Act (except that this section shall not be applicable to persons described in section 2(c)(2)(B)(ii)(II) or 2(c)(2)(B)(ii)(III) of the Act).

(b) *Fraudulent conduct prohibited.* It shall be unlawful for any person, directly or indirectly, in or in connection with any account, agreement, contract or transaction that is subject to paragraph (a) of this section:

(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.

[66 FR 42269, Aug. 10, 2001]

§ 1.2 Liability of principal for act of agent.

The act, omission, or failure of any official, agent, or other person acting for any individual, association, partnership, corporation, or trust, within the scope of his employment or office, shall be deemed the act, omission, or failure of such individual, association, partnership, corporation, or trust as well as of such official, agent, or other person.

§ 1.3 Definitions.

Words used in the singular form in the rules and regulations in this chapter shall be deemed to import the plural and vice versa, as the context may require. The following terms, as used in the Commodity Exchange Act, or in the rules and regulations in this chapter, shall have the meanings hereby assigned to them, unless the context otherwise requires:

(a) *Board of Trade.* This term means any exchange or association, whether incorporated or unincorporated, of persons who shall be engaged in the business of buying or selling any commodity or receiving the same for sale on consignment.

(b) *Business day.* This term means any day other than a Sunday or holiday. In all notices required by the act or by the rules and regulations in this chapter to be given in terms of business days the rule for computing time shall be to exclude the day on which notice is given and include the day on which shall take place the act of which notice is given.

(c) *Clearing member.* This term means any person who is a member of, or enjoys the privilege of clearing trades in his own name through, the clearing organization of a contract market.

(d) *Clearing organization.* This term means the person or organization

which acts as a medium for clearing transactions in commodities for future delivery or commodity option transactions, or for effecting settlements of contracts for future delivery or commodity option transactions, for and between members of any contract market.

(e) *Commodity*. This term means and includes wheat, cotton, rice, corn, oats, barley, rye, flaxseed, grain sorghums, millfeeds, butter, eggs, Irish potatoes, wool, wool tops, fats and oils (including lard, tallow, cottonseed oil, peanut oil, soybean oil, and all other fats and oils), cottonseed meal, cottonseed, peanuts, soybeans, soybean meal, livestock, livestock products, and frozen concentrated orange juice, and all other goods and articles, except onions as provided in Pub. L. 85–839, and all services, rights and interests in which contracts for future delivery are presently or in the future dealt in.

(Sec. 2(a)(1), 88 Stat. 1395; 7 U.S.C. 2(1))

(f) *Commodity Exchange Act; the Act*. These terms mean the Commodity Exchange Act, as amended, 7 U.S.C. 1 et seq.

(g) *Institutional customer*. This term has the same meaning as ''eligible contract participant'' as defined in section 1a(12) of the Act.

(h) *Contract market*. This term means a board of trade designated by the Commission as a contract market under the Commodity Exchange Act or in accordance with the provisions of part 33 of this chapter.

(i) *Contract of sale*. This term includes sales, purchases, agreements of sale or purchase and agreements to sell or purchase.

(j) *Controlled account*. An account shall be deemed to be controlled by a person if such person by power of attorney or otherwise actually directs trading for such account.

(k) *Customer; commodity customer*. These terms have the same meaning and refer to a customer trading in any commodity named in the definition of commodity herein: *Provided, however,* An owner or holder of a proprietary account as defined in paragraph (y) of this section shall not be deemed to be a customer within the meaning of section 4d of the Act, the regulations that implement sections 4d and 4f of the Act and § 1.35, and such an owner or holder of such a proprietary account shall otherwise be deemed to be a customer within the meaning of the Act and §§ 1.37 and 1.46 and all other sections of these rules, regulations and orders which do not implement sections 4d and 4f.

(l) *Delivery month*. This term means the month of delivery specified in a contract of sale of any commodity for future delivery.

(m) [Reserved]

(n) *Floor broker*. This term means any person who, in or surrounding any pit, ring, post or other place provided by a contract market for the meeting of persons similarly engaged, shall purchase or sell for any other person any commodity for future delivery on or subject to the rules of any contract market and shall include any person required to register as a floor broker under the Act by virtue of part 33 of this chapter.

(o) *Future delivery*. This term does not include any sale of a cash commodity for deferred shipment or delivery.

(p) *Futures commission merchant*. This term means:

(1) Individuals, associations, partnerships, corporations, and trusts engaged in soliciting or in accepting orders for the purchase or sale of any commodity for future delivery on or subject to the rules of any contract market and that, in or in connection with such solicitation or acceptance of orders, accepts any money, securities, or property (or extends credit in lieu thereof) to margin, guarantee or secure any trades or contracts that result or may result therefrom; and

(2) Shall include any person required to register as a futures commission merchant under the Act by virtue of part 32 or part 33 of this chapter.

(q) *Member of a contract market*. This term means and includes individuals, associations, partnerships, corporations, and trusts owning or holding membership in, or admitted to membership representation on, a contract market or given members' trading privileges thereon.

(r) *Net equity*. This term means the credit balance which would be obtained

by combining the commodity margin balance of any person with the net profit or loss, if any, accruing on the open trades or contracts or commodity option transactions of such person.

(s) *Net deficit.* This term means the debit balance which would be obtained by combining the commodity margin balance of any person with the net profit or loss, if any, accruing on the open trades or contracts or commodity option transactions of such person.

(t) *Open contracts.* This term means contracts of purchase or sale of any commodity made by or for any person on or subject to the rules of a board of trade for future delivery during a specified month or delivery period which have not been fulfilled by delivery nor offset by other contracts of sale or purchase in the same commodity and delivery month.

(u) *Person.* This term includes individuals, associations, partnerships, corporations, and trusts.

(v) [Reserved]

(w) *Secretary of Agriculture.* This term means the Secretary of Agriculture or any person to whom authority has heretofore lawfully been delegated or to whom authority may hereafter lawfully be delegated to act in his stead.

(x) *Floor trader.* This term means any person who, in our surrounding any pit, ring, post, or other place provided by a contract market for the meeting of persons similarly engaged, purchases or sells solely for such person's own account, or has been authorized by a contract market to purchase or sell for such person's own account, any commodity for future delivery on or subject to the rules of any contract market and shall include any person required to register as a floor trader under the Act by virtue of part 33 of this chapter or by rule or regulation of the Commission pertaining to the operation of an electronic trading system.

(y) *Proprietary account.* This term means a commodity futures or commodity option trading account carried on the books and records of an individual, a partnership, corporation or other type association (1) for one of the following persons, or (2) of which ten percent or more is owned by one of the following persons, or an aggregate of ten percent or more of which is owned by more than one of the following persons:

(i) Such individual himself, or such partnership, corporation or association itself;

(ii) In the case of a partnership, a general partner in such partnership;

(iii) In the case of 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 the trades or customer funds of customers or option customers of such partnership,

(C) The keeping of records pertaining to the trades or customer funds of customers or option customers of such partnership, or

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

(iv) In the case of 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 individual, partnership, corporation or association whose duties include:

(A) The management of the business of such individual, partnership, corporation or association or any part thereof,

(B) The handling of the trades or customer funds of customers or option customers of such individual, partnership, corporation or association,

(C) The keeping of records pertaining to the trades or customer funds of customers or option customers of such individual, partnership, corporation or association, or

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

(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 individual, partnership, corporation or association.

(viii) A business affiliate that, directly or indirectly is controlled by or is under common control with, such individual, partnership, corporation or association. *Provided, however,* That an account owned by any shareholder or

member of a cooperative association of producers, within the meaning of sections 5(5) and 6a of the Act, which association is registered as a futures commission merchant and carries such account on its records, shall be deemed to be an account of a customer or option customer and not a proprietary account of such association, unless the shareholder or member is an officer, director or manager of the association.

(z) *Bona fide hedging transactions and positions*—(1) *General definition.* Bona fide hedging transactions and positions shall mean transactions or positions in a contract for future delivery on any contract market, or in a commodity option, where such transactions or positions normally represent a substitute for transactions to be made or positions to be taken at a later time in a physical marketing channel, and where they are economically appropriate to the reduction of risks in the conduct and management of a commercial enterprise, and where they arise from:

(i) The potential change in the value of assets which a person owns, produces, manufactures, processes, or merchandises or anticipates owning, producing, manufacturing, processing, or merchandising,

(ii) The potential change in the value of liabilities which a person owns or anticipates incurring, or

(iii) The potential change in the value of services which a person provides, purchases, or anticipates providing or purchasing.

Notwithstanding the foregoing, no transactions or positions shall be classified as bona fide hedging unless their purpose is to offset price risks incidental to commercial cash or spot operations and such positions are established and liquidated in an orderly manner in accordance with sound commercial practices and, for transactions or positions on contract markets subject to trading and position limits in effect pursuant to section 4a of the Act, unless the provisions of paragraphs (z) (2) and (3) of this section and §§ 1.47 and 1.48 of the regulations have been satisfied.

(2) *Enumerated hedging transactions.* The definitions of bona fide hedging transactions and positions in paragraph (z)(1) of this section includes, but is not limited to, the following specific transactions and positions:

(i) *Sales* of any commodity for future delivery on a contract market which do not exceed in quantity:

(A) Ownership or fixed-price purchase of the same cash commodity by the same person; and

(B) Twelve months' unsold anticipated production of the same commodity by the same person provided that no such position is maintained in any future during the five last trading days of that future.

(ii) *Purchases* of any commodity for future delivery on a contract market which do not exceed in quantity.

(A) The fixed-price sale of the same cash commodity by the same person.

(B) The quantity equivalent of fixed-price sales of the cash products and by-products of such commodity by the same person; and

(C) Twelve months' unfilled anticipated requirements of the same cash commodity for processing, manufacturing, or feeding by the same person, provided that such transactions and positions in the five last trading days of any one future do not exceed the person's unfilled anticipated requirements of the same cash commodity for that month and for the next succeeding month.

(iii) Offsetting sales and purchases for future delivery on a contract market which do not exceed in quantity that amount of the same cash commodity which has been bought and sold by the same person at unfixed prices basis different delivery months of the contract market, provided that no such position is maintained in any future during the five last trading days of that future.

(iv) Sales and purchases for future delivery described in paragraphs (z)(2)(i), (ii), and (iii) of this section may also be offset other than by the same quantity of the same cash commodity, provided that the fluctuations in value of the position for future delivery are substantially related to the fluctuations in value of the actual or anticipated cash position, and provided that the positions in any one future shall not be maintained during the five last trading days of that future.

(3) *Non-enumerated cases.* Upon specific request made in accordance with §1.47 of the regulations, the Commission may recognize transactions and positions other than those enumerated in paragraph (z)(2) of this section as bona fide hedging in such amount and under such terms and conditions as it may specify in accordance with the provisions of §1.47. Such transactions and positions may include, but are not limited to, purchases or sales for future delivery on any contract market by an agent who does not own or who has not contracted to sell or purchase the offsetting cash commodity at a fixed price, *provided* That the person is responsible for the merchandising of the cash position which is being offset.

(aa) *Associated person.* This term means any natural person who is associated in any of the following capacities with:

(1) 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 (i) the solicitation or acceptance of customers' or option customers' orders (other than in a clerical capacity) or (ii) the supervision of any person or persons so engaged;

(2) An introducing broker 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 customers' or option customers' orders (other than in a clerical capacity) or (ii) the supervision of any person or persons so engaged;

(3) A commodity pool operator 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 commodity pool or (ii) the supervision of any person or persons so engaged; or

(4) A commodity trading advisor 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; and

(5) A leverage transaction merchant 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 or acceptance of leverage customers' orders (other than in a clerical capacity) for leverage transactions as defined in §31.4(x) of this chapter, or (ii) the supervision of any person or persons so engaged.

(bb)(1) *Commodity trading advisor.* This term means any person who, for compensation or profit, engages in the business of advising others, either directly or through publications, writings or electronic media, as to the value of or the advisability of trading in any contract of sale of a commodity for future delivery made or to be made on or subject to the rules of a contract market, any commodity option authorized under section 4c of the Act, or any leverage transaction authorized under section 19 of the Act, or who, for compensation or profit, and as part of a regular business, issues or promulgates analyses or reports concerning any of the foregoing; but such term does not include (i) any bank or trust company or any person acting as an employee thereof, (ii) any news reporter, news columnist, or news editor of the print or electronic media, or any lawyer, accountant, or teacher, (iii) any floor broker or futures commission merchant, (iv) the publisher or producer of any print or electronic data of general and regular dissemination, including its employees, (v) the named fiduciary, or trustee, of any defined benefit plan which is subject to the provisions of the Employee Retirement Income Security Act of 1974, or any fiduciary whose sole business is to advise that plan, (vi) any contract market, and (vii) such other persons not within the intent of this definition as the Commission may specify by rule, regulation or order: *Provided,* That the furnishing of such services by the foregoing persons is solely incidental to the conduct of their business or profession: *Provided further,* That the Commission, by rule

or regulation, may include within this definition, any person advising as to the value of commodities or issuing reports or analyses concerning commodities, if the Commission determines that such rule or regulation will effectuate the purposes of this provision.

(cc) *Commodity pool operator.* This term means any person engaged in a business which is of the nature of an investment trust, syndicate, or similar form of enterprise, and who, in connection therewith, solicits, accepts, or receives from others, funds, securities, or property, either directly or through capital contributions, the sale of stock or other forms of securities, or otherwise, for the purpose of trading in any commodity for future delivery or commodity option on or subject to the rules of any contract market, but does not include such persons not within the intent of this definition as the Commission may specify by rule or regulation or by order.

(dd) *Commission.* This term means the Commodity Futures Trading Commission.

(ee) *Self-regulatory organization.* This term means a contract market (as defined in §1.3(h)), or a registered futures association under section 17 of the Act.

(ff) *Designated self-regulatory organization.* This term means:

(1) Self-regulatory organization of which a futures commission merchant, an introducing broker or a leverage transaction merchant is a member; or

(2) If a futures commission merchant or an introducing broker is a member of more than one self-regulatory organization and such futures commission merchant or introducing broker is the subject of an approved plan under §1.52 of this part, then a self-regulatory organization delegated the responsibility by such a plan for monitoring and auditing such futures commission merchant or introducing broker for compliance with the minimum financial and related reporting requirements of the self-regulatory organizations of which the futures commission merchant or introducing broker is a member, and for receiving the financial reports necessitated by such minimum financial and related reporting requirements from such futures commission merchant or introducing broker; or

(3) If a leverage transaction merchant is a member of more than one self-regulatory organization and such leverage transaction merchant is the subject of an approved plan under §31.28 of this chapter, then a self-regulatory organization delegated the responsibility by such a plan for monitoring and auditing such leverage transaction merchant for compliance with the minimum financial, cover, segregation and sales practice, and related reporting requirements of the self-regulatory organizations of which the leverage transaction merchant is a member, and for receiving the reports necessitated by such minimum financial, cover, segregation and sales practice, and related reporting requirements from such leverage transaction merchant.

(gg) *Customer funds.* This term means all money, securities, and property received by a futures commission merchant or by a clearing organization from, for, or on behalf of, customers or option customers:

(1) In the case of commodity customers, to margin, guarantee, or secure contracts for future delivery on or subject to the rules of a contract market and all money accruing to such customers as the result of such contracts; and

(2) In the case of option customers, in connection with a commodity option transaction on or subject to the rules of a contract market:

(i) To be used as a premium for the purchase of a commodity option for an option customer;

(ii) As a premium payable to an option customer;

(iii) To guarantee or secure performance of a commodity option by an option customer; or

(iv) Representing accruals (including, for purchasers of a commodity option for which the full premium has been paid, the market value of such commodity option) to an option customer.

(3) Notwithstanding paragraphs (gg)(1) and (2) of this section, the term customer funds shall exclude money, securities or property received to margin, guarantee or secure the trades or contracts of opt-out customers, and all money accruing to opt-out customers

as the result of such trades or contracts, to the extent that such trades or contracts are made on or subject to the rules of any registered derivatives transaction execution facility that has authorized opting out in accordance with § 37.7 of this chapter.

(4) Notwithstanding paragraphs (gg)(1), (2) and (3) of this section, the term customer funds shall exclude money, securities or property held to margin, guarantee or secure security futures products held in a securities account, and all money accruing as the result of such security futures products.

(hh) *Commodity option transaction; commodity option.* These terms each mean any transaction or agreement in interstate commerce which is or is held out to be of the character of, or is commonly known to the trade as, an ''option,'' ''privilege,'' ''indemnity,'' ''bid,'' ''offer,'' ''call,'' ''put.'' ''advance guaranty,'' or ''decline guaranty,'' and which is subject to regulation under the Act and these regulations.

(ii) *Premium.* This term means the amount agreed upon between the purchaser and seller, or their agents, for the purchase or sale of a commodity option on or subject to the rules of a contract market.

(jj) *Option customer.* This term means any person who directly or indirectly, purchases or grants (sells), or otherwise acquires or disposes of any interest in a commodity option for value, but does not include: (1) For purposes of §§ 1.16, 1.17, 1.20–1.30, 1.32, 1.36, 33.3 and 33.7 of this chapter, the owner or holder of a proprietary account; and (2) option customers whose option transactions are conducted in accordance with the requirements of part 32 of this chapter.

(kk) *Strike price.* This term means the price, per unit, at which a person may purchase or sell the contract of sale of a commodity for future delivery or the physical which is the subject of a commodity option: *Provided,* That for purposes of § 1.17, the term ''strike price'' means the total price at which a person may purchase or sell the contract of sale of a commodity for future delivery or the physical which is the subject of a commodity option *(i.e.,* price per unit times the number of units).

(ll) *Physical.* This term means any good, article, service, right or interest upon which a commodity option may be traded in accordance with the Act and these regulations.

(mm) *Introducing broker.* This term means:

(1) Any person who, for compensation or profit, whether direct or indirect, is engaged in soliciting or in accepting orders (other than in a clerical capacity) for the purchase or sale of any commodity for future delivery on or subject to the rules of any contract market who does not accept any money, securities, or property (or extend credit in lieu thereof) to margin, guarantee, or secure any trades or contracts that result or may result therefrom; and

(2) Includes any person required to register as an introducing broker by virtue of part 33 of this chapter: *Provided,* That the term ''introducing broker'' shall not include:

(i) Any futures commission merchant, floor broker, or associated person, acting in its capacity as such, regardless of whether that futures commission merchant, floor broker, or associated person is registered or exempt from registration in such capacity;

(ii) Any commodity trading advisor, which, acting in its capacity as a commodity trading advisor, is not compensated on a per-trade basis or which solely manages discretionary accounts pursuant to a power of attorney, regardless of whether that commodity trading advisor is registered or exempt from registration in such capacity; and

(iii) Any commodity pool operator which, acting in its capacity as a commodity pool operator, solely operates commodity pools, regardless of whether that commodity pool operator is registered or exempt from registration in such capacity.

(nn) *Guarantee agreement.* This term means an agreement of guaranty in the form set forth in part B of Form 1–FR, executed by a registered futures commission merchant 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)(2)(ii).

(oo) *Leverage transaction merchant.* Means and includes any individual, association, partnership, corporation, trust or other person that is engaged in the business of offering to enter into, entering into or confirming the execution of leverage contracts, or soliciting or accepting orders for leverage contracts, and who accepts leverage customer funds (or extends credit in lieu thereof) in connection therewith.

(pp) *Leverage customer funds.* Means all money, securities and property received, directly or indirectly by a leverage transaction merchant from, for, or on behalf of leverage customers to margin, guarantee or secure leverage contracts and all money, securities and property accruing to such customers as the result of such contracts, or the customers' leverage equity. In the case of a long leverage transaction, profit or loss accruing to a leverage customer is the difference between the leverage transaction merchant's current bid price for the leverage contract and the ask price of the leverage contract when entered into. In the case of a short leverage transaction, profit or loss accruing to a leverage customer is the difference between the bid price of the leverage contract when entered into and the leverage transaction merchant's current ask price for the leverage contract.

(qq) *Leverage contract.* Shall have the same meaning as that set forth in § 31.4(w) of this chapter.

(rr) *Foreign futures or foreign options secured amount.* This term means all money, securities and property held by or held for or on behalf of a futures commission merchant from, for, or on behalf of foreign futures or foreign options customers as defined in § 30.1 of this chapter:

(1) In the case of foreign futures customers, money, securities and property required by a futures commission merchant to margin, guarantee, or secure open foreign futures contracts plus or minus any unrealized gain or loss on such contracts; and

(2) In the case of foreign options customers in connection with open foreign options transactions money, securities and property representing premiums paid or received, plus any other funds required to guarantee or secure open transactions plus or minus any unrealized gain or loss on such transactions.

(ss) *Foreign board of trade.* This term means any board of trade, exchange or market located outside the United States, its territories or possessions, whether incorporated or unincorporated, where foreign futures or foreign options transactions are entered into.

(tt) *Electronic signature* means an electronic sound, symbol, or process attached to or logically associated with a record and executed or adopted by a person with the intent to sign the record.

(uu) *Opt-out customer.* This term means a customer that is an eligible contract participant, as defined in section 1a(12) of the Act, and that, in accordance with § 1.68, has elected not to have funds that are being carried for purposes of trading on or through the facilities of a registered derivatives transaction execution facility, separately accounted for and segregated by the futures commission merchant pursuant to section 4d of the Act and §§ 1.20–1.30, 1.32 and 1.36. A customer is an opt-out customer solely with respect to agreements, contracts or transactions, and the money, securities or property received by a futures commission merchant to margin, guarantee or secure such agreements, contracts or transactions, made on or subject to the rules of any derivatives transaction execution facility that has adopted rules permitting a customer to elect to be an opt-out customer and with respect to which the customer has made such an election. For all other purposes under the Act and the rules thereunder, except where otherwise provided, an opt-out customer shall be a customer as defined in § 1.3(k).

(vv) *Futures account.* This term means an account that is maintained in accordance with the segregation requirements of section 4d of the Commodity Exchange Act and the rules thereunder.

(ww) *Securities account.* This term means an account that is maintained in accordance with the requirements of

section 15(c)(3) of the Securities Exchange Act of 1934 and Rule 15c3–3 thereunder.

[41 FR 3194, Jan. 21, 1976]

EDITORIAL NOTE: For FEDERAL REGISTER citations affecting §1.3, see the List of CFR Sections Affected, which appears in the Finding Aids sections of the printed volume and on GPO Access.

§ 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 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, 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, 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.

[65 FR 12469, Mar. 9, 2000]

MINIMUM FINANCIAL AND RELATED REPORTING REQUIREMENTS

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

(a) *Application for registration.* (1) Except as otherwise provided, a futures commission merchant or an applicant for registration as a futures commission merchant, in order to satisfy any requirement in this part that it file a Form 1–FR, must file a Form 1–FR–FCM, and any reference in this part to Form 1–FR with respect to a futures commission merchant or applicant therefor shall be deemed to be a reference to Form 1–FR–FCM. Except as otherwise provided, an introducing broker or an applicant for registration as an introducing broker, in order to satisfy any requirement in this part that it file a Form 1–FR, must file a Form 1–FR–IB, and any reference in this part to Form 1–FR with respect to an introducing broker or applicant therefor shall be deemed to be a reference to Form 1–FR–IB.

(2) (i) (A) Except as provided in paragraphs (a)(3) and (h) of this section, each person who files an application for registration as a futures commission merchant and who is not so registered at the time of such filing, must, concurrently with the filing of such application, file either:

(*1*) A Form 1–FR–FCM 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 such report is filed; or

(*2*) 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 in accordance with §1.16 as of a date not more than one year prior to the date on which such report is filed.

(B) 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.

(ii) (A) Except as provided in paragraphs (a)(3) and (h) of this section, each person who files an application for registration as an introducing broker and who is not so registered at the time of such filing, must, concurrently with the filing of such application, file 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 such report is filed;

(*2*) A Form 1–FR–IB 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-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 such report is filed;

(*3*) A Form 1–FR–IB as of a date not more than 17 business days prior to the date on which such report is filed, *Provided, however,* that such applicant shall be subject to a review by the applicant's designated self-regulatory organization within six months of registration; or

(*4*) A guarantee agreement.

(B) Each person filing in accordance with paragraphs (a)(2)(ii)(A) (*1*), (*2*) or (*3*) of this section 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)(i) The provisions of paragraph (a)(2) of this section do not apply to any person succeeding to and continuing the business of another futures commission merchant. Each such person who files an application for registration as a futures commission merchant and who is not so registered in that capacity at the time of such filing must file a Form 1–FR–FCM as of the first month end following the date on which his registration is approved. Such report must be filed with the National Futures Association, the Commission and the designated self-regulatory organization, if any, not more than 17 business days after the date for which the report is made.

(ii) The provisions of paragraph (a)(2) of this section do not apply to any person succeeding to and continuing the business of another introducing broker.

(A) Each such person who succeeds to and continues the business of an introducing broker which was not operating pursuant to a guarantee agreement, or which was operating pursuant to a guarantee agreement and was also a securities broker or dealer at the time of succession, who files an application for registration as an introducing broker, and who is not so registered in that capacity at the time of such filing, must file with the National Futures Association either a guarantee agreement with his application for registration or a Form 1–FR–IB as of the first month end following the date on which his registration is approved. Such Form 1–FR–IB must be filed not more than 17 business days after the date for which the report is made.

(B) Each such person who succeeds to and continues the business of an introducing broker which was operating pursuant to a guarantee agreement and which was not also a securities broker or dealer at the time of succession, who files an application for registration as an introducing broker, and who is not so registered in that capacity at the time of such filing, must file with the National Futures Association either a guarantee agreement or a Form 1–FR–IB with his application for registration. If such person files a Form 1–FR–IB with his application for registration, such person must also file a Form 1–FR–IB, certified by an independent public accountant, as of a date no later than the end of the month registration is granted. The Form 1–FR–IB certified by an independent public accountant must be filed with the National Futures Association not more than 45 days after the date for which the report is made.

(b) *Filing of financial reports.* (1)(i) Except as provided in paragraphs (b)(3) and (h) of this section, each person registered as a futures commission merchant must file a Form 1–FR–FCM for each fiscal quarter of each fiscal year, including the final fiscal quarter of each fiscal year, unless the futures commission merchant elects, pursuant to paragraph (e)(2) of this section, to file a Form 1–FR–FCM for each calendar quarter of each calendar year, including the final calendar quarter of each calendar year. Each Form 1–FR–FCM must be filed no later than 17 business days after the date for which the report is made: *Provided, however,* That for each fiscal or calendar quarter ending between June 30, 1997 and December 31, 1997, inclusive, each Form 1–FR–FCM must be filed no later than 30 calendar days after the date for which the report is made.

(ii) In addition to the financial reports required by paragraph (b)(1)(i) of this section, each person registered as a futures commission merchant must file a Form 1–FR–FCM as of the close

of its fiscal year (even if it files quarterly reports as of each calendar quarter) which must be certified by an independent public accountant in accordance with § 1.16 no later than 90 days after the close of each futures commission merchant's fiscal year: *Provided, however,* that a registrant which is registered with the Securities and Exchange Commission as a securities broker or dealer must file this report not later than the time permitted for filing an annual audit report under § 240.17a–5(d)(5) of this title.

(2)(i) Except as provided in paragraphs (b)(3) and (h) of this section, and except for an introducing broker operating pursuant to a guarantee agreement which is not also a securities broker or dealer, each person registered as an introducing broker must file a Form 1–FR–IB semiannually as of the middle and the close of each fiscal year unless the introducing broker elects pursuant to paragraph (e)(2) of this section to file a Form 1–FR–IB semiannually as of the middle and the close of each calendar year. Each Form 1–FR–IB must be filed no later than 17 business days after the date for which the report is made: *Provided, however,* That for each reporting period ending between June 30, 1997 and December 31, 1997, inclusive, each Form 1–FR–IB must be filed no later than 30 calendar days after the date for which the report is made.

(ii) (A) In addition to the financial reports required by paragraph (b)(2)(i) of this section, each person registered as an introducing broker must file a Form 1–FR–IB as of the close of its fiscal year (even if it files semiannual reports on a calendar year basis) which must be certified by an independent public accountant in accordance with § 1.16 no later than 90 days after the close of each introducing broker's fiscal year: *Provided, however,* that a registrant which is registered with the Securities and Exchange Commission as a securities broker or dealer must file this report not later than the time permitted for filing an annual audit report under § 240.17a–5(d)(5) of this title.

(B) If an introducing broker has filed previously a Form 1–FR–IB, certified by an independent public accountant in accordance with the provisions of paragraphs (a)(2)(ii) or (j)(8) of this section and § 1.16 of this part, as of a date not more than one year prior to the close of such introducing broker's fiscal year, it need not have certified by an independent public accountant the Form 1–FR–IB filed as of the introducing broker's first fiscal year-end following the as of date of its initial certified Form 1–FR–IB. In such a case, the introducing broker's Form 1–FR–IB filed as of the close of the second fiscal year-end following the as of date of its initial certified Form 1–FR–IB must cover the period of time between those two dates and must be certified by an independent public accountant in accordance with § 1.16 of this part.

(iii) A Form 1–FR required to be certified by an independent public accountant in accordance with § 1.16 which is filed by a futures commission merchant, an introducing broker or an applicant for registration in either category, must be filed in paper form and may not be filed electronically.

(3) The provisions of paragraphs (b)(1) and (b)(2) of this section may be met by any person registered as a futures commission merchant or as an introducing broker who is a member of a designated self-regulatory organization and conforms to minimum financial standards and related reporting requirements set by such designated self-regulatory organization in its bylaws, rules, regulations, or resolutions and approved after the effective date of these regulations by the Commission pursuant to section 4f(b) of the Act and § 1.52: *Provided, however,* That each such registrant shall promptly file with the Commission a true and exact copy of each financial report which it files with such designated self-regulatory organization.

(4) Upon receiving written notice from any representative of the National Futures Association, the Commission or any self-regulatory organization of which it is a member, an applicant or registrant, except an applicant for registration as an introducing broker which has filed concurrently with its application for registration a guarantee agreement and which is not also a securities broker or dealer, must, monthly or at such times as specified, furnish the National Futures

Association, the Commission or the self-regulatory organization requesting such information a Form 1–FR or such other financial information as requested by the National Futures Association, the Commission or the self-regulatory organization. Each such Form 1–FR or such other information must be furnished within the time period specified in the written notice, and in accordance with the provisions of paragraph (c) of this section.

(c) *Where to file reports.* The reports provided for in this section will be considered filed when received by the regional office of the Commission nearest the principal place of business of the registrant (except that a registrant under the jurisdiction of the Commission's Western Regional Office must file such reports with the South-western Regional Office) and by the designated self-regulatory organization, if any; and reports required to be filed by this section by an applicant for registration will be considered filed when received by the National Futures Association and by the regional office of the Commission nearest the principal place of business of the applicant (except that an applicant under the jurisdiction of the Commission's Western Regional Office must file such reports with the South western Regional Office): *Provided, however,* That any report filed pursuant to paragraphs (b)(1), (b)(2), or (b)(4) of this section or §1.12 (a) or (b) which need not be certified in accordance with §1.16 may be submitted to the Commission in electronic form using a Commission-assigned Personal Identification Number, and otherwise in accordance with instructions issued by the Commission, if the futures commission merchant, introducing broker 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: *And, provided further,* That any guarantee agreement entered into between a futures commission merchant and an introducing broker in accordance with the provisions of this section need be filed only with and will be considered filed when received by the National Futures Association.

(d) *Contents of financial reports.* (1) Each Form 1–FR filed pursuant to this §1.10 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 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;

(iii) 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;

(iv) A statement of the computation of the minimum capital requirements pursuant to §1.17 as of the date for which the report is made;

(v) For a futures commission merchant only, the statements of segregation requirements and funds in segregation for customers trading on U.S. commodity exchanges and for customers' dealer options accounts, and the statement of secured amounts and funds held in separate accounts for foreign futures and foreign options customers in accordance with §30.7 of this chapter as of the date for which the report is made; and

(vi) In addition to the information expressly required, such futher material information as may be necessary to make the required statements and schedules not misleading.

(2) Each Form 1–FR filed pursuant to this §1.10 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)(2) 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 §1.17 as of the date for which the report is made;

(iv) For a futures commission merchant only, the statements of segregation requirements and funds in segregation for customers trading on U.S. commodity exchanges and for customers' dealer options accounts, and the statement of secured amounts and funds held in separate accounts for foreign futures and foreign options customers in accordance with §30.7 of this chapter as of the date for which the report is made;

(v) Appropriate footnote disclosures;

(vi) A reconciliation, including appropriate explanations, of the statement of the computation of the minimum capital requirements pursuant to §1.17 and, for a futures commission merchant only, the statements of segregation requirements and funds in segregation for customers trading on U.S. commodity exchanges and for customers' dealer option accounts, and the statement of secured amounts and funds held in separate accounts for foreign futures and foreign options customers in accordance with §30.7 of this chapter, in the certified Form 1–FR with the applicant's or registrant's corresponding uncertified most recent Form 1–FR filing when material differences exist or, if no material differences exist, a statement so indicating; and

(vii) 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 (d)(2)(i) and (d)(2)(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 paragraphs (b)(1)(ii) or (b)(2)(ii) of this section or accompanying the application for registration pursuant to paragraph (a)(2) 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 and a reconciliation is provided reconciling such statement of financial condition to the statement of the computation of the minimum capital requirements pursuant to §1.17. Such reconciliation must be certified by an independent public accountant in accordance with §1.16.

(4) Attached to each Form 1–FR 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 is true and correct. If the applicant or registrant is a sole proprietorship, then the oath or affirmation must be made by the proprietor; if a partnership, by a general partner; or if a corporation, by the chief executive officer or chief financial officer. In the case of a Form 1–FR filed via electronic transmission in accordance with procedures established by the Commission, such transmission must be accompanied by the Commission-assigned Personal Identification Number of the authorized signer and such Personal Identification Number 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 this paragraph.

(e) *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 pursuant to paragraph (a)(2) of this section, but in no event may such fiscal year end more than one year from the date of the Form 1–FR filed pursuant to paragraph (a)(2) of this section. A copy of such written notice must also be filed with the regional office of the Commission nearest the principal place of business of the applicant (except that an applicant under the jurisdiction of the Commission's Western Regional Office

must file such a notice with the Commission's Southwestern Regional Office). An applicant which does not so notify the National Futures Association and the Commission will be deemed to have elected the calendar year as its fiscal year. A registrant must continue to use its elected fiscal year, calendar or otherwise, unless a change in such fiscal year is approved upon written application to the principal office of the Commission in Washington, DC, and written notice of such change is given to the designated self-regulatory organization, if any.

(2) An applicant may elect to file its Form 1–FR for each calendar quarter in lieu of each fiscal quarter by notifying the National Futures Association of its election, in writing, concurrently with the filing of the Form 1–FR pursuant to paragraph (a)(2) of this section. A copy of such written notice must also be filed with the regional office of the Commission nearest the principal place of business of the applicant (except that an applicant under the jurisdiction of the Commission's Western Regional Office must file such a notice with the Commission's Southwestern Regional Office). A registrant wishing to change such election or to make such election other than concurrently with the filing of the Form 1–FR pursuant to paragraph (a)(2) of this section may do so only if such change or election is approved by the Commission upon written application to the principal office of the Commission in Washington, DC, and written notice of such change is given to the designated self-regulatory organization, if any.

(f) *Extension of time for filing uncertified reports.* (1) In the event a registrant finds that it cannot file its report for any period within the time specified in paragraphs (b)(1)(i), (b)(2)(i) or (b)(4) of this section or § 1.12(b) without substantial undue hardship, it may file with the principal office of the Commission in Washington, D.C., an application for an extension of time to a specified date which may not be more than 90 days after the date as of which the financial statements were to have been filed. The application must state the reasons for the requested extension and must contain an agreement to file the report on or before the specified date. The application must be received by the Commission before the time specified in paragraphs (b)(1)(i), (b)(2)(i) or (b)(4) of this section or § 1.12(b) for filing the report. Notice of such application must be given to the designated self-regulatory organization, if any, concurrently with the filing of such application with the Commission. Within ten calendar days after receipt of the application for an extension of time, the Commission shall: (i) Notify the registrant of the grant or denial of the requested extension; or (ii) indicate to the registrant that additional time is required to analyze the request, in which case the amount of time needed will be specified. (See § 1.16(f) for extension of the time for filing certified financial statements.)

(2) In the event an applicant finds that it cannot file its report for any period within the time specified in paragraph (b)(4) of this section or § 1.12(b) without substantial undue hardship, it may file with the National Futures Association an application for an extension of time to a specified date which may not be more than 90 days after the date as of which the financial statements were to have been filed. The application must state the reasons for the requested extension and must contain an agreement to file the report on or before the specified date. The application must be received by the National Futures Association before the time specified in paragraph (b)(4) of this section or § 1.12(b) for filing the report. Notice of such application must be filed with the regional office of the Commission nearest the principal place of business of the applicant (except that an applicant under the jurisdiction of the Commission's Western Regional Office must file such a notice with the Commission's Southwestern Regional Office) concurrently with the filing of such application with the National Futures Association. Within ten calendar days after receipt of the application for an extension of time, the National Futures Association shall:

(i) Notify the applicant of the grant or denial of the requested extension; or

(ii) Indicate to the applicant that additional time is required to analyze the request, in which case the amount of time needed will be specified.

