
HENDERSON & LYMAN

FINANCIAL SERVICES PRACTICE GROUP CLIENT UPDATE

Summary of Final CFTC Forex Rules

On August 30, 2010, the CFTC issued its final rules regulating off-exchange retail foreign exchange transactions (the “Final Rules”). The Final Rules will become effective on October 18, 2010. This Client Update will summarize key provisions of the Final Rules.

In the Final Rules, the CFTC creates a new regulatory framework that establishes requirements for, among other things, registration, disclosure, recordkeeping, financial reporting, and minimum capital for forex participants. The theme of the Final Rules is that the CFTC has endeavored, wherever possible, to apply to the forex industry the principles that have guided its regulation of on-exchange instruments. In other words, retail forex transactions will be subject to significant regulation, comparable to that of commodity futures and options.

In summary, the major provisions of the Final Rules include:

- A new Part 5 to the CFTC’s Regulations, which is devoted exclusively to retail forex transactions.
- A revised definition of “commodity interest” (*i.e.*, futures) to include off-exchange retail forex transactions, over which the CFTC now has jurisdiction.
- New registration requirements, such that:
 - A dealer in retail forex transactions must register as a retail foreign exchange dealer (“RFED”).
 - A person who solicits or accepts orders for a RFED, an FCM, or an affiliate of an FCM must register as an IB.
 - A person who exercises discretionary trading authority over retail forex transactions accounts must register as a CTA.
 - A person who operates or solicits funds or property for a pooled investment vehicle must register as a CPO.
 - An associated person of the foregoing must register as an AP.
- New leverage requirements:
 - 2% security deposit in the case of major currencies (50:1 leverage); and
 - 5% of the notional value of the transaction for all other currencies (20:1 leverage).
- Clarification that an FCM that is “primarily or substantially”¹ engaged in the

¹ The term “primarily or substantially” refers to: 1) such activities account for more than 50% of the FCM’s gross revenues, computed in accordance with GAAP, on an annual basis; 2) the FCM receives gross revenues, computed in accordance with GAAP, from such activities in excess of \$500,000 in any

futures business may continue to engage in retail forex as an FCM, and need not register as a RFED. However, currently-registered FCMs who solely trade in retail forex, or FCMs who are not “primarily or substantially” dealing in exchange-traded futures, must register as RFEDs.

- A requirement that RFEDs and FCMs engaging in retail forex trading are required to meet a \$20 million minimum net capital requirement.
- Clarification that a RFED that provides trading advice solely in connection with its business as a RFED would be exempt from also registering as a CTA.
- A requirement that all RFEDs, FCMs and their APs must establish and enforce internal rules, procedures and controls to:
 - prevent “front running”;
 - establish settlement prices fairly and objectively; and
 - create and maintain transaction records and make them available to customers (including time and price information, account records, trading platform price changes and volume, and any algorithm used to determine bid and ask prices).
- Application of Rule 166.3 supervisory requirements to Part 5.
- Disclosure by FCMs and RFEDs of the number of non-discretionary retail accounts maintained and the percentage that are profitable for the last four quarters.

The Final Rules eliminated the following two requirements that were contained in the proposed rules and that were subject to significant controversy by commentators:

- The proposed rules contained a requirement that all IBs and all applicants for registration as IBs in connection with retail forex transactions enter into a guarantee agreement with a RFED or an FCM. Under the Final Rules, there is no guarantee requirement so long as the IB meets the net capital requirements.
- The proposed rules contained a requirement that forex counterparties collect from the retail forex customer a security deposit equal to ten percent of the notional value of the retail forex transaction, thus imposing a 10:1 leverage ratio. Under the Final Rules, the leverage ratios will be as follows: (1) two percent security deposit in the case of major currencies (50:1 leverage) and (2) five percent of the notional value of the transaction for all other currencies (20:1 leverage).

For a more extensive analysis of the CFTC’s Final Rules, please see the attached section-by-section analysis.

twelve month period; or 3) the FCM is a clearing member of a registered derivatives clearing organization. *See* Final Rule 5.1(g).

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