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(c)(4) of this section and shall recommence with the business day after the public comment period ends.

(ii) Nothing in this section shall require the Commission and the Securities and Exchange Commission to issue any joint order.

(iii) If the Commission and the Securities and Exchange Commission do not issue a joint order within the time period described in paragraph (c)(5)(i) of this section, each of the Commission and the Securities and Exchange Commission shall publicly provide the reasons for not issuing such a joint order within that timeframe.

[77 FR 48354, Aug. 13, 2012]

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 as of the close of business each month. Each Form 1-FR-FCM must be filed no later than 17 business days after the date for which the report is made.

(ii) In addition to the monthly 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, which must be certified by an independent public accountant in accordance with § 1.16, and must be filed no later than 60 days after the close of the 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. Each Form 1-FR-IB must be filed no later than 17 business 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 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

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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.

(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 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.

(5) Each futures commission merchant must file with the Commission the measure of the future commission merchant's leverage as of the close of the business each month. For purpose of this section, the term "leverage" shall be defined by a registered futures association of which the futures commission merchant is a member. The futures commission merchant is required to file the leverage information with the Commission within 17 business days of the close of the futures commission merchant's month end.

(c) *Where to file reports.* (1) Form 1-FR filed by an introducing broker pursuant to paragraph (b)(2) of this section need be filed only with, and will be considered filed when received by, the National Futures Association. Other reports or information provided for in this section will be considered filed when received by the Regional office of the Commission with jurisdiction over the state in which the registrant's principal place of business is located (as set forth in §140.02 of this chapter) and by the designated self-regulatory organization, if any; and reports or other information required to be filed by this section by an applicant for registration will be considered filed when received by the National Futures Association. Any report or information 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.

(2)(i) All filings or other notices prepared by a futures commission merchant pursuant to this section must be submitted to the Commission in electronic form using a form of user authentication assigned in accordance with procedures established by or approved by the Commission, and otherwise in accordance with instructions

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issued by or approved by the Commission, if the futures commission merchant 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. 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 must be filed electronically.

(ii) Except as provided in paragraph (h) of this section, all filings or other notices or applications prepared by an introducing broker or applicant for registration as an introducing broker or futures commission merchant pursuant to this section must be filed electronically in accordance with electronic filing procedures established by the National Futures Association. In the case of a Form 1-FR-IB that is required to be certified by an independent public accountant in accordance with § 1.16, a paper copy of any such filing with the original manually signed certification must be maintained by the introducing broker or applicant for registration as an introducing broker in accordance with § 1.31.

(3) Any information required of a registrant by a self-regulatory organization pursuant to paragraph (b)(4) of this section need be furnished only to such self-regulatory organization and the Commission, and any information required of an applicant by the National Futures Association pursuant to paragraph (b)(4) of this section need be furnished only to the National Futures Association and the Commission.

(4) 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) Statements of income (loss) and 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, the statement of secured amounts and funds held in separate accounts for 30.7 customers (as defined in § 30.1 of this chapter) in accordance with § 30.7 of this chapter, and the statement of cleared swaps customer segregation requirements and funds in cleared swaps customer accounts under section 4d(f) of the Act as of the date for which the report is made; and

(vi) In addition to the information expressly required, such further 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, the statement of secured amounts and funds held in separate accounts for 30.7 customers (as defined in §30.1 of this chapter) in accordance with §30.7 of the chapter, and the statement of cleared swaps customers segregation requirements and funds in cleared swaps customer accounts under section 4d(f) of the Act 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, the statement of secured amounts and funds held in separate accounts for 30.7 customers (as defined in §30.1 of this chapter) in accordance with §30.7 of this chapter, and the statement of cleared swaps customer segregation requirements and funds in cleared swaps customer accounts under section 4d(f) of the Act, 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. The individual making such oath or affirmation must be:

(i) If the registrant or applicant is a sole proprietorship, the proprietor; if a partnership, any general partner; if a corporation, the chief executive officer or chief financial officer; and, if a limited liability company or limited liability partnership, the chief executive officer, the chief financial officer, the manager, the managing member, or those members vested with the management authority for the limited liability company or limited liability partnership; or

(ii) If the registrant or applicant is registered with the Securities and Exchange Commission as a securities broker or dealer, the representative authorized under §240.17a-5 of this title to file for the securities broker or dealer its Financial and Operational Combined Uniform Single Report under the Securities Exchange Act of 1934, part II, part IIA, or part II CSE.

(iii) In the case of a Form 1-FR filed via electronic transmission in accordance with procedures established by or approved by the Commission, such transmission must be accompanied by the user authentication assigned to the authorized signer under such procedures, and the use of such user authentication 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. An applicant that does not so notify the National Futures Association will be deemed to have elected the calendar year as its fiscal year.

(2) (i) A registrant must continue to use its elected fiscal year, calendar or otherwise, unless a change in such fiscal year has been approved pursuant to this paragraph (e)(2).

(ii) *Futures commission merchant registrants.* (A) A futures commission merchant may file with its designated self-regulatory organization an application to change its fiscal year, a copy of which the registrant must file with the Commission. The application shall be approved or denied in writing by the designated self-regulatory organization. The registrant must file immediately with the Commission a copy of any notice it receives from the designated self-regulatory organization to approve or deny the registrant's application to change its fiscal year. A written notice of approval shall become effective upon the filing by the registrant of a copy with the Commission, and a written notice of denial shall be effective as of the date of the notice.

(B) A futures commission merchant that is registered with the Securities and Exchange Commission as a securities broker or dealer may file with its designated self-regulatory organization copies of any notice or application filed with its designated examining authority, pursuant to §240.17a-5(d)(1)(i) of this title, for a change in fiscal year or "as of" date for its annual audited financial statement. The registrant must also file immediately with the designated self-regulatory organization and the Commission copies of any notice it receives from its designated ex-

amining authority to approve or deny the registrant's request for change in fiscal year or "as of" date. Upon the receipt by the designated self-regulatory organization and the Commission of copies of any such notice of approval, the change in fiscal year or "as of" date referenced in the notice shall be deemed approved under this paragraph (e)(2).

(C) Any copy that under this paragraph (e)(2) is required to be filed with the Commission shall be filed with the regional office of the Commission with jurisdiction over the state in which the registrant's principal place of business is located, and any copy or application to be filed with the designated self-regulatory organization shall be filed at its principal place of business.

(iii) *Introducing broker registrants.* (A) An introducing broker may file with the National Futures Association an application to change its fiscal year, which shall be approved or denied in writing.

(B) An introducing broker that is registered with the Securities and Exchange Commission as a securities broker or dealer may file with the National Futures Association copies of any notice or application filed with its designated examining authority, pursuant to §240.17a-5(d)(1)(i) of this title, for a change in fiscal year or "as of" date for its annual audited financial statement. The registrant must also file immediately with the National Futures Association copies of any notice it receives from its designated examining authority to approve or deny the registrant's request for change in fiscal year or "as of" date. Upon the receipt by the National Futures Association of copies of any such notice of approval, the change in fiscal year or "as of" date referenced in the notice shall be deemed approved under this paragraph (e)(2).

(f) *Extension of time for filing uncertified reports.* (1) In the event a registrant finds that it cannot file its Form 1-FR, or, in accordance with paragraph (h) of this section, its Financial and Operational Combined Uniform Single Report under the Securities Exchange Act of 1934, Part II, Part IIA, or Part IIC (FOCUS report), for any period within the time specified in

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paragraphs (b)(1)(i) or (b)(2)(i) of this section without substantial undue hardship, it may request approval for an extension of time, as follows:

(i) *Futures commission merchant registrants.* (A) A futures commission merchant may file with its designated self-regulatory organization an application for extension of time, a copy of which the registrant must file with the Commission. The application shall be approved or denied in writing by the designated self-regulatory organization. The registrant must file immediately with the Commission a copy of any notice it receives from the designated self-regulatory organization to approve or deny the registrant's request for extension of time. A written notice of approval shall become effective upon the filing by the registrant of a copy with the Commission, and a written notice of denial shall be effective as of the date of the notice.