(g) *Nonpublic treatment of reports.* (1) The following portions of Forms 1–FR filed pursuant to this section will be public: the statement of financial condition, the statement of the computation of the minimum capital requirements, the statements (to be filed by a futures commission merchant only) of segregation requirements and funds in segregation for customers trading on U.S. commodity exchanges and for customers' dealer options accounts, and the statement (to be filed by a futures commission merchant only) of secured amounts and funds held in separate accounts for foreign futures and foreign options customers in accordance with §30.7 of this chapter. The other financial statements (including the statement of income (loss)), footnote disclosures and schedules of Form 1–FR, trade secrets and certain other commercial or financial information on such other statements and schedules will be treated as nonpublic for purposes of the Freedom of Information Act and the Government in the Sunshine Act and parts 145 and 147 of this chapter.

(2) The following portions of copies of the Financial and Operational Combined Uniform Single Report under the Securities Exchange Act of 1934, Part II or Part IIA filed pursuant to paragraph (h) of this section, will be public: The statement of financial condition, the computations of net capital and the minimum capital requirements, the statements (to be filed by a futures commission merchant only) of segregation requirements and funds in segregation for customers trading on U.S. commodity exchanges and for customers' dealer options accounts, and the statement (to be filed by a futures commission merchant only) of secured amounts and funds held in separate accounts for foreign futures and foreign options customers in accordance with §30.7 of this chapter. The other financial statements (including the statement of income (loss)), footnote disclosures and schedules of the Financial and Operational Combined Uniform Single Report under the Securities and Exchange Act of 1934, Part II or Part IIA, trade secrets and certain other commercial or financial information on such other statements and schedules will be treated as nonpublic for purposes of the Freedom of Information Act and the Government in the Sunshine Act and parts 145 and 147 of this chapter.

(3) [Reserved]

(4) All information on such other statements, footnote disclosures and schedules will, however, be available for official use by any official or employee of the United States or any State, by any self-regulatory organization of which the person filing such report is a member, by the National Futures Association in the case of an applicant, and by any other person to whom the Commission believes disclosure of such information is in the public interest. Nothing in this paragraph (g) will limit the authority of any self-regulatory organization to request or receive any information relative to its members' financial condition.

(5) The independent accountant's opinion and a guarantee agreement filed pursuant to this section will be deemed public information.

(h) *Filing option available to a futures commission merchant or an introducing broker which is also a securities broker or dealer.* Any applicant or registrant which is registered with the Securities and Exchange Commission as a securities broker or dealer may comply with the requirements of this section by filing (in accordance with paragraphs (a), (b), (c), and (j) of this section) a copy of its Financial and Operational Combined Uniform Single Report under the Securities Exchange Act of 1934, part II or part IIA, in lieu of Form 1–FR: *Provided, however,* That all information which is required to be furnished on and submitted with Form 1–FR is provided with such Report.

(i) *Filing option available to an introducing broker or applicant for registration as an introducing broker which is also a country elevator.* Any introducing broker or applicant for registration as an introducing broker which is also a country elevator but which is not also a securities broker or dealer may comply with the requirements of this section by filing (in accordance with paragraphs (a), (b) and (c) of this section) a copy of a financial report prepared by a grain commission firm which has been

authorized by the Deputy Vice President of the Commodity Credit Corporation of the United States Department of Agriculture to provide a compilation report of financial statements of warehousemen for purposes of Uniform Grain Storage Agreements, and which complies with the standards for independence set forth in §1.16(b)(2) with respect to the registrant or applicant: *Provided, however,* That all information which is required to be furnished on and submitted with Form 1–FR is provided with such financial report, including a statement of the computation of the minimum capital requirements pursuant to §1.17: *And, provided further,* That the balance sheet is presented in a format as consistent as possible with the Form 1–FR and a reconciliation is provided reconciling such balance sheet to the statement of the computation of the minimum capital requirements pursuant to §1.17. Attached to each financial report filed pursuant to this paragraph (i) must be an oath or affirmation that to the best knowledge and belief of the individual making such oath or affirmation the information contained therein is true and correct. If the applicant or registrant is a sole proprietorship, then the oath or affirmation must be made by the proprietor; if a partnership, by a general partner; or if a corporation, by the chief executive officer or chief financial officer.

(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 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 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.

(2) No futures commission merchant 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); or

(ii) There is filed against the futures commission merchant 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 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.

(4)(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 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.

(5) 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 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 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 and the introducing broker.

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

(7) An introducing broker may not simultaneously be a party to more than one guarantee agreement: *Provided, however,* That the provisions of this paragraph (j)(7) shall not be deemed to preclude an introducing broker from entering into a guarantee agreement with another futures commission merchant if the introducing broker or the futures commission merchant 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)(5) 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)(7) shall not be deemed to preclude an introducing broker from entering into a guarantee agreement with another futures commission merchant if the futures commission merchant 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)(4)(ii) of this section.

(8)(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)(5) of this section, or that is due to expire in accordance with the provisions of paragraph (j)(4)(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.

(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)(8)(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)(5)(ii) of this section shall not be deemed to be in violation of the minimum adjusted net capital requirement of §1.17(a)(1)(ii) 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.

(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.

(k) *Filing option available to an introducing broker.* (1) Any introducing broker or applicant for registration as an introducing broker which is not operating or intending to operate pursuant to a guarantee agreement may comply with the requirements of this section by filing (in accordance with paragraphs (a), (b) and (c) of this section) a Form 1–FR–IB in lieu of a Form 1–FR–FCM.

(2) If an introducing broker or applicant therefor avails itself of the filing option available under paragraph (k)(1) of this section, the report required to be filed in accordance with § 1.16(c)(5) of this part must be filed as of the date of the Form 1–FR–IB being filed, and such an introducing broker or applicant therefor must maintain its financial records and make its monthly formal computation of its adjusted net capital, as required by § 1.18 of this part, in a manner consistent with Form 1–FR–IB.

(The information collection requirements contained in § 1.10 were approved by the Office of Management and Budget under control number 3038–0024; in paragraphs (a) and (b) under control number 3038–0023; and in paragraph (f) under control number 3038–0003.)

[43 FR 39967, Sept. 8, 1978, as amended at 45 FR 80491, Dec. 5, 1980; 46 FR 63035, Dec. 30, 1981; 48 FR 35280, Aug. 3, 1983; 49 FR 39524, Oct. 9, 1984; 53 FR 4611, Feb. 17, 1988; 53 FR 7179, Mar. 7, 1988; 57 FR 23143, June 2, 1992; 58 FR 10953, Feb. 23, 1993; 58 FR 12988, Mar. 8, 1993; 58 FR 19589, Apr. 15, 1993; 59 FR 5525, Feb. 7, 1994; 62 FR 4639, Jan. 31, 1997; 62 FR 10444, Mar. 7, 1997; 62 FR 33007, June 18, 1997; 66 FR 53516, Oct. 23, 2001]

§ 1.11 [Reserved]

§ 1.12 Maintenance of minimum financial requirements by futures commission merchants and introducing brokers.

(a) Each person registered as a futures commission merchant or who files an application for registration as a futures commission merchant, and each person registered as an introducing broker or who files an application for registration as an introducing broker (except for an introducing broker or applicant for registration as an introducing broker operating pursuant to, or who has filed concurrently with its application for registration, a guarantee agreement and who is not also a securities broker or dealer), who knows or should have known that its adjusted net capital at any time is less than the minimum required by § 1.17 or by the capital rule of any self-regulatory organization to which such person is subject, if any, must:

(1) Give telephonic notice, to be confirmed in writing by telegraphic or facsimile notice, as set forth in paragraph (i) of this section that the applicant's or registrant's adjusted net capital is less than required by § 1.17 or by other capital rule, identifying the applicable capital rule. The notice must be given

immediately after the applicant or registrant knows or should know that its adjusted net capital is less than required by any of the aforesaid rules to which the applicant or registrant is subject; and

(2) If the person is a futures commission merchant or applicant therefor, within 24 hours after giving such notice file a statement of financial condition, a statement of the computation of the minimum capital requirements pursuant to §1.17 (computed in accordance with the applicable capital rule), the statements of segregation requirements and funds in segregation for customers trading on U.S. commodity exchanges and for customers' dealer options accounts, and the statement of secured amounts and funds held in separate accounts for foreign futures and foreign options customers in accordance with §30.7 of this chapter, all as of the date such applicant's or registrant's adjusted net capital is less than the minimum required; or

(3) If the person is an introducing broker or applicant therefor, within 24 hours after giving such notice file a statement of financial condition and a statement of the computation of the minimum capital requirements pursuant to §1.17 (computed in accordance with the applicable capital rule) all as of the date such applicant's or registrant's adjusted net capital is less than the minimum required.

(b) Each person registered as a futures commission merchant, or who files an application for registration as a futures commission merchant, who knows or should have known that its adjusted net capital at any time is less than the greatest of:

(1) 150 percent of the appropriate minimum dollar amount required by §1.17(a)(1)(i);

(2) Six percent of the following amount: The customer funds required to be segregated pursuant to the Act and the regulations in this part, plus the funds of opt-out customers that, but for the election to opt out pursuant to §1.68, would be required to be segregated, plus the foreign futures or foreign options secured amount, less the market value of commodity options purchased by such customers on or subject to the rules of a contract market or a foreign board of trade for which the full premiums have been paid: *Provided, however,* that the deduction for each such customer shall be limited to the amount of customer funds in such customer's account(s) and foreign futures and foreign options secured amounts;

(3) 150 percent of the amount of adjusted net capital required by a registered futures association of which it is a member; or

(4) For securities brokers or dealers, the amount of net capital specified in Rule 17a–11(b) of the Securities and Exchange Commission (17 CFR 240.17a–11(b)), must file written notice to that effect as set forth in paragraph (i) of this section within five (5) business days of such event. Such applicant or registrant must also file a Form 1–FR–FCM (or, if such applicant or registrant is registered with the Securities and Exchange Commission as a securities broker or dealer, it may file, in accordance with §1.10(h), a copy of its Financial and Operational Combined Uniform Single Report under the Securities Exchange Act of 1934, Part II, in lieu of Form 1–FR–FCM) or such other financial statement designated by the National Futures Association, in the case of an applicant, or by the Commission or the designated self-regulatory organization, if any, in the case of a registrant, as of the close of business for the month during which such event takes place and as of the close of business for each month thereafter until three (3) successive months have elapsed during which the applicant's or registrant's adjusted net capital is at all times equal to or in excess of the minimums set forth in this paragraph (b) which are applicable to such applicant or registrant. Each financial statement required by this paragraph (b) must be filed within 17 business days after the end of the month for which such report is being made: *Provided, however,* That for each month ending between June 30, 1997 and December 31, 1997, inclusive, for which a financial statement is required by this paragraph (b), such financial statement must be filed within 30 calendar days after the end of the month for which such report is being made.

(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, give telegraphic or facsimile notice of such fact, specifying the books and records which have not been made or which are not current, and within 5 business days 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 these regulations, of the existence of any material inadequacy, as specified in §1.16(d)(2) of these regulations, such applicant or registrant must give telegraphic or facsimile notice of such material inadequacy within 3 business days, and within 5 business days 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 §1.12, that self-regulatory organization must immediately report this failure by telephone, confirmed in writing immediately by telegraphic or facsimile notice, as provided in paragraph (i) of this section.

(f)(1) Whenever a clearing organization determines that any position it carries for one of its clearing members which is registered as a futures commission merchant or as a leverage transaction merchant must be liquidated immediately, transferred immediately or that the trading of any account of such futures commission merchant or such leverage transaction merchant shall be only for the purposes of liquidation, because that clearing member has failed to meet a call for margin or to make other required deposits, the clearing organization must give telephonic, confirmed in writing by telegraphic or facsimile notice of such a determination to the principal office of the Commission at Washington, DC immediately.

(2) Whenever a registered futures commission merchant determines that any position it carries for another registered futures commission merchant or for a registered leverage transaction merchant must be liquidated immediately, transferred immediately or that the trading of any account of such futures commission merchant or leverage transaction merchant shall be only for purposes of liquidation, because the other futures commission merchant or the leverage transaction merchant has failed to meet a call for margin or to make other required deposits, the carrying futures commission merchant must give telephonic, confirmed in writing by telegraphic or facsimile notice of such a determination to the principal office of the Commission at Washington, DC, immediately.

(3) Whenever a registered futures commission merchant determines that an account which it is carrying is undermargined by an amount which exceeds the futures commission merchant's adjusted net capital determined in accordance with §1.17, the futures commission merchant must give immediate telephonic, confirmed in writing by telegraphic or facsimile notice of such a determination to the designated self-regulatory organization and the principal office of the Commission at Washington, DC. This paragraph (f)(3) shall apply to any account carried by the futures commission merchant, whether a customer, noncustomer, omnibus or proprietary account. For purposes of this paragraph (f)(3), if any person has an interest of 10 percent or more in ownership or equity in, or guarantees, more than one account, or has guaranteed an account in addition to his own account, all such accounts shall be combined. A designated self-regulatory organization may grant an exemption from the provisions of this paragraph to a futures commission merchant with respect to any particular account on a continuous basis provided the designated self-regulatory organization documents the reasons for granting such an exemption and continues to monitor any such account.

(4) A futures commission merchant shall report immediately by telephone, confirmed in writing immediately by

telegraphic or facsimile notice, whenever any commodity interest account it carries is subject to a margin call, or call for other deposits required by the futures commission merchant, that exceeds the futures commission merchant's excess adjusted net capital, determined in accordance with §1.17, and such call has not been answered by the close of business on the day following the issuance of the call. This applies to all accounts carried by the futures commission merchant, whether customer, noncustomer, or omnibus, that are subject to margining, including commodity futures and options. In addition to actual margin deposits by an account owner, a futures commission merchant may also take account of favorable market moves in determining whether the margin call is required to be reported under this paragraph.

(5)(i) A futures commission merchant shall report immediately by telephone, confirmed in writing immediately by telegraphic or facsimile notice, whenever its excess adjusted net capital is less than six percent of the maintenance margin required by the futures commission merchant on all positions held in accounts of a noncustomer other than a noncustomer who is subject to the minimum financial requirements of:

(A) A futures commission merchant, or

(B) The Securities and Exchange Commission for a securities broker and dealer.

(ii) For purposes of paragraph (f)(5)(i), maintenance margin shall include all deposits which the futures commission merchant requires the noncustomer to maintain in order to carry its positions at the futures commission merchant.

(g) A futures commission merchant 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 §1.10. 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 (or, if the futures commission merchant is qualified to use the filing option available under §1.10(h), tentative net capital as defined in the rules of the Securities and Exchange Commission) 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 equity capital of the futures commission merchant or a subsidiary or affiliate of the futures commission merchant consolidated pursuant to §1.17(f) (or 17 CFR 240.15c3–1e) would be withdrawn by action of a stockholder or a partner 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, employee or affiliate, such that the withdrawal, advance or loan would cause, on a net basis, a reduction in excess adjusted net capital (or, if the futures commission merchant is qualified to use the filing option available under §1.10(h), excess net capital as defined in the rules of the Securities and Exchange Commission) 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 (g)(1) and (g)(2) of this section do not apply to any futures or securities transaction in the ordinary course of business between a futures commission merchant and any affiliate where the futures commission merchant 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, the Director of the Division of Clearing and Intermediary Oversight or the Director's designee may require that the futures commission merchant provide or cause a Material Affiliated Person (as that term is defined in §1.14(a)(2)) to provide, within three business days from the date of request or such shorter period as the Division Director or designee may specify, such other information as the Division Director or designee determines to be necessary based

upon market conditions, reports provided by the futures commission merchant, or other available information.

(h) Whenever a person registered as a futures commission merchant knows or should know that the total amount of its funds on deposit in segregated accounts on behalf of customers, or that the total amount set aside on behalf of customers trading on non-United States markets, is less than the total amount of such funds required by the Act and the Commission's rules to be on deposit in segregated or secured amount accounts on behalf of such customers, the registrant must report immediately by telephone, confirmed in writing immediately by telegraphic or facsimile notice, such deficiency to the registrant's designated self-regulatory organization and the principal office of the Commission in Washington, D.C., to the attention of the Director and the Chief Accountant of the Division of Clearing and Intermediary Oversight.

(i)(1) Every notice and written report required to be given or filed by this section (except for notices required by paragraph (f) of this section) by a futures commission merchant, an applicant for registration as a futures commission merchant or a self-regulatory organization must be filed with the regional office of the Commission nearest the principal place of business of the applicant or registrant (except that an applicant, registrant or self-regulatory organization under the jurisdiction of the Commission's Western Regional Office must file such notices and reports with the Southwestern Regional Office), with the designated self-regulatory organization, if any, with the Securities and Exchange Commission, if such applicant or registrant is a securities broker or dealer, and with the National Futures Association, if the firm is an applicant. In addition, every notice required to be given by this section must also be filed with the principal office of the Commission in Washington, DC. Each statement of financial condition, each statement of the computation of the minimum capital requirements pursuant to §1.17 of this part, and each schedule of segregation requirements and funds on deposit in segregation required by this section must be filed in accordance with the provisions of §1.10(d) of this part unless otherwise indicated.

(2) Every notice and written report which an introducing broker or applicant for registration as an introducing broker is required to give or file by paragraphs (a), (c) and (d) of this section must be filed with the National Futures Association (on behalf of the Commission), with the designated self-regulatory organization, if any, and with every futures commission merchant carrying or intending to carry customer accounts for the introducing broker or applicant for registration as an introducing broker. Any notice or report filed with the National Futures Association pursuant to this paragraph shall be deemed for all purposes to be filed with, and to be the official record of, the Commission.

(Approved by the Office of Management and Budget under control number 3038–0024)

[43 FR 39969, Sept. 8, 1978, as amended at 45 FR 6539, Jan. 29, 1980; 46 FR 63035, Dec. 30, 1981; 47 FR 41516, Sept. 21, 1982; 48 FR 35283, Aug. 3, 1983; 49 FR 5521, Feb. 13, 1984; 49 FR 39525, Oct. 9, 1984; 52 FR 28248, July 29, 1987; 52 FR 28995, Aug. 5, 1987; 53 FR 4612, Feb. 17, 1988; 58 FR 10953, Feb. 23, 1993; 59 FR 66688, Dec. 28, 1994; 61 FR 19185, May 1, 1996; 62 FR 4640, Jan. 31, 1997; 63 FR 32731, June 16, 1998; 63 FR 45715, Aug. 27, 1998; 66 FR 20744, Apr. 25, 2001; 67 FR 62351, Oct. 7, 2002]

§ 1.13 [Reserved]

§ 1.14 Risk assessment recordkeeping requirements for futures commission merchants.

(a) *Requirement to maintain and preserve information.* (1) Each futures commission merchant registered with the Commission pursuant to Section 4d of the Act, unless exempt pursuant to paragraph (d) of this section, shall prepare, maintain and preserve the following information:

(i) An organizational chart which includes the futures commission merchant 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 futures commission merchant'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 futures commission merchant, 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 futures commission merchant's proprietary and noncustomer clearing activities, including systems and policies for supervising, monitoring, reporting and reviewing trading activities in 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 noncustomer 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 futures commission merchant 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 futures commission merchant's organizational structure, which shall include the futures commission merchant 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 futures commission merchant's highest level Material Affiliated Person as part of its internal financial reporting process. Any additional information required to be filed under § 1.15(a)(2)(iii) 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 futures commission merchant's organizational structure, which shall include the futures commission merchant 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 futures commission merchant's highest level Material Affiliated Person as part of its internal financial reporting process. Any additional information required to be filed under § 1.15(a)(2)(iii) shall also be maintained and preserved.

(2) The determination of whether an affiliated person of a futures commission merchant 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 futures commission merchant and the affiliated person;

(ii) The overall financing requirements of the futures commission merchant and the affiliated person, and the degree, if any, to which the futures commission merchant and the affiliated person are financially dependent on each other;

(iii) The degree, if any, to which the futures commission merchant or its customers rely on the affiliated person for operational support or services in connection with the futures commission merchant's business;

(iv) The level of market, credit or other risk present in the activities of the affiliated person; and

(v) The extent to which the affiliated person has the authority or the ability to cause a withdrawal of capital from the futures commission merchant.

(3) For purposes of this section and § 1.15, 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.

(b) *Special provisions with respect to Material Affiliated Persons subject to the supervision of certain domestic regulators.* A futures commission merchant shall be deemed to be in compliance with the recordkeeping requirements of paragraphs (a)(1)(i), (a)(1)(iii) and (a)(1)(iv) of this section with respect to a Material Affiliated Person if:

(1) The futures commission merchant is required, or that Material Affiliated Person is required, to maintain and preserve information, or such information is maintained and preserved by the futures commission merchant on behalf of the Material Affiliated Person, pursuant to § 240.17h–1T of this title, or such other risk assessment regulations as the Securities and Exchange Commission may adopt, and 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 such futures commission merchant or its 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 futures commission merchant 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 futures commission merchant 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) *Special provisions with respect to Material Affiliated Persons subject to the supervision of a Foreign Regulatory Authority.* A futures commission merchant shall be deemed to be in compliance with the recordkeeping requirements of paragraphs (a)(1)(iii) and (a)(1)(iv) of this section with respect to a Material Affiliated Person if such futures commission merchant 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: (1) the futures commission merchant 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 futures commission merchant, 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 futures commission merchant's fiscal year-end and which will allow the Commission to obtain the type of information required herein. The futures commission merchant 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.* (1) The provisions of this section shall not apply to any futures commission merchant which holds funds or property of or for futures customers of less than $6,250,000 and has less than $5,000,000 in adjusted net capital as of the futures commission merchant's current fiscal year-end; provided, however, that such futures commission merchant is not a clearing member of an exchange.

(2) The Commission may, upon written application by a Reporting Futures Commission Merchant, exempt from the provisions of this section, other than paragraph (a)(1)(ii) of this section, either unconditionally or on specified terms and conditions, any futures commission merchant affiliated with such Reporting Futures Commission Merchant. The term ''Reporting Futures Commission Merchant'' shall mean, in the case of a futures commission merchant that is affiliated with another registered futures commission merchant, the futures commission merchant which maintains the greater amount of adjusted net capital as last reported on financial reports filed with the Commission pursuant to § 1.10 unless another futures commission merchant is acting as the Reporting Broker or Dealer under § 240.17h–2T of this title, or the Commission permits another futures commission merchant to act as the Reporting Futures Commission Merchant. In granting exemptions under this section, the Commission shall consider, among other factors, whether the records required by this section concerning the Material Affiliated Persons of the futures commission merchant affiliated with the Reporting Futures Commission Merchant will be available to the Commission pursuant to this section or § 1.15. A request for exemption filed under this paragraph (d)(2) shall explain the basis for the designation of a particular futures commission merchant as the Reporting Futures Commission Merchant and will become effective on the thirtieth day after receipt of such request by the Commission unless the Commission objects to the request by that date.

(3) The Commission may exempt any futures commission merchant 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 futures commission merchant 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. If such records are maintained at a place other than the futures commission merchant'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 futures commission merchant 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 futures commission merchant required to maintain and preserve such records from any of its responsibilities under this section or § 1.15.

(f) *Confidentiality*. All information obtained by the Commission pursuant to the provisions of this section from a futures commission merchant concerning a Material Affiliated Person shall be deemed confidential information for the purposes of section 8 of the Act.

(g) *Implementation schedule.* (1) Each futures commission merchant registered as of December 31, 1994 and subject to the requirements of this section shall maintain and preserve the information required by paragraphs (a)(1)(i) and (a)(1)(ii) of this section commencing April 30, 1995 and the information required by paragraphs (a)(1)(iii) and (a)(1)(iv) of this section commencing May 15, 1995 or, if December 31, 1994 is not the futures commission merchant's fiscal year-end, 135 calendar days following the first fiscal year-end occurring after December 31, 1994.

(2) Each futures commission merchant whose registration becomes effective after December 31, 1994 and is subject to the requirements of this section shall maintain and preserve the information required by paragraphs (a)(1)(i) and (a)(1)(ii) of this section commencing 60 calendar days after registration become effective and the information required by paragraphs (a)(1)(iii) and (a)(1)(iv) of this section commencing 105 calendar days following the first fiscal year-end occurring after registration becomes effective.

[59 FR 66688, Dec. 28, 1994]

§ 1.15 Risk assessment reporting requirements for futures commission merchants.

(a) *Reporting requirements with respect to information required to be maintained by § 1.14.* (1) Each futures commission merchant registered with the Commission pursuant to Section 4d of the Act, unless exempt pursuant to paragraph (c) of this section, shall file the following with the regional office with which it files periodic financial reports by no later than April 30, 1995, provided that in the case of a futures commission merchant whose registration becomes effective after December 31, 1994, such futures commission merchant shall file the following within 60 calendar days after the effective date of such registration, or by April 30, 1995, whichever comes later:

(i) A copy of the organizational chart maintained by the futures commission merchant pursuant to paragraph (a)(l)(i) of § 1.14. 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 futures commission merchant pursuant to paragraph (a)(l)(ii) of § 1.14. If the futures commission merchant 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 futures commission merchant registered with the Commission pursuant to Section 4d of the Act, unless exempt pursuant to paragraph (c) of this section, 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 futures commission merchant's organizational structure, which shall include the futures commission merchant 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 futures commission merchant'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 futures commission merchant's organizational structure, which shall include the futures commission merchant 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 futures commission merchant'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 futures commission merchant's organizational structure.

(3) For the purposes of this section, the term Material Affiliated Person shall have the meaning used in § 1.14.

(4) The reports required to be filed pursuant to paragraphs (a)(1) and (a)(2) of this section shall be considered filed when received by the regional office of the Commission with whom the futures commission files financial reports pursuant to § 1.10.

(b) [Reserved]

(c) *Exemptions.* (1) The provisions of this section shall not apply to any futures commission merchant which holds funds or property of or for futures customers of less than $6,250,000 and has less than $5,000,000 in adjusted net capital as of the futures commission merchant's fiscal year-end; provided, however, that such futures commission merchant is not a clearing member of an exchange.

(2) The Commission may, upon written application by a Reporting Futures Commission Merchant, exempt from the provisions of this section, other than paragraph (a)(1)(ii) of this section, either unconditionally or on specified terms and conditions, any futures commission merchant affiliated with such Reporting Futures Commission Merchant. The term ''Reporting Futures Commission Merchant'' shall mean, in the case of a futures commission merchant that is affiliated with another registered futures commission merchant, the futures commission merchant which maintains the greater amount of net capital as last reported on its financial reports filed with the Commission pursuant to § 1.10 unless another futures commission merchant is acting as the Reporting Broker or Dealer under § 240.17h–2T of this title or the Commission permits another futures commission merchant to act as the Reporting Futures Commission Merchant. In granting exemptions under this section, the Commission shall consider, among other factors, whether the records and other information required to be maintained pursuant to § 1.14 concerning the Material Affiliated Persons of the futures commission merchant affiliated with the Reporting Futures Commission Merchant will be available to the Commission pursuant to the provisions of this section. A request for exemption filed under this paragraph (c)(2) shall explain the basis for the designation of a

particular futures commission merchant as the Reporting Futures Commission Merchant and will become effective on the thirtieth day after receipt of such request by the Commission unless the Commission objects to the request by that date. The Reporting Futures Commission Merchant must submit the information required by paragraph (a)(1)(ii) of this section on behalf of its affiliated futures commission merchants.

(3) The Commission may exempt any futures commission merchant 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.

(d) *Special provisions with respect to Material Affiliated Persons subject to the supervision of certain domestic regulators.* (1) In the case of a futures commission merchant which is required to file, or has a Material Affiliated Person which is required to file, Form 17–H (or such other forms or reports as may be required) with the Securities and Exchange Commission pursuant to §240.17h–2T of this title, or such other risk assessment regulations as the Securities and Exchange Commission may adopt, such futures commission merchant shall be deemed to be in compliance with the reporting requirements of paragraphs (a)(1)(i) and (a)(2) of this section if the futures commission merchant furnishes, in accordance with paragraph (a)(2) of this section, a copy of the most recent Form 17–H filed by the futures commission merchant or its Material Affiliated Person with the Securities and Exchange Commission, provided however, that if the futures commission merchant has designated any of its affiliated persons as Material Affiliated Persons for purposes of this section and §1.14 which are not designated as Material Associated Persons for purposes of the Form 17–H filed pursuant to §§240.17h–1T and 240.17h–2T of this title, the futures commission must also designate any such affiliated person as a Material Affiliated Person on the organizational chart required as Item 1 of Part I of Form 17–H. To comply with paragraphs (a)(1)(i) and (a)(2) of this section, such futures commission merchant may, at its option, file Form 17–H in its entirety or file such form without the information required under Part II of Form 17–H.

(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 futures commission merchant 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 futures commission merchant or such Material Affiliated Person maintains in accordance with §1.14 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 futures commission merchant 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 futures commission merchant 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 futures commission merchant or such Material Affiliated Person maintains in accordance with §1.14 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 futures commission merchant or such Material Affiliated Person maintains, in addition to the annual statements with schedules and exhibits required to be maintained pursuant to §1.14, 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 futures commission merchant 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 futures commission merchant pursuant to this section shall not constitute an admission for any purpose that a Material Affiliated Person is otherwise subject to the Act.

(e) *Special provisions with respect to Material Affiliated Persons subject to the supervision of a Foreign Regulatory Authority*. A futures commission merchant 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 futures commission merchant 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 futures commission merchant 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 futures commission merchant, 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 futures commission merchant's fiscal year-end and which will allow the Commission to obtain the type of information required herein. The futures commission merchant 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.

(f) *Confidentiality*. All information obtained by the Commission pursuant to the provisions of this section from a futures commission merchant concerning a Material Associated Person shall be deemed confidential information for the purposes of section 8 of the Act.

(g) *Implementation schedule*. Each futures commission merchant registered as of December 31, 1994 and subject to the requirements of this section shall file the information required by paragraph (a)(1) of this section no later than April 30, 1995 and the information required by paragraph (a)(2) of this section no later than May 15, 1995. Each futures commission merchant whose registration becomes effective after December 31, 1994 and 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, or by April 30, 1995, whichever comes later and the information required by paragraph (a)(2) of this section within 105 calendar days after registration is granted or by May 15, 1995, whichever comes later.

[59 FR 66690, Dec. 28, 1994; 60 FR 13901, Mar. 15, 1995]

§ 1.16 Qualifications and reports of accountants.

(a) *Definitions*—(1) *Accountant's report*. The term ''accountant's report,'' when used in regard to financial statements and schedules, means a document in which an independent licensed or certified public accountant indicates the scope of the audit (or examination) which he has made and sets forth his

opinion regarding the financial statements and schedules taken as a whole or an assertion to the fact that an overall opinion cannot be expressed. When an overall opinion cannot be expressed, the reasons therefore must be stated.

(2) *Audit or examination.* The terms ''audit'' and ''examination,'' when used in regard to financial statements and schedules, mean an examination of the statements and schedules by an accountant in accordance with generally accepted auditing standards for the purposes of expressing an opinion thereon.

(3) *Certified.* The term ''certified,'' when used in regard to financial statements and schedules, means audited and reported upon with an opinion expressed by an independent certified public accountant or independent licensed public accountant.

(4) *Customer.* The term ''customer'' means customer (as defined in §1.3(k)) and option customer (as defined in §1.3(jj) of this part and in §32.1(c) of this chapter) and includes a foreign futures and foreign options customer (as defined in §30.1(c) of this chapter).

(b) *Qualifications of accountants.* (1) The Commission will recognize any person as a certified public accountant who is duly registered and in good standing as such under the laws of the place of his residence or principal office. The Commission will recognize any person as a licensed public accountant who was duly licensed on or before December 31, 1970, and is in good standing as such under the laws of the place of his residence or principal office.

(2) The Commission will not recognize any certified public accountant or licensed public accountant as independent who is not in fact independent. For example, an accountant will not be considered independent with respect to any applicant or registrant or any parent, subsidiary, or other affiliate of such applicant or registrant (i) in which, during the period of his professional engagement to examine the financial statements and schedules being reported on or at the date of his report, he or his firm or a member thereof had, or was committed to acquire, any direct financial interest or any material indirect financial interest, or (ii) with which, during the period of his professional engagement to examine the financial statements and schedules being reported on, at the date of his report or during the period covered by the financial statements, he or his firm or a member thereof was connected as a promoter, underwriter, voting trustee, director, officer, or employee, except that a firm will be deemed independent with respect to an applicant or registrant and its affiliates if a former employee or officer of such applicant or registrant or any such affiliate is employed by the firm and such individual has completely disassociated himself from the applicant or registrant and its affiliates and does not participate in auditing financial statements and schedules of the applicant or registrant or its affiliates covering any period of his employment by the applicant or registrant or its affiliates. An accountant will not be considered independent if he or his firm or a member thereof performs manual or automated bookkeeping services or assumes responsibility for maintenance of the accounting records, including accounting classification decisions, of such applicant or registrant or any of its affiliates. For the purposes of this §1.16(b), the term ''member'' means all partners in the firm and all professional employees participating in the audit or located in the office of the firm participating in a significant portion of the audit.

(3) In determining whether an accountant may in fact not be independent with respect to a particular applicant or registrant, the Commission will give appropriate consideration to all relevant circumstances, including evidence bearing on all relationships between the accountant and that applicant or registrant or any affiliate thereof, and will not confine itself to the relationship existing in connection with the filing of reports with the Commission.

(c) *Accountant's reports*—(1) *Technical requirements.* The accountant's report (i) must be dated, (ii) must be signed manually, (iii) must indicate the city and State where issued and (iv) must identify without detailed enumeration

the financial statements covered by the report.

(2) *Representations as to the audit.* The accountant's report (i) must state whether the audit was made in accordance with generally accepted auditing standards, and (ii) must designate any auditing procedures deemed necessary by the accountant under the circumstances of the particular case which have been omitted and the reasons for their omission. However, nothing in this paragraph (c)(2) shall be construed to imply authority for the omission of any procedure which independent accountants would ordinarily employ in the course of an audit made for the purposes of expressing the opinion required by paragraph (c)(3) of this section.

(3) *Opinion to be expressed.* The accountant's report must state clearly: (i) The opinion of the accountant with respect to the financial statements and schedules covered by the report and the accounting principles and practices reflected therein and (ii) the opinion of the accountant as to the consistency of the application of the accounting principles, or as to any changes in such principles which have material effect on the financial statements and schedules.

(4) *Exceptions.* Any matters to which the accountant takes exception must be clearly identified, such exceptions specifically and clearly stated, and to the extent practicable, the effect of each exception on related financial statements and schedules given.

(5) *Accountant's report on material inadequacies.* A registrant must file concurrently with the annual audit report a supplemental report by the accountant describing any material inadequacies found to exist or found to have existed since the date of the previous audit. An applicant must file concurrently with the audit report a supplemental report by the accountant describing any material inadequacies found to exist as of the date of the Form 1–FR being filed: *Provided, however,* That if such applicant is registered with the Securities and Exchange Commission as a securities broker or dealer, and it files (in accordance with § 1.10(h)) a copy of its Financial and Operational Combined Uniform Single Report under the Securities Exchange Act of 1934, part II or part IIA, in lieu of Form 1–FR, the accountant's supplemental report must be made as of the date of such report. The supplemental report must indicate any corrective action taken or proposed by the applicant or registrant in regard thereto. If the audit did not disclose any material inadequacies, the supplemental report must so state.

(d) *Audit objectives.* (1) The audit must be made in accordance with generally accepted auditing standards and must include a review and appropriate tests of the accounting system, the internal accounting control, and the procedures for safeguarding customer and firm assets in accordance with the provisions of the Act and the regulations thereunder, since the prior examination date. The audit must include all procedures necessary under the circumstances to enable the independent licensed or certified public accountant to express an opinion on the financial statements and schedules. The scope of the audit and review of the accounting system, the internal controls, and procedures for safeguarding customer and firm assets must be sufficient to provide reasonable assurance that any material inadequacies existing at the date of the examination in (i) the accounting system, (ii) the internal accounting controls, and (iii) the procedures for safeguarding customer and firm assets (including, in the case of a futures commission merchant, the segregation requirements of section 4d(2) of the Act and these regulations and the secured amount requirements of the Act and these regulations) will be discovered. Additionally, as specified objectives the audit must include reviews of the practices and procedures followed by the registrant in making (A) periodic computations of the minimum financial requirements pursuant to § 1.17 and (B) in the case of a futures commission merchant, daily computations of the segregation requirements of section 4d(2) of the Act and these regulations and the secured amount requirements of the Act and these regulations.

(2) A material inadequacy in the accounting system, the internal accounting controls, the procedures for safeguarding customer and firm assets, and

the practices and procedures referred to in paragraph (d)(1) of this section which is to be reported in accordance with paragraph (e)(2) of this section includes any conditions which contributed substantially to or, if appropriate corrective action is not taken, could reasonably be expected to:

(i) Inhibit an applicant or registrant from promptly completing transactions or promptly discharging his responsibilities to customers or other creditors;

(ii) Result in material financial loss;

(iii) Result in material misstatement of the applicant's or registrant's financial statements and schedules; or

(iv) Result in violations of the Commission's segregation or secured amount (in the case of a futures commission merchant), recordkeeping or financial reporting requirements to the extent that could reasonably be expected to result in the conditions described in paragraph (d)(2) (i), (ii), or (iii) of this section.

