

Commodity Futures Trading Commission

§ 1.71

Act for alleged violation of any anti-fraud provisions of the Act or any anti-fraud 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]

§ 1.71 Conflicts of interest policies and procedures by futures commission merchants and introducing brokers.

(a) *Definitions.* For purposes of this section, the following terms shall be defined as provided.

(1) *Affiliate.* This term means, with respect to any person, a person controlling, controlled by, or under common control with, such person.

(2) *Business trading unit.* This term means any department, division, group, or personnel of a futures commission merchant or introducing broker or any of its affiliates, whether or not identified as such, that performs, or personnel exercising direct supervisory authority over the performance of, any pricing (excluding price verification for risk management purposes), trading, sales, marketing, advertising, solicitation, structuring, or brokerage activities on behalf of a futures commission merchant or introducing broker or any of its affiliates.

(3) *Clearing unit.* This term means any department, division, group, or personnel of a futures commission merchant or any of its affiliates, whether or not identified as such, that performs, or personnel exercising direct supervisory authority over the performance of, any proprietary or customer clearing activities on behalf of a futures commission merchant or any of its affiliates.

(4) *Derivative.* This term means:

- (i) A contract for the purchase or sale of a commodity for future delivery;
- (ii) A security futures product;
- (iii) A swap;
- (iv) Any agreement, contract, or transaction described in section

2(c)(2)(C)(i) or section 2(c)(2)(D)(i) of the Act; and

(v) Any commodity option authorized under section 4c of the Act; and (vi) any leverage transaction authorized under section 19 of the Act.

(5) *Non-research personnel.* This term means any employee of the business trading unit or clearing unit, or any other employee of the futures commission merchant or introducing broker, other than an employee performing a legal or compliance function, who is not directly responsible for, or otherwise not directly involved in, research or analysis intended for inclusion in a research report.

(6) *Public appearance.* This term means any participation in a conference call, seminar, forum (including an interactive electronic forum) or other public speaking activity before 15 or more persons (individuals or entities), or interview or appearance before one or more representatives of the media, radio, television or print media, or the writing of a print media article, in which a research analyst makes a recommendation or offers an opinion concerning a derivatives transaction. This term does not include a password-protected Webcast, conference call or similar event with 15 or more existing customers, provided that all of the event participants previously received the most current research report or other documentation that contains the required applicable disclosures, and that the research analyst appearing at the event corrects and updates during the public appearance any disclosures in the research report that are inaccurate, misleading, or no longer applicable.

(7) *Research analyst.* This term means the employee of a futures commission merchant or introducing broker who is primarily responsible for, and any employee who reports directly or indirectly to such research analyst in connection with, preparation of the substance of a research report relating to any derivative, whether or not any such person has the job title of "research analyst."

(8) *Research department.* This term means any department or division that is principally responsible for preparing

§ 1.71

17 CFR Ch. I (4–1–14 Edition)

the substance of a research report relating to any derivative on behalf of a futures commission merchant or introducing broker, including a department or division contained in an affiliate of a futures commission merchant or introducing broker.

(9) *Research report.* This term means any written communication (including electronic) that includes an analysis of the price or market for any derivative, and that provides information reasonably sufficient upon which to base a decision to enter into a derivatives transaction. This term does not include:

(i) Communications distributed to fewer than 15 persons;

(ii) Commentaries on economic, political or market conditions;

(iii) Statistical summaries of multiple companies' financial data, including listings of current ratings;

(iv) Periodic reports or other communications prepared for investment company shareholders or commodity pool participants that discuss individual derivatives positions in the context of a fund's past performance or the basis for previously-made discretionary decisions;

(v) Any communications generated by an employee of the business trading unit that is conveyed as a solicitation for entering into a derivatives transaction, and is conspicuously identified as such; and

(vi) Internal communications that are not given to current or prospective customers.

(b) *Policies and procedures.* (1) Except as provided in paragraph (b)(2) of this section, each futures commission merchant and introducing broker subject to this rule must adopt and implement written policies and procedures reasonably designed to ensure that the futures commission merchant or introducing broker and its employees comply with the provisions of this rule.

(2) *Small Introducing Brokers.* An introducing broker that has generated, over the preceding 3 years, \$5 million or less in aggregate gross revenues from its activities as an introducing broker must establish structural and institutional safeguards reasonably designed to ensure that the activities of any person within the firm relating to research or analysis of the price or

market for any commodity or derivative are separated by appropriate informational partitions within the firm from the review, pressure, or oversight of persons whose involvement in trading or clearing activities might potentially bias the judgment or supervision of the persons.

(c) *Research analysts and research reports—(1) Restrictions on relationship with research department.* (i) Non-research personnel shall not direct a research analyst's decision to publish a research report of the futures commission merchant or introducing broker, and non-research personnel shall not direct the views and opinions expressed in a research report of the futures commission merchant or introducing broker.