(B) A futures commission merchant that is registered with the Securities and Exchange Commission as a securities broker or dealer may file with its designated self-regulatory organization a copy of any application that the registrant has filed with its designated examining authority, pursuant to §240.17-a5(1)(5) of this title, for an extension of time to file its FOCUS report. The registrant must also file immediately with the designated self-regulatory organization and the Commission copies of any notice it receives from its designated examining authority to approve or deny the requested extension of time. Upon receipt by the designated self-regulatory organization and the Commission of copies of any such notice of approval, the requested extension of time referenced in the notice shall be deemed approved under this paragraph (f)(1).

(C) Any copy that under this subparagraph (f)(1)(i) is required to be filed with the Commission shall be filed with the regional office of the Commission with jurisdiction over the state in which the registrant's principal place of business is located.

(ii) *Introducing broker registrants.* (A) An introducing broker may file with the National Futures Association an application for extension of the time,

which shall be approved or denied in writing.

(B) An introducing broker that is registered with the Securities and Exchange Commission as a securities broker or dealer may file with the National Futures Association copies of any application that the registrant has filed with its designated examining authority, pursuant to §240.17-a5(1)(5) of this title, for an extension of time to file its FOCUS report. The registrant must also file immediately with the National Futures Association copies of any notice it receives from its designated examining authority to approve or deny the requested extension of time. Upon the receipt by the National Futures Association of a copy of any such notice of approval, the requested extension of time referenced in the notice shall be deemed approved under this paragraph (f)(1)(ii).

(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 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 for filing the report. Notice of such application must be filed with the regional office of the Commission with jurisdiction over the state in which the applicant's principal place of business is located 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) *Public availability of reports.* (1) Forms 1–FR filed pursuant to this section, and FOCUS reports filed in lieu of Forms 1–FR pursuant to paragraph (h) of this section, will be treated as exempt from mandatory public disclosure for purposes of the Freedom of Information Act and the Government in the Sunshine Act and parts 145 and 147 of this chapter, except for the information described in paragraph (g)(2) of this section.

(2) The following information in Forms 1–FR, and the same or equivalent information in FOCUS reports filed in lieu of Forms 1–FR, will be publicly available:

(i) The amount of the applicant’s or registrant’s adjusted net capital; the amount of its minimum net capital requirement under § 1.17 of this chapter; and the amount of its adjusted net capital in excess of its minimum net capital requirement; and

(ii) The following statements and footnote disclosures thereof: the Statement of Financial Condition in the certified annual financial reports of futures commission merchants and introducing brokers; 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, the Statement (to be filed by a futures commission merchant only) of Secured Amounts and Funds held in Separate Accounts for 30.7 Customers (as defined in § 30.1 of this chapter) in accordance with § 30.7 of this chapter, and the Statement (to be filed by futures commission merchants only) of Cleared Swaps Customer Segregation Requirements and Funds in Cleared Swaps Customer Accounts under section 4d(f) of the Act.

(3) [Reserved]

(4) All information that is exempt from mandatory public disclosure under paragraph (g)(1) of this section 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 Commis-

sion 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 that 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, a security-based swap dealer, or a major security-based market participant may comply with the requirements of this section by filing (in accordance with paragraphs (a), (b), (c), and (j) of this section) a copy, as applicable, of its Financial and Operational Combined Uniform Single Report under the Securities Exchange Act of 1934, Part II, Part IIA, Part IIC, or Part II CSE (FOCUS Report), 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 FOCUS Report; and *Provided, further,* That a certified FOCUS Report filed by an introducing broker or applicant for registration as an introducing broker in lieu of a certified Form 1–FR–IB must be filed according to National Futures Association rules, either in paper form or electronically, in accordance with procedures established by the National Futures Association, and if filed electronically, a paper copy of such filing with the original manually signed certification must be maintained by such introducing broker or applicant in accordance with § 1.31.

(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

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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 or retail foreign exchange dealer 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, retail foreign exchange dealer, 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; and, if the firm is a limited liability company or limited liability partnership, either the chief executive officer, the chief financial officer, the manager, the managing member, or those members vested with the management authority for the limited liability company or limited liability partnership.

(2) No futures commission merchant or retail foreign exchange dealer 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) of this part or §5.6(b) of this chapter, as applicable; or

(ii) There is filed against the futures commission merchant or retail foreign exchange dealer 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 retail foreign exchange dealer may enter into a guarantee agreement only with an introducing broker as defined in §5.1(f)(1) of this chapter. A retail foreign exchange dealer may not enter into a guarantee agreement with an introducing broker as defined in §1.3 of this part.

(4) 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.

(5)(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 or retail foreign exchange dealer is suspended or revoked, the guarantee agreement shall expire 30 days after such suspension or revocation, or at such earlier time as

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may be approved by the Commission, the introducing broker, and the introducing broker's designated self-regulatory organization.

(6) 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 or retail foreign exchange dealer 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 or retail foreign exchange dealer 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 or retail foreign exchange dealer and the introducing broker.

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

(8) An introducing broker may not simultaneously be a party to more than one guarantee agreement: *Provided, however,* That the provisions of this paragraph (j)(8) shall not be deemed to preclude an introducing broker from entering into a guarantee agreement with another futures commission merchant or retail foreign exchange dealer if the introducing broker, futures commission merchant or retail foreign exchange dealer 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)(6) 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)(8) shall not be deemed to preclude an introducing broker from entering into a guarantee agreement with another futures commission merchant or retail foreign exchange dealer if the futures commission merchant or retail foreign exchange dealer 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)(6)(ii) of this section.

(9)(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)(6) of this section, or that is due to expire in accordance with the provisions of paragraph (j)(5)(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: *Provided, however*, that an introducing broker as defined in § 5.1(f)(1) of this chapter that is party to a guarantee agreement that has been terminated or that has expired 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 a new guarantee agreement effective on or before the termination or expiration date of the terminating or expiring guarantee agreement.

(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)(9)(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)(6)(ii) of this section shall not be deemed to be in violation of the minimum adjusted net capital requirement of § 1.17(a)(1)(iii) 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: *Provided, however*, that an introducing broker as defined in § 5.1(f)(1) of this chapter that is party to a guarantee agreement that has been terminated must cease doing business as an introducing broker from and after the effective date of such termination, and may not resume doing business as an introducing broker as defined in § 5.1(f)(1) of this chapter unless and until it files a new guarantee agreement.

(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]

EDITORIAL NOTE: For FEDERAL REGISTER citations affecting § 1.10, see the List of CFR Sections Affected, which appears in the

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Finding Aids section of the printed volume and at www.govinfo.gov.

§ 1.11 Risk Management Program for futures commission merchants.

(a) *Applicability.* Nothing in this section shall apply to a futures commission merchant that 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 from soliciting or accepting orders for the purchase or sale of any commodity interest.

(b) *Definitions.* For purposes of this section:

(1) *Business unit* means any department, division, group, or personnel of a futures commission merchant or any of its affiliates, whether or not identified as such that:

(i) Engages in soliciting or in accepting orders for the purchase or sale of any commodity interest 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; or

(ii) Otherwise handles segregated funds, including managing, investing, and overseeing the custody of segregated funds, or any documentation in connection therewith, other than for risk management purposes; and

(iii) Any personnel exercising direct supervisory authority of the performance of the activities described in paragraph (b)(1)(i) or (ii) of this section.

(2) *Customer* means a futures customer as defined in § 1.3, Cleared Swaps Customer as defined in § 22.1 of this chapter, and 30.7 customer as defined in § 30.1 of this chapter.

(3) *Governing body* means the proprietor, if the futures commission merchant is a sole proprietorship; a general partner, if the futures commission merchant is a partnership; the board of directors if the futures commission merchant is a corporation; the chief executive officer, the chief financial officer, the manager, the managing member, or those members vested with the management authority if the futures commission merchant is a limited li-

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ability company or limited liability partnership.

(4) *Segregated funds* means money, securities, or other property held by a futures commission merchant in separate accounts pursuant to § 1.20 for futures customers, pursuant to § 22.2 of this chapter for Cleared Swaps Customers, and pursuant to § 30.7 of this chapter for 30.7 customers.