(e) *Extent and timing of audit procedures.* (1) The extent and timing of audit procedures are matters for the independent public accountant to determine on the basis of his review and evaluation of existing internal controls and other audit procedures performed in accordance with generally accepted auditing standards and the audit objectives set forth in paragraph (d) of this section. In determining the extent of testing, consideration must be given to the materiality of an area and to the possible effect on the financial statements and schedules of a material misstatement in a related account.

(2) If during the course of an audit or interim work, the independent public accountant determines that any material inadequacies exist in the accounting system, in the internal accounting control, in the procedures for safeguarding customer or firm assets, or as otherwise defined in paragraph (d) of this section, he must call such inadequacies to the attention of the applicant or registrant, which has the responsibility to give notice to the National Futures Association and, if an applicant, or the Commission and the designated self-regulatory organization, if any, if a registrant, in accordance with paragraphs (d) and (g) of § 1.12: *Provided, however,* That if the applicant or registrant is an introducing broker or applicant for registration as an introducing broker, it also has the responsibility to give notice to the National Futures Association, the designated self-regulatory organization, if any, and every futures commission merchant carrying or intending to carry customer accounts for the introducing broker or applicant for registration as an introducing broker. The applicant or registrant must also furnish the accountant with a copy of said notice within three (3) business days. If the accountant fails to receive such notice from the applicant or registrant within three (3) business days, or if he disagrees with the statements contained in the notice of the applicant or registrant, the accountant must inform the National Futures Association, in the case of an applicant, or the Commission and the designated self-regulatory organization, if any, in the case of a registrant, by reporting the material inadequacy and, in the case of an applicant or registrant which is an introducing broker or applicant for registration as in introducing broker, the accountant must also inform the National Futures Association, the designated self-regulatory organization, if any, and every futures commission merchant carrying or intending to carry customer accounts for the introducing an introducing broker, within three (3) business days thereafter. Such report from the accountant must, if the applicant or registrant failed to file a notice, describe the material inadequacies found to exist. If the applicant or registrant filed a notice, the accountant must file a report detailing the aspects, if any, of the applicant's or registrant's notice with which the accountant does not agree.

(f) *Extension of time for filing audited reports.* (1) In the event a registrant finds that it cannot file its certified financial statements and schedules for any year within the time specified in § 1.10 without substantial undue hardship, it may file with the principal office of the Commission in Washington, DC, an application for extension of time to a specified date not more than 90 days after the date as of which the certified financial statements and

schedules were to have been filed. Notice of such application must be sent to the designated self-regulatory organization, if any. The application must be made by the registrant and must:

(i) State the reasons for the requested extension;

(ii) Indicate that the inability to make a timely filing is due to circumstances beyond the control of the registrant, if such is the case, and describe briefly the nature of such circumstances;

(iii) Be accompanied by the latest available formal computation of the registrant's adjusted net capital and minimum financial requirements computed in accordance with § 1.17;

(iv) In the case of a futures commission merchant, be accompanied by the latest available computation of required segregation and by a computation of the amount of money, securities, and property segregated on behalf of customers, and by a computation of secured amounts and funds held in separate accounts for foreign futures and foreign options customers in accordance with § 30.7 of this chapter, as of the date of the latest available computation;

(v) Contain an agreement to file the report on or before the date specified by the registrant in the application;

(vi) Be received by the principal office of the Commission in Washington, DC and by the designated self-regulatory organization, if any, prior to the date on which the report is due; and

(vii) Be accompanied by a letter from the independent public accountant answering the following questions:

(A) What specifically are the reasons for the extension request?

(B) On the basis of that part of your audit to date, do you have any indication that may cause you to consider commenting on any material inadequacies in the accounting system, internal accounting controls or procedures for safeguarding customer or firm assets?

(C) Do you have any indication from the part of your audit completed to date that would lead you to believe that the firm was or is not meeting the minimum capital requirements specified in § 1.17 or (in the case of a futures commission merchant) either the segregation requirements of section 4d(2) of the Act and these regulations or the secured amount requirements of the Act and these regulations, or has any significant financial or recordkeeping problems?

(2) Within ten calendar days after receipt of an application for extension of time, the Commission shall: (i) Notify the registrant of the grant or denial of the requested extension; or (ii) indicate to the registrant that additional time is required to analyze the request, in which case the amount of time needed will be specified.

(3) On the written request of any designated self-regulatory organization or registrant, or on its own motion, the Commission may grant an extension of time or an exemption from any of the certified financial reporting requirements of this chapter either unconditionally or on specified terms and conditions.

(g) *Replacement of accountant.* (1) In the event (i) the independent public accountant who was previously engaged as the principal accountant to audit an applicant's or registrant's financial statements resigns (or indicates he declines to stand for re-election after the completion of the current audit) or is dismissed as the applicant's or registrant's principal accountant, (ii) another independent accountant is engaged as principal accountant, or (iii) an independent accountant on whom the principal accountant expresses reliance in his report regarding a subsidiary resigns (or formally indicates he declines to stand for re-election after completion of the current audit) or is dismissed or another independent public accountant is engaged to audit that subsidiary, an applicant shall file written notice of such occurrence with the National Futures Association, and a registrant shall file written notice of such occurrence with the Commission at its principal office in Washington, DC, and with the designated self-regulatory organization, if any, not more than 15 business days after such occurrence.

(2) Such notice must state (i) the date of such resignation (or declination to stand for re-election, dismissal or engagement) and (ii) whether, in connection with the audit of the two most recent fiscal years and any subsequent

interim period preceding such resignation, dismissal or engagement, there were any disagreements with the former accountant on any matter of accounting principles or practices, financial statements disclosure, auditing scope or procedures, or compliance with the applicable rules of the Commission, which, if not resolved to the satisfaction of the former accountant, would have caused him to make reference in connection with his report to the subject matter of the disagreements (if so, describe such disagreements). The disagreements required to be reported in this paragraph (g)(2) include both those resolved to the former accountant's satisfaction and those not resolved to the former accountant's satisfaction. Disagreements contemplated by this paragraph (g)(2) are those which occur at the decision-making level, *i.e.,* between personnel of the applicant or registrant responsible for presentation of its financial statements and schedules and personnel of the accounting firm responsible for rendering its report. The notice must also state whether the accountant's report on the financial statements and schedules for any of the past two years contained an adverse opinion or a disclaimer of opinion or was qualified as to uncertainties, audit scope, or accounting principles (if so, describe the nature of each such adverse opinion, disclaimer of opinion, or qualification). An applicant must also request the former accountant to furnish the applicant with a letter addressed to the National Futures Association, and a registrant must also request the former accountant to furnish the registrant with a letter addressed to the Commission, stating whether he agrees with the statements contained in the notice of the applicant or registrant and, if not, stating the respects in which he does not agree. Each copy of the notice and accountant's letter must be manually signed by the sole proprietor or a general partner or a duly authorized corporate officer of the applicant or registrant, as appropriate, and by the accountant.

(3) If (i) within the 24 months prior to the date of the most recent audited financial statement, a notice has been filed pursuant to paragraph (g)(1) of this section reporting a change of accountants, (ii) included in such filing there is a reported disagreement on any matters of accounting principles or practices, financial statements disclosure, auditing scope, or noncompliance with the applicable rules of the Commission, (iii) during the fiscal year in which the change in accountants took place or during the subsequent fiscal year, there have been any transactions or events similar to those which involved a reported disagreement, and (iv) such transactions or events are material and were accounted for or disclosed in a manner different from that which the former accountant apparently would have concluded was required, the existence and nature of the disagreements and also the effect on the financial statements must be stated in a written notice to the National Futures Association, in the case of an applicant, or to the Commission at its principal office in Washington, DC, and the designated self-regulatory organization, if any, in the case of a registrant, if the method which the former accountant apparently would have concluded was required had been followed. These disclosures need not be made if the method asserted by the former accountant ceases to be generally accepted because of authoritative standards or interpretations subsequently issued. The notice required by this paragraph (g)(3) must be filed by the applicant or registrant concurrently with the financial statements and schedules to which it pertains.

(h) *Exemption for introducing broker or applicant therefor.* The provisions of this section do not apply to an introducing broker which is operating pursuant to a guarantee agreement, nor do such provisions apply to an applicant for registration as an introducing broker who files concurrently with such application a guarantee agreement, provided such introducing

broker or applicant therefor is not also a securities broker or dealer.

(Approved by the Office of Management and Budget under control numbers 3038–0007, 3038–0024)

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§ 1.17 Minimum financial requirements for futures commission merchants and introducing brokers.

(a)(1)(i) Except as provided in paragraph (a)(2)(i) of this section, each person registered as a futures commission merchant must maintain adjusted net capital equal to or in excess of the greatest of:

(A) $250,000;

(B) Four percent of the following amount: The customer funds required to be segregated pursuant to the Act and the regulations in this part, plus the funds of opt-out customers that, but for the election to opt out pursuant to § 1.68, would be required to be segregated, plus the foreign futures or foreign options secured amount, less the market value of commodity options purchased by customers on or subject to the rules of a contract market or a foreign board of trade for which the full premiums have been paid: *Provided, however,* that the deduction for each customer shall be limited to the amount of segregated customer funds in such customer's account(s) and foreign futures and foreign options secured accounts;

(C) The amount of adjusted net capital required by a registered futures association of which it is a member; or

(D) For securities brokers and dealers, the amount of net capital required by Rule 15c3–1(a) of the Securities and Exchange Commission (17 CFR 240.15c3–1(a)).

(ii) Each person registered as a futures commission merchant engaged in soliciting or accepting orders and customer funds related thereto for the purchase or sale of any commodity for future delivery or any commodity option on or subject to the rules of a registered derivatives transaction execution facility from any customer who does not qualify as an ''institutional customer'' as defined in § 1.3(g) must:

(A) Be a clearing member of a derivatives clearing organization and maintain net capital in the amount of the greater of $20,000,000 or the amounts otherwise specified in paragraph (a)(1)(i) of this section; or

(B) Receive orders on behalf of the customer from a commodity trading advisor acting in accordance with § 4.32 of this chapter.

(iii) Except as provided in paragraph (a)(2) of this section, each person registered as an introducing broker must maintain adjusted net capital equal to or in excess of the greatest of:

(A) $30,000;

(B) The amount of adjusted net capital required by a registered futures association of which it is a member; or

(C) For securities brokers and dealers, the amount of net capital required by Rule 15c3–1(a) of the Securities and Exchange Commission (17 CFR 240.15c3–1(a)).

(2)(i) The requirements of paragraph (a)(1) of this section shall not be applicable if the registrant is a member of a designated self-regulatory organization and conforms to minimum financial standards and related reporting requirements set by such designated self-regulatory organization in its bylaws, rules, regulations or resolutions approved by the Commission pursuant to section 4f(b) of the Act and § 1.52.

(ii) The minimum requirements of paragraph (a)(1)(ii) of this section shall not be applicable to an introducing broker which elects to meet the alternative adjusted net capital requirement for introducing brokers by operating pursuant to a guarantee agreement which meets the requirements set forth in § 1.10(j). Such an introducing broker shall be deemed to meet the adjusted net capital requirement under this section so long as such agreement is binding and in full force and effect, and, if the introducing broker is also a securities broker or dealer, it maintains the amount of net capital required by Rule 15c3–1(a) of the Securities and Exchange Commission (17 CFR 240.15c3–1(a)).

(3) No person applying for registration as a futures commission merchant or as an introducing broker shall be so

registered unless such person affirmatively demonstrates to the satisfaction of the National Futures Association that it complies with the financial requirements of this section. 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 designated self-regulatory organization.

(4) A futures commission merchant who is not in compliance with this section, or is unable to demonstrate such compliance as required by paragraph (a)(3) of this section, must transfer all customer accounts and immediately cease doing business as a futures commission merchant until such time as the firm is able to demonstrate such compliance: *Provided, however,* The registrant may trade for liquidation purposes only unless otherwise directed by the Commission and/or the designated self-regulatory organization: *And, Provided further,* That if such registrant immediately demonstrates to the satisfaction of the Commission or the designated self-regulatory organization the ability to achieve compliance, the Commission or the designated self-regulatory organization may in its discretion allow such registrant up to a maximum of 10 business days in which to achieve compliance without having to transfer accounts and cease doing business as required above. Nothing in this paragraph (a)(4) shall be construed as preventing the Commission or the designated self-regulatory organization from taking action against a registrant for non-compliance with any of the provisions of this section.

(5) An introducing broker who is not in compliance with this section, or is unable to demonstrate such compliance as required by paragraph (a)(3) of this section, must immediately cease doing business as an introducing broker until such time as the registrant is able to demonstrate such compliance: *Provided, however,* That if such registrant immediately demonstrates to the satisfaction of the Commission or the designated self-regulatory organization the ability to achieve compliance, the Commission or the designated self-regulatory organization may in its discretion allow such registrant up to a maximum of 10 business days in which to achieve compliance without having to cease doing business as required above. If the introducing broker is required to cease doing business in accordance with this paragraph (a)(5), the introducing broker must immediately notify each of its customers and the futures commission merchants carrying the account of each customer that it has ceased doing business. Nothing in this paragraph (a)(5) shall be construed as preventing the Commission or the 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.

(2) *Customer* means customer (as defined in § 1.3(k)), option customer (as defined in § 1.3(jj) of this part and in § 32.1(c) of this chapter) and includes a foreign futures and foreign options customer (as defined in § 30.1(c) of this chapter).

(3) *Proprietary account* means a commodity futures or options account carried on the books of the applicant or registrant for the applicant or registrant itself, or for general partners in the applicant or registrant.

(4) *Noncustomer account* means a commodity futures or option account carried on the books of the applicant or registrant which is not included in the definition of customer (as defined in paragraph (b)(2)) or proprietary account (as defined in paragraph (b)(3) of this section).

(5) *Clearing organization* means clearing organization (as defined in § 1.3(d)) and includes a clearing organization of any board of trade.

(6) *Business day* means any day other than a Sunday, Saturday, or holiday.

(c) Definitions: For the purposes of this section:

(1) *Net capital* means the amount by which current assets exceed liabilities. In determining ''net capital'':

(i) Unrealized profits shall be added and unrealized losses shall be deducted in the accounts of the applicant or registrant, including unrealized profits and losses on fixed price commitments and forward contracts;

(ii) All long and all short positions in commodity options which are traded on a contract market and listed security options shall be marked to their market value and all long and all short securities and commodities positions shall be marked to their market value;

(iii) The value attributed to any commodity option which is not traded on a contract market shall be the difference between the option's strike price and the market value for the physical or futures contract which is the subject of the option. In the case of a call commodity option which is not traded on a contract market, if the market value for the physical or futures contract which is the subject of the option is less than the strike price of the option, it shall be given no value. In the case of a put commodity option which is not traded on a contract market, if the market value for the physical or futures contract which is the subject of the option is more than the strike price of the option, it shall be given no value; and

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

(2) The term *current assets* means cash and other assets or resources commonly identified as those which are reasonably expected to be realized in cash or sold during the next 12 months. ''Current assets'' shall:

(i) Exclude any unsecured commodity futures or option account containing a ledger balance and open trades, the combination of which liquidates to a deficit or containing a debit ledger balance only: *Provided, however,* Deficits or debit ledger balances in unsecured customers', non-customers', and proprietary accounts, which are the subject of calls for margin or other required deposits may be included in current assets until the close of business on the business day following the date on which such deficit or debit ledger balance originated providing that the account had timely satisfied, through the deposit of new funds, the previous day's debit or deficits, if any, in its entirety.

(ii) Exclude all unsecured receivables, advances and loans except for:

(A) Receivables resulting from the marketing of inventories commonly associated with the business activities of the applicant or registrant and advances on fixed price purchases commitments: *Provided,* Such receivables or advances are outstanding no longer than 3 calendar months from the date that they are accrued;

(B) Interest receivable, floor brokerage receivable, commissions receivable from other brokers or dealers (other than syndicate profits), mutual fund concessions receivable and management fees receivable from registered investment companies and commodity pools: *Provided,* Such receivables are outstanding no longer than thirty (30) days from the date they are due; and dividends receivable outstanding no longer than thirty (30) days from the payable date;

(C) Receivables from clearing organizations and securities clearing organizations;

(D) Receivables from registered futures commission merchants or brokers, resulting from commodity futures or option transactions, except those specifically excluded under paragraph (c)(2)(i) of this section;

(E) Insurance claims which arise from a reportable segment of the applicant's or registrant's overall business activities, as defined in generally accepted accounting principles, other than in the commodity futures, commodity option, security and security option segments of the applicant's or registrant's business activities which

are not outstanding more than 3 calendar months after the date they are recorded as a receivable;

(F) All other insurance claims not subject to paragraph (c)(2)(ii)(E) of this section, which are not older than seven (7) business days from the date the loss giving rise to the claim is discovered; insurance claims which are not older than twenty (20) business days from the date the loss giving rise to the claim is discovered and which are covered by an option of outside counsel that the claim is valid and is covered by insurance policies presently in effect; insurance claims which are older than twenty (20) business days from the date the loss giving rise to the claim is discovered and which are covered by an opinion of outside counsel that the claim is valid and is covered by insurance policies presently in effect and which have been acknowledged in writing by the insurance carrier as due and payable: *Provided,* Such claims are not outstanding longer than twenty (20) business days from the date they are so acknowledged by the carrier;

(iii) Exclude all prepaid expenses and deferred charges;

(iv) Exclude all inventories except for:

(A) Readily marketable spot commodities; or spot commodities which ''adequately collateralize'' indebtedness under paragraph (c)(7) of this section;

(B) Securities which are considered ''readily marketable'' (as defined in § 240.15c3–1(c)(11) of this title) or which ''adequately collateralize'' indebtedness under paragraph (c)(7) of this section;

(C) Work in process and finished goods which result from the processing of commodities at market value;

(D) Raw materials at market value which will be combined with spot commodities to produce a finished processed commodity; and

(E) Inventories held for resale commonly associated with the business activities of the applicant or registrant;

(v) Include fixed assets and assets which otherwise would be considered noncurrent to the extent of any long-term debt adequately collateralized by assets acquired for use in the ordinary course of the trade or business of an applicant or registrant and any other long-term debt adequately collateralized by assets of the applicant or registrant if the sole recourse of the creditor for nonpayment of such liability is to such asset: *Provided,* Such liabilities are not excluded from liabilities in the computation of net capital under paragraph (c)(4)(vi) of this section;

(vi) Exclude all assets doubtful of collection or realization less any reserves established therefor;

(vii) Include, in the case of future income tax benefits arising as a result of unrealized losses, the amount of such benefits not exceeding the amount of income tax liabilities accrued on the books and records of the applicant or registrant, but only to the extent such benefits could have been applied to reduce accrued tax liabilities on the date of the capital computation, had the related unrealized losses been realized on that date;

(viii) Include guaranteee deposits with clearing organizations and stock in clearing organizations to the extent of its margin value;

(ix) In the case of an introducing broker or an applicant for registration as an introducing broker, include 50 percent of the value of a guarantee or security deposit with a futures commission merchant which carries or intends to carry accounts for the customers of the introducing broker; and

(x) Exclude exchange memberships.

(3) A loan or advance or any other form of receivable shall not be considered ''secured'' for the purposes of paragraph (c)(2) of this section unless the following conditions exist:

(i) The receivable is secured by readily marketable collateral which is otherwise unencumbered and which can be readily converted into cash: *Provided, however,* That the receivable will be considered secured only to the extent of the market value of such collateral after application of the percentage deductions specified in paragraph (c)(5) of this section; and

(ii)(A) The readily marketable collateral is in the possession or control of the applicant or registrant; or

(B) The applicant or registrant has a legally enforceable, written security agreement, signed by the debtor, and

has a perfected security interest in the readily marketable collateral within the meaning of the laws of the State in which the readily marketable collateral is located.

(4) The term *liabilities* means the total money liabilities of an applicant or registrant arising in connection with any transaction whatsoever, including economic obligations of an applicant or registrant that are recognized and measured in conformity with generally accepted accounting principles. ''Liabilities'' also include certain deferred credits that are not obligations but that are recognized and measured in conformity with generally accepted accounting principles. For the purposes of computing ''net capital'', the term ''liabilities'':

(i) Excludes liabilities of an applicant or registrant which are subordi- nated to the claims of all general creditors of the applicant or registrant pursuant to a satisfactory subordination agreement, as defined in paragraph (h) of this section;

(ii) Excludes, in the case of a futures commission merchant, the amount of money, securities and property due to commodity futures or option customers which is held in segregated accounts in compliance with the requirements of the Act and these regulations: *Provided, however,* That such exclusion may be taken only if such money, securities and property held in segregated accounts have been excluded from current assets in computing net capital;

(iii) Includes, in the case of an applicant or registrant who is a sole proprietor, the excess of liabilities which have not been incurred in the course of business as a futures commission merchant or as an introducing broker over assets not used in the business;

(iv) Excludes the lesser of any deferred income tax liability related to the items in paragraphs (c)(4)(i) (A), (B), and (C) below, or the sum of paragraphs (c)(4)(i) (A), (B), and (C) below:

(A) The aggregate amount resulting from applying to the amount of the deductions computed in accordance with paragraph (c)(5) of this section the appropriate Federal and State tax rate(s) applicable to any unrealized gain on the asset on which the deduction was computed;

(B) Any deferred tax liability related to income accrued which is directly related to an asset otherwise deducted pursuant to this section;

(C) Any deferred tax liability related to unrealized appreciation in value of any asset(s) which has been otherwise excluded from current assets in accordance with the provisions of this section;

(v) Excludes any current tax liability related to income accrued which is directly related to an asset otherwise deducted pursuant to this section; and

(vi) Excludes liabilities which would be classified as long term in accordance with generally accepted accounting principles to the extent of the net book value of plant, property and equipment which is used in the ordinary course of any trade or business of the applicant or registrant which is a reportable segment of the applicant's or registrant's overall business activities, as defined in generally accepted accounting principles, other than in the commodity futures, commodity option, security and security option segments of the applicant's or registrant's business activities: *Provided,* That such plant, property and equipment is not included in current assets pursuant to paragraph (c)(2)(v) of this section.

(5) The term *adjusted net capital* means net capital less:

(i) The amount by which any advances paid by the applicant or registrant on cash commodity contracts and used in computing net capital exceeds 95 percent of the market value of the commodities covered by such contracts;

(ii) In the case of all inventory, fixed price commitments and forward contracts, except for inventory and forward contracts in those foreign currencies which are purchased or sold for future delivery on or subject to the rules of a contract market and covered by an open futures contract for which there will be no charge, the applicable percentage of the net position specified below:

(A) Inventory which is currently registered as deliverable on a contract market and covered by an open futures contract or by a commodity option on a physical.—No charge.

(B) Inventory which is covered by an open futures contract or commodity option.—5 percent of the market value.

(C) Inventory which is not covered.—20 percent of the market value.

(D) Fixed price commitments (open purchases and sales) and forward contracts which are covered by an open futures contract or commodity option.—10 percent of the market value.

(E) Fixed price commitments (open purchases and sales) and forward contracts which are not covered by an open futures contract or commodity option.—20 percent of the market value.

(iii)–(iv) [Reserved]

(v) In the case of securities and obligations used by the applicant or registrant in computing net capital, and in the case of a futures commission merchant with securities in segregation pursuant to section 4d(2) of the Act and the regulations in this chapter which were not deposited by customers, the percentages specified in Rule 240.15c3–1(c)(2)(vi) of the Securities and Exchange Commission (17 CFR 240.15c3–1(c)(2)(vi)) (''securities haircuts'') and 100 percent of the value of ''nonmarketable securities'' as specified in Rule 240.15c3–1(c)(2)(vii) of the Securities and Exchange Commission (17 CFR 240.15c3–1(c)(2)(vii));

(vi) In the case of securities options and/or other options for which a haircut has been specified for the option or for the underlying instrument in § 240.15c3–1 appendix A of this title, the treatment specified in, or under, § 240.15c3–1 appendix A, after effecting certain adjustments to net capital for listed and unlisted options as set forth in such appendix;

(vii) In the case of an applicant or registrant who has open contractual commitments, as hereinafter defined, the deductions specified in § 240.15c3–1(c)(2)(viii) of this title;

(viii) In the case of a futures commission merchant, for undermargined customer commodity futures accounts and commodity option customer accounts the amount of funds required in each such account to meet maintenance margin requirements of the applicable board of trade or if there are no such maintenance margin requirements, clearing organization margin requirements applicable to such positions, after application of calls for margin or other required deposits which are outstanding three business days or less. If there are no such maintenance margin requirements or clearing organization margin requirements, then the amount of funds required to provide margin equal to the amount necessary after application of calls for margin or other required deposits outstanding three business days or less to restore original margin when the original margin has been depleted by 50 percent or more: *Provided,* To the extent a deficit is excluded from current assets in accordance with paragraph (c)(2)(i) of this section such amount shall not also be deducted under this paragraph (c)(5)(viii). In the event that an owner of a customer account has deposited an asset other than cash to margin, guarantee or secure his account, the value attributable to such asset for purposes of this subparagraph shall be the lesser of (A) the value attributable to the asset pursuant to the margin rules of the applicable board of trade, or (B) the market value of the asset after application of the percentage deductions specified in this paragraph (c)(5);

(ix) In the case of a futures commission merchant, for undermargined commodity futures and commodity option noncustomer and omnibus accounts the amount of funds required in each such account to meet maintenance margin requirements of the applicable board of trade or if there are no such maintenance margin requirements, clearing organization margin requirements applicable to such positions, after application of calls for margin or other required deposits which are outstanding two business days or less. If there are no such maintenance margin requirements or clearing organization margin requirements, then the amount of funds required to provide margin equal to the amount necessary after application of calls for margin or other required deposits outstanding two business days or less to restore original margin when the original margin has been depleted by 50 percent or more: *Provided,* To the extent a deficit is excluded from current assets in accordance with paragraph (c)(2)(i) of this section such amount shall not also be

deducted under this paragraph (c)(5)(ix). In the event that an owner of a noncustomer or omnibus account has deposited an asset other than cash to margin, guarantee or secure his account the value attributable to such asset for purposes of this subparagraph shall be the lesser of (A) the value attributable to such asset pursuant to the margin rules of the applicable board of trade, or (B) the market value of such asset after application of the percentage deductions specified in this paragraph (c)(5);

(x) In the case of open futures contracts and granted (sold) commodity options held in proprietary accounts carried by the applicant or registrant which are not covered by a position held by the applicant or registrant or which are not the result of a ''changer trade'' made in accordance with the rules of a contract market:

(A) For an applicant or registrant which is a clearing member of a clearing organization for the positions cleared by such member, the applicable margin requirement of the applicable clearing organization;

(B) For an applicant or registrant which is a member of a self-regulatory organization 150 percent of the applicable maintenance margin requirement of the applicable board of trade, or clearing organization, whichever is greater;

(C) For all other applicants or registrants, 200 percent of the applicable maintenance margin requirements of the applicable board of trade or clearing organization, whichever is greater; or

(D) For open contracts or granted (sold) commodity options for which there are no applicable maintenance margin requirements, 200 percent of the applicable initial margin requirement: *Provided*, The equity in any such proprietary account shall reduce the deduction required by this paragraph (c)(5)(x) if such equity is not otherwise includable in adjusted net capital;

(xi) In the case of an applicant or registrant which is a purchaser of a commodity option not traded on a contract market which has value and such value is used to increase adjusted net capital, ten percent of the market value of the physical or futures contract which is the subject of such option but in no event more than the value attributed to such option;

(xii) In the case of an applicant or registrant which is a purchaser of a commodity option which is traded on a contract market the same safety factor as if the applicant or registrant were the grantor of such option in accordance with paragraph (c)(5)(x) of this section, but in no event shall the safety factor be greater than the market value attributed to such option;

(xiii) Five percent of all unsecured receivables includable under paragraph (c)(2)(ii)(D) of this section used by the applicant or registrant in computing ''net capital'' and which are not due from:

(A) A registered futures commission merchant;

(B) A broker or dealer that is registered as such with the Securities and Exchange Commission; or

(C) A foreign broker that has been granted comparability relief pursuant to §30.10 of this chapter, *Provided, however,* that the amount of the unsecured receivable not subject to the five percent capital charge is no greater than 150 percent of the current amount required to maintain futures and option positions in accounts with the foreign broker, or 100 percent of such greater amount required to maintain futures and option positions in the accounts at any time during the previous six-month period, and *Provided, that,* in the case of customer funds, such account is treated in accordance with the special requirements of the applicable Commission order issued under §30.10 of this chapter.

(xiv) For securities brokers and dealers, all other deductions specified in § 240.15c3–1 of this title.

(6) [Reserved]

(7) *Liabilities* are ''adequately collateralized'' when, pursuant to a legally enforceable written instrument, such liabilities are secured by identified assets that are otherwise unencumbered and the market value of which exceeds the amount of such liabilities.

(8) The term *contractual commitments* shall include underwriting, when issued, when distributed, and delayed delivery contracts; and the writing or

endorsement of security puts and calls and combinations thereof; but shall not include uncleared regular way purchases and sales of securities. A series of contracts of purchase or sale of the same security, conditioned, if at all, only upon issuance, may be treated as an individual commitment.

(d) Each applicant or registrant shall have equity capital (inclusive of satisfactory subordination agreements which qualify under this paragraph (d) as equity capital) of not less than 30 percent of the debt-equity total, provided, an applicant or registrant may be exempted from the provisions of this paragraph (d) for a period not to exceed 90 days or for such longer period which the Commission may, upon application of the applicant or registrant, grant in the public interest or for the protection of investors. For the purposes of this paragraph (d):

(1) Equity capital means a satisfactory subordination agreement entered into by a partner or stockholder which has an initial term of at least 3 years and has a remaining term of not less than 12 months if:

(i) It does not have any of the provisions for accelerated maturity provided for by paragraphs (h)(2) (ix)(A), (x)(A), or (x)(B) of this section, or the provisions allowing for special prepayment provided for by paragraph (h)(2)(vii)(B) of this section, and is maintained as capital subject to the provisions restricting the withdrawal thereof required by paragraph (e) of this section; or

(ii) The partnership agreement provides that capital contributed pursuant to a satisfactory subordination agreement as defined in paragraph (h) of this section shall in all respects be partnership capital subject to the provisions restricting the withdrawal thereof required by paragraph (e) of this section, and

(A) In the case of a corporation, the sum of its par or stated value of capital stock, paid in capital in excess of par, retained earnings, unrealized profit and loss, and other capital accounts.

(B) In the case of a partnership, the sum of its capital accounts of partners (inclusive of such partners' commodities, options and securities accounts subject to the provisions of paragraph (e) of this section), and unrealized profit and loss.

(C) In the case of a sole proprietorship, the sum of its capital accounts of the sole proprietorship and unrealized profit and loss.

(2) Debt-equity total means equity capital as defined in paragraph (d)(1) of this section plus the outstanding principal amount of satisfactory subordination agreements.

(e) No equity capital of the applicant or registrant or a subsidiary's or affiliate's equity capital consolidated pursuant to paragraph (f) of this section, whether in the form of capital contributions by partners (including amounts in the commodities, options and securities trading accounts of partners which are treated as equity capital but excluding amounts in such trading accounts which are not equity capital and excluding balances in limited partners' capital accounts in excess of their stated capital contributions), par or stated value of capital stock, paid-in capital in excess of par or stated value, retained earnings or other capital accounts, may be withdrawn by action of a stockholder or partner 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, nor may any unsecured advance or loan be made to a stockholder, partner, sole proprietor, or employee if, after giving effect thereto and to any other such withdrawals, advances, or loans and any payments of payment obligations (as defined in paragraph (h) of this section) under satisfactory subordination agreements and any payments of liabilities excluded pursuant to paragraph (c)(4)(vi) of this section which are scheduled to occur within six months following such withdrawal, advance or loan:

(1) Either adjusted net capital of any of the consolidated entities would be less than the greatest of:

(i) 120 percent of the appropriate minimum dollar amount required by paragraphs (a)(1)(i)(A) or (a)(1)(ii)(A) of this section;

(ii) For a futures commission merchant or applicant therefor, 6 percent of the following amount: The customer

funds required to be segregated pursuant to the Act and the regulations in this part, plus the funds of opt-out customers that, but for the election to opt out pursuant to §1.68, would be required to be segregated, plus the foreign futures or foreign options secured amount, less the market value of commodity options purchased by customers on or subject to the rules of a contract market or a foreign board of trade for which the full premiums have been paid: Provided, however, That the deduction for each customer shall be limited to the amount of customer funds in such customer's account(s) and foreign futures and foreign options secured amounts;

(iii) 120 percent of the amount of adjusted net capital required by a registered futures association of which it is a member; or

(iv) For an applicant or registrant which is also a securities broker or dealer, the amount of net capital specified in Rule 15c3–1(e) of the Securities and Exchange Commission (17 CFR 240.15c3–1(e)); or

(2) In the case of any applicant or registrant included within such consolidation, if equity capital of the applicant or registrant (inclusive of satisfactory subordination agreements which qualify as equity under paragraph (d) of this section) would be less than 30 percent of the required debt-equity total as defined in paragraph (d) of this section.

Provided, That this paragraph (e) shall not preclude an applicant or registrant from making required tax payments or preclude the payment to partners of reasonable compensation. The Commission may, upon application of the applicant or registrant, grant relief from this paragraph (e) if the Commission deems it to be in the public interest or for the protection of nonproprietary accounts.

(f)(1) Every applicant or registrant, in computing its net capital pursuant to this section must, subject to the provisions of paragraphs (f)(2) and (f)(4) of this section, consolidate in a single computation, assets and liabilities of any subsidiary or affiliate for which it guarantees, endorses, or assumes directly or indirectly the obligations or liabilities. The assets and liabilities of a subsidiary or affiliate whose liabilities and obligations have not been guaranteed, endorsed, or assumed directly or indirectly by the applicant or registrant may also be so consolidated if an opinion of counsel is obtained as provided for in paragraph (f)(2) of this section.

(2)(i) If the consolidation, provided for in paragraph (f)(1) of this section, of any such subsidiary or affiliate results in the increase of the applicant's or registrant's adjusted net capital or decreases the minimum adjusted net capital requirement, and an opinion of counsel called for in paragraph (f)(2)(ii) of this section has not been obtained, such benefits shall not be recognized in the applicant's or registrant's computation required by this section.

(ii) Except as provided for in paragraph (f)(2)(i) of this section, consolidation shall be permitted with respect to any subsidiaries or affiliates which are majority owned and controlled by the applicant or registrant, and for which the applicant can demonstrate to the satisfaction of the National Futures Association, or for which the registrant can demonstrate to the satisfaction of the Commission and the designated self-regulatory organization, if any, by an opinion of counsel, that the net asset values or the portion thereof related to the parent's ownership interest in the subsidiary or affiliate, may be caused by the applicant or registrant or an appointed trustee to be distributed to the applicant or registrant within 30 calendar days. Such opinion must also set forth the actions necessary to cause such a distribution to be made, identify the parties having the authority to take such actions, identify and describe the rights of other parties or classes of parties, including but not limited to customers, general creditors, subordinated lenders, minority shareholders, employees, litigants, and governmental or regulatory authorities, who may delay or prevent such a distribution and such other assurances as the National Futures Association, the Commission or the designated self-regulatory organization by rule or interpretation may require. Such opinion must be current and periodically renewed in connection with the applicant's or registrant's annual

audit pursuant to §1.10 or upon any material change in circumstances.

(3) In preparing a consolidated computation of adjusted net capital pursuant to this section, the following minimum and non–exclusive requirements shall be observed;

(i) Consolidated adjusted net capital shall be reduced by the estimated amount of any tax reasonably anticipated to be incurred upon distribution of the assets of the subsidiary or affiliate.

(ii) Liabilities of a consolidated subsidiary or affiliate which are subordinated to the claims of present and future creditors pursuant to a satisfactory subordination agreement shall be deducted from consolidated adjusted net capital unless such subordination extends also to the claims of present or future creditors of the parent applicant or registrant and all consolidated subsidiaries.

(iii) Subordinated liabilities of a consolidated subsidiary or affiliate which are consolidated in accordance with paragraph (f)(3)(ii) of this section may not be prepaid, repaid, or accelerated if any of the entities included in such consolidation would otherwise be unable to comply with the provisions of paragraph (h) of this section.

(iv) Each applicant or registrant included within the consolidation shall at all times be in compliance with the adjusted net capital requirement to which it is subject.

(4) No applicant or registrant shall guarantee, endorse, or assume directly or indirectly any obligation or liability of a subsidiary or affiliate unless the obligation or liability is reflected in the computation of adjusted net capital pursuant to this section except as provided in paragraph (f)(2)(i) of this section.

(g) [Reserved]

(h) The term *satisfactory subordination agreement* (''subordination agreement'') means an agreement which contains the minimum and nonexclusive requirements set forth below.

(1) Certain definitions for purposes of this section:

(i) A subordination agreement may be either a subordinated loan agreement or a secured demand note agreement.

(ii) The term *subordinated loan agreement* means the agreement or agreements evidencing or governing a subordinated borrowing of cash.

(iii) The term ''collateral value'' of any securities pledged to secure a secured demand note means the market value of such securities after giving effect to the percentage deductions specified in Rule 240.15c3–1d(a)(2)(iii) of the Securities and Exchange Commission (17 CFR 240.15c3–1d(a)(2)(iii)).