(ii) No research analyst may be subject to the supervision or control of any employee of the futures commission merchant's or introducing broker's business trading unit or clearing unit, and no employee of the business trading unit or clearing unit may have any influence or control over the evaluation or compensation of a research analyst.

(iii) Except as provided in paragraph (c)(1)(iv) of this section, non-research personnel, other than the board of directors and any committee thereof, shall not review or approve a research report of the futures commission merchant or introducing broker before its publication.

(iv) Non-research personnel may review a research report before its publication as necessary only to verify the factual accuracy of information in the research report, to provide for non-substantive editing, to format the layout or style of the research report, or to identify any potential conflicts of interest, provided that:

(A) Any written communication between non-research personnel and research department personnel concerning the content of a research report must be made either through authorized legal or compliance personnel of the futures commission merchant or introducing broker or in a transmission copied to such personnel; and

(B) Any oral communication between non-research personnel and research department personnel concerning the

Commodity Futures Trading Commission

§ 1.71

content of a research report must be documented and made either through authorized legal or compliance personnel acting as an intermediary or in a conversation conducted in the presence of such personnel.

(2) *Restrictions on communications.* Any written or oral communication by a research analyst to a current or prospective customer relating to any derivative must not omit any material fact or qualification that would cause the communication to be misleading to a reasonable person.

(3) *Restrictions on research analyst compensation.* A futures commission merchant or introducing broker may not consider as a factor in reviewing or approving a research analyst's compensation his or her contributions to the futures commission merchant's or introducing broker's trading or clearing business. Except for communicating client or customer feedback, ratings and other indicators of research analyst performance to research department management, no employee of the business trading unit or clearing unit of the futures commission merchant or introducing broker may influence the review or approval of a research analyst's compensation.

(4) *Prohibition of promise of favorable research.* No futures commission merchant or introducing broker may directly or indirectly offer favorable research, or threaten to change research, to an existing or prospective customer as consideration or inducement for the receipt of business or compensation.

(5) *Disclosure requirements.* (i) *Ownership and material conflicts of interest.* A futures commission merchant or introducing broker must disclose in research reports and a research analyst must disclose in public appearances whether the research analyst maintains a financial interest in any derivative of a type, class, or category that the research analyst follows, and the general nature of the financial interest.

(ii) *Prominence of disclosure.* Disclosures and references to disclosures must be clear, comprehensive, and prominent. With respect to public appearances by research analysts, the disclosures required by paragraph (c)(5) of this section must be conspicuous.

(iii) *Records of public appearances.* Each futures commission merchant and introducing broker must maintain records of public appearances by research analysts sufficient to demonstrate compliance by those research analysts with the applicable disclosure requirements under paragraph (c)(5) of this section.

(iv) *Third-party research reports.* (A) For the purposes of paragraph (c)(5)(iv) of this section, "independent third-party research report" shall mean a research report, in respect of which the person or entity producing the report:

(1) Has no affiliation or business or contractual relationship with the distributing futures commission merchant or introducing broker, or that futures commission merchant's or introducing broker's affiliates, that is reasonably likely to inform the content of its research reports; and

(2) Makes content determinations without any input from the distributing futures commission merchant or introducing broker or from the futures commission merchant's or introducing broker's affiliates.

(B) Subject to paragraph (c)(5)(iv)(C) of this section, if a futures commission merchant or introducing broker distributes or makes available any independent third-party research report, the futures commission merchant or introducing broker must accompany the research report with, or provide a web address that directs the recipient to, the current applicable disclosures, as they pertain to the futures commission merchant or introducing broker, required by this section. Each futures commission merchant and introducing broker must establish written policies and procedures reasonably designed to ensure the completeness and accuracy of all applicable disclosures.

(C) The requirements of paragraph (c)(5)(iv)(B) of this section shall not apply to independent third-party research reports made available by a futures commission merchant or introducing broker to its customers:

(1) Upon request; or

(2) Through a Web site maintained by the futures commission merchant or introducing broker.

(6) *Prohibition of retaliation against research analysts.* No futures commission

merchant or introducing broker, and no employee of a futures commission merchant or introducing broker who is involved with the futures commission merchant's or introducing broker's trading or clearing activities, may, directly or indirectly, retaliate against or threaten to retaliate against any research analyst employed by the futures commission merchant or introducing broker or its affiliates as a result of an adverse, negative, or otherwise unfavorable research report or public appearance written or made, in good faith, by the research analyst that may adversely affect the futures commission merchant's or introducing broker's present or prospective trading or clearing activities.

(7) *Small Introducing Brokers.* An introducing broker that has generated, over the preceding 3 years, \$5 million or less in aggregate gross revenues from its activities as an introducing broker is exempt from the requirements set forth in this paragraph (c).