(5) *Senior management* means, any officer or officers specifically granted the authority and responsibility to fulfill the requirements of senior management by the governing body.

(c) *Risk Management Program.* (1) Each futures commission merchant shall establish, maintain, and enforce a system of risk management policies and procedures designed to monitor and manage the risks associated with the activities of the futures commission merchant as such. For purposes of this section, such policies and procedures shall be referred to collectively as a “Risk Management Program.”

(2) Each futures commission merchant shall maintain written policies and procedures that describe the Risk Management Program of the futures commission merchant.

(3) The Risk Management Program and the written risk management policies and procedures, and any material changes thereto, shall be approved in writing by the governing body of the futures commission merchant.

(4) Each futures commission merchant shall furnish a copy of its written risk management policies and procedures to the Commission and its designated self-regulatory organization upon application for registration and thereafter upon request.

(d) *Risk management unit.* As part of the Risk Management Program, each futures commission merchant shall establish and maintain a risk management unit with sufficient authority; qualified personnel; and financial, operational, and other resources to carry out the risk management program established pursuant to this section. The risk management unit shall report directly to senior management and shall be independent from the business unit.

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(e) *Elements of the Risk Management Program.* The Risk Management Program of each futures commission merchant shall include, at a minimum, the following elements:

(1) *Identification of risks and risk tolerance limits.* (i) The Risk Management Program shall take into account market, credit, liquidity, foreign currency, legal, operational, settlement, segregation, technological, capital, and any other applicable risks together with a description of the risk tolerance limits set by the futures commission merchant and the underlying methodology in the written policies and procedures. The risk tolerance limits shall be reviewed and approved quarterly by senior management and annually by the governing body. Exceptions to risk tolerance limits shall be subject to written policies and procedures.

(ii) The Risk Management Program shall take into account risks posed by affiliates, all lines of business of the futures commission merchant, and all other trading activity engaged in by the futures commission merchant. The Risk Management Program shall be integrated into risk management at the consolidated entity level.

(iii) The Risk Management Program shall include policies and procedures for detecting breaches of risk tolerance limits set by the futures commission merchant, and alerting supervisors within the risk management unit and senior management, as appropriate.

(2) *Periodic Risk Exposure Reports.* (i) The risk management unit of each futures commission merchant shall provide to senior management and to its governing body quarterly written reports setting forth all applicable risk exposures of the futures commission merchant; any recommended or completed changes to the Risk Management Program; the recommended time frame for implementing recommended changes; and the status of any incomplete implementation of previously recommended changes to the Risk Management Program. For purposes of this section, such reports shall be referred to as "Risk Exposure Reports." The Risk Exposure Reports also shall be provided to the senior management and the governing body immediately upon detection of any material change

in the risk exposure of the futures commission merchant.

(ii) *Furnishing to the Commission.* Each futures commission merchant shall furnish copies of its Risk Exposure Reports to the Commission within five (5) business days of providing such reports to its senior management.

(3) *Specific risk management considerations.* The Risk Management Program of each futures commission merchant shall include, but not be limited to, policies and procedures necessary to monitor and manage the following risks:

(i) *Segregation risk.* The written policies and procedures shall be reasonably designed to ensure that segregated funds are separately accounted for and segregated or secured as belonging to customers as required by the Act and Commission regulations and must, at a minimum, include or address the following:

(A) A process for the evaluation of depositories of segregated funds, including, at a minimum, documented criteria that any depository that will hold segregated funds, including an entity affiliated with the futures commission merchant, must meet, including criteria addressing the depository's capitalization, creditworthiness, operational reliability, and access to liquidity. The criteria should further consider the extent to which segregated funds are concentrated with any depository or group of depositories. The criteria also should include the availability of deposit insurance and the extent of the regulation and supervision of the depository;

(B) A program to monitor an approved depository on an ongoing basis to assess its continued satisfaction of the futures commission merchant's established criteria, including a thorough due diligence review of each depository at least annually;

(C) An account opening process for depositories, including documented authorization requirements, procedures that ensure that segregated funds are not deposited with a depository prior to the futures commission merchant receiving the acknowledgment letter required from such depository pursuant to §§ 1.20, and 22.2 and 30.7 of this chapter, and procedures that ensure that

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such account is properly titled to reflect that it is holding segregated funds pursuant to the Act and Commission regulations;

(D) A process for establishing a targeted amount of residual interest that the futures commission merchant seeks to maintain as its residual interest in the segregated funds accounts and such process must be designed to reasonably ensure that the futures commission merchant maintains the targeted residual amounts and remains in compliance with the segregated funds requirements at all times. The policies and procedures must require that senior management, in establishing the total amount of the targeted residual interest in the segregated funds accounts, perform appropriate due diligence and consider various factors, as applicable, relating to the nature of the futures commission merchant's business including, but not limited to, the composition of the futures commission merchant's customer base, the general creditworthiness of the customer base, the general trading activity of the customers, the types of markets and products traded by the customers, the proprietary trading of the futures commission merchant, the general volatility and liquidity of the markets and products traded by customers, the futures commission merchant's own liquidity and capital needs, and the historical trends in customer segregated fund balances, including undermargined amounts and net deficit balances in customers' accounts. The analysis and calculation of the targeted amount of the future commission merchant's residual interest must be described in writing with the specificity necessary to allow the Commission and the futures commission merchant's designated self-regulatory organization to duplicate the analysis and calculation and test the assumptions made by the futures commission merchant. The adequacy of the targeted residual interest and the process for establishing the targeted residual interest must be reassessed periodically by Senior Management and revised as necessary;

(E) A process for the withdrawal of cash, securities, or other property from accounts holding segregated funds,

where the withdrawal is not for the purpose of payments to or on behalf of the futures commission merchant's customers. Such policies and procedures must satisfy the requirements of § 1.23, § 22.17 of this chapter, or § 30.7 of this chapter, as applicable;

(F) A process for assessing the appropriateness of specific investments of segregated funds in permitted investments in accordance with § 1.25. Such policies and procedures must take into consideration the market, credit, counterparty, operational, and liquidity risks associated with such investments, and assess whether such investments comply with the requirements in § 1.25 including that the futures commission merchant manage the permitted investments consistent with the objectives of preserving principal and maintaining liquidity;

(G) Procedures requiring the appropriate separation of duties among individuals responsible for compliance with the Act and Commission regulations relating to the protection and financial reporting of segregated funds, including the separation of duties among personnel that are responsible for advising customers on trading activities, approving or overseeing cash receipts and disbursements (including investment operations), and recording and reporting financial transactions. The policies and procedures must require that any movement of funds to affiliated companies and parties are properly approved and documented;

(H) A process for the timely recording of all transactions, including transactions impacting customers' accounts, in the firm's books of record;

(I) A program for conducting annual training of all finance, treasury, operations, regulatory, compliance, settlement, and other relevant officers and employees regarding the segregation requirements for segregated funds required by the Act and regulations, the requirements for notices under § 1.12, procedures for reporting suspected breaches of the policies and procedures required by this section to the chief compliance officer, without fear of retaliation, and the consequences of failing to comply with the segregation requirements of the Act and regulations; and

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(J) Policies and procedures for assessing the liquidity, marketability and mark-to-market valuation of all securities or other non-cash assets held as segregated funds, including permitted investments under § 1.25, to ensure that all non-cash assets held in the customer segregated accounts, both customer-owned securities and investments in accordance with § 1.25, are readily marketable and highly liquid. Such policies and procedures must require daily measurement of liquidity needs with respect to customers; assessment of procedures to liquidate all non-cash collateral in a timely manner and without significant effect on price; and application of appropriate collateral haircuts that accurately reflect market and credit risk.

(ii) *Operational risk.* The Risk Management Program shall include automated financial risk management controls reasonably designed to prevent the placing of erroneous orders, including those that exceed pre-set capital, credit, or volume thresholds. The Risk Management Program shall ensure that the use of automated trading programs is subject to policies and procedures governing the use, supervision, maintenance, testing, and inspection of such programs.