(iv) The term *payment obligation* means the obligation of an applicant or registrant in respect to any subordination agreement:

(A) To repay cash loaned to the applicant or registrant pursuant to a subordinated loan agreement; or

(B) To return a secured demand note contributed to the applicant or registrant or to reduce the unpaid principal amount thereof and to return cash or securities pledged as collateral to secure the secured demand note; and (C) ''payment'' shall mean the performance by an applicant or registrant of a payment obligation.

(v)(A) The term *secured demand note agreement* means an agreement (including the related secured demand note) evidencing or governing the contribution of a secured demand note to an applicant or registrant and the pledge of securities and/or cash with the applicant or registrant as collateral to secure payment of such secured demand note. The secured demand note agreement may provide that neither the lender, his heirs, executors, administrators, or assigns shall be personally liable on such note and that in the event of default the applicant or registrant shall look for payment of such note solely to the collateral then pledged to secure the same.

(B) The secured demand note shall be a promissory note executed by the lender and shall be payable on the demand of the applicant or registrant to which it is contributed: *Provided, however,* That the making of such demand may be conditioned upon the occurrence of any of certain events which are acceptable to the designated self-regultory organization and the Commission.

(C) If such note is not paid upon presentment and demand as provided for

therein, the applicant or registrant shall have the right to liquidate all or any part of the securities then pledged as collateral to secure payment of the same and to apply the net proceeds of such liquidation, together with any cash then included in the collateral, in payment of such note. Subject to the prior rights of the applicant or registrant as pledgee, the lender, as defined in paragraph (h)(i)(v)(F) of this section may retain ownership of the collateral and have the benefit of any increases and bear the risks fo any decreases in the value of the collateral and may retain the right to vote securities contained within the collateral and any right to income therefrom or distributions thereon, except the applicant or registrant shall have the right to receive and hold as pledgee all dividends payable in securities and all partial and complete liquidating dividends.

(D) Subject to the prior rights of the applicant or registrant as pledgee, the lender may have the right to direct the sale of any securities included in the collateral, to direct the purchase of securities with any cash included therein, to withdraw excess collateral or to substitute cash or other securities as collateral: *Provided,* That the net proceeds of any such sale and the cash so substituted and the securities so purchased or substituted are held by the applicant or registrant as pledgee, and are included within the collateral to secure payment of the secured demand note: *And provided further,* That no such transaction shall be permitted, if, after giving effect therto, the sum of the amount of any cash, plus the collateral value of the securities, then pledged as collateral to secure the secured demand note would be less than the unpaid principal amount of the secured demand note.

(E) Upon payment by the lender, as distinguished from a reduction by the lender which is provided for in paragraph (h)(2)(vi)(C) of this section or reduction by the applicant or registrant as provided for in paragraph (h)(2)(vii) of this section, of all or any part of the unpaid principal amount of the secured demand note, the applicant or registrant shall issue to the lender a subordinated loan agreement in the amout of such payment (or in the case of an pplicant or registrant that is a partnership, credit a capital account of the lender), or issue preferred or common stock of the applicant or registrant in the amount of such payment, or any combination of the foregoing, as provided for in the secured demand note agreement.

(F) The term *lender* means the person who lends cash to an applicant or registrant pursuant to a subordinated loan agreement and the person who contributes a secured demand note to an applicant or registrant pursuant to a secured demand note agreement.

(2) Minimum requirements for subordination agreements:

(i) Subject to paragraph (h)(1) of this section, a subordination agreement shall mean a written agreement between the applicant or registrant and the lender, which:

(A) Has a minimum term of 1 year, except for temporary subordination agreements provided for in paragraph (h)(3)(v) of this section, and

(B) Is a valid and binding obligation enforceable in accordance with its terms (subject as to enforcement to applicable bankruptcy, insolvency, reorganization, moratorium, and other similar laws) against the applicant or registrant and the lender and their respective heirs, executors, administrators, successors, and assigns.

(ii) *Specific amount.* All subordination agreements shall be for a specific dollar amount which shall not be reduced for the duration of the agreement except by installments as specifically provided for therein and except as otherwise provided in this paragraph (h)(2) of this section.

(iii) *Effective subordination.* The subordination agreement shall effectively subordinate any right of the lender to receive any payment with respect thereto, together with accrued interest or compensation, to the prior payment or provision for payment in full of all claims of all present and future creditors of the applicant or registrant arising out of any matter occurring prior to the date on which the related payment obligation matures, except for claims which are the subject of subordination agreements which rank on the same priority as or junior to the claim

of the lender under such subordination agreements.

(iv) *Proceeds of subordinated loan agreements.* The subordinated loan agreement shall provide that the cash proceeds thereof shall be used and dealt with by the applicant or registrant as part of its capital and shall be subject to the risks of the business.

(v) *Certain rights of the borrower.* The subordination agreement shall provide that the applicant or registrant shall have the right to:

(A) Deposit any cash proceeds of a subordinated loan agreement and any cash pledged as collateral to secure a secured demand note in an account or accounts in its own name in any bank or trust company;

(B) Pledge, repledge, hypothecate and rehypothecate, any or all of the securities pledged as collateral to secure a secured demand note, without notice, separately or in common with other securities or property for the purpose of securing any indebtedness of the applicant or registrant; and

(C) Lend to itself or others any or all of the securities and cash pledged as collateral to secure a secured demand note.

(vi) *Collateral for secured demand notes.* Only cash and securities which are fully paid for and which may be publicly offered or sold without registration under the Securities Act of 1933, and the offer, sale, and transfer of which are not otherwise restricted, may be pledged as collateral to secure a secured demand note. The secured demand note agreement shall provide that if at any time the sum of the amount of any cash, plus the collateral value of any securities, then pledged as collateral to secure the secured demand note is less than the unpaid principal amount of the secured demand note, the applicant or registrant must immediately transmit written notice to that effect to the lender. The secured demand note agreement shall also provide that if the borrower is an applicant, such notice must also be transmitted immediately to the National Futures Association, and if the borrower is a registrant, such notice must also be transmitted immediately to the designated self-regulatory organization, if any, and the Commission. The secured demand note agreement shall also require that following such transmittal:

(A) The lender, prior to noon of the business day next succeeding the transmittal of such notice, may pledge as collateral additional cash or securities sufficient, after giving effect to such pledge, to bring the sum of the amount of any cash plus the collateral value of any securities, then pledged as collateral to secure the secured demand note, up to an amount not less than the unpaid principal amount of the secured demand note; and

(B) Unless additional cash or securities are pledged by the lender as provided in paragraph (h)(2)(vi)(A) above, the applicant or registrant at noon on the business day next succeeding the transmittal of notice to the lender must commence sale, for the account of the lender, of such of the securities then pledged as collateral to secure the secured demand note and apply so much of the net proceeds thereof, together with such of the cash then pledged as collateral to secure the secured demand note as may be necessary to eliminate the unpaid principal amount of the secured demand note: *Provided, however,* That the unpaid principal amount of the secured demand note need not be reduced below the sum of the amount of any remaining cash, plus the collateral value of the remaining securities, then pledged as collateral to secure the secured demand note. The applicant or registrant may not purchase for its own account any securities subject to such a sale; and

(C) The secured demand note agreement may also provide that, in lieu of the procedures specified in the provisions required by paragraph (h)(2)(vi)(B) of this section, the lender, with the prior written consent of the applicant and the National Futures Association, or with the prior written consent of the registrant and the designated self-regulatory organization or, if the registrant is not a member of a designated self-regulatory organization, the Commission, may reduce the unpaid principal amount of the secured demand note: *Provided,* That after giving effect to such reduction the adjusted net capital of the applicant or

registrant would not be less than the greatest of:

(*1*) 120 percent of the appropriate minimum dollar amount required by paragraphs (a)(1)(i)(A) or (a)(1)(ii)(A) of this section;

(*2*) For a futures commission merchant or applicant therefor, 7 percent of the following amount: The customer funds required to be segregated pursuant to the Act and the regulations in this part, plus the funds of opt-out customers that, but for the election to opt out pursuant to §1.68, would be required to be segregated, plus the foreign futures or foreign options secured amount, less the market value of commodity options purchased by customers on or subject to the rules of a contract market or a foreign board of trade for which the full premiums have been paid: *Provided, however,* That the deduction for each customer shall be limited to the amount of customer funds in such customer's account(s) and foreign futures and foreign options secured amounts;

(*3*) 120 percent of the amount of adjusted net capital required by a registered futures association of which it is a member; or

(*4*) For an applicant or registrant which is also a securities broker or dealer, the amount of net capital specified in Rule 15c3–1d(b)(6)(iii) of the Securities and Exchange Commission (17 CFR 240.15c3–1d(b)(6)(iii)): *Provided, further,* That no single secured demand note shall be permitted to be reduced by more than 15 percent of its original principal amount and after such reduction no excess collateral may be withdrawn.

(vii) *Permissive prepayments and special prepayments.* (A) An applicant or registrant at its option, but not at the option of the lender, may, if the subordination agreement so provides, make a payment of all or any portion of the payment obligation thereunder prior to the scheduled maturity date of such payment obligation (hereinafter referred to as a ''prepayment''), but in no event may any prepayment be made before the expiration of one year from the date such subordination agreement became effective: *Provided, however,* That the foregoing restriction shall not apply to temporary subordination agreements which comply with the provisions of paragraph (h)(3)(v) of this section nor shall it apply to ''special prepayments'' made in accordance with the provisions of paragraph (h)(2)(vii)(B) of this section. No prepayment shall be made if, after giving effect thereto (and to all payments of payment obligations under any other subordination agreements then outstanding, the maturity or accelerated maturities of which are scheduled to fall due within six months after the date such prepayment is to occur pursuant to this provision, or on or prior to the date on which the payment obligation in respect to such prepayment is scheduled to mature disregarding this provision, whichever date is earlier) without reference to any projected profit or loss of the applicant or registrant, the adjusted net capital of the applicant or registrant is less than the greatest of:

(*1*) 120 percent of the appropriate minimum dollar amount required by paragraphs (a)(1)(i)(A) or (a)(1)(ii)(A) of this section;

(*2*) For a futures commission merchant or applicant therefor, 7 percent of the following amount: The customer funds required to be segregated pursuant to the Act and the regulations in this part, plus the funds of opt-out customers that, but for the election to opt out pursuant to §1.68, would be required to be segregated, plus the foreign futures or foreign options secured amount, less the market value of commodity options purchased by customers on or subject to the rules of a contract market or a foreign board of trade for which the full premiums have been paid: *Provided, however,* That the deduction for each customer shall be limited to the amount of customer funds in such customer's account(s) and foreign futures and foreign options secured amounts;

(*3*) 120 percent of the amount of adjusted net capital required by a registered futures association of which it is a member; or

(*4*) For an applicant or registrant which is also a securities broker or dealer, the amount of net capital specified in Rule 15c3–1d(b)(7) of the Securities and Exchange Commission (17 CFR 240.15c3–1d(b)(7)).

(B) An applicant or registrant at its option, but not at the option of the lender, may, if the subordination agreement so provides, make a payment at any time of all or any portion of the payment obligation thereunder prior to the scheduled maturity date of such payment obligation (hereinafter referred to as a ''special prepayment''). No special prepayment shall be made if, after giving effect thereto (and to all payments of payment obligations under any other subordination agreements then outstanding, the maturity or accelerated maturities of which are scheduled to fall due within six months after the date such special prepayment is to occur pursuant to this provision, or on or prior to the date on which the payment obligation in respect to such special prepayment is scheduled to mature disregarding this provision, whichever date is earlier) without reference to any projected profit or loss of the applicant or registrant, the adjusted net capital of the applicant or registrant is less than the greatest of:

(*1*) 200 percent of the appropriate minimum dollar amount required by paragraphs (a)(1)(i)(A) or (a)(1)(ii)(A) of this section;

(2) For a futures commission merchant or applicant therefor, 10 percent of the following amount: The customer funds required to be segregated pursuant to the Act and the regulations in this part, plus the funds of opt-out customers that, but for the election to opt out pursuant to §1.68, would be required to be segregated, plus the foreign futures or foreign options secured amount, less the market value of commodity options purchased by customers on or subject to the rules of a contract market or a foreign board of trade for which the full premiums have been paid: *Provided, however,* That the deduction for each customer shall be limited to the amount of customer funds in such customer's account(s) and foreign futures and foreign options secured amounts;

(*3*) 120 percent of the amount of adjusted net capital required by a registered futures association of which it is a member; or

(*4*) For an applicant or registrant which is also a securities broker or dealer, the amount of net capital specified in Rule 15c3–1d(c)(5)(ii) of the Securities and Exchange Commission (17 CFR 240.15c3–1d(c)(5)(ii)): *Provided, however,* That no special prepayment shall be made if pre-tax losses during the latest three-month period were greater than 15 percent of current excess adjusted net capital.

(C)(*1*) Notwithstanding the provisions of paragraphs (h)(2)(vii)(A) and (h)(2)(vii)(B) of this section, in the case of an applicant, no prepayment or special prepayment shall occur without the prior written approval of the National Futures Association; in the case of a registrant, no prepayment or special prepayment shall occur without the prior written approval of the designated self-regulatory organization, if any, or of the Commission if the registrant is not a member of a self-regulatory organization.

(*2*) A registrant may make a prepayment or special prepayment without the prior written approval of the designated self-regulatory organization: Provided, That the registrant: Is a securities broker or dealer registered with the Securities and Exchange Commission; files a request to make a prepayment or special prepayment with its applicable securities designated examining authority, as defined in Rule 15c3–1(c)(12) of the Securities and Exchange Commission (17 CFR 240.15c3–1(c)(12)), in the form and manner prescribed by the designated examining authority; files a copy of the prepayment request or special prepayment request with the designated self-regulatory organization at the time it files such request with the designated examining authority in the form and manner prescribed by the designated self-regulatory organization; and files a copy of the designated examining authority's approval of the prepayment or special prepayment with the designated self-regulatory organization immediately upon receipt of such approval. The approval of the prepayment or special prepayment by the designated examining authority will be deemed approval by the designated self-regulatory organization, unless the designated self-regulatory organization

notifies the registrant that the designated examining authority's approval shall not constitute designated self-regulatory organization approval.

(*3*) The designated self-regulatory organization shall immediately provide the Commission with a copy of any notice of approval issued where the requested prepayment or special prepayment will result in the reduction of the registrant's net capital by 20 percent or more or the registrant's excess adjusted net capital by 30 percent or more.

(viii) *Suspended repayment.* (A) The payment obligation of the applicant or registrant in respect of any subordination agreement shall be suspended and shall not mature if, after giving effect to payment of such payment obligation (and to all payments of payment obligations of the applicant or registrant under any other subordination agreement(s) then outstanding which are scheduled to mature on or before such payment obligation), the adjusted net capital of the applicant or registrant would be less than the greatest of:

(*1*) 120 percent of the appropriate minimum dollar amount required by paragraphs (a)(1)(i)(A) or (a)(1)(ii)(A) of this section;

(*2*) For a futures commission merchant or applicant therefor, 6 percent of the following amount: The customer funds required to be segregated pursuant to the Act and the regulations in this part, plus the funds of opt-out customers that, but for the election to opt out pursuant to §1.68, would be required to be segregated, plus the foreign futures or foreign options secured amount, less the market value of commodity options purchased by customers on or subject to the rules of a contract market or a foreign board of trade for which the full premiums have been paid: *Provided, however,* That the deduction for each customer shall be limited to the amount of customer funds in such customer's account(s) and foreign futures and foreign options secured amounts;

(*3*) 120 percent of the amount of adjusted net capital required by a registered futures association of which it is a member; or

(*4*) For an applicant or registrant which is also a securities broker or dealer, the amount of net capital specified in Rule 15c3–1d(b)(8)(i) of the Securities and Exchange Commission (17 CFR 240.15c3–1d(b)(8)(i)): *Provided,* That the subordination agreement may provide that if the payment obligation of the applicant or registrant thereunder does not mature and is suspended as a result of the requirement of this paragraph (h)(2)(viii) for a period of not less than six months, the applicant or registrant shall then commence the rapid and orderly liquidation of its business, but the right of the lender to receive payment, together with accrued interest or compensation, shall remain subordinate as required by the provisions of this section.

(B) [Reserved]

(ix) *Accelerated maturity.* Obligation to repay to remain subordinate:

(A) Subject to the provisions of paragraph (h)(2)(viii) of this section, a subordination agreement may provide that the lender may, upon prior written notice to the applicant and the National Futures Association, or upon prior written notice to the registrant and the designated self-regulatory organization or, if the registrant is not a member of a designated self-regulatory organization, the Commission, given not earlier than six months after the effective date of such subordination agreement, accelerate the date on which the payment obligation of the borrower, together with accrued interest or compensation, is scheduled to mature to a date not earlier than six months after giving of such notice, but the right of the lender to receive payment, together with accrued interest or compensation, shall remain subordinate as required by the provisions of this paragraph (h)(2) of this section.

(B) Notwithstanding the provisions of paragraph (h)(2)(viii) of this section, the payment obligation of the applicant or registrant with respect to a subordination agreement, together with accrued interest and compensation, shall mature in the event of any receivership, insolvency, liquidation pursuant to the Securities Investor Protection Act of 1970 or otherwise, bankruptcy, assignment for the benefit of creditors, reorganization whether or not pursuant to the bankruptcy laws, or any other marshalling of the assets

and liabilities of the applicant or registrant, but the right of the lender to receive payment, together with accrued interest or compensation, shall remain subordinate as required by the provisions of paragraph (h)(2) of this section.

(x) *Accelerated maturity of subordination agreements on event of default and event of acceleration.* Obligation to repay to remain subordinate:

(A) A subordination agreement may provide that the lender may, upon prior written notice to the applicant and the National Futures Association, or upon prior written notice to the registrant and the designated self-regulatory organization or, if the registrant is not a member of a designated self-regulatory organization, the Commission, of the occurrence of any event of acceleration (as hereinafter defined) given no sooner than six months after the effective date of such subordination agreement, accelerate the date on which the payment obligation of the applicant or registrant, together with accrued interest or compensation, is scheduled to mature, to the last business day of a calendar month which is not less than six months after notice of acceleration is received by the applicant and by the National Futures Association, or by the registrant and the designated self-regulatory organization or, if the registrant is not a member of a designated self-regulatory organization, the Commission. Any subordination agreement containing such events of acceleration may also provide that, if upon such accelerated maturity date the payment obligation of the applicant or registrant is suspended as required by paragraph (h)(2)(viii) of this section and liquidation of the applicant or registrant has not commenced on or prior to such accelerated maturity date, notwithstanding paragraph (h)(2)(viii) of this section, the payment obligation of the applicant or registrant with respect to such subordination agreement shall mature on the day immediately following such accelerated maturity date and in any such event the payment obligations of the applicant or registrant with respect to all other subordination agreements then outstanding shall also mature at the same time but the rights of the respective lenders to receive payment, together with accrued interest or compensation, shall remain subordinate as required by the provisions of paragraph (h)(2) of this section. Events of acceleration which may be included in a subordination agreement complying with this paragraph (h)(2)(x) of this section shall be limited to:

(*1*) Failure to pay interest or any installment of principal on a subordination agreement as scheduled;

(*2*) Failure to pay when due other money obligations of a specified material amount;

(*3*) Discovery that any material, specified representation or warranty of the applicant or registrant which is included in the subordination agreement and on which the subordination agreement was based or continued was inaccurate in a material respect at the time made;

(*4*) Any specified and clearly measurable event which is included in the subordination agreement and which the lender and the applicant or registrant agree, (a) is a significant indication that the financial position of the applicant or registrant has changed materially and adversely from agreed upon specified norms; or (b) could materially and adversely affect the ability of the applicant or registrant to conduct its business as conducted on the date the subordination agreement was made; or (c) is a significant change in the senior management of the applicant or registrant or in the general business conducted by the applicant or registrant from that which obtained on the date the subordination agreement became effective;

(*5*) Any continued failure to perform agreed covenants included in the subordination agreement relating to the conduct of the business of the applicant or registrant or relating to the maintenance and reporting of its financial position; and

(B) Notwithstanding the provisions of paragraph (h)(2)(viii) of this section, a subordination agreement may provide that, if liquidation of the business of the applicant or registrant has not already commenced, the payment obligation of the applicant or registrant shall mature, together with accrued interest or compensation, upon the occurrence

of an event of default (as hereinafter defined). Such agreement may also provide that, if liquidation of the business of the applicant or registrant has not already commenced, the rapid and orderly liquidation of the business of the applicant or registrant shall then commence upon the happening of an event of default. Any subordination agreement which so provides for maturity of the payment obligation upon the occurrence of an event of default shall also provide that the date on which such event of default occurs shall, if liquidation of the applicant or registrant has not already commenced, be the date on which the payment obligation of the applicant or registrant with respect to all other subordination agreements then outstanding shall mature but the rights of the respective lenders to receive payment, together with accrued interest or compensation, shall remain subordinate as required by the provisions of paragraph (h)(2) of this section. Events of default which may be included in a subordination agreement shall be limited to:

(*1*) The making of an application by the Securities Investor Protection Corporation for a decree adjudicating that customers of the applicant or registrant are in need of protection under the Securities Investor Protection Act of 1970 and the failure of the applicant or registrant to obtain the dismissal of such application within 30 days;

(*2*) Failure to meet the minimum capital requirements of the designated self-regulatory organization, or of the Commission, throughout a period of 15 consecutive business days, commencing on the day the borrower first determines and notifies the designated self-regulatory organization, if any, of which he is a member and the Commission, in the case of a registrant, or the National Futures Association, in the case of an applicant, or commencing on the day any self-regulatory organization, the Commission or the National Futures Association first determines and notifies the applicant or registrant of such fact;

(*3*) The Commission shall revoke the registration of the applicant or registrant;

(*4*) The self-regulatory organization shall suspend (and not reinstate within 10 days) or revoke the applicant or registrant's status as a member thereof;

(*5*) Any receivership, insolvency, liquidation pursuant to the Securities Investor Protection Act of 1970 or otherwise, bankruptcy, assignment for the benefit of creditors, reorganization whether or not pursuant to bankruptcy laws, or any other marshalling of the assets and liabilities of the applicant or registrant. A subordination agreement which contains any of the provisions permitted by this subparagraph (2)(x) shall not contain the provision otherwise permitted by paragraph (h)(2)(ix)(A) of this section.

(3) *Miscellaneous provisions*—(i) *Prohibited cancellation*. The subordination agreement shall not be subject to cancellation by either party; no payment shall be made with respect thereto and the agreement shall not be terminated, rescinded or modified by mutual consent or otherwise if the effect thereof would be inconsistent with the requirements of paragraph (h) of this section.

(ii) *Notice of maturity or accelerated maturity*. Every applicant or registrant shall immediately notify the National Futures Association, and the registrant shall immediately notify the designated self-regulatory organization, if any, and the Commission if, after giving effect to all payments of payment obligations under subordination agreements then outstanding which are then due or mature within the following six months without reference to any projected profit or loss of the applicant or registrant, its adjusted net capital would be less than:

(A) 120 percent of the minimum dollar amount required by paragraphs (a)(1)(i)(A) or (a)(1)(ii)(A) of this section;

(B) For a futures commission merchant or applicant therefor, 6 percent of the following amount: The customer funds required to be segregated pursuant to the Act and the regulations in this part, plus the funds of opt-out customers that, but for the election to opt out pursuant to §1.68, would be required to be segregated, plus the foreign futures or foreign options secured amount, less the market value of commodity options purchased by customers on or subject to the rules of a contract market or a foreign board of

trade for which the full premiums have been paid: *Provided, however,* That the deduction for each customer shall be limited to the amount of customer funds in such customer's account(s) and foreign futures and foreign options secured amounts;

(C) 120 percent of the amount of adjusted net capital required by a registered futures association of which it is a member; or

(D) For an applicant or registrant which is also a securities broker or dealer, the amount of net capital specified in Rule 15c3–1d(c)(2) of the Securities and Exchange Commission (17 CFR 240.15c3–1d(c)(2)).

(iii) *Certain legends.* If all the provisions of a satisfactory subordination agreement do not appear in a single instrument, then the debenture or other evidence of indebtedness shall bear on its face an appropriate legend stating that it is issued subject to the provisions of a satisfactory subordination agreement which shall be adequately referred to and incorporated by reference.

(iv) *Legal title to securities.* All securities pledged as collateral to secure a secured demand note must be in bearer form, or registered in the name of the applicant or registrant or the name of its nominee or custodian.

(v) *Temporary subordinations.* To enable an applicant or registrant to participate as an underwriter of securities or undertake other extraordinary activities and remain in compliance with the adjusted net capital requirements of this section, an applicant or registrant shall be permitted, on no more than three occasions in any 12-month period, to enter into a subordination agreement on a temporary basis which has a stated term of no more than 45 days from the date the subordination agreement became effective: *Provided,* That this temporary relief shall not apply to any applicant or registrant if the adjusted net capital of the applicant or registrant is less than the greatest of:

(A) 120 percent of the appropriate minimum dollar amount required by paragraphs (a)(1)(i)(A) or (a)(1)(ii)(A) of this section;

(B) For a futures commission merchant or applicant therefor, 7 percent of the following amount: The customer funds required to be segregated pursuant to the Act and the regulations in this part, plus the funds of opt-out customers that, but for the election to opt out pursuant to §1.68, would be required to be segregated, plus the foreign futures or foreign options secured amount, less the market value of commodity options purchased by customers on or subject to the rules of a contract market or a foreign board of trade for which the full premiums have been paid: *Provided, however,* That the deduction for each customer shall be limited to the amount of customer funds in such customer's account(s) and foreign futures and foreign options secured amounts;

(C) 120 percent of the amount of adjusted net capital required by a registered futures association of which it is a member;

(D) For an applicant or registrant which is also a securities broker or dealer, the amount of net capital specified in Rule 15c3–1d(c)(5)(i) of the Securities and Exchange Commission (17 CFR 240.15c3–1d(c)(5)(i)); or

(E) The amount of equity capital as defined in paragraph (d) of this section is less than the limits specified in paragraph (d) of this section. Such temporary subordination agreement shall be subject to all the other provisions of this section.

(vi) *Filing.* An applicant shall file a signed copy of any proposed subordination agreement (including nonconforming subordination agreements) with the National Futures Association at least ten days prior to the proposed effective date of the agreement or at such other time as the National Futures Association for good cause shall accept such filing. A registrant that is not a member of any designated self-regulatory organization shall file two signed copies of any proposed subordination agreement (including nonconforming subordination agreements) with the regional office of the Commission nearest the principal place of business of the registrant (except that a registrant under the jurisdiction of the Commission's Western Regional Office shall file such copies with the Commission's Southwestern Regional Office) at

least ten days prior to the proposed effective date of the agreement or at such other time as the Commission for good cause shall accept such filing. A registrant that is a member of a designated self-regulatory organization shall file signed copies of any proposed subordination agreement (including nonconforming subordination agreements) with the designated self-regulatory organization in such quantities and at such time as the designated self-regulatory organization may require prior to the effective date. The applicant or registrant shall also file with said parties a statement setting forth the name and address of the lender, the business relationship of the lender to the applicant or registrant and whether the applicant or registrant carried funds or securities for the lender at or about the time the proposed agreement was so filed. A proposed agreement filed by an applicant with the National Futures Association shall be reviewed by the National Futures Association, and no such agreement shall be a satisfactory subordination agreement for the purposes of this section unless and until the National Futures Association has found the agreement acceptable and such agreement has become effective in the form found acceptable. A proposed agreement filed by a registrant shall be reviewed by the designated self-regulatory organization with whom such an agreement is required to be filed prior to its becoming effective or, if the registrant is not a member of any designated self-regulatory organization, by the regional office of the Commission where the agreement is required to be filed prior to its becoming effective. No proposed agreement shall be a satisfactory subordination agreement for the purposes of this section unless and until the designated self-regulatory organization or, if a registrant is not a member of any designated self-regulatory organization, the Commission, has found the agreement acceptable and such agreement has become effective in the form found acceptable: Provided, however, That a proposed agreement shall be a satisfactory subordination agreement for purpose of this section if the registrant: is a securities broker or dealer registered with the Securities and Exchange Commission; files signed copies of the proposed subordination agreement with the applicable securities designated examining authority, as defined in Rule 15c3–1(c)(12) of the Securities and Exchange Commission (17 CFR 240.15c3–1(c)(12)), in the form and manner prescribed by the designated examining authority; files signed copies of the proposed subordination agreement with the designated self-regulatory organization at the time it files such copies with the designated examining authority in the form and manner prescribed by the designated self-regulatory organization; and files a copy of the designated examining authority's approval of the proposed subordination agreement with the designated self-regulatory organization immediately upon receipt of such approval. The designated examining authority's determination that the proposed subordination agreement satisfies the requirements for a satisfactory subordination agreement will be deemed a like finding by the designated self-regulatory organization, unless the designated self-regulatory organization notifies the registrant that the designated examining authority's determination shall not constitute a like finding by the designated self-regulatory organization.

(vii) *Subordination agreements in effect prior to adoption.* Any subordination agreement which has been entered into prior to the effective date of this section and which has been deemed to be satisfactorily subordinated pursuant to this section previously in effect or the adjusted net capital rules of a self-regulatory organization shall continue to be deemed a satisfactory subordination agreement until the maturity of such agreement. *Provided,* That no renewal of an agreement which provides for automatic or optional renewal by the applicant or registrant or lender shall be deemed to be a satisfactory subordination agreement unless such renewal agreement meets the requirements of this section, within 6 months of the effective date of this section. *Provided further,* That all subordination agreements must meet the requirements of this rule within 5 years of the effective date of this section.

(4) A designated self-regulatory organization and the Commission may allow debt with a maturity date of 1 year or more to be treated as meeting the provisions of this paragraph (h): *Provided,* (i) Such exemption shall only be given when the registrant's adjusted net capital is less than the minimum required by this section or by the capital rule of the designated self-regulatory organization to which such registrant is subject;

(ii) That such debt did not exist prior to its use under this paragraph (h)(4);

(iii) Such exemption shall be for a period of 30 days or such lesser period as the designated self-regulatory organization and the Commission may determine;

(iv) Such exemption shall not be allowed more than once in any 12 month period; and

(v) At all times during such exemption the registrant shall make a good faith effort to comply with the provisions of this section or the capital rule of the designated self-regulatory organization to which such registrant is subject exclusive of any benefits derived from this paragraph (h)(4).

(i) [Reserved]

(j) For the purposes of this section *cover* is defined as follows:

(1) *General definition.* Cover shall mean transactions or positions in a contract for future delivery on a board of trade or a commodity option where such transactions or positions normally represent a substitute for transactions to be made or positions to be taken at a later time in a physical marketing channel, and where they are economically appropriate to the reduction of risks in the conduct and management of a commercial enterprise, and where they arise from:

(i) The potential change in the value of assets which a person owns, produces, manufactures, processes, or merchandises or anticipates owning, producing, manufacturing, processing, or merchandising.

(ii) The potential change in the value of liabilities which a person owes or anticipates incurring, or

(iii) The potential change in the value of services which a person provides, purchases or anticipates providing or purchasing. Notwithstanding the foregoing, no transactions or positions shall be classified as cover for the purposes of this section unless their purpose is to offset price risks incidental to commercial cash or spot operations and such positions are established and liquidated in accordance with sound commercial practices and unless the provisions of paragraphs (j)(2) and (3) of this section have been satisfied.

(2) *Enumerated cover transactions.* The definition of covered transactions and positions in paragraph (j)(1) of this section includes, but is not limited to, the following specific transactions and positions:

(i) Ownership or fixed-price purchase of any commodity which does not exceed in quantity (A) the sales of the same commodity for future delivery on a board of trade or (B) the purchase of a put commodity option of the same commodity for which the market value for the actual commodity or futures contract which is the subject of the option is less than the strike price of the option or (C) the ownership of a commodity option position established by the sale (grant) of a call commodity option of the same commodity for which the market value for the actual commodity or futures contract which is the subject of the option is more than the strike price of the option: *Provided,* That for purposes of paragraph (c)(5)(x) of this section the market value for the actual commodity or futures contract which is the subject of such option need not be more than the strike price of that option;

(ii) Fixed-price sale of any commodity which does not exceed in quantity (A) the purchase of the same commodity for future delivery on a board of trade or (B) the purchase of a call commodity option of the same commodity for which the market value for the actual commodity or futures contract which is the subject of such option is more than the strike price of the option or (C) ownership of a commodity option position established by the sale (grant) of a put commodity option of the same commodity for which the market value for the actual commodity or futures comtract which is the subject of the option is less than the strike price of the option: *Provided,*

That for purposes of paragraph (c)(5)(x) of this section the market value for the actual commodity or futures contract which is the subject of such option need not be less than the strike price of that option; and

(iii) Ownership or fixed-price contracts of a commodity described in paragraphs (j)(2)(i) and (j)(2)(ii) of this section may also be covered other than by the same quantity of the same cash commodity, provided that the fluctuations in value of the position for future delivery or commodity option are substantially related to the fluctuations in value of the actual cash position.

(3) *Nonenumerated cases.* Upon specific request, the Commission may recognize transactions and positions other than those enumerated in paragraph (j)(2) of this section as cover in amounts and under the terms and conditions as it may specify. Any applicant or registrant who wishes to avail itself of the provisions of this paragraph (j)(3) must apply to the Commission in writing at its principal office in Washington, DC giving full details of the transaction including detailed information which will demonstrate that the transaction is economically appropriate to the reduction of risk exposure attendant to the conduct and management of a commercial enterprise.

(Approved by the Office of Management and Budget under control number 3038–0024)

[43 FR 39972, Sept. 8, 1978]

EDITORIAL NOTE: For FEDERAL REGISTER citations affecting §1.17, see the List of Sections Affected, which appears in the Finding Aids section of the printed volume and on GPO Access.

§ 1.18 Records for and relating to financial reporting and monthly computation by futures commission merchants and introducing brokers.

(a) No person shall be registered as a futures commission merchant or as an introducing broker 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 Form 1–FR–IB, respectively, or, if such person is registered with the Securities and Exchange Commission as a securities broker or dealer and he files (in accordance with §1.10(h)) a copy of his Financial and Operational Combined Uniform Single Report under the Securities Exchange Act of 1934, Part II or Part IIA, in lieu of Form 1–FR–FCM or Form 1–FR–IB, the account classification subdivisions specified on such Report, or categories that are in accord with generally accepted accounting principles. 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 formal computations of its adjusted net capital and of its minimum financial requirements pursuant to §1.17 or the requirements of the designated self-regulatory organization to which it is subject as of the close of business each month. An applicant or registrant which is also registered as a securities broker or dealer with the Securities and Exchange Commission may meet the computation requirements of this paragraph (b) by completing the Statement of Financial and Operational Combined Uniform Single Report under the Securities Exchange Act of 1934, Part II or Part IIA. 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: *Provided, however,* That for each month ending between June 30, 1997 and December 31, 1997, inclusive, such computations must be completed and made available for inspection within 30 calendar days after the date for which the computations are made.

(c) The provisions of this section do not apply to an introducing broker

which is operating pursuant to a guarantee agreement, nor do such provisions apply to an applicant for registration as an introducing broker who files concurrently with such application a guarantee agreement, provided such introducing broker or applicant therefor is not also a securities broker or dealer.

[48 FR 35288, Aug. 3, 1983, as amended at 49 FR 39530, Oct. 9, 1984; 62 FR 4641, Jan. 31, 1997]

PROHIBITED TRADING IN COMMODITY OPTIONS

§ 1.19 Prohibited trading in certain "puts" and "calls".

No futures commission merchant or introducing broker may make, underwrite, issue, or otherwise assume any financial responsibility for the fulfillment of, any commodity option except:

(a) Commodity options traded on or subject to the rules of a contract market in accordance with the requirements of part 33 of this chapter;

(b) Commodity options traded on or subject to the rules of a foreign board of trade in accordance with the requirements of part 30 of this chapter; or

(c) For futures commission merchants, any option permitted under § 32.4 of this chapter, *provided however,* that a capital treatment for such options is referenced in § 1.17(c)(5)(vi).

[52 FR 28997, Aug. 5, 1987, as amended at 58 FR 68520, Dec. 28, 1993]

CUSTOMERS' MONEY, SECURITIES, AND PROPERTY

§ 1.20 Customer funds to be segregated and separately accounted for.

(a) All customer funds shall be separately accounted for and segregated as belonging to commodity or option customers. Such customer funds when deposited with any bank, trust company, clearing organization or another futures commission merchant shall be deposited under an account name which clearly identifies them as such and shows that they are segregated as required by the Act and this part. Each registrant shall obtain and retain in its files for the period provided in § 1.31 a written acknowledgment from such bank, trust company, clearing organization, or futures commission merchant, that it was informed that the customer funds deposited therein are those of commodity or option customers and are being held in accordance with the provisions of the Act and this part: *Provided, however,* that an acknowledgment need not be obtained from a clearing organization that has adopted and submitted to the Commission rules that provide for the segregation as customer funds, in accordance with all relevant provisions of the Act and the rules and orders promulgated thereunder, of all funds held on behalf of customers. Under no circumstances shall any portion of customer funds be obligated to a clearing organization, any member of a contract market, a futures commission merchant, or any depository except to purchase, margin, guarantee, secure, transfer, adjust or settle trades, contracts or commodity option transactions of commodity or option customers. No person, including any clearing organization or any depository, that has received customer funds for deposit in a segregated account, as provided in this section, may hold, dispose of, or use any such funds as belonging to any person other than the option or commodity customers of the futures commission merchant which deposited such funds.