(d) *Clearing activities.* (1) No futures commission merchant shall permit any affiliated swap dealer or major swap participant to directly or indirectly interfere with, or attempt to influence, the decision of the clearing unit personnel of the futures commission merchant to provide clearing services and activities to a particular customer, including but not limited to a decision relating to the following:

(i) Whether to offer clearing services and activities to a particular customer;

(ii) Whether to accept a particular customer for the purposes of clearing derivatives;

(iii) Whether to submit a customer's transaction to a particular derivatives clearing organization;

(iv) Whether to set or adjust risk tolerance levels for a particular customer;

(v) Whether to accept certain forms of collateral from a particular customer; or

(vi) Whether to set a particular customer's fees for clearing services based upon criteria that are not generally available and applicable to other customers of the futures commission merchant.

(2) Each futures commission merchant shall create and maintain an appropriate informational partition be-

tween business trading units of an affiliated swap dealer or major swap participant and clearing unit personnel of the futures commission merchant to reasonably ensure compliance with the Act and the prohibitions specified in paragraph (d)(1) of this section. At a minimum, such informational partitions shall require that:

(i) No employee of a business trading unit of an affiliated swap dealer or major swap participant may review or approve the provision of clearing services and activities by clearing unit personnel of the futures commission merchant, make any determination regarding whether the futures commission merchant accepts clearing customers, or in any way condition or tie the provision of trading services upon or to the provision of clearing services or otherwise participate in the provision of clearing services by improperly incentivizing or encouraging the use of the affiliated futures commission merchant. Any employee of a business trading unit of an affiliated swap dealer or major swap participant may participate in the activities of the futures commission merchant as necessary for (A) participating in default management undertaken by a derivatives clearing organization during an event of default; and (B) transferring, liquidating, or hedging any proprietary or customer positions during an event of default;

(ii) No employee of a business trading unit of an affiliated swap dealer or major swap participant shall supervise, control, or influence any employee of a clearing unit of the futures commission merchant; and

(iii) No employee of the business trading unit of an affiliated swap dealer or major swap participant shall influence or control compensation or evaluation of any employee of the clearing unit of the futures commission merchant.

(e) *Undue influence on customers.* Each futures commission merchant and introducing broker must adopt and implement written policies and procedures that mandate the disclosure to

Commodity Futures Trading Commission

§ 1.73

its customers of any material incentives and any material conflicts of interest regarding the decision of a customer as to the trade execution and/or clearing of the derivatives transaction.

(f) *Records.* All records that a futures commission merchant or introducing broker is required to maintain pursuant to this regulation shall be maintained in accordance with Commission Regulation §1.31 and shall be made available promptly upon request to representatives of the Commission.

[77 FR 20198, Apr. 3, 2012]

§ 1.72 Restrictions on customer clearing arrangements.

No futures commission merchant providing clearing services to customers shall enter into an arrangement that:

(a) Discloses to the futures commission merchant or any swap dealer or major swap participant the identity of a customer's original executing counterparty;

(b) Limits the number of counterparties with whom a customer may enter into a trade;

(c) Restricts the size of the position a customer may take with any individual counterparty, apart from an overall limit for all positions held by the customer at the futures commission merchant;

(d) Impairs a customer's access to execution of a trade on terms that have a reasonable relationship to the best terms available; or

(e) Prevents compliance with the timeframes set forth in §1.74(b), §23.610(b), or §39.12(b)(7) of this chapter.

[77 FR 21306, Apr. 9, 2012]

§ 1.73 Clearing futures commission merchant risk management.

(a) Each futures commission merchant that is a clearing member of a derivatives clearing organization shall:

(1) Establish risk-based limits in the proprietary account and in each customer account based on position size, order size, margin requirements, or similar factors;

(2) Screen orders for compliance with the risk-based limits in accordance with the following:

(i) When a clearing futures commission merchant provides electronic market access or accepts orders for automated execution, it shall use automated means to screen orders for compliance with the limits;

(ii) When a clearing futures commission merchant accepts orders for non-automated execution, it shall establish and maintain systems of risk controls reasonably designed to ensure compliance with the limits;

(iii) When a clearing futures commission merchant accepts transactions that were executed bilaterally and then submitted for clearing, it shall establish and maintain systems of risk management controls reasonably designed to ensure compliance with the limits;

(iv) When a firm executes an order on behalf of a customer but gives it up to another firm for clearing,

(A) The clearing futures commission merchant shall establish risk-based limits for the customer, and enter into an agreement in advance with the executing firm that requires the executing firm to screen orders for compliance with those limits in accordance with paragraph (a)(2)(i) or (ii) as applicable; and

(B) The clearing futures commission merchant shall establish and maintain systems of risk management controls reasonably designed to ensure compliance with the limits.

(v) When an account manager bunches orders on behalf of multiple customers for execution as a block and post-trade allocation to individual accounts for clearing:

(A) The futures commission merchant that initially clears the block shall establish risk-based limits for the block account and screen the order in accordance with paragraph (a)(2)(i) or (ii) as applicable;

(B) The futures commission merchants that clear the allocated trades on behalf of customers shall establish risk-based limits for each customer and enter into an agreement in advance with the account manager that requires the account manager to screen orders for compliance with those limits; and

(C) The futures commission merchants that clear the allocated trades on behalf of customers shall establish