(iii) *Capital risk.* The written policies and procedures shall be reasonably designed to ensure that the futures commission merchant has sufficient capital to be in compliance with the Act and the regulations, and sufficient capital and liquidity to meet the reasonably foreseeable needs of the futures commission merchant.

(4) *Supervision of the Risk Management Program.* The Risk Management Program shall include a supervisory system that is reasonably designed to ensure that the policies and procedures required by this section are diligently followed.

(f) *Review and testing.* (1) The Risk Management Program of each futures commission merchant shall be reviewed and tested on at least an annual basis, or upon any material change in the business of the futures commission merchant that is reasonably likely to alter the risk profile of the futures commission merchant.

(2) The annual reviews of the Risk Management Program shall include an analysis of adherence to, and the effectiveness of, the risk management policies and procedures, and any recommendations for modifications to the Risk Management Program. The annual testing shall be performed by qualified internal audit staff that are independent of the business unit, or by a qualified third party audit service reporting to staff that are independent of the business unit. The results of the annual review of the Risk Management Program shall be promptly reported to and reviewed by the chief compliance officer, senior management, and governing body of the futures commission merchant.

(3) Each futures commission merchant shall document all internal and external reviews and testing of its Risk Management Program and written risk management policies and procedures including the date of the review or test; the results; any deficiencies identified; the corrective action taken; and the date that corrective action was taken. Such documentation shall be provided to Commission staff, upon request.

(g) *Distribution of risk management policies and procedures.* The Risk Management Program shall include procedures for the timely distribution of its written risk management policies and procedures to relevant supervisory personnel. Each futures commission merchant shall maintain records of the persons to whom the risk management policies and procedures were distributed and when they were distributed.

(h) *Recordkeeping.* (1) Each futures commission merchant shall maintain copies of all written approvals required by this section.

(2) All records or reports, including, but not limited to, the written policies and procedures and any changes thereto that a futures commission merchant is required to maintain pursuant to this regulation shall be maintained in accordance with § 1.31 and shall be made available promptly upon request to representatives of the Commission.

[78 FR 68620, Nov. 14, 2013]

§ 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, or the minimum net capital requirements of the Securities and Exchange Commission if the applicant or registrant is registered with the Securities and Exchange Commission, must:

(1) Give notice, as set forth in paragraph (n) of this section that the applicant's or registrant's capital is below the applicable minimum requirement. Such notice must be given immediately after the applicant or registrant knows or should have known that its adjusted net capital or net capital, as applicable, is less than minimum required amount; and

(2) Provide together with such notice documentation, in such form as necessary, to adequately reflect the applicant's or registrant's capital condition as of any date on which such person's adjusted net capital is less than the minimum required; *Provided, however*, that if the applicant or registrant cannot calculate or otherwise immediately determine its financial condition, it must provide the notice required by paragraph (a)(1) of this section and include in such notice a statement that the entity cannot presently calculate its financial condition. The applicant or registrant must provide similar documentation of its financial condition for other days as the Commission may request.

(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 minimum dollar amount required by § 1.17(a)(1)(i)(A);

(2) 110 percent of the amount required by § 1.17(a)(1)(i)(B);

(3) 150 percent of the amount of adjusted net capital required by a registered futures association of which it is a member, unless such amount has been determined by a margin-based capital computation set forth in the rules of the registered futures association, and such amount meets or exceeds the amount of adjusted net capital required under the margin-based capital computation set forth in § 1.17(a)(1)(i)(B), in which case the required percentage is 110 percent;

(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)); or

(5) For security-based swap dealers or major security-based swap participants, the amount of net capital specified in Rule 18a-8(b) of the Securities and Exchange Commission (17 CFR 240.18a-8(b)), must file notice to that effect, as soon as possible and no later than twenty-four (24) hours of such event.

(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, provide notice of such fact as specified in paragraph (n) of this section, specifying the books and records which have not been made or which are not current, and as soon as possible, but not later than forty-eight (48) hours after giving such notice, file a report as required by paragraph (n) of this section 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 the existence of any material inadequacy, as specified

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in §1.16(d)(2), such applicant or registrant must give notice of such material inadequacy, as provided in paragraph (n) of this section, as soon as possible but not later than twenty-four (24) hours of discovering or being notified of the material inadequacy. The applicant or registrant must file, in the manner provided for under paragraph (n) of this section, a report stating what steps have been and are being taken to correct the material inadequacy within forty-eight (48) hours of filing its notice of the material inadequacy.

(e) Whenever any self-regulatory organization learns that a member registrant has failed to file a notice or report as required by this section, that self-regulatory organization must immediately report this failure by notice, as provided in paragraph (n) of this section.

(f)(1) [Reserved]

(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 immediately give notice, as provided in paragraph (n) of this section, of such a determination.

(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 immediately provide notice, as provided in paragraph (n) of this section, of such a determination to the designated self-regulatory organization and the Commission. 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, 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 its own account, all such accounts shall be combined.

(4) A futures commission merchant shall provide immediate notice, as provided in paragraph (n) of this section, 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, cleared swaps, 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 provide immediate notice, as provided in paragraph (n) of this section, 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 or dealer.

(ii) For purposes of paragraph (f)(5)(i) of this section, 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 notice, as provided in

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paragraph (n) of this section, 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 as provided in paragraph (n) of this section within two business days of the event or series of events causing the reduction stating the reason for the reduction and steps the futures commission merchant will be taking to ensure an appropriate level of net capital is maintained by the futures commission merchant; 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 a limited liability company member 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, limited liability company member, 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 as provided in paragraph (n) of this section 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 commis-

sion 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, or upon a reasonable belief that a substantial reduction in capital has occurred or will occur, the Director of the Division of Swap Dealer 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 trading on designated contract markets, or the amount of funds on deposit in segregated accounts for customers transacting in Cleared Swaps under part 22 of this chapter, or the total amount set aside on behalf of customers trading on non-United States markets under part 30 of this chapter, is less than the total amount of such funds required by the Act and the regulations to be on deposit in segregated or secured amount accounts on behalf of such customers, the registrant must report such deficiency immediately by notice to the registrant's designated self-regulatory organization and the Commission, as provided in paragraph (n) of this section.

(i) A futures commission merchant must provide immediate notice, as set forth in paragraph (n) of this section, whenever it discovers or is informed that it has invested funds held for futures customers trading on designated contract markets pursuant to § 1.20, Cleared Swaps Customer Collateral, as

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defined in § 22.1 of this chapter, or 30.7 customer funds, as defined in § 30.1 of this chapter, in instruments that are not permitted investments under § 1.25, or has otherwise violated the requirements governing the investment of funds belonging to customers under § 1.25.

(j) A futures commission merchant must provide immediate notice, as provided in paragraph (n) of this section, whenever the futures commission merchant does not hold a sufficient amount of funds in segregated accounts for futures customers under § 1.20, in segregated accounts for Cleared Swaps Customers under part 22 of this chapter, or in secured amount accounts for customers trading on foreign markets under part 30 of this chapter to meet the futures commission merchant's targeted residual interest in the segregated or secured amount accounts pursuant to its policies and procedures required under § 1.11, or whenever the futures commission merchant's amount of residual interest is less than the sum of the undermargined amounts in its customer accounts as determined at the point in time that the firm is required to maintain the undermargined amounts under § 1.22, and §§ 22.2 and 30.7 of this chapter.

(k) A futures commission merchant must provide immediate notice, as provided in paragraph (n) of this section, whenever the futures commission merchant, or the futures commission merchant's parent or material affiliate, experiences a material adverse impact to its creditworthiness or ability to fund its obligations, including any change that could adversely impact the firm's liquidity resources.

(l) A futures commission merchant must provide prompt notice, but in no event later than 24 hours, as provided in paragraph (n) of this section, whenever the futures commission merchant experiences a material change in its operations or risk profile, including a change in the senior management of the futures commission merchant, the establishment or termination of a line of business, or a material adverse change in the futures commission merchant's clearing arrangements.

