Commodity Futures Trading Commission

§ 31.8 Cover of leverage contracts.

(a)(1) Each leverage transaction merchant must at all times maintain cover of at least 90 percent of the amount of physical commodities subject to open long leverage contracts entered into with leverage customers, and must at all times also maintain cover of at least 90 percent of the amount of physical commodities subject to open short leverage contracts entered into with leverage customers. At least 25 percent of the amount of physical commodities subject to open long leverage contracts must be covered by the types of permissible cover set forth in paragraphs (a)(2)(i) and (ii) of this section.

(ii) Permissible cover for a long leverage contract is limited to:

(i) Warehouse receipts for the leverage commodity subject to the leverage contract held in commercial banks located in the United States or in approved contract market depositories: Provided, That the balance of the principal and accrued interest on any loan against such warehouse receipts does not exceed 70 percent of the current market value of the commodity represented by each receipt.

(ii) Warehouse receipts for gold bullion, silver bullion in the case of leverage contracts on bulk silver coins, bulk silver coins in the case of leverage contracts on silver bullion, one type of bulk gold coins for leverage contracts involving another type of bulk gold coins on an ounce-for-ounce basis if each type of bulk gold coins used as cover is the subject of a leverage contract offered by the leverage transaction merchant pursuant to registration under §31.6 of this part, and one type of bulk silver coins for leverage contracts involving another type of bulk silver coins on an ounce-for-ounce basis if each type of bulk silver coins used as cover is the subject of a leverage contract offered by the leverage transaction merchant pursuant to registration under §31.6 of this part, which are held in commercial banks located in the United States or in approved contract market depositories: Provided, That the balance of the principal and accrued interest on any loans against such warehouse receipts does not exceed 70 percent of the current market value of the commodity for which it represents cover.

(iii) Purchase, in physical form, of the leverage commodity subject to the leverage contract, or of the same alternative commodities provided for in paragraph (a)(2)(ii) of this section, must be covered by the types of permissible cover set forth in paragraphs (a)(2)(i) and (ii) of this section.

(ii) Permissible cover for a long leverage contract is limited to:

(i) Warehouse receipts for the leverage commodity subject to the leverage contract held in commercial banks located in the United States or in approved contract market depositories: Provided, That the balance of the principal and accrued interest on any loan against such warehouse receipts does not exceed 70 percent of the current market value of the commodity represented by each receipt.

(ii) Warehouse receipts for gold bullion in the case of leverage contracts on bulk gold coins, bulk gold coins in the case of leverage contracts on gold bullion, silver bullion in the case of leverage contracts on bulk silver coins, bulk silver coins in the case of leverage contracts on silver bullion, one type of bulk gold coins for leverage contracts involving another type of bulk gold coins on an ounce-for-ounce basis if each type of bulk gold coins used as cover is the subject of a leverage contract offered by the leverage transaction merchant pursuant to registration under §31.6 of this part, and one type of bulk silver coins for leverage contracts involving another type of bulk silver coins on an ounce-for-ounce basis if each type of bulk silver coins used as cover is the subject of a leverage contract offered by the leverage transaction merchant pursuant to registration under §31.6 of this part, which are held in commercial banks located in the United States or in approved contract market depositories: Provided, That the balance of the principal and accrued interest on any loans against such warehouse receipts does not exceed 70 percent of the current market value of the commodity for which it represents cover.

(iv) A long spot futures contract on the leverage commodity subject to the
leverage contract, or of the same alternative commodities provided for in paragraph (a)(2)(ii) of this section, if the leverage transaction merchant has stopped a delivery notice which is non-transferable with respect to that futures contract and has otherwise complied with any procedures, including payment, necessary for taking delivery, even though the leverage transaction merchant does not have possession or control of a warehouse receipt for two business days: Provided, however, That the amount of physical commodities subject to such long spot futures contracts at no time constitutes more than 10 percent of the amount of physical commodities subject to open long leverage contracts entered into with leverage customers: And, provided further, That the leverage transaction merchant maintains, in accordance with §31.14 of this part, detailed records of its deliveries on futures contracts, which will be subject to inspection, copying and audit by the Commission and a designated self-regulatory organization.