(b) All customer funds received by a clearing organization from a member of the clearing organization to purchase, margin, guarantee, secure or settle the trades, contracts or commodity options of the clearing member's commodity or option customers and all money accruing to such commodity or option customers as the result of trades, contracts or commodity options so carried shall be separately accounted for and segregated as belonging to such commodity or option customers, and a clearing organization shall not hold, use or dispose of such customer funds except as belonging to such commodity or option customers. Such customer funds when deposited in a bank or trust company shall be deposited under an account name which clearly shows that they are the customer funds of the commodity or option customers of clearing members, segregated as required by the Act and

these regulations. The clearing organization shall obtain and retain in its files for the period provided by § 1.31 an acknowledgment from such bank or trust company that it was informed that the customer funds deposited therein are those of commodity or option customers of its clearing members and are being held in accordance with the provisions of the Act and these regulations.

(c) Each futures commission merchant shall treat and deal with the customer funds of a commodity customer or of an option customer as belonging to such commodity or option customer. All customer funds shall be separately accounted for, and shall not be commingled with the money, securities or property of a futures commission merchant or of any other person, or be used to secure or guarantee the trades, contracts or commodity options, or to secure or extend the credit, of any person other than the one for whom the same are held: *Provided, however,* That customer funds treated as belonging to the commodity or option customers of a futures commission merchant may for convenience be commingled and deposited in the same account or accounts with any bank or trust company, with another person registered as a futures commission merchant, or with a clearing organization, and that such share thereof as in the normal course of business is necessary to purchase, margin, guarantee, secure, transfer, adjust, or settle the trades, contracts or commodity options of such commodity or option customers or resulting market positions, with the clearing organization or with any other person registered as a futures commission merchant, may be withdrawn and applied to such purposes, including the payment of premiums to option grantors, commissions, brokerage, interest, taxes, storage and other fees and charges, lawfully accruing in connection with such trades, contracts or commodity options: *Provided, further,* That customer funds may be invested in instruments described in § 1.25.

(Approved by the Office of Management and Budget under control numbers 3038–0007, and 3038–0024)

[46 FR 54518, Nov. 3, 1981, as amended at 46 FR 63035, Dec. 30, 1981; 50 FR 36051, Sept. 5, 1985; 65 FR 78009, Dec. 13, 2000]

§ 1.21 Care of money and equities accruing to customers.

All money received directly or indirectly by, and all money and equities accruing to, a futures commission merchant from any clearing organization or from any clearing member or from any member of a contract market incident to or resulting from any trade, contract or commodity option made by or through such futures commission merchant on behalf of any commodity or option customer shall be considered as accruing to such commodity or option customer within the meaning of the Act and these regulations. Such money and equities shall be treated and dealt with as belonging to such commodity or option customer in accordance with the provisions of the Act and these regulations. Money and equities accruing in connection with commodity or option customers' open trades, contracts, or commodity options need not be separately credited to individual accounts but may be treated and dealt with as belonging undivided to all commodity or option customers having open trades, contracts, or commodity option positions which if closed would result in a credit to such commodity or option customers.

[46 FR 54519, Nov. 3, 1981]

§ 1.22 Use of customer funds restricted.

No futures commission merchant shall use, or permit the use of, the customer funds of one commodity and/or option customer to purchase, margin, or settle the trades, contracts, or commodity options of, or to secure or extend the credit of, any person other than such customer or option customer. Customer funds shall not be

used to carry trades or positions of the same commodity and/or option customer other than in commodities or commodity options traded throught the facilities of a contract market.

[47 FR 57007, Dec. 22, 1982]

§ 1.23 Interest of futures commission merchant in segregated funds; additions and withdrawals.

The provision in section 4d(2) of the Act and the provision in § 1.20(c), which prohibit the commingling of customer funds with the funds of a futures commission merchant, shall not be construed to prevent a futures commission merchant from having a residual financial interest in the customer funds, segregated as required by the Act and the rules in this part and set apart for the benefit of commodity or option customers; nor shall such provisions be construed to prevent a futures commission merchant from adding to such segregated customer funds such amount or amounts of money, from its own funds or unencumbered securities from its own inventory, of the type set forth in § 1.25, as it may deem necessary to ensure any and all commodity or option customers' accounts from becoming undersegregated at any time. The books and records of a futures commission merchant shall at all times accurately reflect its interest in the segregated funds. A futures commission merchant may draw upon such segregated funds to its own order, to the extent of its actual interest therein, including the withdrawal of securities held in segregated safekeeping accounts held by a bank, trust company, contract market clearing organization or other futures commission merchant. Such withdrawal shall not result in the funds of one commodity and/or option customer being used to purchase, margin or carry the trades, contracts or commodity options, or extend the credit of any other commodity customer, option customer or other person.

[62 FR 42400, Aug. 7, 1997]

§ 1.24 Segregated funds; exclusions therefrom.

Money held in a segregated account by a futures commission merchant shall not include: (a) Money invested in obligations or stocks of any clearing organization or in memberships in or obligations of any contract market; or (b) money held by any clearing organization which it may use for any purpose other than to purchase, margin, guarantee, secure, transfer, adjust, or settle the contracts, trades, or commodity options of the commodity or option customers of such futures commission merchant.

[46 FR 54519, Nov. 3, 1981]

§ 1.25 Investment of customer funds.

(a) *Permitted investments.* (1) Subject to the terms and conditions set forth in this section, a futures commission merchant or a clearing organization may invest customer funds in the following instruments (permitted investments):

(i) Obligations of the United States and obligations fully guaranteed as to principal and interest by the United States (U.S. government securities);

(ii) General obligations of any State or of any political subdivision thereof (municipal securities);

(iii) General obligations issued by any agency sponsored by the United States (government sponsored agency securities);

(iv) Certificates of deposit issued by a bank (certificates of deposit) as defined in section 3(a)(6) of the Securities Exchange Act of 1934, or a domestic branch of a foreign bank that carries deposits insured by the Federal Deposit Insurance Corporation;

(v) Commercial paper;

(vi) Corporate notes;

(vii) General obligations of a sovereign nation; and

(viii) Interests in money market mutual funds.

(2)(i) In addition, a futures commission merchant or derivatives clearing organization may buy and sell the permitted investments listed in paragraphs (a)(1)(i) through (viii) of this section pursuant to agreements for resale or repurchase of the instruments, in accordance with the provisions of paragraph (d) of this section.

(ii) A futures commission merchant or a derivatives clearing organization may sell securities deposited by customers as margin pursuant to agreements to repurchase subject to the following:

(A) Securities subject to such repurchase agreements must meet the marketability requirement of paragraph (b)(1) of this section.

(B) Securities subject to such repurchase agreements must not be ''specifically identifiable property'' as defined in § 190.01(kk) of this chapter.

(C) The terms and conditions of such an agreement to repurchase must be in accordance with the provisions of paragraph (d) of this section.

(D) Upon the default by a counterparty to a repurchase agreement, the futures commission merchant or derivatives clearing organization shall act promptly to ensure that the default does not result in any direct or indirect cost or expense to the customer.

(b) *General terms and conditions.* A futures commission merchant or a clearing organization is required to manage the permitted investments consistent with the objectives of preserving principal and maintaining liquidity and according to the following specific requirements.

(1) *Marketability.* Except for interests in money market mutual funds, investments must be ''readily marketable'' as defined in § 240.15c3–1 of this title.

(2) *Ratings.* (i) *Initial requirement.* Instruments that are required to be rated by this section must be rated by an NRSRO. For an investment to qualify as a permitted investment, ratings are required as follows:

(A) U.S. government securities need not be rated;

(B) Municipal securities, government sponsored agency securities, certificates of deposit, commercial paper, and corporate notes, except notes that are asset-backed, must have the highest short-term rating of an NRSRO or one of the two highest long-term ratings of an NRSRO;

(C) Corporate notes that are asset-backed must have the highest ratings of an NRSRO;

(D) Sovereign debt must be rated in the highest category by at least one NRSRO; and

(E) Money market mutual funds that are rated by an NRSRO must be rated at the highest rating of the NRSRO.

(ii) *Effect of downgrade.* If an NRSRO lowers the rating of an instrument that was previously a permitted investment on the basis of that rating to below the minimum rating required under this section, the value of the instrument recognized for segregation purposes will be the lesser of:

(A) The current market value of the instrument; or

(B) The market value of the instrument on the business day preceding the downgrade, reduced by 20 percent of that value for each business day that has elapsed since the downgrade.

(3) *Restrictions on instrument features.* (i) With the exception of money market mutual funds, no permitted investment may contain an embedded derivative of any kind, including but not limited to a call option, put option, or collar, cap, or floor on interest paid.

(ii) No instrument may contain interest-only payment features.

(iii) No instrument may provide payments linked to a commodity, currency, reference instrument, index, or benchmark except as provided in paragraph (b)(3)(iv) of this section.

(iv) Variable-rate securities are permitted, provided the interest rates paid correlate closely and on an unleveraged basis to a benchmark of either the Federal Funds target or effective rate, the prime rate, the three-month Treasury Bill rate, or the one-month or three-month LIBOR rate.

(v) Certificates of deposit, if negotiable, must be able to be liquidated within one business day or, if not negotiable, must be redeemable at the issuing bank within one business day, with any penalty for early withdrawal limited to any accrued interest earned according to its written terms.

(4) *Concentration.* (i) *Direct investments.* (A) U.S. government securities and money market mutual funds shall not be subject to a concentration limit or other limitation.

(B) Securities of any single issuer of government sponsored agency securities held by a futures commission merchant or clearing organization may not exceed 25 percent of total assets held in segregation by the futures commission merchant or clearing organization.

(C) Securities of any single issuer of municipal securities, certificates of deposit, commercial paper, or corporate notes held by a futures commission

merchant or clearing organization may not exceed 5 percent of total assets held in segregation by the futures commission merchant or clearing organization.

(D) Sovereign debt is subject to the following limits: a futures commission merchant may invest in the sovereign debt of a country to the extent it has balances in segregated accounts owed to its customers denominated in that country's currency; a clearing organization may invest in the sovereign debt of a country to the extent it has balances in segregated accounts owed to its clearing member futures commission merchants denominated in that country's currency.

(ii) *Repurchase agreements.* For purposes of determining compliance with the concentration limits set forth in this section, securities sold by a futures commission merchant or clearing organization subject to agreements to repurchase shall be combined with securities held by the futures commission merchant or clearing organization as direct investments.

(iii) *Reverse repurchase agreements.* The concentration limit applicable to securities of each issuer that are held by a futures commission merchant or clearing organization subject to agreements to resell to a particular counterparty shall be as follows:

(A) For a portfolio of securities held that are subject to resale to a counterparty that has been rated single A or higher by two or more NRSROs, or whose obligation under an agreement is guaranteed by a parent or affiliate company that has been rated single A or higher by two or more NRSROs:

(*1*) Government sponsored agency debt, issued by the same issuer and supplied by the counterparty, may not exceed 50 percent of the total amount of securities supplied by such counterparty; and

(*2*) Municipal securities, certificates of deposit, commercial paper, and corporate notes, issued by the same issuer and supplied by the counterparty, may not exceed 10 percent of the total amount of securities supplied by such counterparty; and

(B) For a portfolio of securities held that are subject to resale to a counterparty that does not have a rating or guarantee as specified in paragraph (b)(4)(iii)(A) of this section:

(*1*) Government sponsored agency debt, issued by the same issuer and supplied by the counterparty, may not exceed 25 percent of the total amount of securities supplied by such counterparty; and

(*2*) Municipal securities, certificates of deposit, commercial paper, and corporate notes, issued by the same issuer and supplied by the counterparty, may not exceed 5 percent of the total amount of securities supplied by such counterparty.

(iv) *Treatment of securities issued by affiliates.* For purposes of determining compliance with the concentration limits set forth in this section, securities issued by entities that are affiliated, as defined in paragraph (b)(6) of this section, shall be aggregated and deemed the securities of a single issuer. An interest in a permitted money market mutual fund is not deemed to be a security issued by its sponsoring entity.

(v) *Treatment of customer-owned securities.* For purposes of determining compliance with the concentration limits set forth in this section, securities owned by the customers of a futures commission merchant and posted as margin collateral are not included in total assets held in segregation by the futures commission merchant, and securities posted by a futures commission merchant with a clearing organization are not included in total assets held in segregation by the clearing organization.

(5) *Time-to-maturity.* (i) Except for investments in money market mutual funds, the dollar-weighted average of the time-to-maturity of the portfolio, as that average is computed pursuant to §270.2a-7 of this title, may not exceed 24 months.

(ii) For purposes of determining the time-to-maturity of the portfolio, an instrument that is set forth in paragraphs (a)(1)(i) through (vii) of this section may be treated as having a one-day time-to-maturity if the following terms and conditions are satisfied:

(A) The instrument is deposited solely on an overnight basis with a derivatives clearing organization pursuant to

the terms and conditions of a collateral management program that has become effective in accordance with § 39.4 of this chapter;

(B) The instrument is one that the futures commission merchant owns or has an unqualified right to pledge, is not subject to any lien, and is deposited by the futures commission merchant into a segregated account at a derivatives clearing organization;

(C) The derivatives clearing organization prices the instrument each day based on the current mark-to-market value; and

(D) The derivatives clearing organization reduces the assigned value of the instrument each day by a haircut of at least 2 percent.

(6) *Investments in instruments issued by affiliates.* (i) A futures commission merchant shall not invest customer funds in obligations of an entity affiliated with the futures commission merchant, and a clearing organization shall not invest customer funds in obligations of an entity affiliated with the clearing organization. An affiliate includes parent companies, including all entities through the ultimate holding company, subsidiaries to the lowest level, and companies under common ownership of such parent company or affiliates.

(ii) A futures commission merchant or clearing organization may invest customer funds in a fund affiliated with that futures commission merchant or clearing organization.

(7) *Recordkeeping.* A futures commission merchant and a clearing organization shall prepare and maintain a record that will show for each business day with respect to each type of investment made pursuant to this section, the following information:

(i) The type of instruments in which customer funds have been invested;

(ii) The original cost of the instruments; and

(iii) The current market value of the instruments.

(c) *Money market mutual funds.* The following provisions will apply to the investment of customer funds in money market mutual funds (the fund).

(1) Generally, the fund must be an investment company that is registered under the Investment Company Act of 1940 with the Securities and Exchange Commission and that holds itself out to investors as a money market fund, in accordance with § 270.2a–7 of this title. A fund sponsor, however, may petition the Commission for an exemption from this requirement. The Commission may grant such an exemption provided that the fund can demonstrate that it will operate in a manner designed to preserve principal and to maintain liquidity. The application for exemption must describe how the fund's structure, operations and financial reporting are expected to differ from the requirements contained in § 270.2a–7 of this title and the risk-limiting provisions for direct investments contained in this section. The fund must also specify the information that the fund would make available to the Commission on an ongoing basis.

(2) The fund must be sponsored by a federally-regulated financial institution, a bank as defined in section 3(a)(6) of the Securities Exchange Act of 1934, an investment adviser registered under the Investment Advisers Act of 1940, or a domestic branch of a foreign bank insured by the Federal Deposit Insurance Corporation, except for a fund exempted in accordance with paragraph (c)(1) of this section.

(3) A futures commission merchant or clearing organization shall maintain the confirmation relating to the purchase in its records in accordance with § 1.31 and note the ownership of fund shares (by book-entry or otherwise) in a custody account of the FCM or clearing organization in accordance with § 1.26(a). If the futures commission merchant or the clearing organization holds its shares of the fund with the fund's shareholder servicing agent, the sponsor of the fund and the fund itself are required to provide the acknowledgment letter required by § 1.26.

(4) The net asset value of the fund must be computed by 9 a.m. of the business day following each business day and made available to the futures commission merchant or clearing organization by that time.

(5) A fund must be able to redeem an interest by the business day following a redemption request by the futures commission merchant or clearing organization. Demonstration that this requirement has been met may include

either an appropriate provision in the offering memorandum of the fund or a separate side agreement between the fund and a futures commission merchant or clearing organization.

(6) The agreement pursuant to which the futures commission merchant or clearing organization has acquired and is holding its interest in a fund must contain no provision that would prevent the pledging or transferring of shares.

(d) *Repurchase and reverse repurchase agreements.* A futures commission merchant or clearing organization may buy and sell the permitted investments listed in paragraphs (a)(1)(i) through (viii) of this section pursuant to agreements for resale or repurchase of the securities (agreements to repurchase or resell), provided the agreements to repurchase or resell conform to the following requirements:

(1) The securities are specifically identified by coupon rate, par amount, market value, maturity date, and CUSIP or ISIN number.

(2) Counterparties are limited to a bank as defined in section 3(a)(6) of the Securities Exchange Act of 1934, a domestic branch of a foreign bank insured by the Federal Deposit Insurance Corporation, a securities broker or dealer, or a government securities broker or government securities dealer registered with the Securities and Exchange Commission or which has filed notice pursuant to section 15C(a) of the Government Securities Act of 1986.

(3) The transaction is executed in compliance with the concentration limit requirements applicable to the securities held in connection with the agreements to repurchase referred to in paragraphs (b)(4)(ii) and (iii) of this section.

(4) The transaction is made pursuant to a written agreement signed by the parties to the agreement, which is consistent with the conditions set forth in paragraphs (d)(1) through (d)(12) of this section and which states that the parties thereto intend the transaction to be treated as a purchase and sale of securities.

(5) The term of the agreement is no more than one business day, or reversal of the transaction is possible on demand.

(6) The securities transferred under the agreement are held in a safekeeping account with a bank as referred to in paragraph (d)(2) of this section, a clearing organization, or the Depository Trust Company in an account that complies with the requirements of § 1.26.

(7) The futures commission merchant or the clearing organization may not use securities received under the agreement in another similar transaction and may not otherwise hypothecate or pledge such securities, except securities may be pledged on behalf of customers at another futures commission merchant or clearing organization. Substitution of securities is allowed, *provided, however,* that:

(i) The qualifying securities being substituted and original securities are specifically identified by date of substitution, market values substituted, coupon rates, par amounts, maturity dates and CUSIP or ISIN numbers;

(ii) Substitution is made on a ''delivery versus delivery'' basis; and

(iii) The market value of the substituted securities is at least equal to that of the original securities.

(8) The transfer of securities is made on a delivery versus payment basis in immediately available funds. The transfer is not recognized as accomplished until the funds and/or securities are actually received by the custodian of the futures commission merchant's or clearing organization's customer funds or securities purchased on behalf of customers. The transfer or credit of securities covered by the agreement to the futures commission merchant's or clearing organization's customer segregated custodial account is made simultaneously with the disbursement of funds from the futures commission merchant's or clearing organization's customer segregated cash account at the custodian bank. On the sale or resale of securities, the futures commission merchant's or clearing organization's customer segregated cash account at the custodian bank must receive same-day funds credited to such segregated account simultaneously with the delivery or transfer of securities from the customer segregated custodial account.

(9) A written confirmation to the futures commission merchant or clearing organization specifying the terms of the agreement and a safekeeping receipt are issued immediately upon entering into the transaction and a confirmation to the futures commission merchant or clearing organization is issued once the transaction is reversed.

(10) The transactions effecting the agreement are recorded in the record required to be maintained under §1.27 of investments of customer funds, and the securities subject to such transactions are specifically identified in such record as described in paragraph (d)(1) of this section and further identified in such record as being subject to repurchase and reverse repurchase agreements.

(11) An actual transfer of securities by book entry is made consistent with Federal or State commercial law, as applicable. At all times, securities received subject to an agreement are reflected as ''customer property.''

(12) The agreement makes clear that, in the event of the bankruptcy of the futures commission merchant or clearing organization, any securities purchased with customer funds that are subject to an agreement may be immediately transferred. The agreement also makes clear that, in the event of a futures commission merchant or clearing organization bankruptcy, the counterparty has no right to compel liquidation of securities subject to an agreement or to make a priority claim for the difference between current market value of the securities and the price agreed upon for resale of the securities to the counterparty, if the former exceeds the latter.

(e) *Deposit of firm-owned securities into segregation.* A futures commission merchant shall not be prohibited from directly depositing unencumbered securities of the type specified in this section, which it owns for its own account, into a segregated safekeeping account or from transferring any such securities from a segregated account to its own account, up to the extent of its residual financial interest in customers' segregated funds; provided, however, that such investments, transfers of securities, and disposition of proceeds from the sale or maturity of such securities are recorded in the record of investments required to be maintained by §1.27. All such securities may be segregated in safekeeping only with a bank, trust company, clearing organization, or other registered futures commission merchant. Furthermore, for purposes of §§1.25, 1.26, 1.27, 1.28 and 1.29, investments permitted by §1.25 that are owned by the futures commission merchant and deposited into such a segregated account shall be considered customer funds until such investments are withdrawn from segregation.

[65 FR 78010, Dec. 13, 2000, as amended at 65 FR 82271, Dec. 28, 2000; 69 FR 6145, Feb. 10, 2004]

§1.26 Deposit of instruments purchased with customer funds.

(a) Each futures commission merchant who invests customer funds in instruments described in §1.25 shall separately account for such instruments and segregate such instruments as belonging to such commodity or option customers. Such instruments, when deposited with a bank, trust company, clearing organization or another futures commission merchant, shall be deposited under an account name which clearly shows that they belong to commodity or option customers and are segregated as required by the Act and this part. Each futures commission merchant upon opening such an account shall obtain and retain in its files an acknowledgment from such bank, trust company, clearing organization or other futures commission merchant that it was informed that the instruments belong to commodity or option customers and are being held in accordance with the provisions of the Act and this part. *Provided, however,* that an acknowledgment need not be obtained from a clearing organization that has adopted and submitted to the Commission rules that provide for the segregation as customer funds, in accordance with all relevant provisions of the Act and the rules and orders promulgated thereunder, of all funds held on behalf of customers and all instruments purchased with customer funds. Such acknowledgment shall be retained in accordance with §1.31. Such bank, trust company, clearing organization or other futures commission

merchant shall allow inspection of such obligations at any reasonable time by representatives of the Commission.

(b) Each clearing organization which invests money belonging or accruing to commodity or option customers of its clearing members in instruments described in § 1.25 shall separately account for such instruments and segregate such instruments as belonging to such commodity or option customers. Such instruments, when deposited with a bank or trust company, shall be deposited under an account name which will clearly show that they belong to commodity or option customers and are segregated as required by the Act and this part. Each clearing organization upon opening such an account shall obtain and retain in its files a written acknowledgment from such bank or trust company that it was informed that the instruments belong to commodity or option customers of clearing members and are being held in accordance with the provisions of the Act and this part. Such acknowledgment shall be retained in accordance with § 1.31. Such bank or trust company shall allow inspection of such instruments at any reasonable time by representatives of the Commission.

[65 FR 78012, Dec. 13, 2000]

§ 1.27 Record of investments.

(a) Each futures commission merchant which invests customer funds, and each clearing organization which invests customer funds of its clearing members' customers or option customers, shall keep a record showing the following:

(1) The date on which such investments were made;

(2) The name of the person through whom such investments were made;

(3) The amount of money so invested;

(4) A description of the instruments in which such investments were made, including the CUSIP or ISIN numbers;

(5) The identity of the depositories or other places where such instruments are segregated;

(6) The date on which such investments were liquidated or otherwise disposed of and the amount of money received of such disposition, if any; and

(7) The name of the person to or through whom such investments were disposed of.

(b) Each clearing organization which receives documents from its clearing members representing investment of customer funds shall keep a record showing separately for each clearing member the following:

(1) The date on which such documents were received from the clearing member;

(2) A description of such documents, including the CUSIP or ISIN numbers; and

(3) The date on which such documents were returned to the clearing member or the details of disposition by other means.

(c) Such records shall be retained in accordance with § 1.31. No such investments shall be made except in instruments described in § 1.25.

(Approved by the Office of Management and Budget under control numbers 3038–0007 and 3038–0024)

[46 FR 54520, Nov. 3, 1981, as amended at 46 FR 63035, Dec. 30, 1981; 62 FR 42401, Aug. 7, 1997; 65 FR 78013, Dec. 13, 2000]

§ 1.28 Appraisal of instruments purchased with customer funds.

Futures commission merchants who invest customer funds in instruments described in § 1.25 of this part shall include such instruments in segregated account records and reports at values which at no time exceed current market value, determined as of the close of the market on the date for which such computation is made.

[58 FR 10953, Feb. 23, 1993, as amended at 65 FR 78013, Dec. 13, 2000]

§ 1.29 Increment or interest resulting from investment of customer funds.

The investment of customer funds in instruments described in § 1.25 shall not prevent the futures commission merchant or clearing organization so investing such funds from receiving and retaining as its own any increment or interest resulting therefrom.

[46 FR 54520, Nov. 3, 1981, as amended at 65 FR 78013, Dec. 13, 2000]

§ 1.30 Loans by futures commission merchants; treatment of proceeds.

Nothing in these regulations shall prevent a futures commission merchant from lending its own funds to commodity or option customers on securities and property pledged by such commodity or option customers, or from repledging or selling such securities and property pursuant to specific written agreement with such commodity or option customers. The proceeds of such loans used to purchase, margin, guarantee, or secure the trades, contracts, or commodity options of commodity or option customers shall be treated and dealt with by a futures commission merchant as belonging to such commodity or option customers, in accordance with and subject to the provisions of section 4d(2) of the Act and these regulations.

[46 FR 54520, Nov. 3, 1981]

RECORDKEEPING

§ 1.31 Books and records; keeping and inspection.

(a)(1) All books and records required to be kept by the Act or by these regulations shall be kept for a period of five years from the date thereof and shall be readily accessible during the first 2 years of the 5-year period. All such books and records shall be open to inspection by any representative of the Commission or the United States Department of Justice.

(2) A copy of any book or record required to be kept by the Act or by these regulations shall be provided, at the expense of the person required to keep the book or record, to a Commission representative upon the representative's request. Instead of furnishing a copy, such person may provide the original book or record for reproduction, which the representative may temporarily remove from such person's premises for this purpose. All copies or originals shall be provided promptly. Upon request, the Commission representative shall issue a receipt provided by such person for any copy or original book or record received. At the request of the Commission representative, such person shall, upon the return thereof, issue a receipt for any copy or original book or record returned by the representative.

(b) Except as provided in paragraph (d) of this section, immediate reproductions on either ''micrographic media'' (as defined in paragraph (b)(1)(i) of this section) or ''electronic storage media'' (as defined in paragraph (b)(1)(ii) this section) may be kept in that form for the required time period under the conditions set forth in this paragraph (b).

(1) For purposes of this section:

(i) The term ''micrographic media'' means microfilm or microfiche or any similar medium.

(ii) The term ''electronic storage media'' means any digital storage medium or system that:

(A) Preserves the records exclusively in a non-rewritable, non-erasable format;

(B) Verifies automatically the quality and accuracy of the storage media recording process;

(C) Serializes the original and, if applicable, duplicate units of storage media and creates a time-date record for the required period of retention for the information placed on such electronic storage media; and

(D) Permits the immediate downloading of indexes and records preserved on the electronic storage media onto paper, microfilm, microfiche or other medium acceptable under this paragraph upon the request of representatives of the Commission or the Department of Justice.

(2) Persons who use either micrographic media or electronic storage media to maintain records in accordance with this section must:

(i) Have available at all times, for examination by representatives of the Commission or the Department of Justice, facilities for immediate, easily readable projection or production of micrographic media or electronic storage media images;

(ii) Be ready at all times to provide, and immediately provide at the expense of the person required to keep such records, any easily readable hard-copy image that representatives of the Commission or Department of Justice may request;

(iii) Keep only Commission-require records on the individual medium employed (e.g., a disk or sheets of microfiche);

(iv) Store a duplicate of the record, in any medium acceptable under this regulation, at a location separate from the original for the period of time required for maintenance of the original; and

(v) Organize and maintain an accurate index of all information maintained on both the original and duplicate storage media such that:

(A) The location of any particular record stored on the media may be immediately ascertained;

(B) The index is available at all times for immediate examination by representatives of the Commission or the Department of Justice;

(C) A duplicate of the index is stored at a location separate from the original index; and

(D) Both the original index and the duplicate index are preserved for the time period required for the records included in the index.

(3) In addition to the foregoing conditions, persons using electronic storage media must:

(i) Be ready at all times to provide, and immediately provide at the expense of the person required to keep such records, copies of such records on such approved machine-readable media as defined in § 15.00(1) of this chapter which any representative of the Commission or the Department of Justice may request. Records must use a format and coding structure specified in the request.

(ii) Develop and maintain written operational procedures and controls (an ''audit system'') designed to provide accountability over both the initial entry of required records to the electronic storage media and the entry of each change made to any original or duplicate record maintained on the electronic storage media such that:

(A) The results of such audit system are available at all times for immediate examination by representatives of the Commission or the Department of Justice;

(B) The results of such audit system are preserved for the time period required for the records maintained on the electronic storage media; and

(C) The written operational procedures and controls are available at all times for immediate examination by representatives of the Commission or the Department of Justice.

(iii) Either

(A) Maintain, keep current, and make available at all times for immediate examination by representatives of the Commission or Department of Justice all information necessary to access records and indexes maintained on the electronic storage media; or

(B) Place in escrow and keep current a copy of the physical and logical format of the electronic storage media, the file format of all different information types maintained on the electronic storage media and the source code, documentation, and information necessary to access the records and indexes maintained on the electronic storage media.

(4) In addition to the foregoing conditions, any person who uses only electronic storage media to preserve some or all of its required records (''Electronic Recordkeeper'') shall, prior to the media's use, enter into an arrangement with at least one third party technical consultant (''Technical Consultant'') who has the technical and financial capability to perform the undertakings described in this paragraph (b)(4). The arrangement shall provide that the Technical Consultant will have access to, and the ability to download, information from the Electronic Recordkeeper's electronic storage media to any medium acceptable under this regulation.

(i) The Technical Consultant must file with the Commission an undertaking in a form acceptable to the Commission, signed by the Technical Consultant or a person duly authorized by the Technical Consultant. An acceptable undertaking must include the following provision with respect to the Electronic Recordkeeper:

With respect to any books and records maintained or preserved on behalf of the Electronic Recordkeeper, the undersigned hereby undertakes to furnish promptly to any representative of the United States Commodity Futures Trading Commission or the United States Department of Justice

(the ''Representative''), upon reasonable request, such information as is deemed necessary by the Representative to download information kept on the Electronic Recordkeeper's electronic storage media to any medium acceptable under 17 CFR 1.31. The undersigned also undertakes to take reasonable steps to provide access to information contained on the Electronic Recordkeeper's electronic storage media, including, as appropriate, arrangements for the downloading of any record required to be maintained under the Commodity Exchange Act or the rules, regulations, or orders of the United States Commodity Futures Trading Commission, in a format acceptable to the Representative. In the event the Electronic Recordkeeper fails to download a record into a readable format and after reasonable notice to the Electronic Recordkeeper, upon being provided with the appropriate electronic storage medium, the undersigned will undertake to do so, at no charge to the United States, as the Representative may request.

(ii) [Reserved]

(c) Persons employing an electronic storage system shall provide a representation to the Commission prior to the initial use of the system. The representation shall be made by the person required to maintain the records, the storage system vendor, or another third party with appropriate expertise and shall state that the selected electronic storage system meets the requirements set forth in paragraph (b)(1)(ii) of this section. Persons employing an electronic storage system using media other than optical disk or CD–ROM technology shall so state. The representation shall be accompanied by the type of oath or affirmation described in § 1.10(d)(4).

(d) Trading cards, documents on which trade information is originally recorded in writing, and written orders required to be kept pursuant to § 1.35(a), (a–1)(1), (a–1)(2) and (d) must be retained in hard-copy for the required time period.

(Approved by the Office of Management and Budget under control numbers 3038–0007 and 3038–0022)

[41 FR 3194, Jan. 21, 1976, as amended at 46 FR 22, Jan. 2, 1981; 46 FR 63035, Dec. 30, 1981; 58 FR 27464, 27467, May 10, 1993; 62 FR 24031, May 2, 1997; 64 FR 28742, May 27, 1999]

§ 1.32 Segregated account; daily computation and record.

(a) Each futures commission merchant must compute as of the close of each business day, on a currency-by-currency basis:

(1) The total amount of customer funds on deposit in segregated accounts on behalf of commodity and option customers;

(2) the amount of such customer funds required by the Act and these regulations to be on deposit in segregated accounts on behalf of such commodity and option customers; and

(3) the amount of the futures commission merchant's residual interest in such customer funds.

(b) In computing the amount of funds required to be in segregated accounts, a futures commission merchant may offset any net deficit in a particular customer's account against the current market value of readily marketable securities, less applicable percentage deductions (*i.e.*, ''securities haircuts'') as set forth in Rule 15c3–1(c)(2)(vi) of the Securities and Exchange Commission (17 CFR 241.15c3–1(c)(2)(vi)), held for the same customer's account. The futures commission merchant must maintain a security interest in the securities, including a written authorization to liquidate the securities at the futures commission merchant's discretion, and must segregate the securities in a safekeeping account with a bank, trust company, clearing organization of a contract market, or another futures commission merchant. For purposes of this section, a security will be considered readily marketable if it is traded on a ''ready market'' as defined in Rule 15c3–1(c)(11)(i) of the Securities and Exchange Commission (17 CFR 240.15c3–1(c)(11)(i)).

(c) The daily computations required by this section must be completed by the futures commission merchant prior to noon on the next business day and must be kept, together with all supporting data, in accordance with the requirements of § 1.31.

[66 FR 41133, Aug. 7, 2001, as amended at 68 FR 5551, Feb. 4, 2003]

§ 1.33 Monthly and confirmation statements.

(a) *Monthly statements.* Each futures commission merchant must promptly furnish in writing to each commodity customer and to each option customer and to each foreign futures and foreign options 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 commodity customer and foreign futures customer—

(i) The open contracts with prices at which acquired;

(ii) The net unrealized profits or losses in all open contracts marked to the market; and

(iii) Any customer funds carried with the futures commission merchant; and

(iv) A detailed accounting of all financial charges and credits to such customer accounts during the monthly reporting period, including all customer funds and funds on deposit with respect to foreign futures transactions in accordance with § 30.7 of this chapter received from or disbursed to such customer and realized profits and losses; and

(2) For each option customer and foreign options customer—

(i) All commodity options and foreign options purchased, sold, exercised, or expired during the monthly reporting period, identified by underlying futures contract or underlying physical, strike price, transaction date, and expiration date;

(ii) The open commodity option and foreign option positions carried for such customer as of the end of the monthly reporting period, identified by underlying futures contract or underlying physical, strike price, transaction date, and expiration date;

(iii) All open commodity option and foreign option positions marked to the market and the amount each position is in the money, if any;

(iv) Any customer funds carried in such customer's account(s); and

(v) A detailed accounting of all financial charges and credits to such customer's account(s) during the monthly reporting period, including all customer funds and funds on deposit with respect to foreign options transactions received from or disbursed to such customer, premiums charged and received, and realized profits and losses.

(b) *Confirmation statement.* Each futures commission merchant must, not later than the next business day after any commodity futures or commodity option transaction, including any foreign futures or foreign options transactions, furnish:

(1) To each commodity customer, a written confirmation of each commodity futures transaction caused to be executed by it for the customer.

(2) To each option customer, a written confirmation of each commodity option transaction, containing at least the following information:

(i) The option 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 commodity option transaction;

(iii) The strike price;

(iv) The underlying futures contract or underlying physical;

(v) The final exercise date of the commodity option purchased or sold; and

(vi) The date the commodity option transaction was executed.

(3) To each option customer, upon the expiration or exercise of any commodity option, a written confirmation statement thereof, which statement shall include the date of such occurrence, a description of the option involved, and, in the case of exercise, the details of the futures or physical position which resulted therefrom including, if applicable, the final trading date of the contract for future delivery underlying the option.

(4) Notwithstanding the provisions of paragraphs (b)(1) through (b)(3) of this section, a commodity futures or commodity option transaction that is caused to be executed for a commodity

pool need be confirmed only to the operator of the commodity pool.

(c) *Exemptions.* The requirements of paragraphs (a)(1)(i), (a)(1)(ii), and (b)(1) of this section shall not apply to the following:

(1) Any account carried for a person who is a member of any contract market;

(2) Any omnibus account carried for another futures commission merchant; and

(3) Any account containing only bona fide hedge positions, except that confirmations must be furnished to accounts containing only bona fide hedge positions.

(d) *Controlled accounts.* With respect to any account controlled by any person other than the commodity customer or option customer for whom such account is carried, each futures commission merchant shall:

(1) Promptly furnish in writing to such other person the information required by paragraphs (a) and (b) of this section;

(2) [Reserved]

(3) Promptly furnish in writing to such other person a copy of the statement required by §1.46: *Provided, however,* That the provisions of this paragraph (d) shall not apply to an account controlled by the spouse, parent or child of the customer for whom such account is carried.

(e) *Recordkeeping.* Each futures commission merchant shall retain, in accordance with §1.31, a copy of each monthly statement and confirmation required by this section.

(f) *Introduced accounts.* Each statement provided pursuant to the provisions of this section must, if applicable, show that the account for which the futures commission merchant is providing the statement was introduced by an introducing broker and the names of the futures commission merchant and introducing broker.