(m) A futures commission merchant must provide notice, if the futures

commission merchant has been notified by the Securities and Exchange Commission, a securities self-regulatory organization, or a futures self-regulatory organization, that it is the subject of a formal investigation. A futures commission merchant must provide a copy of any examination report issued to the futures commission merchant by the Securities and Exchange Commission or a securities self-regulatory organization. A futures commission merchant must provide the Commission with notice of any correspondence received from the Securities and Exchange Commission or a securities self-regulatory organization that raises issues with the adequacy of the futures commission merchant's capital position, liquidity to meet its obligations or otherwise operate its business, or internal controls. The notices and examination reports required by this section must be filed in a prompt manner, but in no event later than 24 hours of the reportable event, and must be filed in accordance with paragraph (n) of the section; *Provided, however*, that a futures commission merchant is not required to file a notice or copy of an examination report with the Securities and Exchange Commission, a securities self-regulatory organization, or a futures self-regulatory organization if such entity originally provided the communication or report to the futures commission merchant.

(n) *Notice.* (1) Every notice and report required to be filed by this section by a futures commission merchant or a self-regulatory organization must be filed with the Commission, with the designated self-regulatory organization, if any, and with the Securities and Exchange Commission, if such registrant is a securities broker or dealer. Every notice and report required to be filed by this section by an applicant for registration as a futures commission merchant must be filed with the National Futures Association (on behalf of the Commission), with the designated self-regulatory organization, if any, and with the Securities and Exchange Commission, if such applicant is a securities broker or dealer. Every notice or report that is required to be filed by this section by a futures commission

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merchant or a self-regulatory organization must include a discussion of how the reporting event originated and what steps have been, or are being taken, to address the reporting event.

(2) Every notice and report which an introducing broker or applicant for registration as an introducing broker is required to 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. Every notice or report that is required to be filed by this section by an introducing broker or applicant for registration as an introducing broker must include a discussion of how the reporting event originated and what steps have been, or are being taken, to address the reporting event.

(3) Every notice or report that is required to be filed by a futures commission merchant with the Commission or with a designated self-regulatory organization under this section must be in writing and must be filed via electronic transmission using a form of user authentication assigned in accordance with procedures established by or approved by the Commission, and otherwise in accordance with instructions issued by or approved by the Commission; *Provided, however*, that if the registered futures commission merchant cannot file the notice or report using the electronic transmission approved by the Commission due to a transmission or systems failure, the futures commission merchant must immediately contact the Commission's regional office with jurisdiction over the futures commission merchant as provided in §140.02 of this chapter, and by email to FCMNotice@CFTC.gov. Any such electronic submission must clearly indicate the futures commission merchant on whose behalf such filing is made and the use of such user authen-

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tication in submitting such filing will constitute and become a substitute for the manual signature of the authorized signer.

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

[43 FR 39969, Sept. 8, 1978]

EDITORIAL NOTE: For FEDERAL REGISTER citations affecting §1.12, see the List of CFR Sections Affected, which appears in the Finding Aids section of the printed volume and at www.govinfo.gov.

§ 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

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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 Mate-

rial 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 ac-

cordance 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

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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

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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)(1)(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)(1)(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

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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 (2) of this section must be filed via electronic transmission using a form of user authentication assigned in accordance with procedures established by or approved by the Commission, and otherwise in accordance with instructions issued by or approved by the Commission. Any such electronic submission must clearly indicate the registrant on whose behalf such filing is made and the use of such user authentication in submitting such filing will constitute and become a substitute for the manual signature of the authorized signer.

(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; pro-

vided, 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

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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

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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, as amended at 78 FR 68625, Nov. 14, 2013]

§ 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, and 30.7 customer, as defined in §30.1 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; *Provided, however,* that a certified public accountant engaged to conduct an examination of a futures commission merchant must be registered with the Public Company Accounting Oversight Board and must have undergone an examination by the Public Company Accounting Oversight Board, and may not be subject to a permanent or temporary bar to engage in the examination of public issuers or brokers or dealers registered with the Securities and Exchange Commission as a result of a Public Company Accounting Oversight Board disciplinary hearing.

(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.

(4) The governing body of each futures commission merchant must ensure that the certified public accountant engaged is duly qualified to perform an audit of the futures commission merchant. Such an evaluation of the qualifications of the certified public accountant should include, among other issues, the certified public accountant’s experience in auditing futures commission merchants, the depth of the certified public accountant’s staff, the certified public accountant’s knowledge of the Act and Regulations, the size and geographic location of the futures commission merchant, and the independence of the certified public accountant. The governing body should

also review and consider the inspection reports issued by the Public Company Accounting Oversight Board as part of the assessment of the qualifications of the public accountant to perform an audit of the futures commission merchant.

(c) *Accountant's reports*—(1) *Technical requirements.* The accountant's report must:

- (i) Be dated;
- (ii) Indicate the city and State where issued; and
- (iii) Identify without detailed enumeration the financial statements covered by the report.

(2) *Representations as to the audit.* The accountant's report must state whether the audit was made in accordance with the auditing standards adopted by the Public Company Accounting Oversight Board, and 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 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 account-

ant 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, Part IIA, or Part II CSE, 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(a)(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(a)(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 state-

ments 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 an 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

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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)(1) *Extension of time for filing audited reports.* In the event a registered futures commission merchant or a registered introducing broker finds that it cannot file, without substantial undue hardship, its certified financial statements and schedules for any year within the time specified in § 1.10 (b)(1)(ii) or § 1.10 (b)(2)(ii) of this part, as applicable, such registrants may request approval for an extension of time, as follows:

(i) *Futures commission merchant registrants.* (A) A futures commission merchant may file with its designated self-regulatory organization an application for an extension of time, a copy of which the registrant must file with the Commission. The application shall be approved or denied in writing by the designated self-regulatory organization. The registrant must file immediately with the Commission a copy of any notice it receives from the designated self-regulatory organization to approve or deny the registrant's request for extension of time. A written notice of approval shall become effective upon the filing by the registrant of a copy with the Commission, and a written notice of denial shall be effective as of the date of the notice.

(B) A futures commission merchant that is registered with the Securities and Exchange Commission as a securities broker or dealer may file with its designated self-regulatory organization a copy of any application that the registrant has filed with its designated examining authority, pursuant to § 240.17a-5(m) of this title, for an extension of time to file annual reports. The registrant must also promptly file with the designated self-regulatory organization and the Commission copies of any notice it receives from its designated examining authority to approve or deny the requested extension of time. Upon receipt by the designated self-regulatory organization and the Commission of copies of any such notice of approval, the requested exten-

sion of time referenced in the notice shall be deemed approved under this paragraph (f)(1)(i).

(C) Any copy that under this paragraph is required to be filed with the Commission must be filed via electronic transmission using a form of user authentication assigned in accordance with procedures established by or approved by the Commission, and otherwise in accordance with instructions issued by or approved by the Commission. Any such electronic submission must clearly indicate the registrant on whose behalf such filing is made and the use of such user authentication in submitting such filing will constitute and become a substitute for the manual signature of the authorized signer.

(ii) *Introducing broker registrants.* (A) An introducing broker may file with the National Futures Association an application for extension of time, which shall be approved or denied in writing.

(B) An introducing broker that is registered with the Securities and Exchange Commission as a securities broker or dealer may file with the National Futures Association copies of any application that the registrant has filed with its designated examining authority, pursuant to § 240.17a-5(m) of this title, for an extension of time to file annual reports. The registrant must also file promptly with the National Futures Association copies of any notice it receives from its designated examining authority to approve or deny the requested extension of time. Upon the receipt by the National Futures Association of a copy of any such notice of approval, the requested extension of time referenced in the notice shall be deemed approved under this paragraph (f)(1)(ii).

(2) *Exemption requests.* 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

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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.

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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) \$1,000,000, *Provided, however*, that if the futures commission merchant also is a swap dealer, the minimum amount shall be \$20,000,000;

(B) The futures commission merchant's risk-based capital requirement, computed as the sum of:

(I) Eight percent of the total risk margin requirement (as defined in § 1.17(b)(8) of this section) for positions carried by the futures commission mer-

chant in customer accounts and non-customer accounts; and

(2) For a futures commission merchant that is also a registered swap dealer, two percent of the total uncleared swap margin, as that term is defined in paragraph (b)(11) of this section.

(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) A futures commission merchant that is registered as a swap dealer and has received approval to use internal models to compute market risk and credit risk charges for uncleared swaps must maintain net capital equal to or in excess of \$100 million and adjusted net capital equal to or in excess of \$20 million.

(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) \$45,000;

(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)(iii) 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 operation 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, or who cannot certify to the Commission immediately upon request and demonstrate with verifiable evidence that it has sufficient access to liquidity to continue operating as a going concern, 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 shall be construed as preventing the Com-

mission 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*. This term means a futures customer as defined in §1.3, a cleared over the counter customer as defined in paragraph (b)(10) of this section, and a 30.7 customer as defined in §30.1 of this chapter.

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(3) *Proprietary account* means an account in which commodity futures, options or cleared over the counter derivative positions are 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 an account in which commodity futures, options or cleared over the counter derivative positions are carried on the books of the applicant or registrant which is either:

(i) An account that is not included in the definition of customer (as defined in § 1.17(b)(2)) or proprietary account (as defined in § 1.17(b)(3)), or

(ii) An account for a foreign-domiciled person trading futures or options on a foreign board of trade, and such account is a proprietary account as defined in § 1.3 of this title, but is not a proprietary account as defined in § 1.17(b)(3).

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

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

(7) *Customer account*. This term means an account in which commodity futures, options or cleared over the counter derivative positions are carried on the books of the applicant or registrant which is an account that is included in the definition of customer as defined in § 1.17(b)(2).

(8) *Risk margin* for an account means the level of maintenance margin or performance bond required for the customer or noncustomer positions by the applicable exchanges or clearing organizations, and, where margin or performance bond is required only for accounts at the clearing organization, for purposes of the FCM's risk-based capital calculations applying the same margin or performance bond requirements to customer and noncustomer positions in accounts carried by the FCM, subject to the following:

(i) Risk margin does not include the equity component of short or long option positions maintained in an account;

(ii) The maintenance margin or performance bond requirement associated

with a long option position may be excluded from risk margin to the extent that the value of such long option position does not reduce the total risk maintenance or performance bond requirement of the account that holds the long option position;

(iii) The risk margin for an account carried by a futures commission merchant which is not a member of the exchange or the clearing organization that requires collection of such margin should be calculated as if the futures commission merchant were such a member; and

(iv) If a futures commission merchant does not possess sufficient information to determine what portion of an account's total margin requirement represents risk margin, all of the margin required by the exchange or the clearing organization that requires collection of such margin for that account, shall be treated as risk margin.

(9) *Cleared over the counter derivative positions* means a swap cleared by a derivatives clearing organization or a clearing organization exempted by the Commission from registering as a derivatives clearing organization, and further includes positions cleared by any organization permitted to clear such positions under the laws of the relevant jurisdiction.

(10) *Cleared over the counter customer* means any person for whom the futures commission merchant carries on its books one or more accounts for the cleared over the counter derivative positions of such person, and such account or accounts are not proprietary accounts as defined in § 1.3 of this part.

(11) *Uncleared swap margin*: This term means the amount of initial margin, computed in accordance with § 23.154 of this chapter, that a dually-registered futures commission merchant and swap dealer would be required to collect from each counterparty for each outstanding swap position of the dually-registered futures commission merchant and swap dealer. A dually-registered futures commission merchant and swap dealer must include all swap positions in the calculation of the uncleared swap margin amount, including swaps that are exempt or excluded from the scope of the Commission's margin regulations for uncleared swaps

pursuant to § 23.150 of this chapter, exempt foreign exchange swaps or foreign exchange forwards, or netting set of swaps or foreign exchange swaps, for each counterparty, as if the counterparty was an unaffiliated swap dealer. Furthermore, in computing the uncleared swap margin amount, a dually-registered futures commission merchant and swap dealer may not exclude the *initial margin threshold amount* or the *minimum transfer amount* as such terms are defined in § 23.151 of this chapter.

(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, uncleared swaps, uncleared security-based swaps, 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 commodity 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 commodity 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 commodity 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, options, cleared swaps, or other Commission regulated 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’, noncustomers’, 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)(1) 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 that are not outstanding more than thirty (30) days from the date they are due;

(2) Dividends receivable that are not outstanding more than thirty (30) days from the payable date; and

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(3) Commissions or fees receivable, including from other brokers or dealers, resulting from swap transactions that are not outstanding more than sixty (60) days from the month end accrual date provided they are billed promptly after the close of the month of their inception;

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

(D) Receivables from registered futures commission merchants or brokers, resulting from commodity futures, options, cleared swaps, foreign futures or foreign options 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 opinion 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;

(G) Receivables from third-party custodians that maintain the futures commission merchant's initial margin

deposits associated with uncleared swap and security-based swap transactions pursuant to the margin rules of the Commission, the Securities and Exchange Commission, a prudential regulator, as defined in section 1a(39) of the Act, or a foreign jurisdiction that has received a Comparability Determination under §23.160 of this chapter.

(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 guarantee 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 subordinated 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

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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, 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 commodity—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) Inventory and forward contracts in those foreign currencies that are purchased or sold for future delivery on or subject to the rules of a contract market, and which are covered by an open futures contract.—No charge

(E) Inventory and forward contracts in euros, British pounds, Canadian dollars, Japanese yen, or Swiss francs, and which are not covered by an open futures contract or commodity option.—6 percent of the market value.

(F) 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.

(G) 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) Swaps:

(A) *Uncleared swaps that are credit-default swaps referencing broad-based securities indices.*(1) *Short positions (selling protection).* In the case of an uncleared short credit default swap that references a broad-based securities index, deducting the percentage of the notional amount based upon the current basis point spread of the credit default swap and the maturity of the credit default swap in accordance with the following table:

TABLE TO § 1.17(C)(5)(III)(A)(1)—MARKET RISK CHARGES FOR UNCLEARED CREDIT DEFAULT SWAPS

Length of time to maturity of CDS contract	Basis point spread (%)					
	100 or less	101–300	301–400	401–500	501–699	700 or more
Less than 12 months	0.67	1.33	3.33	5.00	6.67	10.00
12 months but less than 24 months	1.00	2.33	5.00	6.67	8.33	11.67
24 months but less than 36 months	1.33	3.33	6.67	8.33	10.00	13.33
36 months but less than 48 months	2.00	4.00	8.33	10.00	11.67	15.00
48 months but less than 60 months	2.67	4.67	10.00	11.67	13.33	16.67
60 months but less than 72 months	3.67	5.67	11.67	13.33	15.00	18.33
72 months but less than 84 months	4.67	6.67	13.33	15.00	16.67	20.00
84 months but less than 120 months	5.67	10.00	15.00	16.67	18.33	26.67
120 months and longer	6.67	13.33	16.67	18.33	20.00	33.33

(2) *Long positions (purchasing protection).* In the case of an uncleared swap that is a long credit default swap referencing a broad-based security index, deducting 50 percent of the deduction that would be required by paragraph (c)(5)(iii)(A)(1) of this section if the swap was a short credit default swap, each such deduction not to exceed the current market value of the long position.

(3) *Long and short positions.* (i) *Long and short uncleared credit default swaps referencing the same broad-based security index.* In the case of uncleared swaps that are long and short credit default swaps referencing the same broad-based security index, have the same credit events which would trigger payment by the seller of protection, have the same basket of obligations which would determine the amount of payment by the seller of protection upon the occurrence of a credit event, that are in the same or adjacent spread category and have a maturity date within three months of the other maturity category, deducting the percentage of the notional amounts specified in the higher maturity category under paragraph (c)(5)(iii)(A)(1) or (c)(5)(iii)(A)(2) of this section on the excess of the long or short position.

(ii) *Long basket of obligors and uncleared long credit default swap referencing a broad-based securities index.* In the case of an uncleared swap that is a long credit default swap referencing a broad-based security index and the futures commission merchant is long a basket of debt securities comprising all of the components of the security index, deducting 50 percent of the amount specified in § 240.15c3-1(c)(2)(vi) of this title for the component of securities, provided the futures commission merchant can deliver the component securities to satisfy the obligation of the futures commission merchant on the credit default swap.

(iii) *Short basket of obligors and uncleared short credit default swap referencing a broad-based securities index.* In the case of an uncleared swap that is a short credit default swap referencing a broad-based security index and the futures commission merchant is short a basket of debt securities comprising all of the components of the security

index, deducting the amount specified in § 240.15c3-1(c)(2)(vi) of this title for the component securities.

(B) *Interest rate swaps.* In the case of an uncleared interest rate swap, deducting the percentage deduction specified in § 240.15c3-1(c)(2)(vi)(A) of this title based on the maturity of the interest rate swap, provided that the percentage deduction must be no less than one eighth of 1 percent of the amount of a long position that is netted against a short position in the case of an uncleared interest rate swap with a maturity of three months or more;

(C) *All other uncleared swaps.* (1) In the case of any uncleared swap that is not a credit default swap or interest rate swap, deducting the amount calculated by multiplying the notional value of the uncleared swap by:

(i) The percentage specified in § 240.15c3-1 of this title applicable to the reference asset if § 240.15c3-1 of this title specifies a percentage deduction for the type of asset and this section does not specify a percentage deduction;

(ii) Six percent in the case of a currency swap that references euros, British pounds, Canadian dollars, Japanese yen, or Swiss francs, and twenty percent in the case of currency swaps that reference any other foreign currencies; or

(iii) In the case of over-the-counter swap transactions involving commodities, 20 percent of the market value of the amount of the underlying commodities.

(D) *Netting of Swap Market Risk Charges.* The deductions under paragraphs (c)(5)(iii)(B) and (C) of this section may be reduced by an amount equal to any reduction recognized for a comparable long or short position in the reference asset or interest rate under this section or in § 240.15c3-1 of this title.

(iv) *Security-based Swaps:* In the case of security-based swaps as defined in section 3(a) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)), the percentage as specified in § 240.15c3-1 of this title.

(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 that invests funds deposited by futures customers as defined in § 1.3, Cleared Swaps Customers as defined in § 22.1 of this chapter, and 30.7 customers as defined in § 30.1 of this chapter in securities as permitted investments under § 1.25, the deductions specified in Rule 240.15c3-1(c)(2)(vi) or Rule 240.15c3-1(c)(2)(vii) of the Securities and Exchange Commission (17 CFR 240.15c3-1(c)(2)(vi) and 17 CFR 240.15c3-1(c)(2)(vii)) (“securities haircuts”). Futures commission merchants that establish and enforce written policies and procedures to assess the credit risk of commercial paper, convertible debt instruments, or nonconvertible debt instruments in accordance with Rule 240.15c3-1(c)(2)(vi) of the Securities and Exchange Commission (17 CFR 240.15c3-1(c)(2)(vi)) may apply the lower haircut percentages specified in Rule 240.15c3-1(c)(2)(vi) for such commercial paper, convertible debt instruments and nonconvertible debt instruments. Futures commission merchants must maintain their written policies and procedures in accordance with § 1.31;

(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 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 no more than one business day. If there are no such maintenance margin requirements or clearing organization margin requirements, then the amount of funds re-

quired to provide margin equal to the amount necessary, after application of calls for margin or other required deposits outstanding no more than one business day, 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. 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 paragraph (c)(5) of this section;

(ix) In the case of a futures commission merchant, for undermargined non-customer 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 no more than one business day. 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 no more than one business day 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. In the event that an owner of a non-customer 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 paragraph shall be the

lesser of the value attributable to such asset pursuant to the margin rules of the applicable board of trade, or the market value of such asset after application of the percentage deductions specified in paragraph (c)(5) of this section;

(x) In the case of open futures contracts, cleared swaps, 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 commodity 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 options 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 the foreign futures or foreign options secured amount, as §1.3 defines such term, 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;

(xv) In the case of a futures commission merchant that is also a registered swap dealer, the amount of funds required from each swap counterparty and security-based swap counterparty to meet initial margin requirements of the Commission or Securities and Exchange Commission, as applicable, after application of calls for margin or other required deposits which are outstanding within the required time frame to collect margin or other required deposits;

(xvi) In the case of a futures commission merchant that is also a registered swap dealer, the amount of initial margin calculated pursuant to §23.154 of

this chapter for the account of a swap counterparty that is subject to a margin exception or exemption under § 23.150 of this chapter, less any margin posted on such account, and the amount of initial margin calculated pursuant to § 240.18a-3(c)(1)(i)(B) of this title for the account of a security-based swap counterparty that is subject to a margin exception or exemption under the rules of the Securities and Exchange Commission, less any margin posted on such account.

(6)(i) *Election of alternative capital deductions that have received approval of Securities and Exchange Commission pursuant to § 240.15c3-1(a)(7) of this title.* Any futures commission merchant that is also registered with the Securities and Exchange Commission as a securities broker or dealer, and who also satisfies the other requirements of this paragraph (c)(6), may elect to compute its adjusted net capital using the alternative capital deductions that, under § 240.15c3-1(a)(7) of this title, the Securities and Exchange Commission has approved by written order in lieu of the deductions that would otherwise be required under this section.

(ii) *Notifications of election or of changes to election.* (A) No election to use the alternative market risk and credit risk deductions referenced in paragraph (c)(6)(i) of this section shall be effective unless and until the futures commission merchant has filed with the Commission, addressed to the Director of the Division of Swap Dealer and Intermediary Oversight, a notice that is to include a copy of the approval order of the Securities and Exchange Commission referenced in paragraph (c)(6)(i) of this section, and to include also a statement that identifies the amount of tentative net capital below which the futures commission merchant is required to provide notice to the Securities and Exchange Commission, and which also provides the following information: a list of the categories of positions that the futures commission merchant holds in its proprietary accounts, and, for each such category, a description of the methods that the futures commission merchant will use to calculate its deductions for market risk and credit risk, and also, if calculated separately, deductions for

specific risk; a description of the value at risk (VaR) models to be used for its market risk and credit risk deductions, and an overview of the integration of the models into the internal risk management control system of the futures commission merchant; a description of how the futures commission merchant will calculate current exposure and maximum potential exposure for its deductions for credit risk; a description of how the futures commission merchant will determine internal credit ratings of counterparties and internal credit risk weights of counterparties, if applicable; and a description of the estimated effect of the alternative market risk and credit risk deductions on the amounts reported by the futures commission merchant as net capital and adjusted net capital.

(B) A futures commission merchant must also, upon the request of the Commission at any time, supplement the statement described in paragraph (c)(6)(ii)(A) of this section, by providing any other explanatory information regarding the computation of its alternative market risk and credit risk deductions as the Commission may require at its discretion.

(C) A futures commission merchant must also file the following supplemental notices with the Director of the Division and Clearing and Intermediary Oversight:

(1) A notice advising that the Securities and Exchange Commission has imposed additional or revised conditions for the approval evidenced by the order referenced in paragraph (c)(6)(i) of this section, and which describes the new or revised conditions in full, and

(2) A notice which attaches a copy of any approval by the Securities and Exchange Commission of amendments that a futures commission merchant has requested for its application, filed under 17 CFR 240.15c3-1e, to use alternative market risk and credit risk deductions approved by the Securities and Exchange Commission.

(D) A futures commission merchant may voluntarily change its election to use the alternative market risk and credit risk deductions referenced in paragraph (c)(6)(i) of this section, by filing with the Director of the Division

of Swap Dealer and Intermediary Oversight a written notice specifying a future date as of which it will no longer use the alternative market risk and credit risk deductions, and will instead compute such deductions in accordance with the requirements otherwise applicable under paragraph (c)(2)(ii) of this section for unsecured receivables from over-the-counter derivatives transactions; by paragraph (c)(5)(ii) of this section for proprietary positions in forward contracts; by paragraph (c)(5)(v) of this section for proprietary positions in securities; and by paragraph (c)(5)(x) of this section for proprietary positions in futures contracts.

(iii) *Conditions under which election terminated.* A futures commission merchant may no longer elect to use the alternative market risk and credit risk deductions referenced in paragraph (c)(6)(i) of this section, and shall instead compute the deductions otherwise required under paragraph (c)(2)(ii) of this section for unsecured receivables from over-the-counter derivatives transactions; by paragraph (c)(5)(ii) of this section for proprietary positions in forward contracts; by paragraph (c)(5)(v) of this section for proprietary positions in securities; and by paragraph (c)(5)(x) of this section for proprietary positions in futures contracts, upon the occurrence of any of the following:

(A) The Securities and Exchange Commission revokes its approval of the market risk and credit risk deductions for such futures commission merchant;

(B) A futures commission merchant fails to come into compliance with its filing requirements under this paragraph (c)(6), after having received from the Director of the Division of Swap Dealer and Intermediary Oversight written notification that the firm is not in compliance with its filing requirements, and must cease using alternative capital deductions permitted under this paragraph (c)(6) if it has not come into compliance by a date specified in the notice; or

(C) The Commission by written order finds that permitting the futures commission merchant to continue to use such alternative market risk and credit risk deductions is no longer necessary or appropriate for the protec-

tion of customers of the futures commission merchant or of the integrity of the futures or options markets.

(iv) *Additional filing requirements.* Any futures commission merchant that elects to use the alternative market risk and credit risk deductions referenced in paragraph (c)(6)(i) of this section must file with the Commission, in addition to the filings required by paragraph (c)(6)(ii) of this section, copies of any and all of the following documents, at such time as the originals are filed with the Securities and Exchange Commission:

(A) Information that the futures commission merchant files on a monthly basis with its designated examining authority or the Securities and Exchange Commission, whether by way of schedules to its FOCUS reports or by other filings, in satisfaction of § 240.17a-5(a)(5) of this title;

(B) The quarterly reports required by 17 CFR 240.17a-5(a)(5)(ii);

(C) The supplemental annual filings as required by 17 CFR 240.17a-5(k);

(D) Any notification to the Securities and Exchange Commission or the futures commission merchant's designated examining authority of planned withdrawals of excess net capital; and

(E) Any notification that the futures commission merchant is required to file with the Securities and Exchange Commission when its tentative net capital is below an amount specified by the Securities and Exchange Commission.

(v) *Election of alternative market risk and credit risk capital deductions for a futures commission merchant that is registered as a swap dealer and has received approval of the Commission or a registered futures association for which the futures commission merchant is a member.* For purposes of this paragraph (c)(6)(v) only, all references to futures commission merchant means a futures commission merchant that is also registered as a swap dealer.

(A) A futures commission merchant may apply in writing to the Commission or a registered futures association of which it is a member for approval to compute deductions for market risk and credit risk using internal models in lieu of the standardized deductions

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otherwise required under this section; *Provided however*, that the Commission must issue a determination that the registered futures association's model requirements and review process are comparable to the Commission's requirements and review process in order for the registered futures association's model approval to be accepted as an alternative means of compliance with this section. The futures commission merchant must file the application in accordance with instructions approved by the Commission and specified on the website of the registered futures association.

(B) A futures commission merchant's application must include the information set forth in Appendix A to Subpart E of Part 23 and the market risk and credit risk charges must be computed in accordance with § 23.102 of this chapter.

(C) The Commission or registered futures association upon obtaining the Commission's determination that its requirements and model approval process are comparable to the Commission's requirements and process, may approve or deny the application, in whole or in part, or approve or deny an amendment to the application, in whole or in part, subject to any conditions or limitations the Commission or registered futures association may require, if the Commission or registered futures association finds the approval to be appropriate in the public interest, after determining, among other things, whether the applicant has met the requirements of § 23.102 of this chapter.

(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 or limited liability company member 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

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the sole proprietorship and unrealized profit and loss.

(D) In the case of a limited liability company, the sum of its capital accounts of limited liability company members, 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 limited liability company member 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, limited liability company member, 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)(iii)(A) of this section;

(ii) For a futures commission merchant or applicant therefor, 120 percent of the amount required by paragraph (a)(1)(i)(B) of this section;

(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

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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)(1) The Commission may by order restrict, for a period of up to twenty business days, any withdrawal by a futures commission merchant of equity capital, or any unsecured advance or loan to a stockholder, partner, limited liability company member, sole proprietor, employee or affiliate if the Commission, based on the facts and information available, concludes that any such withdrawal, advance or loan may be detrimental to the financial integrity of the futures commission merchant, or may unduly jeopardize its ability to meet customer obligations or other liabilities that may cause a significant impact on the markets.

(2) The futures commission merchant may file with the Secretary of the Commission a written petition to request rescission of the order issued under paragraph (g)(1) of this section.

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The petition filed by the futures commission merchant must specify the facts and circumstances supporting its request for rescission. The Commission shall respond in writing to deny the futures commission merchant's petition for rescission, or, if the Commission determines that the order issued under paragraph (g)(1) of this section should not remain in effect, the order shall be rescinded.

(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-regulatory 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 of 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 thereto, 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 amount of such payment (or in the case of an applicant 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)(iii)(A) of this section;

(2) For a futures commission merchant or applicant therefor, 120 percent of the amount required by paragraph (a)(1)(i)(B) of this section;

(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)(iii)(A) of this section;

(2) For a futures commission merchant or applicant therefor, 120 percent of the amount required by paragraph (a)(1)(i)(B) of this section;

(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)(iii)(A) of this section;

(2) For a futures commission merchant or applicant therefor, 125 percent of the amount required by paragraph (a)(1)(i)(B) of this section;

(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)(iii)(A) of this section;

(2) For a futures commission merchant or applicant therefor, 120 percent of the amount required by paragraph (a)(1)(i)(B) of this section;

(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

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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 Commis-

sion, 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 appropriate minimum dollar amount required by paragraphs (a)(1)(i)(A) or (a)(1)(iii)(A) of this section;

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(B) For a futures commission merchant or applicant therefor, 120 percent of the amount required by paragraph (a)(1)(i)(B) of this section;

(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)(iii)(A) of this section;

(B) For a futures commission merchant or applicant therefor, 120 percent of the amount required by paragraph (a)(1)(i)(B) of this section;

(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 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

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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 require-

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ments 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 that incorporate adjusted net capital requirements in effect prior to September 30, 2004.* Any subordination agreement that incorporates the adjusted net capital requirements in paragraphs (h)(2)(vi)(C)(2), (h)(2)(vii)(A)(2) and (B)(2), (h)(2)(viii)(A)(2), (h)(3)(ii)(B), and (h)(3)(v)(B) of this section, as in effect prior to September 30, 2004, and which has been deemed to be satisfactorily subordinated pursuant to this section prior to September 30, 2004, shall continue to be deemed a satisfactory subordination agreement until the maturity of such agreement. In the event, however, that such agreement is amended or renewed for any reason, then such agreement shall not be deemed a satisfactory subordination agreement unless the amended or renewed agreement meets the requirements 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 op-

tion 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 contract 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

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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 CFR Sections Affected, which appears in the Finding Aids section of the printed volume and at www.govinfo.gov.

§ 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, Part IIA, or Part II CSE (FOCUS report) in lieu of Form 1-FR-FCM or Form 1-FR-IB, the account classification subdivisions specified on such FOCUS report, or categories that are in accord with generally accepted accounting principles. Each person so registered shall prepare and keep current such records.

(b)(1) 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

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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. 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.

(2) An applicant or registrant that has filed a monthly Form 1-FR or Statement of Financial and Operational Combined Uniform Single Report under the Securities Exchange Act of 1934, Part II, Part IIA, or Part II CSE (FOCUS report) in accordance with the requirements of § 1.10(b) will be deemed to have satisfied the requirements of paragraph (b)(1) of this section for such month.

(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; 69 FR 49800, Aug. 12, 2004; 71 FR 5594, Feb. 2, 2006]

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