(v)(A) Purchases for future delivery on or subject to the rules of a contract market of the same generic commodity subject to the leverage contract, or of the same alternative commodities provided for in paragraph (a)(2)(ii) of this section; or

(B) Purchases of call commodity options for the same generic commodity subject to the leverage contract, or of the same alternative commodities provided for in paragraph (a)(2)(ii) of this section, on or subject to the rules of a contract market in accordance with the provisions of part 33 of this chapter: Provided, That the market value of the actual commodity or futures contract which is the subject of such option is less than the value of the underlying commodity based on the strike price of the option.

(3) Permissible cover for a short leverage contract is limited to:

(i) Sales for future delivery on or subject to the rules of a contract market of the same generic commodity subject to the leverage contract, or of the same alternative commodities provided for in paragraph (a)(2)(ii) of this section; or

(ii) Purchases of put commodity options for the same generic commodity subject to the leverage contract, or of the same alternative commodities provided for in paragraph (a)(2)(ii) of this section, on or subject to the rules of a contract market in accordance with the provisions of part 33 of this chapter: Provided, That the market value of the actual commodity or futures contract which is the subject of such option is less than the value of the underlying commodity based on the strike price of the option.

(b) Such leverage transaction merchant must be in compliance with paragraph (a) of this section at all times and must be able to demonstrate such compliance to the satisfaction of the Commission and/or the designated self-regulatory organization. A leverage transaction merchant who is not in compliance with paragraph (a) of this section or in unable to demonstrate such compliance must immediately cease engaging in the business of offering to enter into, entering into, or confirming the execution of, any leverage contract until such time as the leverage transaction merchant is able to demonstrate such compliance. Nothing in this paragraph (b) shall be construed as preventing the Commission or the designated self-regulatory organization from taking action against a leverage transaction merchant for non-compliance with any of the provisions of this section.

(c) The amount of cover which is actually maintained by a leverage transaction merchant, and the amount of cover which must be maintained by a leverage transaction merchant in order to comply with the requirements of this section, shall be computed as of the close of each business day by the leverage transaction merchant. A written record of this computation shall be made and kept, together with all supporting data, in accordance with the provisions of §1.31 of this chapter. This daily computation shall be made by noon on the next business day and shall be computed in a format identical to the Schedule of Coverage Requirements and Coverage Provided contained in Form 2–FR. In computing the amount of cover actually maintained, the leverage transaction merchant
§ 31.9 Minimum financial requirements.

(a) Each leverage transaction merchant must at all times maintain adjusted net capital equal to or in excess of $2,500,000, plus 20 percent of the market value of the amount of physical commodities subject to leverage contracts entered into by the leverage transaction merchant which are uncovered, plus 2 1/2 percent of the market value of the amount of physical commodities subject to short leverage contracts entered into by the leverage transaction merchant which are covered.

(d) A leverage transaction merchant who uses as collateral for cash loans warehouse receipts held as cover for leverage contracts shall maintain a separate record for such loans which contains the following information:

1. The date on which the loan was made;
2. The name of the commercial bank or futures commission merchant making such loan;
3. The purpose for which the loan was made;
4. The amount of the loan;
5. The interest rate on the loan;
6. The loan’s maturity date;
7. The date of any partial or complete liquidation of the loan; and
8. A description of the warehouse receipt collateralizing such loan including the receipt number, the issuer’s name, and the total quantity of the commodity covered by the warehouse receipt. Such loans shall be evidenced in a written agreement executed by the leverage transaction merchant and the lender. The leverage transaction merchant shall retain such agreement and any related notes in accordance with the requirements of §31.14 of this part.

(e) The requirements of paragraphs (a) through (d) of this section shall not be applicable if the applicant or 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 19 of the Act and §31.28 of this part.

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