(g) *Electronic transmission of statements.* (1) The statements required by this section, and by §1.46, may be furnished to any customer by means of electronic media if the customer so consents, *Provided, however,* that a 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.

(2) In the case of a customer who does not qualify as an ''institutional customer'' as defined in §1.3(g), a futures commission merchant must obtain the customer's signed consent acknowledging disclosure of the information set forth in paragraph (g)(1) of this section prior to the transmission of any statement by means of electronic media.

(3) Any statement required to be furnished to a person other than a customer in accordance with paragraph (d) of this section may be furnished by electronic media.

(4) A futures commission merchant who furnishes statements to any customer by means of electronic media must retain a daily confirmation statement for such customer as of the end of the trading session, reflecting all transactions made during that session for the customer, in accordance with §1.31.

(Approved by the Office of Management and Budget under control numbers 3038–0007 and 3038–0024; the information collection requirements in paragraph (c) were approved under control number 3038–0005)

[46 FR 54520, Nov. 3, 1981, as amended at 46 FR 63035, Dec. 30, 1981; 47 FR 57008, Dec. 22, 1982; 48 FR 1185, Jan. 11, 1983; 48 FR 35289, Aug. 3, 1983; 52 FR 28997, Aug. 5, 1987; 66 FR 53517, Oct. 23, 2001]

§ 1.34 Monthly record, "point balance".

(a) Each futures commission merchant shall prepare, and retain in accordance with the requirements of §1.31, a statement commonly known as a ''point balance,'' which accrues or brings to the official closing price, or settlement price fixed by the clearing organization, all open contracts of customers as of the last business day of each month or of any regular monthly date selected: *Provided, however,* That a futures commission merchant who carries part or all of customers' open contracts with other futures commission

merchants on an ''instruct basis'' will be deemed to have met the requirements of this section as to open contracts so carried if a monthly statement is prepared which shows that the prices and amounts of such contracts long and short in the customers' accounts are in balance with those in the carrying futures commission merchants' accounts, and such statements are retained in accordance with the requirements of § 1.31.

(b) Each futures commission merchant shall prepare, and retain in accordance with the requirements of § 1.31, a listing in which all open commodity option positions carried for option customers are marked to the market. Such listing shall be prepared as of the last business day of each month, or as of any regular monthly date selected, and shall be by put or by call, by underlying contract for future delivery (by delivery month) or underlying physical (by option expiration date), and by strike price.

(Approved by the Office of Management and Budget under control numbers 3038–0007 and 3038–0024)

[46 FR 54521, Nov. 3, 1981, as amended at 46 FR 63035, Dec. 30, 1981; 47 FR 57008, Dec. 22, 1982]

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

(a) *Futures commission merchants, introducing brokers, and members of contract markets.* Each futures commission merchant, 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, commodity options, and cash commodities. Each futures commission merchant, 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, 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, introducing brokers, and members of contract markets: Recording of customers' and option customers' orders.* (1) Each futures commission merchant and each introducing broker receiving a customer's or option customer's order 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.

(a–2)(1) *Futures commission merchants, introducing brokers, and members of contract markets.* Upon request of the contract market, the Commission, or the United States Department of Justice, each futures commission merchant, introducing broker, and member of a contract market shall request from its customers and, upon receipt thereof, provide to the requesting body documentation of cash transactions underlying exchanges of futures for cash commodities or exchanges of futures in connection with cash commodity transactions.

(2) *Customers.* Each customer of a futures commission merchant, introducing broker, or member of a contract market shall create, retain, and produce upon request of the contract market, the Commission, or the United States Department of Justice documentation of cash transactions underlying exchanges of futures for cash commodities or exchanges of futures in connection with cash commodity transactions.

(3) *Contract markets.* Every contract market shall adopt rules which require its members to provide documentation of cash transactions underlying exchanges of futures for cash commodities or exchanges of futures in connection with cash commodity transactions upon request of the contract market.

(4) *Documentation.* For the purposes of this paragraph, documentation means those documents customarily generated in accordance with cash market practices which demonstrate the existence and nature of the underlying cash transactions, including, but not limited to, contracts, confirmation statements, telex printouts, invoices, and warehouse receipts or other documents of title.

(b) *Futures commission merchants, introducing brokers, and clearing members of contract markets.* Each futures commission merchant 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 option customer all charges against and credits to such customer's or option customer's account, including but not limited to 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; and

(ii) 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 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

(iii) In the case of an introducing broker, the record or journal required by this paragraph (b)(3) shall also include the futures commission merchant carrying the account for which each commodity futures 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 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.

(c) *Clearing members of contract markets.* In the daily record or journal required to be kept under paragraph (b)(3) of this section, each clearing member of a contract market shall also show the floor broker or floor trader executing each transaction, the opposite floor broker or floor trader, and the opposite clearing member with whom it was made.

(d) *Members of contract markets.* (1) Each member of a contract market who, in the place provided by the contract market for the meeting of persons similarly engaged, executes purchases or sales of any commodity for future delivery or commodity option on or subject to the rules of such contract market, shall prepare regularly and promptly a trading card or other record showing such purchases and sales. Such trading card or record shall show the member's name, the name of the clearing member, transaction date, time (as specified in rules of the contract market which comply with the requirements of this section), quantity, and, as applicable, underlying commodity, contract for future delivery or physical, price or premium, delivery month or expiration date, whether the transaction involved a put or a call and strike price. Such trading card or other record shall also clearly identify the opposite floor broker or floor trader with whom the transaction was executed, and the opposite clearing member (if, in accordance with the rules or practice of the contract market, such opposite clearing member is made known to the member).

(2) Each member of a contract market recording purchases and sales on trading cards must record such purchases and sales in exact chronological order of execution on sequential lines of the trading card without skipping lines between trades; Provided, however; That if lines remain after the last execution recorded on a trading card, the remaining lines must be marked through.

(3) Each member of a contract market must identify on his trading cards in the manner prescribed by the rules of the contract market the purchases and sales executed during the opening and closing periods designated by the contract market pursuant to paragraph (j)(7) of this section.

(4) Trading cards prepared by a member of a contract market pursuant to contract market rules must contain:

(i) Pre-printed member identification or other unique identifying information which would permit the trading cards of one member to be distinguished from those of all other members;

(ii) Pre-printed sequence numbers to permit the intra-day sequencing of the cards; and

(iii) Unique and pre-printed identifying information which would distinguish each of the trading cards prepared by the member from other such trading cards for no less than a one-week period.

(5) Trading cards prepared by a member of a contract market and collected pursuant to paragraph (j)(1) of this section must be timestamped promptly to the nearest minute upon collection by either the contract market or the relevant clearing member.

(6) Each member of a contract market shall be accountable for all trading cards prepared pursuant to contract market rules in exact numerical sequence, whether or not such trading cards are relied on as original source documents.

(7) Trading records prepared by a member of a contract market pursuant to contract market rules must:

(i) Be submitted in accordance with contract market rules adopted pursuant to paragraph (j)(1) of this section; and

(ii) Be completed in non-erasable ink. A member may correct any errors by crossing out erroneous information without obliterating or otherwise making illegible any of the originally recorded information. With regard to trading cards only, a member may correct erroneous information by rewriting the trading card; provided, however, that the member must submit a ply of the trading card, or in the absence of plies the original trading card, that is subsequently rewritten in accordance with contract market rules which set forth the required collection schedule for trading cards and provided further that the member is accountable for any trading card that subsequently is rewritten pursuant to paragraph (d)(6) of this section.

(8) Each member of a contract market must use a new trading card at the beginning of each designated 30-minute interval required by paragraph (j)(1) of this section (or such lesser interval as may be determined appropriate by the applicable contract market) or as may be required pursuant hereto.

(e) *Contract markets.* Each contract market shall maintain or cause to be maintained by its clearing organization a single record which shall show for each futures or option trade: the transaction date, time (as described in paragraph (g) of this section), quantity, and, as applicable, underlying commodity, contract for future delivery or physical, price or premium, delivery month or expiration date, whether the transaction involved a put or a call, strike price, floor broker or floor trader buying, clearing member buying, floor broker or floor trader selling, clearing member selling, and symbols indicating the buying and selling customer or option customer types. The customer and option customer type indicators shall show, with respect to each person executing the trade, whether such person:

(1) Was trading for his own account, or an account for which he has discretion;

(2) Was trading for his clearing member's house account;

(3) Was trading for another member present on the exchange floor, or an account controlled by such other member; or

(4) Was trading for any other type of customer or option customer. The record required by this paragraph (e) shall also show, by appropriate and uniform symbols, any transaction which is made non-competitively in accordance with written rules of the contract market which have been submitted to and approved by the Commission in accordance with the provisions of §1.38, and trades cleared on dates other than the date of execution. Except as otherwise approved by the Commission for good cause shown, the record required by this paragraph (e) shall be maintained in a format and coding structure approved by the Commission (i) in hard copy or on microfilm as specified in §1.31 and (ii) for 60 days in computer-readable form on compatible magnetic tapes or discs.

(f) Each contract market shall provide for the identification of floor brokers, floor traders, and clearing members, in the records required to be kept under paragraphs (c), (d), and (e) of this section, by the use of a distinctive, nonvariable designation for each such floor broker, floor trader, and clearing member.

(g) *Time of trade execution.* For purposes of paragraph (e) of this section: (1) The actual time of the execution of each side of a transaction must be obtained, or (2) if a contract market identifies and records the time of a transaction, a single actual time of execution for both sides of the transaction may be obtained. Actual times of execution shall be stated in increments of no more than one minute in length. If a contract market submits rules to the Commission, in accordance with the provisions of section 5a(a)(12)(A) of the Act and §1.41, defining and separately identifying opening and closing time periods, the contract market may, for purposes of paragraph (e) of this section, use those time periods for trades occurring during the opening and closing periods. Contract market rules in effect prior to the effective date of this paragraph (g) upon which a contract market intends to rely in complying herewith must be submitted for this purpose to the Commission in accordance with the provisions of section 5a(a)(12)(A) of the Act and §1.41.

(h) *Contract market price change register.* Each contract market shall establish and maintain a record of all changes in the price of futures or option transactions executed on the floor of the contract market. This record shall include the time of all changes in price to the nearest ten seconds.

(i) *Contract markets.* A contract market, in order to demonstrate that it is exercising due diligence in maintaining the continuing affirmative action program required by the Act and §1.51, shall, at a minimum:

(1) Demonstrate effective use in its continuing affirmative action program of the information required to be obtained by paragraph (e) of this section to reconstruct rapidly and accurately transactions executed on or subject to the rules of such contract market; and

(2) Submit to the Commission such reports as the Commission or the Director of the Division of Trading and Markets, or such persons under the supervision of the Director as may be specified from time to time, may require concerning the accuracy of all information recorded under paragraph (e) of this section and the use of such information in the contract market's affirmative action program.

(j) *Contract markets.* Each contract market must maintain in effect rules which require that:

(1) Trading records prepared by a member of the contract market pursuant to paragraphs (a–1) and (d) of this section be submitted to contract market personnel or the clearing member within 15 minutes of designated intervals not to exceed 30 minutes, commencing with the beginning of each trading session. The time period permitted for the submission of trading records after the close of trading in each market shall not exceed 15 minutes from the close. Such documents should nevertheless be collected as often as is practicable by the contract market or relevant clearing member. Such contract market rules need not, however, require that those original source documents which cannot be relied upon by the contract market or clearing member for clearing purposes be submitted pursuant to this paragraph. Each contract market shall submit a written report to the Commission no later than nine months after the effective date of this paragraph describing with particularity the contract market's system(s) in place to comply with this paragraph and the level of compliance achieved to date.

(2) Trading cards collected pursuant to this paragraph must be timestamped promptly to the nearest minute upon collection by either the contract market or relevant clearing member.

(3) A member of the contract market must use a new trading card at the beginning of each designated 30-minute interval required by paragraph (j)(1) of this section.

(4) A member of the contract market must record trades in the manner prescribed by paragraph (d)(2) of this section.

(5) Trading cards prepared by a member of the contract market must contain the identifying information prescribed by paragraph (d)(4) of this section.

(6) A member of the contract market must be accountable for all trading cards prepared pursuant to contract market rules in exact numerical sequence, whether or not such trading cards are relied on as original source documents.

(7) A member of the contract market must identify on his trading cards trades executed during opening and closing periods either by drawing a line on the trading card to separate those trades from others recorded thereon or by some other method. Each contract market must designate as opening and closing periods for this purpose those periods upon which the opening and closing trading ranges are based for each of its markets.

(8) A member of the contract market must complete trades in non-erasable ink in the manner prescribed by paragraph (d)(7)(ii) of this section.

(k) *Collection of trading cards in intervals not to exceed 15 minutes.* The Commission, in its discretion, may publish a schedule in the FEDERAL REGISTER no earlier than 11 months after paragraph (j)(1) of this section becomes effective, indicating when the records required to be submitted pursuant to that paragraph must be submitted to contract market personnel or the clearing member within 15 minutes of designated intervals not to exceed 15 minutes, commencing with the beginning of each trading session.

(l) A contract market which can demonstrate that it currently has available hand-held terminals or such other automated means for the recordation of trades which can eliminate the opportunity for improper alteration or fabrication of trading records, may petition the Commission for an exemption from Regulations 1.35(a–1) (2) and (4), (d), (j) or (k), as appropriate.

(Approved by the Office of Management and Budget under control numbers 3038–0007 and 3038–0022)

[41 FR 3194, Jan. 21, 1976, as amended by 46 FR 54521, Nov. 3, 1981; 46 FR 55925, Nov. 13, 1981; 46 FR 63035, Dec. 30, 1981; 47 FR 57008, Dec. 22, 1982; 48 FR 35389, Aug. 3, 1983; 51 FR 2691, Jan. 21, 1986; 54 FR 33881, Aug. 17, 1989; 55 FR 8137, Mar. 7, 1990; 58 FR 27465, May 10, 1993; 58 FR 31166, June 1, 1993; 58 FR 40348, July 28, 1993; 59 FR 5525, Feb. 7, 1994; 61 FR 43001, Aug. 20, 1996; 63 FR 45709, Aug. 27, 1998; 63 FR 49955, Sept. 18, 1998; 68 FR 34794, June 11, 2003]

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

(a) Each futures commission merchant shall maintain, as provided in § 1.31, a record of all securities and property received from customers or option customers in lieu of money to margin, purchase, guarantee, or secure the commodity or commodity option transactions of such customers or option customers. Such record shall show separately for each customer or option customer: a description of the securities or property received; the name and address of such 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; the dates of deposits and withdrawals from such depositories; and the dates of return of such securities or property to such 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.

(b) Each clearing organization of a contract market which receives from members securities or property belonging to particular customers or option customers of such members in lieu of money to margin, purchase, guarantee, or secure the commodity or commodity option transactions of such customers or option customers, or receives notice that any such securities or property have been received by a bank or trust company acting as custodian for such clearing organization, shall maintain, as provided in § 1.31, a record which will show separately for each member, the dates when such securities or property were received, the identity of the depositories or other places where such securities or property are segregated, the dates such securities or property were returned to the member, or otherwise disposed of, together with the facts and circumstances of such other disposition including the authorization therefor.

(Approved by the Office of Management and Budget under control numbers 3038–0007 and 3038–0024)

[46 FR 54522, Nov. 3, 1981, as amended at 46 FR 63035, Dec. 30, 1981; 48 FR 8435, Mar. 1, 1983]

§ 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, introducing broker, and member of a contract market shall keep a record in permanent form which shall show for each commodity futures 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.

(2) Each futures commission merchant who receives a customer's election not to have the customer's funds separately accounted for and segregated, in accordance with § 1.68, shall keep a record in permanent form that indicates such customer's election. The record of such a customer election may be indicated on the record required by paragraph (a)(1) of this section.

(b) As of the close of the market each day, each futures commission merchant which carries an account for another futures commission merchant, foreign broker (as defined in § 15.00 of this chapter), member of a contract market, or other person, on an omnibus basis shall maintain a daily record for each such omnibus account of the total open long contracts and the total open short contracts in each future and, for commodity option transactions, the total open put options purchased, the total open put options granted, the total open call options purchased, and the total open call options granted for each commodity option expiration date.

(c) Each designated contract market shall keep a record in permanent form, which shall show the true name, address, and principal occupation or business of any foreign trader executing transactions on the facility or exchange. In addition, upon request, a designated contract market shall provide to the Commission information regarding the name of any person guaranteeing such transactions or exercising any control over the trading of such foreign trader.

(d) Paragraph (c) of this section shall not apply to a designated contract market on which transactions in futures or option contracts of foreign traders are executed through, or the resulting transactions are maintained in, accounts carried by a registered futures commission merchant or introduced by a registered introducing

broker subject to the provisions of paragraph (a) of this section.

(The information collection requirements contained in § 1.37 were approved by the Office of Management and Budget under control numbers 3038–0007 and 3038–0024; and in paragraph (b) under control number 3038–0009)

[46 FR 54523, Nov. 3, 1981, as amended at 46 FR 63035, Dec. 30, 1981; 48 FR 35289, Aug. 3, 1983; 58 FR 28501, May 14, 1993; 66 FR 20744, Apr. 25, 2001; 66 FR 42269, Aug. 10, 2001]

§ 1.38 Execution of transactions.

(a) *Competitive execution required; exceptions.* All purchases and sales of any commodity for future delivery, and of any commodity option, on or subject to the rules of a contract market shall be executed openly and competitively by open outcry or posting of bids and offers or by other equally open and competitive methods, in the trading pit or ring or similar place provided by the contract market, during the regular hours prescribed by the contract market for trading in such commodity or commodity option: *Provided, however,* That this requirement shall not apply to transactions which are executed non-competitively in accordance with written rules of the contract market which have been submitted to and approved by the Commission, specifically providing for the non-competitive execution of such transactions.

(b) *Noncompetitive trades; exchange of futures, etc.; requirements.* Every person handling, executing, clearing, or carrying trades, transactions or positions which are not competitively executed, including transfer trades or office trades, or trades involving the exchange of futures for cash commodities or the exchange of futures in connection with cash commodity transactions, shall identify and mark by appropriate symbol or designation all such transactions or contracts and all orders, records, and memoranda pertaining thereto.

(Approved by the Office of Management and Budget under control numbers 3038–0007 and 3038–0022)

[46 FR 54523, Nov. 3, 1981, as amended at 46 FR 63035, Dec. 30, 1981]

§ 1.39 Simultaneous buying and selling orders of different principals; execution of, for and between principals.

(a) *Conditions and requirements.* A member of a contract market who shall have in hand at the same time both buying and selling orders of different principals for the same commodity for future delivery in the same delivery month or the same option (both puts or both calls, with the same underlying contract for future delivery or the same underlying physical, expiration date and strike price) may execute such orders for and directly between such principals at the market price, if in conformity with written rules of such contract market which have been approved by the Commission, and:

(1)(i) When trading is conducted in a trading pit or ring, such orders are first offered openly and competitively by open outcry in such trading pit or ring (A) by both bidding and offering at the same price, and neither such bid nor offer is accepted, or (B) by bidding and offering to a point where such offer is higher than such bid by not more than the minimum permissible price fluctuation applicable to such futures contract or commodity option on such contract market, and neither such bid nor offer is accepted; or

(ii) When in nonpit trading in contracts of sale for future delivery, bids and offers are posted on a board, such member (A) pursuant to such buying order posts a bid on the board and, incident to the execution of such selling order, accepts such bid and all other bids posted at prices equal to or higher than the bid posted by him, or (B) pursuant to such selling order posts an offer on the board and, incident to the execution of such buying order, accepts such offer and all other offers posted at prices equal to or lower than the offer posted by him;

(2) Such member executes such orders in the presence of an official representative of such contract market designated to observe such transactions and, by appropriate descriptive words or symbol, clearly identifies all such transactions on his trading card or other similar record, made at the time of execution, and notes thereon the exact time of execution and

promptly presents said record to such official representative for verification and initialing;

(3) Such contract market keeps a record in permanent form of each such transaction showing the transaction date, by whom executed, the exact time of execution, quantity, and, as applicable, underlying commodity, contract for future delivery or physical, price or premium, whether a put or a call, and strike price; and

(4) Neither the futures commission merchant receiving nor the member executing such orders has any interest therein, directly or indirectly, except as a fiduciary.

(b) *Large Order Execution Procedures.* A member of a contract market may execute simultaneous buying and selling orders of different principals directly between the principals in compliance with large order execution procedures established by written rules of the contract market that have been approved by the Commission: *Provided,* That, to the extent such large order execution procedures do not meet the conditions and requirements of paragraph (a) of this section, the contract market has petitioned the Commission for, and the Commission has granted, an exemption from the conditions and requirements of paragraph (a) of this section. Any such petition must be accompanied by proposed contract market rules to implement the large order execution procedures. The petition shall include:

(1) An explanation of why the proposed large order execution rules do not comply with paragraph (a) of this section; and

(2) A description of a special surveillance program that would be followed by the contract market in monitoring the large order execution procedures.

The Commission may, in its discretion and upon such terms and conditions as it deems appropriate, grant such petition for exemption if it finds that the exemption is not contrary to the public interest and the purposes of the provision from which exemption is sought. The petition shall be considered concurrently with the proposed large order execution rules.

(c) *Not deemed filling orders by offset nor cross trades.* The execution of orders in compliance with the conditions herein set forth will not be deemed to constitute the filling of orders by offset within the meaning of paragraph (iv) of section 4b(a) of the Act, nor to constitute cross trades within the meaning of paragraph (A) of section 4c(a) of the Act.

(Approved by the Office of Management and Budget under control numbers 3038–0007 and 3038–0022)

[41 FR 3194, Jan. 21, 1976, as amended at 46 FR 63035, Dec. 30, 1981; 47 FR 57008, Dec. 22, 1982; 56 FR 12344, Mar. 25, 1991; 59 FR 5525, Feb. 7, 1994]

MISCELLANEOUS

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

Each futures commission merchant 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 or member which concerns crop or market information or conditions that affect or tend to affect the price of any commodity, and the true source of or authority for the information contained therein.

(Approved by the Office of Management and Budget under control number 3038–0015)

[41 FR 3194, Jan. 21, 1976, as amended at 46 FR 63035, Dec. 30, 1981]

§ 1.41 [Reserved]

§ 1.41a–1.41c [Reserved]

§§ 1.42–1.43 [Reserved]

§ 1.44 Records and reports of warehouses, depositories, and other similar entities; visitation of premises.

Each contract market shall require the operators of warehouses, depositories and other similar entities whose receipts are deliverable in satisfaction of commodity futures contracts or options on physicals made on or subject to the rules of such contract market:

(a) To keep records showing the stocks of each commodity traded for future delivery or upon which option contracts are traded on such contract market in store in such warehouses,

depositories and other similar entities by kinds, by classes, and by grades, if stored under conditions requiring such designation or identification, and including also lots and parcels stored specially or separately or in specially leased space of the warehouse, depository or other similar entity;

(b) Upon call from the Commission, to report the stocks of commodities in such warehouses, depositories and other similar entities and to furnish information concerning stocks of each commodity traded for future delivery or upon which option contracts are traded on such contract market about to be transferred or in the process of being transferred or otherwise moved into or out of such warehouses, depositories and other similar entities, as well as any other information concerning commodities stored in such warehouse, depositories and other similar entities and which are or may be available for delivery on futures contracts or options on physicals; and

(c) To permit visitation of the premises and inspection of the books and records of such warehouses, depositories and other similar entities by duly authorized representatives of the Commission or the Department of Justice, and to keep all books, records, papers, and memoranda relating to the storage and warehousing of commodities in such warehouse, depository or other similar entity for a period of 5 years from the date thereof.

(Approved by the Office of Management and Budget under control number 3038–0019)

(Sec. 5a, 49 Stat. 1497; 7 U.S.C. 7a)

[41 FR 3194, Jan. 21, 1976, as amended at 46 FR 63035, Dec. 30, 1981; 47 FR 57009, Dec. 22, 1982]

§ 1.45 [Reserved]

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

(a) *Application of purchases and sales.* Except with respect to purchases or sales which are for omnibus accounts, or where the customer 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:

(1) 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;

(2) 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;

(3) 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

(4) 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.

(b) *Close-out against oldest open position.* In all instances wherein the short or long futures or option position in such 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 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. Such instructions may also be accepted from any person who, by power of attorney or otherwise, actually directs trading in the customer's or option customer's account unless the person directing the trading is the futures commission merchant (including any partner thereof), or is an officer, employee, or agent of the futures commission merchant. 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 shall clearly show on the statement issued to the customer or option customer in connection with the transaction, that because of the specific instructions given by or on behalf of the 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 has received such specific instructions in writing from the customer or option customer for whom such account is carried.

(c) *In-and-out trades; day trades.* Notwithstanding the provisions of paragraphs (a) and (b) of this section shall not be deemed to require the application of purchases or sales closed out during the same day (commonly known as ''in-and-out trades'' or ''day trades'') against short or long positions carried forward from a prior date.

(d) *Exceptions.* The provisions of this section shall not apply to:

(1) Purchases or sales of commodity options constituting ''bona fide hedging transactions'' pursuant to rules of the contract market which have been adopted in accordance with the requirements of § 1.61(b) and approved by the Commission pursuant to; section 5a(a)(12)(A) of the Act *Provided,* That no contract market or futures commission merchant shall permit such option positions to be offset other than by open and competitive execution in the trading pit or ring provided by the contract market, during the regular hours prescribed by the contract market for trading in such commodity option.

(2) Purchases or sales constituting ''bona fide hedging transactions'' as defined in § 1.3(z); nor

(3) Sales during a delivery period for the purpose of making delivery during such delivery period if such sales are accompanied by instructions to make delivery thereon, together with warehouse receipts or other documents necessary to effectuate such delivery.

(4)–(7) [Reserved]

(8) Purchases or sales held in error accounts, including but not limited to floor broker error accounts, and purchases or sales identified as errors at the time they are assigned to an account that contains other purchases or sales not identified as errors and held in that account (''error trades''), provided that:

(i) Each error trade does not offset another error trade held in the same account;

(ii) Each error trade is offset by open and competitive means on or subject to the rules of a contract market by not later than the close of business on the business day following the day the error trade is discovered and assigned to an error account or identified as an error trade, unless at the close of business on the business day following the discovery of the error trade, the relevant market has reached a daily price fluctuation limit and the trader is unable to offset the error trade, in which case the error trade must be offset as soon as practicable thereafter; and

(iii) No error trade is closed out by transferring such an open position to another account also controlled by that same trader.

(e) The statements required by paragraph (a) of this section may be furnished to the customer or the person

described in § 1.33(d) by means of electronic transmission, in accordance with § 1.33(g).

(Approved by the Office of Management and Budget under control number 3038–0007)

(Secs. 4g, 5, 42 Stat. 1000, 49 Stat. 1496; 7 U.S.C. 6g, 7; secs. 4g, 5, 8a; 7 U.S.C. 6g, 7, 12a)

[41 FR 3194, Jan. 21, 1976, as amended at 46 FR 54524, Nov. 3, 1981; 46 FR 63035, Dec. 30, 1981; 47 FR 57009, Dec. 22, 1982; 48 FR 35289, Aug. 3, 1983; 49 FR 19972, May 11, 1984; 50 FR 26, Jan. 2, 1985; 51 FR 17473, May 13, 1986; 53 FR 614, Jan. 11, 1988; 56 FR 14314, Apr. 9, 1991; 57 FR 55085, Nov. 24, 1992; 59 FR 5526, Feb. 7, 1994; 66 FR 53517, Oct. 23, 2001]

§ 1.47 Requirements for classification of purchases or sales of contracts for future delivery as bona fide hedging under § 1.3(z)(3) of the regulations.

(a) Any person who wishes to avail himself of the provisions of § 1.3(z)(3) of the regulations and to make purchases or sales of any commodity for future delivery in any commodity in excess of trading and position limits then in effect pursuant to section 4a of the Act shall file statement with the Commission in conformity with the requirements of this section. All or a specified portion of the transactions and positions described in these statements shall not be considered as bona fide hedging if such person is so notified by the Commission:

(1) Within 30 days after the Commission is furnished the information required under paragraph (b) of this section, or

(2) Within 10 days after the Commission is furnished with the information required under paragraph (c) of this section.

The Commission may request the person notified to file specific additional information with the Commission to support a determination that all, or the specified portion, of the transactions and positions be considered as bona fide hedging transactions and positions. In such cases, the Commission shall consider all information so filed and, by notice to such person, shall specify the extent to which the Commission has determined that the transactions and positions may be classified as bona fide hedging. In no case shall transactions and positions described be considered as bona fide hedging if they exceed the levels specified in paragraph (d) of this section.

(b) *Initial statement.* Initial statements concerning the classification of transactions and positions as bona fide hedging pursuant to § 1.3(z)(3) shall be filed with the Commission at least 30 days in advance of the date that such transactions or positions would be in excess of limits then in effect pursuant to section 4a of the Act. Such statements shall:

(1) Describe the transactions and positions for future delivery and the offsetting cash positions;

(2) Set forth in detail information which will demonstrate that the purchases and sales are economically appropriate to the reduction of risk exposure attendant to the conduct and management of a commercial enterprise;

(3) Contain, and upon request of the Commission be supplemented by, such other information which is necessary to enable the Commission to make a determination whether the particular purchases and sales for future delivery fall within the scope of those described in section 1.3(z)(1) of the regulations;

(4) Include a statement concerning the maximum size of positions for future delivery (both long and short) which will be acquired any time during the next fiscal year or marketing season of the person filing or on whose behalf the filing is made.

(5) In addition: statements filed by an agent, concerning a futures position which would offset a cash position which the agent does not own or has not contracted to buy or sell, shall contain information describing all contractual arrangements between the agent filing and the person who owns the commodity or holds the cash market commitment being offset;

(6) Statements concerning futures positions to be acquired against unsold anticipated production or unfilled anticipated requirements for manufacturing, processing or feeding shall also include the information required under § 1.48 of the regulations.

(c) *Supplemental reports.* Whenever the purchases or sales which a person wishes to classify as bona fide hedging shall

exceed the amount provided in the person's most recent filing pursuant to this section or the amount previously specified by the Commission pursuant to paragraph (a) of this section, such person shall file with the Commission a statement which updates the information provided in the person's most recent filing and provides the reasons for this change at least ten days in advance of the date that person wishes to exceed those amounts.

(d) *Maximum purchases and sales.* Purchases and sales for future delivery considered bona fide hedging pursuant to § 1.3(z)(3) of the regulations shall at no time exceed the lesser of:

(1) The value fluctuation equivalent (in terms of the commodity for future delivery) of the current cash position described in the information most recently filed pursuant to this section, or

(2) The maximum level of long or short open positions provided in the information most recently filed pursuant to this section or most recently specified by the Commission pursuant to paragraph (a) of this section.

(e) *Updated reports.* Reports updating the information required pursuant to this section also shall be filed with the Commission upon specific request.

(Approved by the Office of Management and Budget under control number 3038–0013)

[42 FR 42751, Aug. 8, 1977, as amended at 46 FR 63035, Dec. 30, 1981]

§ 1.48 Requirements for classification of sales or purchases for future delivery as bona fide hedging of unsold anticipated production or unfilled anticipated requirements under § 1.3(z)(2) (i)(B) or (ii)(C) of the regulations.

(a) Any person who wishes to avail himself of the provisions of § 1.3(z)(2) (i)(B) or (ii)(C) of the regulations and to make sales or purchases for future delivery in any commodity in excess of trading and position limits then in effect pursuant to section 4a of the Act for the purposes of bona fide hedging shall file statements with the Commission in conformity with the requirements of this section. All or a specified portion of the unsold anticipated production or unfilled anticipated requirements described in these statements shall not be considered as offsetting positions for bona fide hedging transactions and positions if such person is so notified by the Commission within ten days after the Commission is furnished with the information required under paragraphs (b) or (c) of this section. The Commission may request the person notified to file specific additional information with the Commission to support a determination that the statement filed accurately reflects unsold anticipated production or unfilled anticipated requirements for manufacturing, processing or feeding. In such cases, the Commission shall consider all additional information so filed and, by notice to such person, shall specify its determination as to what portion of the production or requirements described constitutes unsold anticipated production or unfilled anticipated requirements for the purposes of bona fide hedging. In no case shall such transactions and positions which offset unsold anticipated production or unfilled anticipated requirements be considered bona fide hedging if they exceed the levels specified in paragraph (d) of this section of the regulations.

(b) *Initial statement.* Initial statements concerning the classification of transactions and positions as bona fide hedging pursuant to § 1.3(z)(2) (i)(B) or (ii)(C) shall be filed with the Commission at least ten days in advance of the date that such transactions or positions would be in excess of limits then in effect pursuant to section 4a of the Act. Such statements shall set forth in detail for a specified operating period not in excess of one year the person's unsold anticipated production or unfilled anticipated requirements for processing or manufacturing or feeding and explain the method of determination thereof, including, but not limited to, the following information:

(1) For unsold anticipated production:

(i) Annual production of such commodity for the three complete fiscal years preceding the current fiscal year;

(ii) Anticipated production of such commodity for a specified period not in excess of one year;

(iii) Fixed-price forward sales of such commodity;

(iv) Unsold anticipated production of such commodity for a specified period not in excess of one year.

(2) For unfilled anticipated requirements:

(i) Annual requirements of such commodity for processing or manufacturing or feeding for the three complete fiscal years preceding the current fiscal year;

(ii) Anticipated requirements of such commodity for processing or manufacturing or feeding for a specified operating period not in excess of one year;

(iii) Inventory and fixed-price forward purchases of such commodity, including any quantity in process of manufacture and finished goods and byproducts of manufacture or processing (in terms of such commodity);

(iv) Unfilled anticipated requirements of such commodity for processing or manufacturing or feedings for a specified operating period not in excess of one year.

(3) Additional information: Persons hedging unsold anticipated production or unfilled anticipated requirements which are not the same quantity or are not the same commodity as the commodity to be sold or purchased for future delivery shall furnish this information both in terms of the actual commodity produced or used and in terms of the commodity to be sold or purchased for future delivery. In addition, such persons shall explain the method for determining the ratio of conversion between the amount of the actual unsold anticipated production or unfilled anticipated requirements and the amount of commodity to be sold or purchased for future delivery. Persons hedging unfilled annual feeding requirements for livestock and poultry shall provide the number of cattle, hogs, sheep, or poultry expected to be fed during the specified period, not to exceed one year, and the derivation of their annual requirements based upon these numbers. Persons filing as an agent shall furnish this information on the basis of the fiscal or operating year of the person on whose behalf the filing is made.

(c) *Supplemental reports.* Whenever the sales or purchases which a person wishes to consider as bona fide hedging of unsold anticipated production or unfilled anticipated requirements shall exceed the amounts described by the figures for requirements furnished in the most recent filing pursuant to this section or the amounts determined by the Commission to constitute unsold anticipated production or unfilled anticipated requirements pursuant to paragraph (a) of this section, such person shall file with the Commission a statement which updates the information provided in the person's most recent filing and supplies the reason for this change at least ten days in advance of the date that person wishes to exceed these amounts.

(d) *Maximum sales and purchases.* Sales or purchases for future delivery considered as bona fide hedges pursuant to §1.3(z)(2) (i)(B) or (ii)(C) shall at no time exceed the lesser of:

(1) A person's unsold anticipated production of unfilled anticipated requirements as described by the information must recently filed pursuant to this section or determined by the Commission pursuant to paragraph (a) of this section; or

(2) A person's actual unsold anticipated production or current unfilled anticipated requirements for the length of time specified in the information most recently filed pursuant to this section.

(e) *Updated reports.* Reports updating the information required pursuant to this section shall also be filed with the Commission upon specific request.

(Approved by the Office of Management and Budget under control number 3038–0013)

[42 FR 42752, Aug. 8, 1977, as amended at 46 FR 63035, Dec. 30, 1981]

§ 1.49 Denomination of customer funds and location of depositories.

(a) *Definitions.* For purposes of this section:

(1) *Money center country.* This term means Canada, France, Italy, Germany, Japan, and the United Kingdom.

(2) *Money center currency.* This term means the currency of any money center country and the Euro.

(b) *Permissible denominations of obligations.* (1) Subject to the terms and conditions set forth in this section, a futures commission merchant's obligations to a customer shall be denominated:

(i) In the United States dollar;

(ii) In a currency in which funds were deposited by the customer or were converted at the request of the customer, to the extent of such deposits and conversions; or

(iii) In a currency in which funds have accrued to the customer as a result of trading conducted on a designated contract market or registered derivatives transaction execution facility, to the extent of such accruals.

(2)(i) A futures commission merchant shall prepare and maintain a written record of each transaction converting customer funds from one currency to another.

(ii) A written record prepared under paragraph (b)(2)(i) of this section must include the date the transaction was executed, the currencies converted, the amount converted, and the resulting amount.

(iii) The information required under paragraph (b)(2)(ii) of this section must be provided to the customer upon the customer's request.

(c) *Permissible locations of depositories.* (1) Unless a customer provides instructions to the contrary, a futures commission merchant or a derivatives clearing organization may hold customer funds:

(i) In the United States;

(ii) In a money center country; or

(iii) In the country of origin of the currency.

(2) A futures commission merchant or derivatives clearing organization may hold customer funds outside the United States, in a jurisdiction that is not a money center country, or the country of origin of the currency only to the extent authorized by the customer, *provided,* that the futures commission merchant or derivatives clearing organization must make and maintain a written record of such authorization. Notwithstanding the foregoing, in no event shall a futures commission merchant or a derivatives clearing organization hold customer funds in a restricted country subject to sanctions by the Office of Foreign Assets Control of the U.S. Department of Treasury.

