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LEGAL ALERT

CFTC ANNOUNCES PUBLICATION OF FINAL RETAIL FX REGULATIONS

On August 30, the U.S. Commodity Futures Trading Commission (“CFTC”) announced the publication of final regulations for off-exchange retail foreign currency transactions (“Retail FX”).¹ This final rule release was expected in the wake of passage of the Dodd-Frank Wall Street Reform and Consumer Protection Act in July, which mandated final Retail FX regulations within ninety days of passage. The final Retail FX regulations become effective on October 18, 2010.

Proposed Retail FX regulations implementing the comprehensive Retail FX regulatory provisions of the CFTC Reauthorization Act of 2008 (“CRA”) were first published by the CFTC in January of this year.² The CRA fundamentally altered the Commodity Exchange Act (“CEA”) to delineate Retail FX as a separate, explicit category of regulated product under the jurisdiction of the CFTC. Among other changes, the CRA created a new registration category specifically for Retail FX dealers called Retail Foreign Exchange Dealers (“RFEDs”), and amended the CEA to specifically apply to Retail FX participants acting within current registration categories such as Introducing Brokers (“IBs”), Commodity Trading Advisors (“CTAs”), and Commodity Pool Operators (“CPOs”). In addition, the CRA created a new Part 5 to the CEA encompassing rules and requirements specifically applicable to Retail FX.

Major Change on Leverage Proposal

In the immediate aftermath of the initial proposal, there was vociferous public opposition to the most restrictive provisions of the proposed regulations, especially the 10 to 1 leverage limitation contained in proposed Regulation 5.9. The CFTC reportedly received some 9,000 comments on the proposal, a large portion voicing criticism of the leverage restriction. Somewhat surprisingly, the final Retail FX regulations wholly abandoned the proposed 10 to 1 standard in favor of a more liberal and flexible scheme. In the summary accompanying the final regulations, the CFTC acknowledged that its initial proposal was “conservative” and that a more measured rule anchored in and adaptable to market conditions was a more appropriate framework. The new rule will require a minimum 2% security deposit for major currencies (a 50 to 1 leverage limitation) and a minimum 5% security deposit for all other currencies (a 20 to 1 leverage limitation). The rule also requires periodic review of the leverage restrictions and authorizes

¹ The Federal Register publication of the final rules is available online at:

www.cftc.gov/ucm/groups/public/@newsroom/documents/file/federalregister083010.pdf

² Our Legal Alert on the January Proposal is available online at: www.dlkny.com/CFTCForexRegs011410.pdf

the National Futures Association to further delineate minimum security deposit requirements within those broad categories.³

Independent IBs Survive

In another substantial and surprising deviation from the proposed regulations, the CFTC scrapped a portion of proposed Regulation 5.18(h) that would have required all Retail FX IBs to enter into guarantee agreements with the RFED with which they are doing business. In response to comments from industry participants objecting to this proposal, the CFTC opted to retain the IB regulatory framework now in effect for registered IBs. Retail FX IBs may continue to either act ‘independently’ by meeting a minimum capital requirement or act as guaranteed IBs by entering into an effective guarantee agreement with an RFED.

RFED Capital Requirement

The final net capital rules for RFEDs were adopted in whole as originally published in the proposal, which itself largely tracked NFA Financial Requirements for forex dealer members.⁴ New Regulation 5.7 requires RFEDs (and FCM’s engaging in Retail FX) to maintain adjusted net capital equal to the greater of: (i) \$20 million; (ii) \$20 million plus 5% of aggregate “retail forex obligation” exceeding \$10 million; or (iii) the amount required by a registered futures association.⁵ Despite industry opposition, the CFTC refused to include an exemption from the additional capital requirement equivalent to the current NFA Financial Requirement Section 11 exemption from additional net capital available to members utilizing “straight-through processing” platforms for all Retail FX customers. Regulation 5.7 provides no exemption regardless of platform type or business model.

Disclosure of Aggregate Customer Performance

The final rules contain several new risk disclosure and reporting requirements for RFEDs. Of particular note, Regulation 5.5(e), adopted with only minor revisions, requires RFEDs to calculate and maintain records of profitable and non-profitable accounts for a five year period and to disclose to current and potential customers, for the most recent four calendar quarters: (i) the total number of non-discretionary Retail FX accounts held; (ii) the percentage of such accounts that were profitable; and (iii) the percentage that were not profitable.

Offset Requirement

One final rule of interest that was adopted as originally proposed is Regulation 1.46, which requires RFEDs to close out offsetting long and short positions in a Retail FX customer’s account. As previously reported in our January release, unlike the existing provisions for transactions in on-exchange futures and options

³ NFA is further delegated authority to determine what currencies constitute ‘major’ currencies for the purposes of the rule.

⁴ See *generally* NFA Financial Requirements Section 11

⁵ The “retail forex obligation” is defined as the net credit balance resulting from combining all money, securities and property deposited by Retail FX customers into their accounts, adjusted for realized and unrealized net profit or loss, and not including any accounts that contain net liquidating balances.

contracts, no exception from the offset requirement is afforded for either omnibus accounts or for customer's expressly requesting this treatment.

For Further Information

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