(d) *Qualifications for depositories.* (1) To hold customer funds required to be segregated pursuant to the Act and §§ 1.20 through 1.30, 1.32 and 1.36, a depository must provide the depositing futures commission merchant or derivatives clearing organization with the appropriate written acknowledgment as required under §§ 1.20 and 1.26.

(2) A depository, if located in the United States, must be:

(i) A bank or trust company;

(ii) A futures commission merchant registered as such with the Commission; or

(iii) A derivatives clearing organization.

(3) A depository, if located outside the United States, must be:

(i) A bank or trust company:

(A) That has in excess of $1 billion of regulatory capital; or

(B) Whose commercial paper or long-term debt instrument or, if a part of a holding company system, its holding company's commercial paper or long-term debt instrument, is rated in one of the two highest rating categories by at least one nationally recognized statistical rating organization;

(ii) A futures commission merchant that is registered as such with the Commission; or

(iii) A derivatives clearing organization.

(e) *Segregation requirements.* (1) Each futures commission merchant and each derivatives clearing organization must, as of the close of each business day, hold in segregated accounts on behalf of commodity or option customers:

(i) Sufficient United States dollars, held in the United States, to meet all United States dollar obligations; and

(ii) Sufficient funds in each other currency to meet obligations in such currency.

(2) Notwithstanding paragraph (e)(1)(ii) of this section, assets denominated in one currency may be held to meet obligations denominated in another currency as follows:

(i) United States dollars may be held in the United States or in money center countries to meet obligations denominated in any other currency; and

(ii) Funds in money center currencies may be held in the United States or in money center countries to meet obligations denominated in currencies other than the United States dollar.

(3) Each futures commission merchant and each derivatives clearing organization shall make and maintain records sufficient to demonstrate compliance with this paragraph (e).

[68 FR 5551, Feb. 4, 2003]

§§ 1.50–1.51 [Reserved]

§ 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. 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 and the definition of adjusted net capital must be the same as that prescribed in §1.17(c): *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 or Part IIA, 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.

(b) Each self-regulatory organization shall have in effect and enforce rules submitted to the Commission pursuant to paragraph (a) of this section and approved by the Commission.

(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 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.

Such plan may also delegate the responsibility of monitoring, and examining the books and records kept by, such registered futures commission merchant or registered introducing broker relating to its business of dealing in commodity futures, commodity options, and cash commodities, insofar as such business relates to its dealings on contract markets, as required by §1.51(a)(3) and/or part 33 of this chapter.

(d) Any plan filed under this section may contain provisions for the allocation of expenses reasonably incurred by the designated self-regulatory organization among the self-regulatory organizations participating in such a plan.

(e) A plan's designated self-regulatory organization must report to that plan's other self-regulatory organizations any violation of such other self-regulatory organizations' rules and regulations for which the responsibiity to monitor, audit or examine has been delegated to such designated self-regulatory organization under this section.

(f) The self-regulatory organizations may, among themselves, establish programs to provide access to any necessary financial or related information.

(g) After appropriate notice and opportunity for comment, the Commission may, by written notice, approve such a plan, or any part of the plan, if it finds that the plan, or any part of it:

(1) Is necessary or appropriate to serve the public interest;

(2) Is for the protection and in the interest of customers or option customers;

(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 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 or introducing broker which is a member of more than one self-regulatory organization;

(5) Fosters cooperation and coordination among the contract markets; and

(6) Does not hinder the development of a registered futures association under section 17 of the Act.

(h)(1) Upon the approval of a plan or part of one under paragraph (g) of this section, a self-regulatory organization which is included in such a plan shall be considered to have met its affirmative action responsibilities under §1.51 to the extent that such responsibilities have been delegated to a designated self-regulatory organization.

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

(i) The Commission may at any time, after appropriate notice and opportunity for hearing, withdraw its approval of any plan or part of one established under this section, if such plan or part of one ceases to effectuate adequately the purposes of section 4(f)(b) of the Act or of this section.

(j) Whenever a registered futures commission merchant 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 or such introducing broker.

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

(l) In the event a plan is not filed and/or approved for each registered futures commission merchant or for each registered introducing broker which is a member of more than one self-regulatory organization, the Commission may design and, after notice and opportunity for comment, approve a plan for those futures commission merchants or introducing brokers which are not the subject of an approved plan (under paragraph (g) of this section), delegating to a designated self-regulatory organization the responsibilities described in paragraph (c) of this section.

(Approved by the Office of Management and Budget under control numbers 3038–0007 and 3038–0022)

(7 U.S.C. 6c, 6d, 6f, 6g, 7a, 12a, 19, and 21; 5 U.S.C. 552, 5 U.S.C. 552b, and secs. 2(a)(11), 4b, 4f, 4g, 5a, 8a, and 17 of the Commodity Exchange Act, 7 U.S.C. 4a(j), 6b, 6f, 6g, 7a, 12a, and 21, as amended, 92 Stat 865 *et seq.*)

[43 FR 39981, Sept. 8, 1978, as amended at 46 FR 63035, Dec. 30, 1981; 48 FR 35290, Aug. 3, 1983; 53 FR 4612, Feb. 17, 1988; 59 FR 5526, Feb. 7, 1994; 62 FR 4641, Jan. 31, 1997]

§ 1.53 Enforcement of contract market bylaws, rules, regulations, and resolutions.

Each contract market shall enforce each bylaw, rule, regulation, and resolution, made or issued by it or by the governing board thereof or any committee thereof, which is in effect as of July 18, 1975, and which relates to terms and conditions in contracts of sale to be executed on or subject to the rules of such contract market or relates to other trading requirements, unless such bylaw, rule, regulation, or resolution has been disapproved by the

Commission pursuant to section 5a(a)(12)(A) of the Act, or the amendment or revocation of such bylaw, rule, regulation or resolution has been approved by the Commission pursuant to section 5a(a)(12)(A) of the Act.

(Secs. 5, 5a, 6, 6b; 42 Stat. 1000, 1001, 49 Stat. 1497, 1498, 82 Stat. 29, 30, 31, 88 Stat. 1392, 1400, 1401, 1402; 7 U.S.C. 7, 7a, 8, 13a)

[41 FR 3194, Jan. 21, 1976, as amended at 59 FR 5526, Feb. 7, 1994]

§ 1.54 Contract market rules submitted to and approved or not disapproved by the Secretary of Agriculture.

Notwithstanding any provision of these rules, any bylaw, rule, regulation, or resolution of a contract market that was submitted to the Secretary of Agriculture pursuant or § 1.38(a) or § 1.39(a) of these rules, and was either approved by the Secretary or not disapproved by him, as of April 21, 1975, shall continue in full force and effect unless and until disapproved, altered or supplemented by or with the approval of the Commission. The adoption of this rule does not constitute approval by the Commission of any contract market bylaw, rule, regulation or resolution.

(Sec. 411, Pub. L. 93–463, 88 Stat. 1414; 7 U.S.C. 4a note)

[45 FR 2314, Jan. 11, 1980]

§ 1.55 Distribution of "Risk Disclosure Statement" by futures commission merchants and introducing brokers.

(a)(1) Except as provided in 1.65, no futures commission merchant, or in the case of an introduced account no introducing broker, may open a commodity futures account for a customer, other than for a customer specified in paragraph (f) of this section, unless the futures commission merchant or introducing broker first:

(i) Furnishes the customer with a separate written disclosure statement containing only the language set forth in paragraph (b) of this section (except for nonsubstantive additions such as captions) or as otherwise approved under paragraph (c) of this section; *Provided, however,* that the disclosure statement may be attached to other documents as the cover page or the first page of such documents and as the only material on such page; and

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

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

RISK DISCLOSURE STATEMENT

The risk of loss in trading commodity futures contracts can be substantial. You should, therefore, carefully consider whether such trading is suitable for you in light of your circumstances and financial resources. You should be aware of the following points:

(1) You may sustain a total loss of the funds that you deposit with your broker to establish or maintain a position in the commodity futures market, and you may incur losses beyond these amounts. 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 required funds within the time required by your broker, your position may be liquidated at a loss, and you will be liable for any resulting deficit in your account.

(2) Under certain market conditions, you may find it difficult or impossible to liquidate a position. This can occur, for example, when the market reaches a daily price fluctuation limit (''limit move'').

(3) Placing contingent orders, such as ''stop-loss'' or ''stop-limit'' orders, will not necessarily limit your losses to the intended amounts, since market conditions on the exchange where the order is placed may make it impossible to execute such orders.

(4) All futures positions involve risk, and a ''spread'' position may not be less risky than an outright ''long'' or ''short'' position.

(5) The high degree of leverage (gearing) that is often obtainable in futures trading because of the small margin requirements can work against you as well as for you. Leverage (gearing) can lead to large losses as well as gains.

(6) You should consult your broker concerning the nature of the protections available to safeguard funds or property deposited for your account.

ALL OF THE POINTS NOTED ABOVE APPLY TO ALL FUTURES TRADING WHETHER FOREIGN OR DOMESTIC. IN ADDITION, IF YOU ARE CONTEMPLATING TRADING FOREIGN FUTURES OR OPTIONS CONTRACTS, YOU SHOULD BE AWARE OF THE FOLLOWING ADDITIONAL RISKS:

(7) Foreign futures transactions involve executing and clearing trades on a foreign exchange. This is the case even if the foreign exchange is formally ''linked'' to a domestic exchange, whereby a trade executed on one exchange liquidates or establishes a position on the other exchange. No domestic organization regulates the activities of a foreign exchange, including the execution, delivery, and clearing of transactions on such an exchange, and no domestic regulator has the power to compel enforcement of the rules of the foreign exchange or the laws of the foreign country. Moreover, such laws or regulations will vary depending on the foreign country in which the transaction occurs. For these reasons, customers who trade on foreign exchanges may not be afforded certain of the protections which apply to domestic transactions, including the right to use domestic alternative dispute resolution procedures. In particular, funds received from customers to margin foreign futures transactions may not be provided the same protections as funds received to margin futures transactions on domestic exchanges. Before you trade, you should familiarize yourself with the foreign rules which will apply to your particular transaction.

(8) Finally, you should be aware that the price of any foreign futures or option contract and, therefore, the potential profit and loss resulting therefrom, may be affected by any fluctuation in the foreign exchange rate between the time the order is placed and the foreign futures contract is liquidated or the foreign option contract is liquidated or exercised.

THIS BRIEF STATEMENT CANNOT, OF COURSE, DISCLOSE ALL THE RISKS AND OTHER ASPECTS OF THE COMMODITY MARKETS

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

_____

Date

_____

Signature of Customer

(c) The Commission may approve for use in lieu of the risk disclosure document required by paragraph (b) of this section a risk disclosure statement approved by one or more foreign regulatory agencies or self-regulatory organizations if the Commission determines that such risk disclosure statement is reasonably calculated to provide the disclosure required by paragraph (b) of this section. Notice of risk disclosure statements that may be used to satisfy Commission disclosure requirements, what requirements such statements meet and the jurisdictions which accept each format will be set forth in appendix A to this section.

(d) Any futures commission merchant, or in the case of an introduced account any introducing broker, may open a commodity futures account for a customer without obtaining the separate acknowledgments of disclosure and elections required by this section and by § 1.33(g), and by §§ 33.7 and 190.06 of this chapter, provided that:

(1) Prior to the opening of such account, the futures commission merchant or introducing broker obtains an acknowledgment from the customer, which may consist of a single signature at the end of the futures commission merchant's or introducing broker's customer account agreement, or on a separate page, of the disclosure statements and elections specified in this section and § 1.33(g), and in §§ 33.7 and 190.06 of this chapter, and which may include authorization for the transfer of funds from a segregated customer account to another account of such customer, as listed directly above the signature line, provided the customer has acknowledged by check or other indication next to a description of each specified disclosure statement or election that the customer has received and understood such disclosure statement or made such election; and

(2) The acknowledgment referred to in paragraph (d)(1) of this section is accompanied by and executed contemporaneously with delivery of the disclosures and elective provisions required by this section and § 1.33(g), and by §§ 33.7 and 190.06 of this chapter.

(e) The acknowledgment required by paragraph (a) of this section must be retained by the futures commission merchant or introducing broker in accordance with § 1.31.

(f) A futures commission merchant or, in the case of an introduced account an introducing broker, may open a commodity futures account for an ''institutional customer'' as defined in § 1.3(g) without furnishing such institutional customer the disclosure statements or obtaining the acknowledgments required under paragraph (a) of this section, §§ 1.33(g) and 1.65(a)(3), and §§ 30.6(a), 33.7(a) and 190.10(c) of this chapter.

(g) This section does not relieve a futures commission merchant or introducing broker from any other disclosure obligation it may have under applicable law.

(h) Notwithstanding any other provision of this section or § 1.65, a person registered or required to be registered with the Commission as a futures commission merchant pursuant to sections 4f(a)(1) or 4f(a)(2) of the Commodity Exchange Act and registered or required to be registered with the Securities and Exchange Commission as a broker or dealer pursuant to sections 15(b)(1) or 15(b)(11) of the Securities Exchange Act of 1934 and rules thereunder must provide to a customer or prospective customer, prior to the acceptance of any order for, or otherwise handling any transaction in or in connection with, a security futures product for a customer, the disclosures set forth in § 41.41(b)(1) of this chapter.

(Approved by the Office of Management and Budget under control number 3038–0022)

(Secs. 4b, 4c(b), 4g(1), 4*l*, 4*o*, and 8a(5), Commodity Exchange Act, 7 U.S.C. 6b, 6c(b), 6g(1), 6*l*, 6*o*, and 12a(5)(1976), and sec. 217, Commodity Futures Trading Act of 1974, 88 Stat. 1405; secs. 2(a)(1), 4b, 4c, 4d, 4f and 8a, Commodity Exchange Act, as amended (7 U.S.C. 2, 6b, 6c, 6f and 12a))

APPENDIX A To CFTC RULE 1.55(c) — GENERIC RISK DISCLOSURE STATEMENT

Risk Disclosure Statement for Futures and Options

This brief statement does not disclose all of the risks and other significant aspects of trading in futures and options. In light of the risks, you should undertake such transactions only if you understand the nature of the contracts (and contractual relationships) into which you are entering and the extent of your exposure to risk. Trading in futures and options is not suitable for many members of the public. You should carefully consider whether trading is appropriate for you in light of your experience, objectives, financial resources and other relevant circumstances.

Futures

1. Effect of 'Leverage' or 'Gearing'

Transactions in futures carry a high degree of risk. The amount of initial margin is small relative to the value of the futures contract so that transactions are 'leveraged' or 'geared'. A relatively small market movement will have a proportionately larger impact on the funds you have deposited or will have to deposit: this may work against you as well as for you. You may sustain a total loss of initial margin funds and any additional funds deposited with the firm to maintain your position. If the market moves against your position or margin levels are increased, you may be called upon to pay substantial additional funds on short notice to maintain your position. If you fail to comply with a request for additional funds within the time prescribed, your position may be liquidated at a loss and you will be liable for any resulting deficit.

2. Risk-reducing orders or strategies

The placing of certain orders (e.g. 'stop-loss' orders, where permitted under local law, or 'stop-limit' orders) which are intended to limit losses to certain amounts may not be effective because market conditions may make it impossible to execute such orders. Strategies using combinations of positions, such as 'spread' and 'straddle' positions may be as risky as taking simple 'long' or 'short' positions.

Options

3. Variable degree of risk

Transactions in options carry a high degree of risk. Purchasers and sellers of options should familiarize themselves with the type of option (i.e. put or call) which they contemplate trading and the associated risks. You should calculate the extent to which the value of the options must increase for your position to become profitable, taking into account the premium and all transaction costs.

The purchaser of options may offset or exercise the options or allow the options to expire. The exercise of an option results either in a cash settlement or in the purchaser acquiring or delivering the underlying interest. If the option is on a future, the purchaser will acquire a futures position with associated liabilities for margin (see the section on Futures above). If the purchased options expire worthless, you will suffer a total loss of your investment which will consist of the option premium plus transaction costs. If you are contemplating purchasing deep-out-of-the-money options, you should be aware that the chance of such options becoming profitable ordinarily is remote.

Selling ('writing' or 'granting') an option generally entails considerably greater risk than purchasing options. Although the premium received by the seller is fixed, the seller may sustain a loss well in excess of that amount. The seller will be liable for additional margin to maintain the position if the market moves unfavorably. The seller will also be exposed to the risk of the purchaser exercising the option and the seller will be obligated to either settle the option in cash or to acquire or deliver the underlying interest. If the option is on a future, the seller will acquire a position in a future with associated liabilities for margin (see the section on Futures above). If the option is 'covered' by the seller holding a corresponding position in the underlying interest or a future or another option, the risk may be reduced. If the option is not covered, the risk of loss can be unlimited.

Certain exchanges in some jurisdictions permit deferred payment of the option premium, exposing the purchaser to liability for margin payments not exceeding the amount of the premium. The purchaser is still subject to the risk of losing the premium and transaction costs. When the option is exercised or expires, the purchaser is responsible for any unpaid premium outstanding at that time.

Additional risks common to futures and options

4. Terms and conditions of contracts

You should ask the firm with which you deal about the terms and conditions of the specific futures or options which you are trading and associated obligations (e.g. the circumstances under which you may become obligated to make or take delivery of the underlying interest of a futures contract and, in respect of options, expiration dates and restrictions on the time for exercise). Under certain

circumstances the specifications of outstanding contracts (including the exercise price of an option) may be modified by the exchange or clearing house to reflect changes in the underlying interest.

5. Suspension or restriction of trading and pricing relationships

Market conditions (e.g. illiquidity) and/or the operation of the rules of certain markets (e.g. the suspension of trading in any contract or contract month because of price limits or 'circuit breakers') may increase the risk of loss by making it difficult or impossible to effect transactions or liquidate/offset positions. If you have sold options, this may increase the risk of loss.

Further, normal pricing relationships between the underlying interest and the future, and the underlying interest and the option may not exist. This can occur when, for example, the futures contract underlying the option is subject to price limits while the option is not. The absence of an underlying reference price may make it difficult to judge 'fair' value.

6. Deposited cash and property

You should familiarize yourself with the protections accorded money or other property you deposit for domestic and foreign transactions, particularly in the event of a firm insolvency or bankruptcy. The extent to which you may recover your money or property may be governed by specific legislation or local rules. In some jurisdictions, property which had been specifically identifiable as your own will be pro-rated in the same manner as cash for purposes of distribution in the event of a shortfall.

7. Commission and other charges

Before you begin to trade, you should obtain a clear explanation of all commission, fees and other charges for which you will be liable. These charges will affect your net profit (if any) or increase your loss.

8. Transactions in other jurisdictions

Transactions on markets in other jurisdictions, including markets formally linked to a domestic market, may expose you to additional risk. Such markets may be subject to regulation which may offer different or diminished investor protection. Before you trade you should enquire about any rules relevant to your particular transactions. Your local regulatory authority will be unable to compel the enforcement of the rules of regulatory authorities or markets in other jurisdictions where your transactions have been effected. You should ask the firm with which you deal for details about the types of redress available in both your home jurisdiction and other relevant jurisdictions before you start to trade.

9. Currency risks

The profit or loss in transactions in foreign currency-denominated contracts (whether they are traded in your own or another jurisdiction) will be affected by fluctuations in currency rates where there is a need to convert from the currency denomination of the contract to another currency.

10. Trading facilities

Most open-outcry and electronic trading facilities are supported by computer-based component systems for the order-routing, execution, matching, registration or clearing of trades. As with all facilities and systems, they are vulnerable to temporary disruption or failure. Your ability to recover certain losses may be subject to limits on liability imposed by the system provider, the market, the clearing house and/or member firms. Such limits may vary: you should ask the firm with which you deal for details in this respect.

11. Electronic trading

Trading on an electronic trading system may differ not only from trading in an open-outcry market but also from trading on other electronic trading systems. If you undertake transactions on an electronic trading system, you will be exposed to risks associated with the system including the failure of hardware and software. The result of any system failure may be that your order is either not executed according to your instructions or is not executed at all.

12. Off-exchange transactions

In some jurisdictions, and only then in restricted circumstances, firms are permitted to effect off-exchange transactions. The firm with which you deal may be acting as your counterparty to the transaction. It may be difficult or impossible to liquidate an existing position, to assess the value, to determine a fair price or to assess the exposure to risk. For these reasons, these transactions may involve increased risks. Off-exchange transactions may be less regulated or subject to a separate regulatory regime. Before you undertake such transactions, you should familiarize yourself with applicable rules and attendant risks.

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

_____ Date

_____ Signature of Customer

* * * * *

[The following language should be printed on a page other than the pages containing the disclosure language above and may be omitted from the required disclosure statement]

This disclosure document meets the risk disclosure requirements in the jurisdictions

identified below ONLY for those instruments which are specified.

United States: Commodity futures, options on commodity futures and options on commodities subject to the Commodity Exchange Act.

United Kingdom: Futures, options on futures, options on commodities and options on equities traded by members of the United Kingdom Securities and Futures Authority pursuant to the Financial Services Act, 1986.

Ireland: Financial futures and options on financial futures traded by members of futures exchanges on exchanges whose rules have been approved by the Central Bank of Ireland under Chapter VIII of the Central Bank Act, 1989.

[43 FR 31890, July 24, 1978, as amended at 46 FR 63035, Dec. 30, 1981; 48 FR 35290, Aug. 3, 1983; 50 FR 5383, Feb. 5, 1985; 58 FR 17503, Apr. 5, 1993; 59 FR 34380, July 5, 1994; 59 FR 38119, July 27, 1994; 60 FR 38182, July 25, 1995; 63 FR 8570, Feb. 20, 1998; 63 FR 52157, Sept. 30, 1998; 66 FR 53518, Oct. 23, 2001; 67 FR 58297, Sept. 13, 2002]

§ 1.56 Prohibition of guarantees against loss.

(a) For purposes of this section *commodity interest* means

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

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

(b) No futures commission merchant or introducing broker may in any way represent that it will, with respect to any commodity interest in any account carried by the 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 initial and maintenance margin as established by the rules of the applicable board of trade.

(c) No person may in any way represent that a futures commission merchant or introducing broker will engage in any of the acts or practices described in paragraph (b) of this section.

(d) This section shall not be construed to prevent a futures commission merchant or introducing broker from:

(1) Assuming or sharing in the losses resulting from an error or mishandling of an order; or

(2) Participating as a general partner in a commodity pool which is a limited partnership.

(e) This section shall not affect any guarantee entered into prior to January 28, 1982, but this section shall apply to any extension, modification or renewal thereof entered into after such date.

[46 FR 62844, Dec. 29, 1981, as amended at 48 FR 35291, Aug. 3, 1983]

§ 1.57 Operations and activities of introducing brokers.

(a) Each introducing broker must:

(1) Open and carry each customer's and option customer's account with a carrying futures commission merchant on a fully-disclosed basis: *Provided, however,* That an introducing broker which has entered into a guarantee agreement with a futures commission merchant in accordance with the provisions of §1.10(j) of this part must open and carry such customer's and option customer's account with such guarantor futures commission merchant on a fully-disclosed basis; and

(2) Transmit promptly for execution all customer and option customer orders to:

(i) A carrying futures commission merchant; or

(ii) a floor broker, if the introducing broker identifies its carrying futures commission merchant and that carrying futures commission merchant is also the clearing member with respect to the customer's or option customer's order.

(b) An introducing broker may not carry proprietary accounts, nor may an introducing broker carry accounts in foreign futures.

(c) An introducing broker may not accept any money, securities or property (or extend credit in lieu thereof) to margin, guarantee or secure any trades or contracts of customers or option customers, or any money, securities or property accruing as a result of such trades or contracts: *Provided, however,* That an introducing broker may deposit a check in a qualifying account or forward a check drawn by a customer or option customer if:

(1) The futures commission merchant carrying the customer's or option customer's account authorizes the introducing broker, in writing, to receive a check in the name of the futures commission merchant, and the introducing broker retains such written authorization in its files in accordance with § 1.31;

(2) The check is payable to the futures commission merchant carrying the customer's or option customer's account;

(3) The check is deposited by the introducing broker, on the same day upon which it is received, in a bank or trust company located in the United States in a qualifying account, or the check is mailed or otherwise transmitted by the introducing broker to the futures commission merchant on the same day upon which it is received;

(4) For purposes of this paragraph (c), a qualifying account shall be deemed to be an account:

(i) Which is maintained in an account name which clearly identifies the funds therein as belonging to commodity or option customers of the futures commission merchant carrying the customer's or option customer's account;

(ii) For which the bank or trust company restricts withdrawals to withdrawals by the carrying futures commission merchant;

(iii) For which the bank or trust company prohibits the introducing broker or anyone acting upon its behalf from withdrawing funds; and

(iv) For which the bank or trust company provides the futures commission merchant carrying the customer's or option customer's account with a written acknowledgment, which the futures commission merchant must retain in its files in accordance with § 1.31, that it was informed that the funds deposited therein are those of commodity or option customers and are being held in accordance with the provisions of the Act and these regulations.

[48 FR 35291, Aug. 3, 1983, as amended at 57 FR 23143, June 2, 1992]

§ 1.58 Gross collection of exchange-set margins.

(a) Each futures commission merchant which carries a commodity futures or commodity option position for another futures commission merchant or for a foreign broker on an omnibus basis must collect, and each futures commission merchant and foreign broker for which an omnibus account is being carried must deposit, initial and maintenance margin on each position reported in accordance with § 17.04 of this chapter at a level no less than that established for customer accounts by the rules of the applicable contract market.

(b) If the futures commission merchant which carries a commodity futures or commodity option position for another futures commission merchant or for a foreign broker on an omnibus basis allows a position to be margined as a spread position or as a hedged position in accordance with the rules of the applicable contract market, the carrying futures commission merchant must obtain and retain a written representation from the futures commission merchant or from the foreign broker for which the omnibus account is being carried that each such position is entitled to be so margined.

[61 FR 19187, May 1, 1996]

§ 1.59 Activities of self-regulatory organization employees, governing board members, committee members, and consultants.

(a) *Definitions.* For purposes of this section:

(1) *Self-regulatory organization* means ''self-regulatory organization,'' as defined in Commission regulation 1.3(ee), and includes the term ''clearing organization,'' as defined in Commission regulation 1.3(d).

(2) *Governing board member* means a member, or functional equivalent thereof, of the board of governors of a self-regulatory organization.

(3) *Committee member* means a member, or functional equivalent thereof, of any committee of a self-regulatory organization.

(4) *Employee* means any person hired or otherwise employed on a salaried or contract basis by a self-regulatory organization, but does not include:

(i) Any governing board member compensated by a self-regulatory organization solely for governing board activities; or

(ii) Any committee member compensated by a self-regulatory organization solely for committee activities; or

(iii) Any consultant hired by a self-regulatory organization.

(5) *Material information* means information which, if such information were publicly known, would be considered important by a reasonable person in deciding whether to trade a particular commodity interest on a contract market. As used in this section, ''material information'' includes, but is not limited to, information relating to present or anticipated cash, futures, or option positions, trading strategies, the financial condition of members of self-regulatory organizations or members of linked exchanges or their customers or option customers, or the regulatory actions or proposed regulatory actions of a self-regulatory organization or a linked exchange.

(6) *Non-public information* means information which has not been disseminated in a manner which makes it generally available to the trading public.

(7) *Linked exchange* means: (i) any board of trade, exchange or market outside the United States, its territories or possessions, which has an agreement with a contract market in the United States that permits positions in a commodity interest which have been established on one of the two markets to be liquidated on the other market; (ii) any board of trade, exchange or market outside the United States, its territories or possessions, the products of which are listed on a United States contract market or a trading facility thereof; (iii) any securities exchange, the products of which are held as margin in a commodity account or cleared by a securities clearing organization pursuant to a cross-margining arrangement with a futures clearing organization; or (iv) any clearing organization which clears the products of any of the foregoing markets.

(8) *Commodity interest* means any commodity futures or commodity option contract traded on or subject to the rules of a contract market or linked exchange, or cash commodities traded on or subject to the rules of a board of trade which has been designated as a contract market.

(9) *Related commodity interest* means any commodity interest which is traded on or subject to the rules of a contract market, linked exchange, or other board of trade, exchange or market, other than the self-regulatory organization by which a person is employed, and with respect to which:

(i) Such employing self-regulatory organization has recognized or established intermarket spread margins or other special margin treatment between that other commodity interest and a commodity interest which is traded on or subject to the rules of the employing self-regulatory organization; or

(ii) Such other self-regulatory organization has recognized or established intermarket spread margins or other special margin treatment with another commodity interest as to which the person has access to material, non-public information.

(10) *Pooled investment vehicle* means a trading vehicle organized and operated as a commodity pool within regulation 4.10(d), and whose units of participation have been registered under the Securities Act of 1933, or a trading vehicle for which regulation 4.5 makes available relief from regulation as a commodity pool operator, *i.e.*, registered investment companies, insurance company separate accounts, bank trust funds, and certain pension plans.

(b) *Employees of self-regulatory organizations; Self-regulatory organization rules.* (1) Each self-regulatory organization must maintain in effect rules which have been submitted to the Commission pursuant to Section 5a(a)(12)(A) of the Act and §1.41 (or, pursuant to section 17(j) of the Act in the case of a registered futures association) that, at a minimum, prohibit:

(i) Employees of the self-regulatory organization from:

(A) Trading, directly or indirectly, in any commodity interest traded on or cleared by the employing contract market or clearing organization;

(B) Trading, directly or indirectly, in any related commodity interest;

(C) Trading, directly or indirectly, in a commodity interest traded on or cleared by contract markets or clearing organizations other than the employing self-regulatory organization if

the employee has access to material, non-public information concerning such commodity interest;

(D) Trading, directly or indirectly, in a commodity interest traded on or cleared by a linked exchange if the employee has access to material, non-public information concerning such commodity interest; and

(ii) Employees of the self-regulatory organization from disclosing to any other person any material, non-public information which such employee obtains as a result of his or her employment at the self-regulatory organization where such employee has or should have a reasonable expectation that the information disclosed may assist another person in trading any commodity interest; *Provided, however,* That such rules shall not prohibit disclosures made in the course of an employee's duties, or disclosures made to another self-regulatory organization, linked exchange, court of competent jurisdiction or representative of any agency or department of the federal or state government acting in his or her official capacity.

(2) Each self-regulatory organization 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 (or, pursuant to section 17(j) of the Act in the case of a registered futures association), which set forth circumstances under which exemptions from the trading prohibition contained in paragraph (b)(1)(i) of this section may be granted; such exemptions are to be administered by the self-regulatory organization on a case-by-case basis. Specifically, such circumstances may include:

(i) Participation by an employee in pooled investment vehicles where the employee has no direct or indirect control with respect to transactions executed for or on behalf of such vehicles; and

(ii) Trading by an employee under circumstances enumerated by the self-regulatory organization in rules which the self-regulatory organization determines are not contrary to the purposes of this regulation, the Commodity Exchange Act, the public interest, or just and equitable principles of trade.

(c) *Governing board members, committee members, and consultants; Self-regulatory organization rules.* Each self-regulatory organization must maintain in effect rules which have been submitted to the Commission pursuant to Section 5a(a)(12)(A) of the Act and §1.41 (or, pursuant to Section 17(j) of the Act in the case of a registered futures association) which provide that no governing board member, committee member, or consultant shall use or disclose—for any purpose other than the performance of official duties as a governing board member, committee member, or consultant—material, non-public information obtained as a result of the performance of such person's official duties.

(d) *Prohibited conduct.* (1) No employee, governing board member, committee member, or consultant shall:

(i) Trade for such person's own account, or for or on behalf of any other account, in any commodity interest, on the basis of any material, non-public information obtained through special access related to the performance of such person's official duties as an employee, governing board member, committee member, or consultant; or

(ii) Disclose for any purpose inconsistent with the performance of such person's official duties as an employee, governing board member, committee member, or consultant any material, non-public information obtained through special access related to the performance of such duties.

(2) No person shall trade for such person's own account, or for or on behalf of any other account, in any commodity interest, on the basis of any material, non-public information that such person knows was obtained in violation of paragraph (d)(1) of this section from an employee, governing board member, committee member, or consultant.

[58 FR 54973, Oct. 25, 1993, as amended at 65 FR 47847, Aug. 4, 2000]

§ 1.60 Pending legal proceedings.

(a) Every contract market shall submit to the Commission copies of the complaint, any dispositive or partially dispositive decision, any notice of appeal filed concerning such decisions and such further documents as the

Commission may thereafter request filed in any material legal proceeding to which the contract market is a party or its property or assets is subject.

(b) Every futures commission merchant shall sumit 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 futures commission merchant is a party or its property or assets is subjects.

(c) Every contract market shall submit to the Commission copies of the complaint, any dispositive or partially dispositive decision, any notice of appeal filed concerning such decisions and such further documents as the Commission may thereafter request filed in any material legal proceeding instituted against any officer, director, or other official of the contract market arising from conduct in such person's capacity as a contract market official and alleging violations of:

(1) The act or any rule, regulation, or order thereunder;

(2) the constitution, bylaws or rules of the contract market; or

(3) the applicable provisions of state law relating to the duties of officers, directors, or other officials of business organizations.

(d) Every futures commission merchant 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 futures commission merchant (as that term is defined in §3.1(a) of this chapter) arising from conduct in such person's capacity as a principal of the futures commission merchant and alleging violations 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.

(e) 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: Office of the General Counsel. All documents required by this section to be submitted to the Commission as to matters pending on the effective date of the section (May 25, 1984), shall be mailed to the Commission within 45 days of that effective date. Thereafter, all complaints required by this section to be submitted to the Commission by contract markets shall be mailed to the Commission within 10 days after the initiation of the legal proceedings to which they relate, all decisions required to be submitted by contract markets shall be mailed within 10 days of their date of issuance, all notices of appeal required to be submitted by contract markets shall be mailed within 10 days of the filing or receipt by the contract market of the notice of appeal, and all decisions and notices of appeal required to be submitted by futures commission merchants shall be mailed within 10 days of the filing or receipt by the futures commission merchant of the relevant notice of appeal. For purposes of paragraph (a), (b), (c) and (d) of this rule, 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.

[49 FR 17750, Apr. 25, 1984]

§ 1.61 [Reserved]

§ 1.62 Contract market requirement for floor broker and floor trader registration.

(a)(1) Each contract market shall adopt, maintain in effect, and enforce rules which have become effective pursuant to section 5a(a)(12)(A) of the Act and §1.41 and which provide that no person in or surrounding any pit, ring, post, or other place provided by such contract market for the meeting of persons similarly engaged may:

(i) Purchase or sell for any other person any commodity for future delivery, or any commodity option, on or subject to the rules of that contract market,

unless such person is registered or has been granted a temporary license as a floor broker; or

(ii) Purchase or sell solely for such person's own account, any commodity for future delivery, or any commodity option, on or subject to the rules of that contract market, unless such person is registered or has been granted a temporary license as a floor trader, or has been granted a temporary license as a floor broker to act as a floor trader, in accordance with section 4f of the Act and §3.11 or §3.40 of this chapter, and such temporary license or registration has not been terminated, revoked or withdrawn: *Provided, however,* That such contract market rules must provide that a floor broker or floor trader 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 person's registration or the suspension by a contract market of access of such person to any pit, ring, post or other place provided by such contract market for the meeting of persons engaged in purchasing and selling any commodity for future delivery or commodity option on or subject to the rules of that contract market.

(2) Each contract market shall also adopt, maintain in effect and enforce rules which have become effective pursuant to section 5a(a)(12)(A) of the Act and §1.41 which provide for requests for withdrawal of floor broker or floor trader registration using Form 8–W in accordance with §3.33 of this chapter, which require training of floor brokers and floor traders in accordance with §3.34 of this chapter and which require review of registration information by floor brokers and by floor traders every three years in accordance with §3.11(d) of this chapter.

(b) Each contract market must notify the Commission of any facts regarding a floor broker or floor trader or an applicant for registration as a floor broker or floor trader, or a floor trader whose name appears on a list submitted in accordance with §1.66 in order to qualify for a temporary no-action position thereunder, who has been granted trading privileges at the contract market, which are set forth as statutory disqualifications in section 8a(2) of the Act (unless such facts result from an enforcement action filed by the Commission or a disciplinary action taken by another contract market) or which are terminations of floor trading privileges for cause under §9.11(c) of this chapter within ten business days of the date upon which the contract market first knows of such facts. Notice to the Commission shall be sufficient if the contract market gives notice to the Director of the Division of Clearing and Intermediary Oversight or the Director's designee by facsimile transmission and/or first class mail or equivalent means to the Commission at its Washington, DC office (Attn: Division of Clearing and Intermediary Oversight, Commodity Futures Trading Commission, Three Lafayette Centre, 1155 21st Street, NW., Washington, DC 20581).

[58 FR 19589, Apr. 15, 1993; 59 FR 5700, Feb. 8, 1994, as amended at 60 FR 49334, Sept. 25, 1995; 67 FR 62351, Oct. 7, 2002]

§ 1.63 Service on self-regulatory organization governing boards or committees by persons with disciplinary histories.

(a) *Definitions.* For purposes of this section:

(1) *Self-regulatory organization* means a ''self-regulatory organization'' as defined in Commission regulation 1.3(ee) (§1.3(ee)), and includes a ''clearing organization'' as defined in Commission regulation 1.3(d) (§1.3(d)), except as defined in paragraph (b)(6) of this section.

(2) *Disciplinary committee* means any person or committee of persons, or any subcommittee thereof, that is authorized by a self-regulatory organization to issue disciplinary charges, to conduct disciplinary proceedings, to settle disciplinary charges, to impose disciplinary sanctions or to hear appeals thereof.

(3) *Arbitration panel* means any person or panel empowered by a self-regulatory organization to arbitrate disputes involving such organization's members or their customers.

(4) *Oversight panel* means any panel authorized by a self-regulatory organization to review, recommend or establish policies or procedures with respect

to the self-regulatory organization's surveillance, compliance, rule enforcement or disciplinary responsibilities.

(5) *Final decision* means:

(i) A decision of a self-regulatory organization which cannot be further appealed within the self-regulatory organization, is not subject to the stay of the Commission or a court of competent jurisdiction, and has not been reversed by the Commission or any court of competent jurisdiction; or,

(ii) Any decision by an administrative law judge, a court of competent jurisdiction or the Commission which has not been stayed or reversed.

(6) *Disciplinary offense* means:

(i) Any violation of the rules of a self-regulatory organization except those rules related to

(A) Decorum or attire,

(B) Financial requirements, or

(C) Reporting or recordkeeping unless resulting in fines aggregating more than $5,000 within any calendar year;

(ii) Any rule violation described in subparagraphs (a)(6)(i) (A) through (C) of this regulation which involves fraud, deceit or conversion or results in a suspension or expulsion;

(iii) Any violation of the Act or the regulations promulgated thereunder; or,

(iv) Any failure to exercise supervisory responsibility with respect to acts described in paragraphs (a)(6) (i) through (iii) of this section when such failure is itself a violation of either the rules of a self-regulatory organization, the Act or the regulations promulgated thereunder.

(v) A disciplinary offense must arise out of a proceeding or action which is brought by a self-regulatory organization, the Commission, any federal or state agency, or other governmental body.

(7) *Settlement agreement* means any agreement consenting to the imposition of sanctions by a self-regulatory organization, a court of competent jurisdiction or the Commission.

(b) Each self-regulatory organization must maintain in effect rules which have been submitted to the Commission pursuant to section 5a(a)(12)(A) of the Act and §1.41 or, in the case of a registered futures association, pursuant to section 17(j) of the Act, that render a person ineligible to serve on its disciplinary committees, arbitration panels, oversight panels or governing board who:

(1) Was found within the prior three years by a final decision of a self-regulatory organization, an administrative law judge, a court of competent jurisdiction or the Commission to have committed a disciplinary offense;

(2) Entered into a settlement agreement within the prior three years in which any of the findings or, in the absence of such findings, any of the acts charged included a disciplinary offense;

(3) Currently is suspended from trading on any contract market, is suspended or expelled from membership with any self-regulatory organization, is serving any sentence of probation or owes any portion of a fine imposed pursuant to either:

(i) A finding by a final decision of a self-regulatory organization, an administrative law judge, a court of competent jurisdiction or the Commission that such person committed a disciplinary offense; or,

(ii) A settlement agreement in which any of the findings or, in the absence of such findings, any of the acts charged included a disciplinary offense.

(4) Currently is subject to an agreement with the Commission or any self-regulatory organization not to apply for registration with the Commission or membership in any self-regulatory organization;

(5) Currently is subject to or has had imposed on him within the prior three years a Commission registration revocation or suspension in any capacity for any reason, or has been convicted within the prior three years of any of the felonies listed in section 8a(2)(D) (ii) through (iv) of the Act;

(6) Currently is subject to a denial, suspension or disqualification from serving on the disciplinary committee, arbitration panel or governing board of any self-regulatory organization as that term is defined in section 3(a)(26) of the Securities Exchange Act of 1934.

(c) No person may serve on a disciplinary committee, arbitration panel, oversight panel or governing board of a self-regulatory organization if such

person is subject to any of the conditions listed in paragraphs (b) (1) through (6) of this section.

(d) Each self-regulatory organization shall submit to the Commission a schedule listing all those rule violations which constitute disciplinary offenses as defined in paragraph (a)(6) (i) of this section and to the extent necessary to reflect revisions shall submit an amended schedule within thirty days of the end of each calendar year. Each self-regulatory organization must maintain and keep current the schedule required by this section, post the schedule in a public place designed to provide notice to members and otherwise ensure its availability to the general public.

(e) Each self-regulatory organization shall submit to the Commission within thirty days of the end of each calendar year a certified list of any persons who have been removed from its disciplinary committees, arbitration panels, oversight panels or governing board pursuant to the requirements of this regulation during the prior year.

(f) Whenever a self-regulatory organization finds by final decision that a person has committed a disciplinary offense and such finding makes such person ineligible to serve on that self-regulatory organization's disciplinary committees, arbitration panels, oversight panels or governing board, the self-regulatory organization shall inform the Commission of that finding and the length of the ineligibility in any notice it is required to provide to the Commission pursuant to either section 17(h)(1) of the Act or Commission regulation 9.11.

[55 FR 7890, Mar. 6, 1990, as amended at 58 FR 37653, July 13, 1993; 64 FR 23, Jan. 4, 1999]

§ 1.64 Composition of various self-regulatory organization governing boards and major disciplinary committees.

(a) *Definitions.* For purposes of this section:

(1) *Self-regulatory organization* means ''self-regulatory organization'' as defined in § 1.3(ee), not including a ''clearing organization'' as defined in § 1.3(d).

(2) *Major disciplinary committee* means a committee of persons who are authorized by a self-regulatory organization to conduct disciplinary hearings, to settle disciplinary charges, to impose disciplinary sanctions or to hear appeals thereof in cases involving any violation of the rules of the self-regulatory organization except those which:

(i) Are related to:

(A) Decorum or attire,

(B) Financial requirements, or

(C) Reporting or recordkeeping; and,

(ii) Do not involve fraud, deceit or conversion.

(3) *Regular voting member of a governing board* means any person who is eligible to vote routinely on matters being considered by the board and excludes those members who are only eligible to vote in the case of a tie vote by the board.

(4) *Membership interest* (i) In the case of a contract market, each of the following will be considered a different membership interest:

(A) Floor brokers,

(B) Floor traders,

(C) Futures commission merchants,

(D) Producers, consumers, processors, distributors, and merchandisers of commodities traded on the particular contract market,

(E) Participants in a variety of pits or principal groups of commodities traded on the particular contract market; and,

(F) Other market users or participants; except that with respect to paragraph (c)(2) of this section, a contract market may define membership interests according to the different pits or principal groups of commodities traded on the contract market.

(ii) In the case of a registered futures association, each of the following will be considered a different membership interest:

(A) Futures commission merchants,

(B) Introducing brokers,

(C) Commodity pool operators,

(D) Commodity trading advisors; and,

(E) Associated persons, except that under paragraph (c)(3) of this section an associated person will be deemed to represent the same membership interest as its sponsor.

(b) Each self-regulatory organization must maintain in effect standards and

procedures with respect to its governing board which have been submitted to the Commission pursuant to section 5a(a)(12)(A) of the Act and § 1.41 or, when applicable to a registered futures association, pursuant to section 17(j) of the Act, that ensure:

(1) That twenty percent or more of the regular voting members of the board are persons who:

(i) Are knowledgeable of futures trading or financial regulation or are otherwise capable of contributing to governing board deliberations; and,

(ii) (A) Are not members of the self-regulatory organization,

(B) Are not currently salaried employees of the self-regulatory organization,

(C) Are not primarily performing services for the self-regulatory organization in a capacity other than as a member of the self-regulatory organization's governing board, or

(D) Are not officers, principals or employees of a firm which holds a membership at the self-regulatory organization either in its own name or through an employee on behalf of the firm;

(2) In the case of a contract market, that ten percent or more of the regular voting members of the governing board be comprised where applicable of persons representing farmers, producers, merchants or exporters of principal commodities underlying a commodity futures or commodity option traded on the contract market; and

(3) That the board's membership includes a diversity of membership interests. The self-regulatory organization must be able to demonstrate that the board membership fairly represents the diversity of interests at such self-regulatory organization and is otherwise consistent with this regulation's composition requirements;

(c) Each self-regulatory organization must maintain in effect rules with respect to its major disciplinary committees which have been submitted to the Commission pursuant to section 5a(a)(12)(A) of the Act and § 1.41 or, when applicable to a registered futures association, pursuant to section 17(j) of the Act, that ensure:

(1) That at least one member of each major disciplinary committee or hearing panel thereof be a person who is not a member of the self-regulatory organization whenever such committee or panel is acting with respect to a disciplinary action in which:

(i) The subject of the action is a member of the self-regulatory organization's:

(A) Governing board, or

(B) Major disciplinary committee; or,

(ii) Any of the charged, alleged or adjudicated contract market rule violations involve:

(A) Manipulation or attempted manipulation of the price of a commodity, a futures contract or an option on a futures contract, or

(B) Conduct which directly results in financial harm to a non-member of the contract market;

(2) In the case of a contract market, that more than fifty percent of each major disciplinary committee or hearing panel thereof include persons representing membership interests other than that of the subject of the disciplinary proceeding being considered;

(3) In the case of a registered futures association, that each major disciplinary committee or hearing panel thereof include persons representing membership interests other than that of the subject of the disciplinary proceeding being considered; and,

(4) That each major disciplinary committee or hearing panel thereof include sufficient different membership interests so as to ensure fairness and to prevent special treatment or preference for any person in the conduct of a committee's or the panel's responsibilities.

(d) Each self-regulatory organization must submit to the Commission within thirty days after each governing board election a list of the governing board's members, the membership interests they represent and how the composition of the governing board otherwise meets the requirements of § 1.64(b) and the self-regulatory organization's implementing standards and procedures.

[58 FR 37654, July 13, 1993; 59 FR 5082, Feb. 3, 1994]

§ 1.65 Notice of bulk transfers and disclosure obligations to customers.

(a) *Notice and Disclosure to Customers.* (1) Prior to transferring a customer account to another futures commission merchant or introducing broker other

than at the request of the customer, a futures commission merchant or introducing broker must obtain the customer's specific consent to the transfer.

(2) If the customer account agreement contains a valid consent by the customer to prospective transfers of the account, the transferor futures commission merchant or introducing broker may transfer the account if the customer is provided with written notice of, and a reasonable opportunity to object to, the transfer and the customer has not asserted an objection to the transfer or given other instructions as to the disposition of the account. The notice to the customer must include:

(i) A clear statement of the reason(s) for the transfer, the name, address and telephone number of the proposed transferee firm and other information material to the transfer;

(ii) A statement that the customer is not required to accept the proposed transfer and may direct the transfer or firm to liquidate the account or ransfer the account to a firm of the customer's selection;

(iii) The name, telephone number and address of a contact person at the transferor firm to whom the customer may give instructions as to the disposition of the account;

(iv) Notice that a failure to respond to the letter within a specified time period, which must be a reasonable period in the circumstances, will be deemed consent to the transfer; and

(v) A clear statement as to the means by which the customer may object to or otherwise respond to the notice of proposed transfer.

(3) Where customer accounts are transferred to a futures commission merchant or introducing broker, other than at the customer's request, the transferee introducing broker or futures commission merchant must provide each customer whose account is transferred with the risk disclosure statements and acknowledgments required by §1.55 (domestic futures and foreign futures and options trading), and §§33.7 (domestic exchange-traded commodity options) and 190.10(c) (noncash margin—to be furnished by futures commission merchants only) of this chapter and receive the required acknowledgments within sixty days of the transfer of accounts. This requirement shall not apply:

(i) As to customers owning transferred accounts for which the transferee futures commission merchant or introducing broker has clear written evidence that the customer has received and acknowledged the required disclosure documents; or

(ii) As to customers for which the transferee futures commission merchant or introducing broker has clear evidence that such customer was at the time the account was opened by the transferring futures commission merchant or introducing broker, or is at the time the account is being transferred, a customer listed in §1.55(f); or

(iii) If the transfer of accounts is made from one introducing broker to another introducing broker guaranteed by the same futures commission merchant pursuant to a guarantee agreement in accordance with the requirements of §1.10(j) and such futures commission merchant maintains the relevant acknowledgments required by §1.55(a)(1)(ii) and §33.7(a)(1)(ii) of this chapter and can establish compliance with §190.10(c) of this chapter.

(b) *Notice to the Commission.* Each futures commission merchant or introducing broker shall file with the Commission, at least five business days in advance of the transfer, notice of any transfer of customer accounts carried or introduced by such futures commission merchant or introducing broker that is not initiated at the request of the customer, where the transfer involves the lesser of:

(1) 25 percent of the total number of customer accounts carried or introduced by such firm if that percentage represents at least 100 accounts; or

(2) 50 percent or more of the total number of customer accounts carried or introduced by such firm. The computation of the percentage and number of accounts must be based on the total number of accounts carried by the transferor futures commission merchant or introduced by the introducing broker, irrespective of whether such accounts are transferred to a single or multiple transferees.

(c) The notice required by paragraph (b) of this section shall include:

(1) The name, principal business address and telephone number of the transferor futures commission merchant or introducing broker;

(2) The name, principal business address and telephone number of each transferee 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 the notice to customers informing them of the proposed transfer and providing an opportunity to object to such transfer; and

(6) A statement of the number of accounts to be transferred and the estimated liquidating equity of the accounts to be transferred.

(d) The notice required by paragraph (b) of this section shall be filed 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.

(e) In the event that the notice required by paragraph (b) of this section cannot be filed with the Commission at least five days prior to the account transfer, the transferee futures commission merchant or introducing broker shall file such notice as soon as practicable and no later than the day of the transfer. Such notice shall include a brief statement explaining the circumstances necessitating the delay in filing.

(f) The requirements of this section shall not affect the obligations of a futures commission merchant or introducing broker under the rules of a self-regulatory organization or applicable customer account agreement with respect to transfer of accounts.

(g) 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.

[58 FR 17504, Apr. 5, 1993, as amended at 60 FR 49334, Sept. 25, 1995; 63 FR 8571, Feb. 20, 1998; 67 FR 62351, Oct. 7, 2002]

§ 1.66 No-action positions with respect to floor traders.

(a) Notwithstanding any other provision of law, if a contract market submits to the National Futures Association by April 26, 1993 a list of floor traders who were granted trading privileges on that contract market on or before April 26, 1993, and whose floor trading privileges remain in effect, which includes the name, date of birth and social security number of such floor traders, as well as facts regarding such floor traders which are set forth as statutory disqualifications in section 8a(2) of the Act if the contract market knows of such facts, and such list is signed by the chief operating officer of the contract market, the Commission will not commence an enforcement proceeding against a floor trader on that list based solely upon the floor trader's failure to register or receive a temporary license under section 4f of the Act and §3.11 of this chapter, nor will the Commission commence an enforcement proceeding against the contract market under §1.62 for failing to bar such floor trader from operating as such: *Provided, however,* That for those floor traders listed as to whom the contract market knows of facts set forth as statutory disqualifications in section 8a(2) of the Act, the no-action position contained in paragraph (a) of this section will only apply if the contract market submits a supplemental statement signed by the chief operating officer of the contract market stating that, in light of the Congressional mandate requiring registration of floor traders under the Act, the contract market acknowledges its responsibility to take affirmative action to conduct appropriate surveillance of such floor traders. These no-action positions shall expire upon the floor's trader being granted or denied registration under the Act, or on June 11, 1993, whichever comes earliest: *Provided, however,* That if the floor trader files

an application for registration in accordance with §3.11 of this chapter with the National Futures Association by June 11, 1993, the no-action positions for the floor trader and the contract market as to the registration of such floor trader will be extended until the floor trader is granted or denied registration under the Act, unless an Administrative Law Judge issues an interim order suspending the no-action position as to such floor trader in accordance with paragraph (b) of this section or the application for registration is withdrawn.

(b) *Suspension of no-action position under paragraph (a) of this section pursuant to section 8a(2) of the Act*—(1) *Notice.* On the basis of information obtained by the Commission, the Commission may at any time serve notice upon a floor trader whose name appears on a list submitted in accordance with paragraph (a) of this section that:

(i) The Commission alleges and is prepared to prove that such floor trader is subject to one or more of the statutory disqualifications set forth in section 8a(2) of the Act;

(ii) An Administrative Law Judge shall make a determination, based upon written evidence, as to whether the floor trader is subject to such statutory disqualification; and

(iii) If the floor trader is found to be subject to a statutory disqualification, the no-action status of the floor trader under paragraph (a) of this section may be suspended and the floor trader ordered to show cause why registration should not be denied.

(2) *Written submission.* If the floor trader wishes to challenge the accuracy of the allegations set forth in the notice, the floor trader may submit written evidence limited to the type described in §3.60(b)(1) of this chapter. Such written submission must be served upon the Division of Enforcement and filed with the Proceedings Clerk within twenty days of the date of service of notice to the floor trader.

(3) *Reply.* Within ten days of receipt of any written submission filed by the floor trader, the Division of Enforcement may serve upon the floor trader and file with the Proceedings Clerk a reply.

(4) *Determination by Administrative Law Judge.* A determination by the Administrative Law Judge as to whether the floor trader is subject to a statutory disqualification must be based upon the evidence of the statutory disqualification, notice with proof of service, the written submission, if any, filed by the floor trader in response thereto, any written reply submitted by the Division of Enforcement and such other papers as the Administrative Law Judge may require or permit.

(5) *Suspension and order to show cause.* (i) If the floor trader is found to be subject to a statutory disqualification, the Administrative Law Judge, within thirty days after receipt of the floor trader's written submission, if any, and any reply thereto, shall issue an interim order suspending the no-action status of the floor trader under paragraph (a) of this section and requiring the floor trader to show cause within twenty days of the date of the order why, notwithstanding the existence of the statutory disqualification, the registration of the floor trader should not be denied. The no-action status of the floor trader shall be suspended, effective five days after the order to show cause is served upon the floor trader in accordance with §3.50(a) of this chapter, until a final order with respect to the order to show cause has been issued: *Provided, That* if the sole basis upon which the floor trader is subject to statutory disqualification is the existence of a temporary order, judgment or decree of the type described in section 8a(2)(C) of the Act, the order to show cause shall not be issued and the floor trader shall be suspended until such time as the temporary order, judgment or decree shall have expired: *Provided, however,* That in no event shall the floor trader's no-action status be suspended for a period to exceed six months.

(ii) If the floor trader is found not to be subject to a statutory disqualification, the Administrative Law Judge shall issue an order to that effect and the Proceedings Clerk shall promptly serve a copy of such order on the floor trader, the Division of Clearing and Intermediary Oversight and the Division of Enforcement. Such order shall

be effective as a final order of the Commission fifteen days after the date it is served upon the floor trader in accordance with the provisions of § 3.50(a) of this chapter unless a timely application for review is filed in accordance with § 10.102 of this chapter. The appellate procedures set forth in §§ 10.102, 10.103, 10.104, 10.106, 10.107 and 10.109 of this chapter shall apply to any appeal brought under paragraph (c)(5)(ii) of this section.

(6) *Further proceedings.* If an order to show cause is issued pursuant to paragraph (c)(5)(i) of this section, further proceedings on such order shall be conducted in accordance with the provisions of § 3.60(b) through (j) of this chapter.

[58 FR 19589, Apr. 15, 1993; 58 FR 21776, Apr. 23, 1993, as amended at 60 FR 54801, Oct. 26, 1995; 67 FR 62351, Oct. 7, 2002]

§ 1.67 Notification of final disciplinary action involving financial harm to a customer.

(a) *Definitions.* For purposes of this section:

(1) *Final disciplinary action* means any decision by or settlement with a contract market in a disciplinary matter which cannot be further appealed at the contract market, is not subject to the stay of the Commission or a court of competent jurisdiction, and has not been reversed by the Commission or any court of competent jurisdiction.

(2) [Reserved]

(b) Upon any final disciplinary action in which a contract market finds that a member has committed a rule violation that involved a transaction for a customer, whether executed or not, and that resulted in financial harm to the customer:

(1)(i) the contract market shall promptly provide written notice of the disciplinary action to the futures commission merchant that cleared the transaction; and,

(ii) a futures commission merchant that receives a notice, under paragraph (b)(1)(i) of this section shall promptly provide written notice of the disciplinary action to the customer as disclosed on its books and records. If the customer is another futures commission merchant, such futures commission merchant shall promptly provide the notice to the customer.

(2) A written notice required by paragraph (b)(1) of this section must include the principal facts of the disciplinary action and a statement that the contract market has found that the member has committed a rule violation that involved a transaction for the customer, whether executed or not, and that resulted in financial harm to the customer. For the purposes of this paragraph, a notice which includes the information listed in § 9.11(b) shall be deemed to include the principal facts of the disciplinary action thereof.

[58 FR 37655, July 13, 1993]

§ 1.68 Customer election not to have funds, carried by a futures commission merchant for trading on a registered derivatives transaction execution facility, separately accounted for and segregated.

(a) A futures commission merchant shall not separately account for and segregate, in accordance with the provisions of section 4d of the Act and §§ 1.20–1.30, 1.32 and 1.36, funds received from a customer if:

(1) The customer is an eligible contract participant as defined in section 1a(12) of the Act;

(2) The customer's funds are being carried by the futures commission merchant for the purpose of trading on or through the facilities of a derivatives transaction execution facility registered under section 5a(c) of the Act;

(3) The registered derivatives transaction execution facility has authorized, in accordance with § 37.7 of this chapter, futures commission merchants to offer eligible contract participants the right to elect not to have funds that are being carried for purposes of trading on or through the facilities of the registered derivatives transaction execution facility, separately accounted for and segregated by the futures commission merchant; and

(4) The futures commission merchant and the customer have entered into a written agreement, signed by a person with the authority to bind the customer, in which the customer:

(i) Represents and warrants that the customer is an eligible contract participant as defined in section 1a(12) of the Act;

(ii) Elects not to have its funds separately accounted for and segregated in accordance with the provisions of section 4d of the Act and §§ 1.20–1.30, 1.32 and 1.36 with respect to agreements, contracts or transactions traded on or subject to the rules of any registered derivatives transaction execution facility that has authorized such treatment in accordance with § 37.7 of this chapter;

(iii) Acknowledges that it has been informed, and by making this election agrees that:

(A) The customer's funds, related to agreements, contracts or transactions on any registered derivatives transaction execution facility that authorizes the opting out of segregation will not be segregated from the funds of the futures commission merchant in accordance with the provisions of section 4d of the Act and §§ 1.20–1.30, 1.32 and 1.36;

(B) The futures commission merchant may use such funds in the course of the futures commission merchant's business without the prior consent of the customer or any third party;

(C) In the event the futures commission merchant files, or has a petition filed against it, for bankruptcy, the customer, as to those funds that the customer has elected not to have separately accounted for and segregated by the futures commission merchant in accordance with the provisions of section 4d of the Act and §§ 1.20–1.30, 1.32 and 1.36, will not be entitled to the priority for customer claims provided for under the Bankruptcy Code and part 190 of this chapter;

(D) The customer may not retain a security interest in assets excluded from segregation in accordance with this section;

(E) The customer may not enter into any agreement or other understanding with the futures commission merchant relating to the manner in which the customer's assets will be held at the futures commission merchant, that directly or indirectly gives the customer a priority in bankruptcy that is equal or superior to the priority afforded public customers under the Bankruptcy Code and part 190 of this chapter; and

(iv) Acknowledges that the agreement shall remain in effect unless and until the customer abrogates the agreement in accordance with paragraph (c) of this section.

(b) In no event may money, securities or property representing those funds that customers have elected not to have separately accounted for and segregated by the futures commission merchant, in accordance with this section, be held or commingled and deposited with customer funds in the same account or accounts required to be separately accounted for and segregated pursuant to section 4d of the Act and §§ 1.20–1.30, 1.32 and 1.36.

(c)(1) A customer that has entered into an agreement in accordance with paragraph (a)(4) of this section may abrogate that agreement by so informing the futures commission merchant in writing, signed by a person with the authority to bind the customer. The effective date of the abrogation shall not exceed five business days from the futures commission merchant's receipt of the customer's abrogation. The abrogation shall not become effective if the futures commission merchant files, or has had filed against it, a petition for bankruptcy prior to the effective date of the abrogation.

(2) Upon the effective date of the abrogation, permitted under paragraph (c)(1) of this section, provided that the customer's positions in the non-segregated account are fully margined and the customer is not in default with respect to any of its obligations to the futures commission merchant arising out of agreements, contracts or transactions entered on, or subject to the rules of, a registered entity, as defined in section 1a(29) of the Act, the futures commission merchant shall transfer to a customer segregated account:

(i) All trades or positions of the customer with respect to which the customer had previously elected to opt out of segregation; and

(ii) All money, securities, or property held in such account to margin, guarantee or secure such trades or positions.

(d) Each futures commission merchant shall maintain any agreements entered into with customers pursuant to paragraph (a) of this section and any abrogations of such agreements, made pursuant to paragraph (c) of this section, in accordance with § 1.31.

[66 FR 20744, Apr. 25, 2001]

§ 1.69 Voting by interested members of self-regulatory organization governing boards and various committees.

(a) *Definitions.* For purposes of this section:

(1) *Disciplinary committee* means any person or committee of persons, or any subcommittee thereof, that is authorized by a self-regulatory organization to issue disciplinary charges, to conduct disciplinary proceedings, to settle disciplinary charges, to impose disciplinary sanctions, or to hear appeals thereof in cases involving any violation of the rules of the self-regulatory organization except those cases where the person or committee is authorized summarily to impose minor penalties for violating rules regarding decorum, attire, the timely submission of accurate records for clearing or verifying each day's transactions or other similar activities.

(2) *Family relationship* of a person means the person's spouse, former spouse, parent, stepparent, child, stepchild, sibling, stepbrother, stepsister, grandparent, grandchild, uncle, aunt, nephew, niece or in-law.

(3) *Governing board* means a self-regulatory organization's board of directors, board of governors, board of managers, or similar body, or any subcommittee thereof, duly authorized, pursuant to a rule of the self-regulatory organization that has been approved by the Commission or has become effective pursuant to either Section 5a(a)(12)(A) or 17(j) of the Act to take action or to recommend the taking of action on behalf of the self-regulatory organization.

(4) *Oversight panel* means any panel, or any subcommittee thereof, authorized by a self-regulatory organization to recommend or establish policies or procedures with respect to the self-regulatory organization's surveillance, compliance, rule enforcement, or disciplinary responsibilities.

(5) *Member's affiliated firm* is a firm in which the member is a ''principal,'' as defined in § 3.1(a), or an employee.

(6) *Named party in interest* means a person or entity that is identified by name as a subject of any matter being considered by a governing board, disciplinary committee, or oversight panel.

(7) *Self-regulatory organization* means a ''self-regulatory organization'' as defined in § 1.3(ee) and includes a ''clearing organization'' as defined in § 1.3(d), but excludes registered futures associations for the purposes of paragraph (b)(2) of this section.

8) *Significant action* includes any of the following types of self-regulatory organization actions or rule changes that can be implemented without the Commission's prior approval:

(i) Any actions or rule changes which address an ''emergency'' as defined in § 1.41(a)(4)(i) through (iv) and (vi) through (viii); and,

(ii) Any changes in margin levels that are designed to respond to extraordinary market conditions such as an actual or attempted corner, squeeze, congestion or undue concentration of positions, or that otherwise are likely to have a substantial effect on prices in any contract traded or cleared at such self-regulatory organization; but does not include any rule not submitted for prior Commission approval because such rule is unrelated to the terms and conditions of any contract traded at such self-regulatory organization.

(b) *Self-regulatory organization rules.* Each self-regulatory organization shall maintain in effect rules that have been submitted to the Commission pursuant to Section 5a(a)(12)(A) of the Act and § 1.41 or, in the case of a registered futures association, pursuant to Section 17(j) of the Act, to address the avoidance of conflicts of interest in the execution of its self-regulatory functions. Such rules must provide for the following:

(1) *Relationship with named party in interest*—(i) *Nature of relationship.* A member of a self-regulatory organization's governing board, disciplinary committee or oversight panel must abstain from such body's deliberations

and voting on any matter involving a named party in interest where such member:

(A) Is a named party in interest;

(B) Is an employer, employee, or fellow employee of a named party in interest;

(C) Is associated with a named party in interest through a ''broker association'' as defined in §156.1;

(D) Has any other significant, ongoing business relationship with a named party in interest, not including relationships limited to executing futures or option transactions opposite of each other or to clearing futures or option transactions through the same clearing member; or,

(E) Has a family relationship with a named party in interest.

(ii) *Disclosure of relationship.* Prior to the consideration of any matter involving a named party in interest, each member of a self-regulatory organization governing board, disciplinary committee or oversight panel must disclose to the appropriate self-regulatory organization staff whether he or she has one of the relationships listed in paragraph (b)(1)(i) of this section with a named party in interest.

(iii) *Procedure for determination.* Each self-regulatory organization must establish procedures for determining whether any member of its governing board, disciplinary committees or oversight committees is subject to a conflicts restriction in any matter involving a named party in interest. Taking into consideration the exigency of the committee action, such determinations should be based upon:

(A) Information provided by the member pursuant to paragraph (b)(1)(ii) of this section; and

(B) Any other source of information that is held by and reasonably available to the self-regulatory organization.

(2) *Financial interest in a significant action*—(i) *Nature of interest.* A member of a self-regulatory organization's governing board, disciplinary committee or oversight panel must abstain from such body's deliberations and voting on any significant action if the member knowingly has a direct and substantial financial interest in the result of the vote based upon either exchange or non-exchange positions that could reasonably be expected to be affected by the action.

(ii) *Disclosure of interest.* Prior to the consideration of any significant action, each member of a self-regulatory organization governing board, disciplinary committee or oversight panel must disclose to the appropriate self-regulatory organization staff the position information referred to in paragraph (b)(2)(iii) of this section that is known to him or her. This requirement does not apply to members who choose to abstain from deliberations and voting on the subject significant action.

(iii) *Procedure for determination.* Each self-regulatory organization must establish procedures for determining whether any member of its governing board, disciplinary committees or oversight committees is subject to a conflicts restriction under this section in any significant action. Such determination must include a review of:

(A) Gross positions held at that self-regulatory organization in the member's personal accounts or ''controlled accounts,'' as defined in §1.3(j);

(B) Gross positions held at that self-regulatory organization in proprietary accounts, as defined in §1.17(b)(3), at the member's affiliated firm;

(C) Gross positions held at that self-regulatory organization in accounts in which the member is a principal, as defined in §3.1(a);

(D) Net positions held at that self-regulatory organization in ''customer'' accounts, as defined in §1.17(b)(2), at the member's affiliated firm; and,

(E) Any other types of positions, whether maintained at that self-regulatory organization or elsewhere, held in the member's personal accounts or the proprietary accounts of the member's affiliated firm that the self-regulatory organization reasonably expects could be affected by the significant action.

(iv) *Bases for determination.* Taking into consideration the exigency of the significant action, such determinations should be based upon:

(A) The most recent large trader reports and clearing records available to the self-regulatory organization;

(B) Information provided by the member with respect to positions pursuant to paragraph (b)(2)(ii) of this section; and,

(C) Any other source of information that is held by and reasonably available to the self-regulatory organization.

(3) *Participation in deliberations.* (i) Under the rules required by this section, a self-regulatory organization governing board, disciplinary committee or oversight panel may permit a member to participate in deliberations prior to a vote on a significant action for which he or she otherwise would be required to abstain, pursuant to paragraph (b)(2) of this section, if such participation would be consistent with the public interest and the member recuses himself or herself from voting on such action.

(ii) In making a determination as to whether to permit a member to participate in deliberations on a significant action for which he or she otherwise would be required to abstain, the deliberating body shall consider the following factors:

(A) Wwhether the member's participation in deliberations is necessary for the deliberating body to achieve a quorum in the matter; and

(B) Whether the member has unique or special expertise, knowledge or experience in the matter under consideration.

(iii) Prior to any determination pursuant to paragraph (b)(3)(i) of this section, the deliberating body must fully consider the position information which is the basis for the member's direct and substantial financial interest in the result of a vote on a significant action pursuant to paragraph (b)(2) of this section.

(4) *Documentation of determination.* Self-regulatory organization governing boards, disciplinary committees, and oversight panels must reflect in their minutes or otherwise document that the conflicts determination procedures required by this section have been followed. Such records also must include:

(i) The names of all members who attended the meeting in person or who otherwise were present by electronic means;

(ii) The name of any member who voluntarily recused himself or herself or was required to abstain from deliberations and/or voting on a matter and the reason for the recusal or abstention, if stated; and

(iii) Information on the position information that was reviewed for each member.

[64 FR 23, Jan. 4, 1999; 64 FR 3340, Jan. 21, 1999]

§ 1.70 Notification of State enforcement actions brought under the Commodity Exchange Act.

(a) Immediately upon instituting any proceeding in any Federal district court for violation of the Act or any rule, regulation or order thereunder against any person who is subject to suit pursuant to sections 6d(1)–(6) of the Act, the authorized State official of the State instituting the proceeding shall submit to the Commission a copy of the complaint filed in the proceeding, together with a written notice which:

(1) Indicates the names of parties to the proceeding;

(2) Indicates the provision of the Act or the rule, regulation or order thereunder which is alleged to have been violated.

The complaint and written notice must be sent by first-class U.S. mail or personally delivered to the Secretary, Commodity Futures Trading Commission, Three Lafayette Centre, 1155 21st Street, NW., Washington, DC 20581.

(b) Prior to instituting any proceeding in a State court for the alleged violation of any antifraud provisions of the Act or any antifraud rule, regulation or order thereunder against any person registered with the Commission who is subject to suit pursuant to the provisions of section 6d(8) of the Act, the authorized State official of the State intending to institute the proceeding shall submit to the Commission written notice which:

(1) Indicates the names of parties to the proposed proceeding;

(2) Indicates the provision of the Act or the rule, regulation or order thereunder which will be alleged to have been violated;

(3) Contains a brief statement of the facts on which the proposed action will be based.

Except as provided in paragraph (c), this written notice must be sent by first-class U.S. mail or personally delivered to the Secretary, Commodity Futures Trading Commission, Three Lafayette Centre, 1155 21st Street, NW., Washington, DC 20581 not less than 5 business days prior to instituting the proceeding in State court.

(c) Where it is impracticable to provide the Commission with written notice within the time period specified in paragraph (b) of this section, the authorized state official must inform the Secretary of the Commission by telephone as soon as practicable to institute a proceeding in state court and must send the written notice required in paragraph (b)(1) through (b)(3) of this section by facsimile or other similarly expeditious means of written communication to the Secretary of the Commission, prior to instituting the proceeding in state court.

(d) Immediately upon instituting any proceeding in a State court pursuant to the provisions of section 6d(8) of the Act for alleged violation of any antifraud provisions of the Act or any antifraud rule, regulation or order thereunder, the authorized State official instituting the proceeding shall submit to the Commission a copy of the complaint filed in the proceeding. The copy of the complaint must be sent by first class U.S. mail or personally delivered to the Secretary, Commodity Futures Trading Commission, Three Lafayette Centre, 1155 21st Street, NW., Washington, DC 20581.

[48 FR 49503, Oct. 26, 1983, as amended at 60 FR 49334, Sept. 25, 1995]

APPENDIX A TO PART 1 [RESERVED]

APPENDIX B TO PART 1—FEES FOR CONTRACT MARKET RULE ENFORCEMENT REVIEWS AND FINANCIAL REVIEWS

(a) Within 60 days of the effective date of a final fee schedule for each fiscal year, each board of trade which has been designated as a contract market for at least one actively trading contract shall submit a check or money order, made payable to the Commodity Futures Trading Commission, to cover the Commission's actual costs in conducting contract market rule enforcement reviews and financial reviews.

(b) The Commission determines fees changed fees charged to exchanges based upon a formula which considers both actual costs and trading volume.

(c) Checks should be sent to the attention of the Office of the Secretariat, Commodity Futures Trading Commission, Three Lafayette Centre, 1155 21st Street, NW., Washington, DC 20581.

[50 FR 930, Jan. 8, 1985, as amended at 52 FR 46072, Dec. 4, 1987; 58 FR 42645, Aug. 11, 1993; 60 FR 49334, Sept. 25, 1995]

PART 2—OFFICIAL SEAL

Sec.
2.1 Description.
2.2 Authority to affix seal.
2.3 Prohibitions against misuse of seal.

AUTHORITY: 7 U.S.C. 4a(j), unless otherwise noted.

SOURCE: 41 FR 9552, Mar. 5, 1976, unless otherwise noted.

§ 2.1 Description.

Pursuant to section 2(a)(10) of the Commodity Exchange Act, as amended, 7 U.S.C. 4(i), the Commodity Futures Trading Commission has adopted an official seal (the ''Seal''), the description of which is as follows:

(a) An American bald eagle in black and white holding the scales of balanced interests over a black and white wheel of commerce and a farmer's plow, also in black and white. These symbols are enclosed with an inner red octagon and a blue outer octagon representing traditional futures contract trading pits. Around the outside of the octagons are the words ''Commodity Futures Trading Commission'' separated by two stars from the year ''1975,'' the first year of the Commission's existence.

(b) The Seal of the Commodity Futures Trading Commission is illustrated as follows: