normal business hours will be deemed received on the next normal business day.

Classification

Executive Order 12866: This rule has been determined to be not significant for purposes of EO 12866.

Administrative Procedure Act: The Department finds under 5 U.S.C. 553(b)(B) that good cause exists to waive prior notice and opportunity for public comment. This final rule amends the Department's FOIA regulations to allow the public to file written appeals with the Office of General Counsel via fax or e-mail. By accepting fax and e-mail transmissions, the Department merely establishes additional means for the public to submit FOIA appeals to the Office of General Counsel. The right to and the requirements of filing such an appeal are unchanged by this rule. Because this amendment is not a substantive change to the regulations, it is unnecessary to provide prior notice and opportunity for public comment. Further, pursuant to 5 U.S.C. 553(b)(A), this rule of agency organization, procedure and practice is not subject to the requirement to provide prior notice and opportunity for public comment. The Department also finds that the 30-day delay in effectiveness required under 5 U.S.C. 553(d) is inapplicable because this rule is not a substantive rule. This final rule merely establishes additional means for the public to submit FOIA appeals to the Office of General Counsel. Because this amendment is not a substantive change to the regulations, the 30-day delay in effectiveness does not apply.

Regulatory Flexibility Act: Because notice and opportunity for comment are not required pursuant to 5 U.S.C. 553 or any other law, the analytical requirements of the Regulatory Flexibility Act (5 U.S.C. 601 *et seq.*) are inapplicable. Therefore, a regulatory flexibility analysis is not required and has not been prepared.

List of Subjects in 15 CFR Part 4

Administrative practice and procedure, Classified information.

■ For the reasons stated in the preamble, the Department of Commerce amends 15 CFR part 4 as set forth below:

PART 4—DISCLOSURE OF GOVERNMENT INFORMATION

■ 1. The authority citation for part 4 continues to read as follows:

Authority: 5 U.S.C. 301; 5 U.S.C. 552; 5 U.S.C. 552a; 5 U.S.C. 553; 31 U.S.C. 3717; 44 U.S.C. 3101; Reorganization Plan No. 5 of 1950.

■ 2. Amend § 4.10 by revising paragraphs (a) and (b) to read as follows:

§ 4.10 Appeals from initial determinations or untimely delays.

(a) If a request for records is initially denied in whole or in part, or has not been timely determined, or if a requester receives an adverse initial determination regarding any other matter under this subpart (as described in § 4.7(b)), the requester may file a written appeal or an electronic appeal, which must be received by the Office of General Counsel during normal business hours (8:30 a.m. to 5 p.m., Eastern Time, Monday through Friday) within thirty calendar days of the date of the written denial or, if there has been no determination, may be submitted anytime after the due date, including the last extension under § 4.6(c), of the determination. Written or electronic appeals arriving after normal business hours will be deemed received on the next normal business day.

(b) Appeals shall be decided by the Assistant General Counsel for Administration (AGC-Admin), except that appeals for records which were initially denied by the AGC-Admin shall be decided by the General Counsel. Written appeals should be addressed to the AGC-Admin, or the General Counsel if the records were initially denied by the AGC-Admin. The address of both is: U.S. Department of Commerce, Office of General Counsel, Room 5875, 14th and Constitution Avenue NW., Washington, DC 20230. An appeal may also be sent via facsimile at 202–482–2552. For a written appeal, both the letter and the appeal envelope should be clearly marked ''Freedom of Information Appeal''. The address for electronic appeals is *FOIAAppeals@doc.gov.* The appeal (written or electronic) must include a copy of the original request and the initial denial, if any, and a statement of the reasons why the records requested should be made available and why the initial denial, if any, was in error. No opportunity for personal appearance, oral argument or hearing on appeal is provided.

* * * * *

Dated: August 6, 2004.

Brenda Dolan,

Departmental Freedom of Information Officer.

[FR Doc. 04–18412 Filed 8–11–04; 8:45 am]

BILLING CODE 3510–17–P

COMMODITY FUTURES TRADING COMMISSION

17 CFR Part 1

RIN 3038 — AB64

Minimum Financial and Related Reporting Requirements for Futures Commission Merchants and Introducing Brokers

AGENCY: Commodity Futures Trading Commission.

ACTION: Final rule.

SUMMARY: The Commodity Futures Trading Commission (''Commission'') is amending several of its regulations relating to the minimum financial and related reporting requirements for futures commission merchants (''FCMs'') and introducing brokers (''IBs''). The amended regulations require an FCM, when calculating its minimum adjusted net capital requirement, to include a computation based on the risk maintenance margin levels of positions carried in customer and noncustomer accounts. The required calculation is identical to capital calculations that each FCM currently is required to perform pursuant to the rules of self-regulatory organizations, including one derivatives clearing organization. The Commission also is adopting conforming margin-based computations for purposes of the Commission's equity capital, subordination agreement and ''early warning'' requirements for FCMs. The margin-based computations required by the final rule replace computations in the Commission's regulations that had been based on the amount of funds held by an FCM to margin, guarantee, or secure futures and option positions carried on behalf of customers. Furthermore, the Commission is amending its regulations to reduce the time periods for FCMs and IBs to report events specified in the Commission's early warning requirements. Finally, the Commission also is adopting amendments to streamline the financial statement reporting requirements for FCMs and IBs.

DATES: *Effective Date:* September 30, 2004.

FOR FURTHER INFORMATION CONTACT: Thomas J. Smith, Associate Deputy Director and Chief Accountant, at (202) 418–5495, or Thelma Diaz, Special Counsel, at (202) 418–5137, Division of Clearing and Intermediary Oversight, Commodity Futures Trading Commission, Three Lafayette Centre, 1155 21st Street, NW., Washington, DC

20581. Electronic mail: (*tsmith@cftc.gov*) or (*tdiaz@cftc.gov*).

SUPPLEMENTARY INFORMATION:

I. Summary of Rule Amendments as Proposed by the Commission

Section 4f(b) of the Commodity Exchange Act (the ''Act'') authorizes the Commission, by regulation, to impose minimum financial and related reporting requirements on FCMs and IBs.[1] On July 9, 2003, the Commission issued a release proposing amendments to Commission Rules 1.10, 1.12, 1.16, 1.17, and 1.18, which set forth certain minimum financial and related reporting requirements for FCMs and IBs (the ''Proposing Release'').[2] The key element of the Proposing Release was a proposal to amend Rule 1.17(a) to require margin-based, also referred to as ''risk-based,'' capital computations for an FCM's calculation of its minimum adjusted net capital requirement. The Proposing Release also included conforming amendments to other paragraphs of Rule 1.17 that set forth capital computations that FCMs must perform for purposes related to their equity capital and subordination agreements, and to capital computations in Rule 1.12 that FCMs must make to comply with the Commission's ''early warning'' requirements. Other rule amendments in the Proposing Release proposed to shorten the time periods specified in Commission rules for FCMs and IBs to report certain financial events to the Commission, and to reduce the time periods before which an FCM is required to take a capital charge for outstanding margin calls on its customer and noncustomer accounts. Lastly, the Proposing Release included proposed revisions of Rules 1.10, 1.16 and 1.18 in order to amend the requirements for the financial statements that FCMs and IBs must file with the Commission.

The Commission received ten letters in response to its request for comments on the proposed rule amendments in the Proposing Release.[3] Of these ten comments, five were from individual firms registered as FCMs,[4] and two were from industry trade associations, the National Introducing Brokers Association (''NIBA'') and the Futures Industry Association (''FIA''). The National Futures Association (''NFA''),[5] the Joint Audit Committee (''JAC''),[6] and a former Commission staff member also submitted comment letters.[7] These comments are discussed in more detail later in this supplementary information section.

The Commission, after further consideration, including consideration of the comments, has determined to adopt the following: (1) A requirement that an FCM include, as part of the calculation of its minimum adjusted net capital requirement, a computation based on the maintenance margin levels of the positions or transactions carried by the FCM in customer and noncustomer accounts, including futures, option on futures, and other transactions that the Commission has, by order or otherwise, approved for carrying in customer segregated accounts in accordance with section 4d of the Act or that are carried by the FCM in noncustomer accounts; [8] (2) a conforming capital computation for early warning purposes, but which has been modified from the version proposed in the Proposing Release; and (3) other capital computations for purposes of an FCM's subordination agreements and equity capital, which have also been modified, as specified herein, from the versions that were originally proposed. Further, the Commission has determined to adopt amendments relating to the financial reporting requirements of FCMs and IBs as proposed in the Proposing Release.

Each of the rule amendments that the Commission has determined to adopt is discussed more fully in Parts II through VI of this supplementary information section, first by summarizing the background of the proposed rule amendment, then by summarizing the comments received in response, and finally by specifying the modifications, if any, that have been made to the final rule as adopted after consideration of the comments received.[9] The Commission also encourages interested persons to read the detailed analysis in the Proposing Release for each of the proposed rule amendments. Citations to the pertinent pages of the Proposing Release have been included as part of the discussion in this final rulemaking release of the amendments being adopted by the Commission.

As discussed in the Proposing Release, Rule 1.10 requires FCMs to prepare Forms 1–FR–FCM to file financial information with the Commission and their designated self-regulatory organization. The Commission advised in the Proposing Release that it would make conforming amendments to the Form 1–FR–FCM to reflect risk-based capital and changes to the early warning reporting requirements, if adopted by the Commission.[10] The Commission has approved such conforming amendments to the Form 1–FR–FCM, and the revised form is available to FCMs upon request from the Commission.[11]

Rule 1.10(d)(1) provides that each Form 1–FR–FCM, which is not required to be certified by an independent public accountant, must be completed in accordance with the instructions to the Form. The Commission issued a Form 1–FR–FCM Instruction Manual in 1989, and the Manual has not been revised since it was issued. Accordingly, the Commission has approved proposed changes to the 1–FR–FCM Instruction Manual to conform the Manual to rule amendments adopted in this final rulemaking. The Instruction Manual is available electronically on the Commission's Web site and hard copies may be obtained by contacting the Commission.[12]

II. Risk-Based Capital Requirements

The Commission's capital requirement for FCMs is set forth in Rule 1.17(a)(1)(i)(A)–(D), which, prior to the amendments adopted by this rulemaking, required an FCM to maintain minimum adjusted net capital

[1] The Act is codified at 7 U.S.C. 1 *et seq.* (2003), and section 4f(b) of the Act is codified at 7 U.S.C. 6f(b). The Commission's rules cited in this final rulemaking may be found at 17 CFR Ch. 1 (2003).

[2] 68 FR 40835 (July 9, 2003). The Proposing Release may be accessed electronically through the Commission's Web site *http://www.cftc.gov/*.

[3] The comment letters are available for inspection and copying at the Commission's Washington office in its public reading room, Room 4072, Three Lafayette Centre, 1155 21st Street, NW., Washington, DC 20581. The telephone number for the public reading room is (202) 418–5025. The comment letters also are available on the Commission's public Web site at *http://www.cftc.gov/foia/comment03/foi03—009_1.htm.*

[4] Comment letters were filed by Cargill Investor Services, Inc.; Fimat USA, Inc.; Man Financial Inc.; R.J. O'Brien & Associates, Inc.; and Carr Futures Inc.

[5] NFA is a registered futures association pursuant to section 17 of the Act.

[6] The JAC is a committee formed by futures exchanges and other self-regulatory organizations to coordinate audit and financial surveillance activities of FCMs.

[7] Paul H. Bjarnason, Jr. filed a comment letter.

[8] The Proposing Release explained that the term ''noncustomer'' is defined by Rule 1.17(b)(4) and generally refers to an entity affiliated with an FCM, including certain employees and officers of an FCM. 68 FR at 40838.

[9] Part V summarizes the Commission's determination to not adopt as part of this final rulemaking the proposed amendments to reduce the time periods before which an FCM is required, pursuant to Rule 1.17(c)(5), to take a capital charge for outstanding margin calls on its customer and noncustomer accounts.

[10] 68 FR at 40838, fn. 13. *See* 60 FR at 40840 — 40842.

[11] Requests for the form should be addressed to the Commission's Office of the Secretariat, Three Lafayette Centre, 1155 21st Street, NW., Washington, DC 20581.

[12] Requests for the Form 1–FR–FCM Instruction Manual should be addressed to the Commission's Office of the Secretariat, Three Lafayette Centre, 1155 21st Street, NW., Washington, DC 20581.

equal to, or in excess of, the greatest of the following:

a. $250,000;

b. Four percent of an amount, hereinafter to referred as the ''Segregated Amount,'' that equals the total of the funds required to be segregated for customers trading on U.S. commodity markets pursuant to section 4d(a)(2) of the Act, including the funds of customers trading on registered derivatives transaction execution facilities that have elected to opt-out of segregation pursuant to Rule 1.68, and the funds required to be secured for customers trading on foreign commodity markets pursuant to Rule 30.7, less the market value of options purchased by customers for which the full premiums have been paid;

c. The amount of adjusted net capital required by a registered futures association (NFA presently being the only such association) of which the FCM is a member; or

d. For FCMs that also are registered with the U.S. Securities and Exchange Commission (''SEC'') as securities brokers or dealers, the amount of net capital required by SEC Rule 15c3–1(a).[13]

In the Proposing Release, the Commission noted various limitations in the current net capital rule that could be addressed by requiring capital computations based on the margin levels of customer and noncustomer positions carried by the FCM, in lieu of the capital computation now required to be based on the Segregated Amount. For example, a primary limitation of the Segregated Amount is that it does not include noncustomer positions and therefore does not fully reflect the extent to which an FCM is financially exposed to commodity positions that it carries for both customers and noncustomers.[14] The Commission accordingly proposed amendments to Rule 1.17(a)(1)(i)(B) that would delete the computation that is based upon the Segregated Amount, and would require in its place a computation based on the aggregate of: (i) Eight percent of the ''risk margin'' requirement on futures and option on futures positions carried in customer accounts; and (ii) four percent of the ''risk margin'' requirement on futures and option on futures positions carried in noncustomer accounts.[15] As noted in the Proposing Release, in proposing this requirement the Commission was intending to frame a margin-based capital computation that would be identical to the margin-based minimum net capital computation that several futures self-regulatory organizations, including one derivatives clearing organization, have adopted for determining the risk-based capital requirements of their respective member-FCMs.[16]

For purposes of the proposed risk-based minimum adjusted net capital requirement, the Commission proposed new or amended definitions in Rule 1.17(b) for the terms ''customer account,'' ''noncustomer account,'' and ''risk margin requirement.'' [17] In general, the term ''customer account'' would be defined by Rule 1.17(b)(7) to include the account of any customer as defined by Rule 1.17(b)(2), which includes customers as defined by Rule 1.3(k), option customers as defined by Rules 1.3(jj) and 32.1(c), and foreign futures and foreign option customers as defined by Rule 30.1(c), and also would include the accounts of foreign-domiciled customers trading on foreign boards of trade. The term ''noncustomer account'' would continue to be defined by Rule 1.17(b)(4) as an account that is not included in the definition of either customer (Rule 1.17(b)(2)) or proprietary account (Rule 1.17(b)(3)), and also would include noncustomer accounts for foreign-domiciled persons trading on foreign boards of trade. The term ''risk margin'' requirement for an account would be defined by a new Rule 1.17(b)(8), which in the Proposing Release was defined to mean the level of maintenance margin, or performance bond, that the exchange [18] on which a position or portfolio of futures contracts and/or options on futures contracts is traded requires its members to collect from the owner of the account, subject to several additional requirements.

Upon further review, the Commission has determined that the definition proposed for Rule 1.17(b)(8) does not adequately encompass all of the margin or performance bond that FCMs, in accordance with the requirements of the futures organizations to which they belong, currently include in their margin-based capital computations. By limiting the computation to ''futures contracts and options on futures contracts'', the proposed rule might have been interpreted to exclude non-futures positions or transactions that the Commission has authorized to be held in customer accounts pursuant to section 4d of the Act, or the non-futures positions or transactions that an FCM elects to hold in noncustomer accounts. For example, options on securities that are held in commodity customer accounts pursuant to section 4d of the Act under the terms and conditions of Commission approved cross-margining programs are included in FCMs' risk-based margin calculations under the current rules of self-regulatory organizations. In addition, over-the-counter contracts and options that FCMs hold in section 4d customer accounts pursuant to Commission orders also are currently included in the FCMs' risk-based capital computations. Furthermore, by limiting the computation to margin required ''by the exchange on which a position or portfolio of futures contracts and/or options on futures contracts is traded'', the proposed rule does not reflect the growing diversity in the types of positions that FCMs may be able to carry for customers and noncustomers, including positions that are not traded on a DCM or DTEF, but are cleared by a derivatives clearing organization.[19]

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[13] The SEC rules cited in this release may be found at 17 CFR Ch. 2 (2003).

[14] The Commission discussed in detail other limitations to the capital rule based upon the Segregated Amount in the Proposing Release. 68 FR at 40837–40.

[15] As discussed in the Proposing Release, U.S. commodity exchanges and numerous foreign commodity exchanges use the Standard Portfolio Analysis of Risk (''SPAN'') margining system for calculating margin requirements on a portfolio of futures and option positions. The SPAN maintenance margin level consists of a ''risk'' component and an ''equity'' component. The risk component covers potential future losses in the portfolio value. Such losses include a market move against a futures position or a short (written) option. The equity component (option premium, marked-to-the market daily) reflects the asset represented by long option positions or the liability represented by short (written) option positions in the portfolio. *Id.*

[16] As of January 1, 1998, the Clearing Corporation (formerly the Board of Trade Clearing Corporation), the Chicago Board of Trade, and the Chicago Mercantile Exchange have all adopted margin-based minimum capital requirements for their respective clearing member firms. The NFA adopted similar risk-based minimum capital requirements for its member FCMs effective October 31, 2000. All of these organizations use the same percentages of risk maintenance margin that the Commission has proposed for its amended net capital rule. 68 FR at 40837–8.

[17] 68 FR at 40847–8.

[18] The applicable exchange rules would include those of foreign exchanges and those of designated contract markets (''DCMs'') and derivatives transaction execution facilities (''DTEFs'') governed by the Act. Also, the proposed definition of ''customer account'' in Rule 1.17(b)(7) would extend to FCM customers trading on DTEFs. Such customers are included in the definition of customer in Rule 1.3(k), which is incorporated by reference in Rule 1.17(b)(2), and all customers included within Rule 1.17(b)(2) are also included in the definition set forth in Rule 1.17(b)(7).

[19] In particular, clearing members of the New York Mercantile Exchange (''NYMEX'') currently maintain accounts for customers clearing products that are listed, but not traded, on the NYMEX exchange. The margin requirements for such products are established by NYMEX as a derivatives clearing organization. *See* Commission order dated February 2, 2004, supplementing the Commission's prior order dated May 30, 2002. A copy of the order is available on the Commission's Web site at *http://www.cftc.gov/files/tm/tmnymexotcorder021004.pdf.*

Accordingly, the Commission has determined to modify the definition it originally proposed to set forth in Rule 1.17(b)(8) for the risk margin requirement for an account. As modified, an account's risk margin requirement would mean the level of maintenance margin, or performance bond, that the FCM is required under the rules of an exchange (or by a clearing organization if the required margin level is established not by an exchange but rather by a clearing organization) to collect from the owner of a customer account or noncustomer account for all positions, whether futures positions or non-futures positions, held in such accounts.[20] This definition would be subject to several additional requirements, which also were included in the definition originally described in the Proposing Release. First, the definition of risk margin would not include the equity component of short or long option positions maintained in an account. Second, 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.[21] Third, 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. Finally, if an FCM does not possess sufficient information to determine what portion of an account's total margin requirement represents risk margin, the proposed definition would require that the FCM treat as risk margin all of the margin required by the exchange, clearing organization, or other FCM or entity for that account. For example, if customer or noncustomer positions are executed on a foreign board of trade and the FCM does not possess sufficient information to determine what portion of the foreign board of trade's required margin is risk margin as defined under Rule 1.17(b)(8), the FCM is required to include the entire margin requirement in its risk-based capital computation.

The commenters overwhelmingly endorsed the Commission's proposal to eliminate the capital computation based upon the Segregated Amount, and supported the application of minimum adjusted net capital requirements based upon risk maintenance margin. The commenters also did not object to any of the definitions proposed by the Commission to implement risk-based capital requirements. However, FIA and two individual commenters endorsed conducting further analysis of the margin-based capital requirements of the NFA and other self-regulatory organizations, with which the Commission rule, as amended, will now be consistent, for the purpose of identifying possible enhancements that might be made to the Commission's rules.[22] FIA offered to undertake such an analysis, in coordination with the self-regulatory organizations, and with the participation of the Commission expressly welcomed.

FIA offered a recommendation that it believed might accelerate the adoption of any changes that received the endorsement of the participants in the proposed analysis. Under FIA's proposal, Rule 1.17(a) would be amended to delete the current capital computation based on the Segregated Amount, but no additional amendments would be made to Rule 1.17(a) to specify a risk-based capital computation. FIA suggested, and NFA agreed, that any recommendations resulting from the proposed review of margin-based capital requirements could be put into effect by NFA's amendment of its rules, because NFA's risk-based capital requirements apply to all FCMs.

The Commission welcomes and encourages the commitment of industry resources towards an active and continuous evaluation of the capital requirements set forth in the Commission's rules. The Commission believes that the analysis proposed in FIA's letter is neither precluded by, nor inconsistent with, the Commission's immediate adoption of the proposed risk-based capital requirements for FCMs. Any proposals for further amendment to these risk-based capital rules would be evaluated by the Commission in light of all the Act's financial safeguards for monitoring the financial integrity of futures intermediaries, and the Commission can thereafter publish for public comment in the **Federal Register** such amendments as it proposes to adopt.

The Commission has considered the comments received and is adopting as final the amendments to Rule 1.17(a) and (b) as set forth in the Proposing Release, with the modification discussed earlier to the definition of risk margin in Rule 1.17(b)(8). As amended, Rule 1.17(a)(1)(i)(B) will no longer be based upon the Segregated Amount, but will instead include the following capital computation: Eight percent of the total risk margin requirement for all positions carried by the FCM in customer accounts, plus four percent of the total risk margin requirement for all positions carried by the FCM in noncustomer accounts. As discussed earlier, the definition of the risk margin requirement for an account is set forth in a new Rule 1.17(b)(8), and is determined generally by subtracting from the maintenance margin that the rules of an exchange or clearinghouse requires an FCM to collect from the owner of a customer or noncustomer account: (i) The equity component of each position; and (ii) the maintenance margin for each long option position that is not held to hedge other positions in the account. However, as noted in the Proposing Release, the Commission understands that calculating the maintenance margin on specific long option positions in a portfolio may require a certain amount of manual processing under current back office operating procedures, which some

[20] For some limited classes of customer accounts, primarily those of non-clearing exchange members trading for their own accounts only, the rules of three DCMs permit member FCMs to refrain from collecting the exchange-established maintenance margin levels otherwise required by such rules for positions held in customer accounts and noncustomer accounts. All of the organizations that have adopted risk-based capital rules for FCMs (the NFA, a derivatives clearing organization and two DCMs, as identified in footnote 16) require their member FCMs to disregard such exceptions when computing their minimum net capital requirements. The Commission intends Rule 1.17, as adopted herein, to impose the same requirement. FCMs must therefore include in their adjusted net capital requirements the exchange-established maintenance margin levels for all positions in the accounts held by the FCM for its customers and noncustomers.

It should also be noted that such rules may permit the exchange or clearinghouse to increase margin requirements to reflect circumstances other than changes in SPAN measurements. For example, an exchange may require an FCM to collect more than the standard margin from a specific customer due to credit or other concerns. The definition of risk margin, both as originally proposed and herein adopted, would include such margin.

[21] There is generally no risk to the FCM associated with a long option position, because the maximum potential loss is the full option premium, which is paid by the customer in full at the inception of the transaction. However, because long option positions that hedge other futures and option positions in a portfolio will reduce the total margin requirement of the portfolio, SPAN includes a risk maintenance margin component to protect against a decline in the market value of such long option positions. The Proposing Release proposed to allow FCMs to deduct from their risk margin requirements the maintenance margin for long option positions that are not hedging other futures or option positions. 68 FR at 40838.

[22] For example, FIA suggested examining such rules to determine whether they reflected advances in risk management made since 1998. An FCM also proposed that the Commission's rule should grant a credit of 25 percent for each dollar of margin that an FCM carries in excess of that required by the exchange, and Mr. Bjarnason identified other possible modifications for the Commission to consider.

FCMs may wish to forego because it would not materially reduce their risk-based minimum capital requirement.[23] Accordingly, the amended rule permits, but does not require, an FCM to exclude the risk maintenance margin for long options that do not hedge other positions maintained in the account.

The amended rule further provides that if the risk margin associated with cleared positions cannot be determined by the FCM, the firm will be required to apply the specified percentages for customer and noncustomer accounts to the total margin required by the exchange, clearing organization, other futures commission merchant or entity for the customer and noncustomer positions carried. In addition, as noted in the Proposing Release, the new margin-based capital computations will not apply to proprietary (*i.e.*, firm-owned) accounts. Rule 1.17(c)(5)(x) currently includes proprietary positions in the calculation of adjusted net capital to the extent that uncovered proprietary positions (*i.e.*, positions that are not hedged by cash market transactions) result in a charge or ''haircut'' to the firm's net capital based on clearinghouse or exchange margin requirements.[24]

III. Early Warning Requirements Under Rule 1.12

Pursuant to Commission Rule 1.12, an FCM or IB must comply with several requirements upon the occurrence of predefined events that may raise concerns regarding the firm's ability to meet its obligations to the market, safeguard customer funds, or otherwise continue normal business operations. The requirements in Rule 1.12, which include notices that the FCM or IB must file with the Commission and the firm's designated self-regulatory organization (''DSRO''),[25] enhance the ability of the Commission and the DSRO to respond with a heightened degree of surveillance, as may be necessary or prudent, in light of the possibility of deteriorating operating or financial conditions at a firm. The requirements in Rule 1.12 are therefore generally referred to as ''early warning'' requirements.

Paragraph (b) of Rule 1.12 currently provides that if an FCM maintains adjusted net capital that is equal to or in excess of the minimum adjusted net capital required by Rule 1.17(a)(1)(i), but below a specified level that is greater than the FCMs' required minimum (to be referred to hereafter as the ''early warning capital level''), then the FCM is required to meet specified notice requirements and to file with the Commission and the firm's DSRO monthly unaudited financial statements. The early warning capital level required under Rule 1.12(b) equals the greatest of the following:

a. $375,000;

b. Six percent of the Segregated Amount;

c. 150 percent of the amount of adjusted net capital required by a registered futures association (*i.e.*, NFA) of which the FCM is a member; or

d. For FCMs that also are registered with the SEC as securities brokers or dealers, the amount of net capital required by SEC Rule 17a–11(b).

Paragraph (c) of Rule 1.12 currently requires an FCM or IB to provide same day notice to the Commission and its DSRO of any failure to make or keep current the books and records that are required by the Commission's regulations, and the firm also must file within five business days after giving such notice a written report that describes what steps have been and are being taken to correct the situation. Paragraph (d) of Rule 1.12 requires an FCM or IB to provide notice, within three business days, to the Commission and its DSRO if the firm discovers or is notified by its independent public accountant of the existence of any material inadequacy in the internal controls of the firm. Within five business days after providing the required notice, the FCM or IB also must file a written report stating what steps have been and are being taken to correct the material inadequacy in its internal controls.

A. Early Warning Capital Levels for FCMs

The amendment proposed for Rule 1.12(b) would replace the early warning capital level computation that is based on six percent of the Segregated Amount held by an FCM with a computation based upon 150 percent of an FCM's minimum adjusted net capital requirement, as determined by the margin-based capital requirements in Rule 1.17(a)(1)(i)(B), as amended. The Commission also proposed to amend Rule 1.12(b) to require that any FCM that did not meet or exceed its early warning capital level (whether based on the margin-based capital computation or one of the other computations set forth in Rule 1.17(a)(1)(i)) to submit written notice within 24 hours, instead of the five business days presently allowed under the Commission's rule. Moreover, the Commission proposed to delete the requirement in Rule 1.12(b) for monthly unaudited financial statements from an FCM that had failed to meet its early warning capital level, because this provision would become moot upon the Commission's adoption of a proposed amendment to Rule 1.10, discussed below, that would require *all* FCMs to file unaudited financial statements on a monthly basis, instead of on a quarterly basis as is currently required under Rule 1.10.[26]

The Proposing Release noted a recommendation from the JAC that the Commission eliminate from Rule 1.12 not only the monthly filing requirement, but also the requirement that an FCM failing to meet or exceed its early warning capital level provide notice to the Commission and its DSRO. The Commission, however, expressed concern that eliminating the notice requirement could diminish the Commission's and the DSRO's ability to react promptly to potential financial crises at an FCM. To assist the Commission with its analysis of this issue, the Commission invited comment from interested parties on whether the proposed 150 percent early warning capital level would be appropriate under a risk-based capital rule or whether it should be adjusted or eliminated.

All of the comments received by the Commission recommended against establishing an early warning capital level for margin-based capital requirements. According to FIA, the proposed amendment is unnecessary since risk-based capital requirements encourage FCMs to maintain capital in excess of their required minimums, reflecting the fact that margin-based capital requirements are more sensitive to significant market moves than are capital requirements based on customer segregated funds.[27] FIA further suggested that the proposed amendment is unnecessary because DSROs employ a variety of methods to identify and to

[23] 68 FR at 40838.

[24] 68 FR at 40837–8.

[25] The Commission explained in the Proposing Release that a DSRO is the self-regulatory organization that, pursuant to Commission Rule 1.52, is primarily responsible for monitoring an FCM's compliance with minimum financial and related reporting requirements, receiving and reviewing an FCM's financial reports, and auditing the FCM's books and records. 68 FR at 40840, fn. 17.

[26] 68 FR at 40842. The Proposing Release also included a technical amendment to Rule 1.12(b) to correct the reference to SEC Rule 17a–11(b), which the SEC has redesignated as 17a–11(c). 58 FR 37655 (July 13, 1993.)

[27] When an exchange increases margin requirements to reflect significant market moves, an FCM's margin-based capital requirements will increase as well. FIA asserted that FCMs therefore will maintain some level of excess capital, as a matter of necessity as well as prudent business practice, to enable them to respond to the more immediate effect that significant market moves have on their risk-based capital requirements.

monitor their member FCMs that may be experiencing financial stress. For example, NFA requires each FCM for which it is the DSRO to report a variety of information on a daily basis, including the FCM's SPAN margin calculation, the FCM's segregation requirements and the amount of funds actually held in segregation. FIA stated its belief that information that the exchanges receive on a daily basis, such as clearing house variation margin pay and collect information, along with other reported information that is available to them, provides the exchanges with sufficient data with which to monitor the capital of a member FCM on a daily basis, if necessary.

The JAC stated that the financial surveillance procedures implemented by the exchanges and the NFA should provide sufficient advance notice of a firm's inability to meet its minimum capital requirement. The JAC also noted that Rule 1.12 itself includes other requirements that serve to provide the Commission and self-regulatory organizations with notice of events that could impair the financial viability of an FCM. Such requirements include those set forth in paragraphs (c) and (d) which, as stated above, relate to notice requirements to report deficiencies in the FCM's books and records or internal controls. The JAC further noted that Rule 1.12(g)(1–2) requires an FCM to provide written notice within two business days if any event or series of events cause a 20 percent or more reduction in the FCM's net capital from the amount last reported to the Commission in a financial report, and a minimum of two days advance notice prior to any withdrawal of equity capital or any unsecured advance or loan to any of the designated persons in the rule, if such withdrawal, advance or loan would cause a 30 percent or more net reduction in the FCM's excess adjusted net capital.

Finally, FIA also noted that institutional clients generally insist that their FCMs maintain capital above any applicable early warning capital level, making the early warning capital level an FCM's effective minimum adjusted net capital requirement. Accordingly, FIA and three other commenters stated that many FCMs would be required to maintain amounts of capital well in excess of 150 percent of the minimum adjusted net capital requirement if the early warning capital level were established at 150 percent of margin-based adjusted net capital requirements.

The Commission appreciates the detailed and insightful comments received in response to its proposal to establish an early warning capital level for capital computations that are based on the FCM's margin requirements. As the Commission has previously explained, the requirements in Rule 1.12 ''are designed to afford [the Commission] and industry self-regulatory organizations sufficient advance notice of a firm's financial or operational problems to take any protective or remedial action that may be needed to assure the safety of customer funds and the integrity of the marketplace.'' [28] After considering the comments, the Commission continues to believe that the effective implementation of the financial safeguards of the Act and its regulations requires provisions that establish a period for prompt reporting that a firm's adjusted net capital does not meet or exceed a specified level in excess of the FCM's minimum adjusted net capital requirement. Such provisions enhance the ability of the Commission and DSRO to adjust appropriately the level of monitoring of the FCM's activities when there appears to be circumstances that may detract from the FCM's ability to safeguard customer funds or otherwise satisfy its financial obligations. Moreover, the provisions in other paragraphs of Rule 1.12 cannot alone serve to provide immediate, sufficient notice to the Commission of a material change in a firm's net capital requirements. For example, Rule 1.12(g)(1), which requires notice to the Commission if the amount of the FCM's net capital declines by a specified percentage, does not result in notice to the Commission if the FCM experiences a material increase in its minimum capital requirement, and the FCM does not take appropriate steps to increase its adjusted net capital. Absent Rule 1.12(b), the Commission would not receive notice of the change in such firm's capital position until the increase in the FCM's minimum adjusted net capital requirement had exceeded the amount of adjusted net capital maintained by the FCM.[29]

However, further review of data available from FCM financial reports filed with the Commission does indicate that the Commission's supervisory concerns can be addressed satisfactorily by an early warning capital level that is based on a different threshold percentage of an FCM's margin-based, or risk-based, minimum adjusted net capital requirement. The JAC comment letter objected that, by its analysis, the proposed requirement of 150 percent of a firm's risk-based minimum capital requirement would adversely affect the FCM industry as a whole by resulting in an onerous increase in FCM capital requirements as compared to the Commission's current rule. The JAC therefore proposed that the Commission should consider an alternative that would be lower than 150 percent of an FCM's margin-based minimum adjusted net capital requirement, if the Commission believed it necessary to retain an early warning capital level. The JAC stated that it believed that the adoption of such an alternative could produce an early warning capital level that more closely parallels the current early warning capital level based upon six percent of the Segregated Amount, and would therefore be far less burdensome upon FCMs and customers.

Commission staff has performed its own analysis of the effects of a revised early warning capital level equal to 110 percent of an FCM's minimum adjusted net capital requirement, as determined by the margin-based requirements adopted by this rule. The analysis indicates that the revised level would cause FCMs to remain subject to an obligation to provide notice to the Commission and DSROs in advance of the undercapitalization of the firm, but that the burden of such an obligation for the industry as a whole would be no greater than experienced under the Commission's current regulations. Based on financial data for all 182 FCMs as of May 31, 2004, the analysis indicates that 60 of the 182 FCMs would be subject to a risk-based minimum capital requirement, with the remaining 122 FCMs subject to either the SEC's minimum capital requirement or the Commission's $250,000 minimum. Of the 60 FCMs subject to risk-based capital requirements, the early warning capital level of roughly half would be lower if determined by an amount equal to 110 percent of risk-based capital rather than 6 percent of capital based on segregated funds, and the early warning capital level of the other firms would be higher and, again, in every case the early warning capital requirements, if triggered, would, like the minimum capital requirements, be driven by the particular risk characteristics of the

[28] 63 FR 45711 (August 27, 1998) (final rule adopting amendments to shorten the time periods for filing undercapitalization and undersegregation notices required by Rule 1.12).

[29] The JAC letter included the comment that the Commission might consider, as an alternative to an early warning capital level, modifying Rule 1.12(g)(2) to require notification if an FCM's excess net capital decreases by more than 30 percent due to an increase in its risk-based capital requirement. Unlike the JAC's other proposal, it is difficult to gauge the sufficiency of the notice that would be provided under this proposal, as compared to the requirements of the Commission's existing rule or proposed amended rule.

positions carried by the individual firm in question. Furthermore, all of the firms whose early warning capital level would be greater under the amended rule already hold adjusted net capital in amounts that exceed the revised requirement of 110 percent of their margin-based minimum adjusted net capital requirement. Thus, replacing the existing requirement of 6 percent of the Segregated Amount with the revised early warning capital level requirement would not require any FCM to increase its adjusted net capital in order to comply with the amended rule.

In consideration of the foregoing, the Commission believes that a revised early warning capital level of 110 percent of the FCM's margin-based minimum capital requirement would retain an advance notice requirement that enhances the ability of the Commission and DSROs to monitor effectively the financial condition of FCMs, while still remaining consistent with the goal of aligning an FCM's capital requirements with the risks of its activities. In addition, the Commission is in the process of enhancing its financial surveillance capabilities over firms and market participants through the use of automated systems that will utilize market position data and FCM financial data to assist Commission staff with identifying situations that could adversely impact an FCM's ability to safeguard customer funds and meet its financial obligations to the market. These automated programs will permit Commission staff to conduct stress testing and other scenario testing of the positions held by both market participants and FCMs to gauge the potential impact on such entities based upon the positions they hold. The Commission is therefore amending Rule 1.12(b)(2) to delete the early warning capital level based upon the Segregated Amount, and to set forth in its place an early warning capital level equal to 110 percent of the FCM's margin-based capital requirement as determined by amended Rule 1.17(a)(1)(i)(B).

Adopting the amendment to paragraph (b)(2) of Rule 1.12 also will necessitate a change to paragraph (b)(3) of the rule, which currently sets forth an early warning capital level equal to ''150 percent of the amount of adjusted net capital required by a registered futures association of which [a firm] is a member.'' As noted above, every FCM must comply with the capital requirements of NFA, a registered futures association. Furthermore, as detailed above, NFA's risk-based capital rule includes a risk-based requirement that is identical to the risk-based capital computation being adopted by the Commission.[30] The Commission is therefore amending Rule 1.12(b)(3) to reduce to 110 percent the required percentage of adjusted net capital that is based on a margin-based capital computation set forth in the rules of a registered futures association, if the amount of such margin-based adjusted net capital meets or exceeds the amount computed under the margin-based computation set forth in Rule 1.17(a)(1)(i)(B). This amendment will help ensure that the same percentage of adjusted net capital will be required as early warning capital whenever a margin-based computation in the rules of a registered futures association is the same as the margin-based computation in the Commission's rules.

The Commission also received comments from the FIA and NFA objecting to its proposal to reduce the reporting period set forth in Rule 1.12(b). Currently, Rule 1.12(b) requires that an FCM who ''knows or should have known'' that its adjusted net capital is below the early warning level to file a written notice ''within five (5) business days of such event.'' With the objective of harmonizing the Commission's rule with the SEC's early warning rule, the Proposing Release included a proposal to amend the phrase five business days to read 24 hours.[31] In response, the NFA and FIA expressed concerns that the amended rule failed to recognize that although FCMs make daily computations of their capital, whenever such computations are made intra-month they are based on estimates only. Moreover, FCMs generally do not complete their daily capital computations until late afternoon, and, given that FCMs conduct business internationally, FIA stated that it would be ''impossible to confirm these numbers'' within 24 hours from when such daily capital computations are made. FIA and NFA therefore argued that FCMs should be permitted to continue to use established procedures to confirm their estimates and provide notice, if required, within five business days of the original estimated daily capital computation. Moreover, FIA stated that it believed that it would be inappropriate to require early warning notices based on unconfirmed estimates because such early warning notices are publicly available.

The Commission believes that the concerns expressed by these commenters would be addressed by the ''know or should have known'' standard already set forth in the rule. This same standard applies to other notices required by the Commission's rules, and, with reference to the undersegregation notices required under Rule 1.12(h), the Commission has previously interpreted this standard as follows:

> That part of the standard requiring an FCM to report when it ''should know'' of a problem may be defined as the point at which a party, in the exercise of reasonable diligence, should become aware of an event.[32]

With respect to the event at issue, *i.e.* adjusted net capital that is less than the required early warning capital level set forth in Rule 1.12(b), but still greater than the minimum required to avoid becoming undercapitalized under Rule 1.12(a), it appears that reasonable diligence on the part of the FCM may include expeditious confirmation of daily, intra-month estimates that have been made in good faith and are otherwise in compliance with Commission regulations. Hence, if confirmation of such estimates were both timely and reasonably necessary, it would be consistent with the amended rule for an FCM to file its required notice within 24 hours of confirmation of such estimates, and compliance with the amended rule would not be impossible under procedures now used by FCMs. The Commission therefore believes it appropriate to amend Rule 1.12(b) as proposed in the Proposing Release, and is hereby amending the rule to require an FCM to file written notice with the Commission and with the FCM's DSRO within 24 hours after it knows or should have known that its adjusted net capital is less than the early warning capital level.

B. Early Warning Requirements: Firm's Books and Records and Internal Controls

Rule 1.12(c) currently requires any FCM or IB that at any time fails to make or keep current books and records required by Commission regulations to be maintained to provide notice on the same day that such event occurs. The notice must specify the books and records that have not been made or are not current, and within five business days after providing such notice the FCM or IB must file a written report

[30] The margin-based capital computation included the NFA's capital requirements for its members is currently set forth in ¶ 7001 of the NFA Manual, Section 1(a)(vi) (2004).

[31] SEC Rule 17a–11(c) requires notice by no later than 24 hours after the broker-dealer's net capital falls below the SEC's required early warning level.

[32] 63 FR 45711, 45713 (August 27, 1988) (adopting rules that would also apply ''know or should have known'' standard for undersegregation notices pursuant to Rule 1.12(h)).

stating what steps have been and are being taken to correct the situation. Paragraph (d) of Rule 1.12 requires an FCM or IB that discovers, or is notified by an independent public accountant pursuant to Rule 1.16(e)(2), of the existence of any material inadequacy as specified in Rule 1.16(d)(2), to provide notice within three business days, and within five business days after giving such notice to file a written report stating what steps have been and are being taken to correct the material inadequacy.

For paragraphs (c) and (d) of Rule 1.12, the Proposing Release proposed to reduce the notice and reporting time frames specified within these paragraphs to be the same as the time frames provided in corresponding SEC regulations governing registered securities broker-dealers. Specifically, the proposed revisions would require an FCM or IB: (i) To transmit within 48 hours the required report stating what the FCM or IB has done or is doing to correct the situation that has caused the firm to fail to maintain current books and records; and (ii) to notify the Commission within 24 hours of discovering a material inadequacy in its accounting systems, and to transmit the required report within 48 hours of such discovery.[33] None of the commenters objected to the proposed shorter periods in Rules 1.12(c) and (d) for FCMs and IBs to file the required notices and reports related to their books and records and internal controls. The Commission is adopting as final the amendments to paragraphs (c) and (d) as proposed in the Proposing Release.[34]

IV. Satisfactory Subordination Agreements and Equity Capital

Commission Rule 1.17(c)(4)(i) permits an FCM or IB, in computing its adjusted net capital, to exclude liabilities that are subordinated to the claims of the firm's general creditors if such subordinated liabilities arise under ''satisfactory subordination agreements'' as defined in Rule 1.17(h). The criteria set forth in Rule 1.17(h) for such ''satisfactory'' subordination agreements include several limitations upon the FCM's or IB's ability to repay or prepay the subordinated obligation. By way of such limitations, the Commission seeks to enhance the stability and permanence of the firm's capital, and to prevent the firm's subordinated debt lenders from withdrawing firm capital to the detriment of the general creditors.

One of the payment limitations specified in Rule 1.17(h) prohibits any prepayment of the subordinated loan after the first year of the agreement unless the firm maintains adjusted net capital in excess of the minimum amount that would otherwise be required under Rule 1.17(a).[35] Specifically, Rule 1.17(h)(2)(vii)(A) restricts subordinated debt prepayments if such prepayments would cause the FCM's or IB's adjusted net capital to be less than the greater of:

a. 120 percent of the minimum dollar amount specified for FCMs in 1.17(a)(1)(i)(A) or for IBs in 1.17(a)(1)(iii)(A) (for FCMs, the required amount would be $300,000, or 120 percent of $250,000; for IB's the required amount would be $36,000); [36]

b. For FCMs, 7 percent of the Segregated Amount;

c. 120 percent of the amount of adjusted net capital required by a registered futures association of which the FCM is a member; or

d. For FCMs that also are registered with the SEC as securities brokers or dealers, the amount of net capital required by SEC Rule 15c3–1d(b)(7).

Several other provisions of Rule 1.17(h) also specify percentages of minimum adjusted net capital to restrict repayments or require action by firms in connection with their satisfactory subordination agreements. These provisions specify percentages applicable to each of the alternative adjusted net capital computations set forth in Rule 1.17(a), including capital computations based upon the Segregated Amount. For example, Rule 1.17(h)(3)(ii) and (h)(2)(viii)(A) require FCMs to suspend any repayment of their subordination agreements, and to provide notice of maturity/accelerated maturity to the Commission, if the FCM's payment obligations, then due or maturing within a specified period, would result in adjusted net capital of less than 6 percent of the Segregated Amount. Furthermore, an FCM whose adjusted net capital would be less than 7 percent of the Segregated Amount is subject to restrictions under Rule 1.17(h)(2)(vi)(C) on any reductions of the unpaid principal balance under a secured demand note subordination agreement,[37] and also subject to restrictions under Rule 1.17(h)(3)(v) on the use of temporary subordinations.[38] Finally, Rule 1.17(h)(2)(vii)(B) restricts ''special prepayments'' by FCMs whose adjusted net capital would be less than 10 percent of the Segregated Amount.[39] In light of the amendments to Rule 1.17(a) adopted by this rulemaking, the capital computations within Rule 1.17(h) that are based on the Segregated Amount must also be amended. Furthermore, similar amendments are also required for Commission Rule 1.17(e), which sets forth the requirements for a firm's ''debt-equity total'', *i.e.,* the total of the outstanding principal amount of satisfactory subordination agreements plus the firm's ''equity capital''.[40] One of the provisions of Rule 1.17(e) requires a specified percentage of minimum adjusted net capital based on the

[33] 68 FR at 40842–3.

[34] The JAC proposed that the Commission also consider, in addition to the rule amendments that the Commission had proposed in the Proposing Release to paragraphs (b), (c) and (d) of Rule 1.12, an amendment to delete paragraph (f)(5) from Rule 1.12. Rule 1.12(f)(5) currently obligates an FCM to provide notice immediately whenever its excess adjusted net capital is less than 6 percent of the maintenance margin required by the FCM on all positions in accounts of a noncustomer. The JAC stated that it believed that this regulation would no longer be necessary because the risk-based capital requirement includes an assessment for an FCM's exposure to noncustomer positions. Commission staff is reviewing this proposal for possible future publication as a proposed rule, with request for public comment.

[35] Prior to the end of the first year, Rule 1.17(h)(2)(vii) generally prohibits any prepayment of the subordinated loan irrespective of whether the firm holds sufficient excess capital.

[36] The Commission redesignated paragraph (a)(1)(ii)(A) of Rule 1.17 as paragraph (a)(1)(iii)(A) in 2001. 66 FR 53510 (October 23, 2001). The Commission therefore proposed technical amendments to various subparagraphs of Rule 1.17(h), and also to Rule 1.17(e), to correct all references within those rules to 1.17(a)(1)(ii)(A) to read 1.17(a)(1)(iii)(A). 68 FR at 40843. The Commission has further determined that Rules 1.10(j)(8)(ii)(A) and 1.17(a)(2)(ii) require similar revision, as these rules also include references to paragraph (a)(1)(ii) of Rule 1.17. The Commission is therefore adopting amendments to Rules 1.17(h) and (e) as proposed, and also is adopting similar amendments to Rules 1.10(j)(8) and 1.17(a)(2). As amended, the existing references within these rules to paragraph (a)(1)(ii) of Rule 1.17 will be revised to read (a)(1)(iii).

[37] The subordination agreement may provide for the FCM or IB to receive either (i) cash or (ii) a demand note that is payable to the FCM or IB and secured by cash or securities that satisfy requirements set forth in the rule.

[38] Pursuant to several conditions specified in the rule, an FCM or IB may qualify for approval of a temporary satisfactory subordination agreement that has a stated term of no more than 45 days.

[39] ''Special prepayments'' is the term used in Rule 1.17 for prepayments made under revolving subordinated agreements. Because revolving agreements may permit prepayments at any time, such payments ordinarily would conflict with Rule 1.17(h)(2)(vii)(prohibiting prepayment within one year of the date upon which the governing subordination agreement became effective.) In 1982, the Commission determined that special prepayments would be acceptable if subject to various conditions, including a higher level of minimum adjusted net capital (10 percent of segregated funds) than is required for prepayments that are subject to the one-year restriction (7 percent of segregated funds). 47 FR 22352 (May 24, 1982).

[40] Rule 1.17(e) requires the firm to hold 30 percent of the total as equity capital. Rule 1.17(d)(1) defines the term ''equity capital'' to include retained earnings and other specified forms of investment. The term also includes funds received under subordination agreements that are not only satisfactory under Rule 1.17(h), but also meet other, more restrictive criteria specified in Rule 1.17(d).

Segregated Amount as a condition for permitting an FCM or IB to make withdrawals of equity capital. Specifically, any withdrawal of equity capital is prohibited if, among other things, it would result in adjusted net capital of less than 6 percent of the Segregated Amount.

In the Proposing Release, the Commission proposed to conform all of the computations in paragraphs (e) and (h) of Rule 1.17 that refer to the Segregated Amount to refer instead to the risk-based capital computation that was proposed in Rule 1.17(a)(1)(i)(B).[41] The Commission stated that the proposed amendments would: (i) Eliminate calculations based on the Segregated Amount; (ii) adopt calculations based on the required maintenance margin for customer and noncustomer futures and option positions carried by an FCM; and (iii) apply percentage requirements that reflect the same proportional increase currently required under Rule 1.17(e) and (h).[42] Thus, for example, where Rule 1.17(e) included a calculation based upon six percent of the Segregated Amount, the Commission proposed to eliminate this calculation and require 150 percent of an FCM's risk-based minimum adjusted net capital requirement. Using this approach for purposes of an FCM's equity capital and satisfactory subordination agreements would result in required percentages of risk-based minimum adjusted net capital of either 150 percent or 175 percent, except that an FCM would be required to hold 250 percent of risk-based minimum adjusted net capital in order to make ''special prepayments'' under a satisfactory subordination agreement.

Of the ten comment letters received by the Commission, the majority had no comments on these proposed conforming revisions to Rule 1.17(e) and (h). One FCM proposed 125 percent as a specific alternative percentage for the Commission to consider for all of the applicable provisions of Rule 1.17(e) and (h), while the NFA suggested using 120 percent, which is the same percentage that Rules 1.17(e) and (h) currently require in the case of minimum adjusted net capital computations that are based on the capital requirements of a registered futures association. The JAC suggested that the Commission might consider reducing the proposed percentages, but did not make any specific recommendations for the percentages to be included in Rules 1.17(e) and (h).

Upon further consideration, the Commission notes that in all but one of the relevant paragraphs of Rules 1.17(e) and (h), the required percentage of minimum adjusted net capital is 120 percent, regardless of whether the FCM's capital computation is based on a registered futures association's capital requirements or on the FCM's required minimum dollar amount ($250,000). This similarity is the product of the Commission's determination in 1995, when proposing to amend Rules 1.17(e) and (h) to include capital computations that would be based on the capital requirements of a registered futures association, to apply the same percentages as then required for capital computations based upon the minimum dollar amount set forth in Rule 1.17(a)(1)(i)(A).[43] Accordingly, the Commission has determined to take the same approach here and reduce to 120 percent all but one of the percentages proposed in the Proposing Release for Rules 1.17(e) and (h). The exception in the amended rule will be in paragraph (h)(2)(vii)(B), which restricts ''special prepayments'' made under satisfactory subordination agreements, and requires a computation of 200 percent of an FCM's minimum adjusted net capital that is based on a minimum dollar amount, *i.e.*, 200 percent of $250,000. In light of the comments received on the enhanced responsiveness of margin-based capital requirements to significant major market moves, the Commission believes that it is sufficient for the purposes of the identified paragraph to amend the rule to require 125 percent of minimum adjusted net capital that is based on an FCM's margin-based capital requirements. The Commission is therefore adopting the amendments to Rule 1.17(e) and (h) as set forth in the Proposing Release, with the following modifications: (1) the required percentage of risk-based minimum adjusted net capital will be 120 percent for subparagraphs (e)(1)(ii), (h)(2)(vi)(C)(*2*), (h)(2)(vii)(A)(*2*), (h)(2)(viii)(A)(*2*), (h)(3)(ii)(B), and (h)(3)(v)(B) of Rule 1.17; and, (2) in subparagraph (h)(2)(vii)(B)(*2*), the required percentage will be 125 percent of an FCM's risk-based minimum adjusted net capital requirement as determined under amended Rule 1.17(a)(1)(i)(B).

The Commission also proposed in the Proposing Release to amend Rule 1.17(h)(3)(vii) to ''grandfather'' in agreements that, prior to the effective date of the final rules as adopted, had been determined to be satisfactory subordination agreements pursuant to Rule 1.17(h).[44] No commenter objected to this proposal, and the Commission adopts the amendment as proposed.

V. Capital Charge for Undermargined Accounts Under Rule 1.17(c)(5)

Commission Rule 1.17(c)(5)(viii) requires an FCM, in computing its adjusted net capital, to take a reduction (*i.e.*, capital charge) from its net capital for any customer account that is undermargined and the margin call issued to the customer has not been answered by the third business day following the issuance of the call. Rule 1.17(c)(5)(ix) requires an FCM to take a capital charge for noncustomer accounts if a noncustomer fails to answer a margin call by the second business day following the issuance of the call. The capital charge under Rule 1.17(c)(5)(viii) and (ix) is equal to the amount of funds required in the undermargined account to meet maintenance margin requirements of the applicable board of trade that the futures or options contracts were executed on or the clearing organization that cleared such transactions. For both customer and noncustomer accounts, the Commission issued proposed rule amendments that would reduce the collection period before a capital charge would have to be taken to one business day following the issuance of a margin call.[45]

Several commenters expressly acknowledged that payment by electronic means within one day after the issuance of a margin call reflects the current practice of the industry in many instances, especially with respect to institutional customers. FIA, NFA, and all five of the individual FCMs, however, expressly objected to shortening the period under Rule 1.17(c)(5)(viii) for outstanding margin calls for customer accounts. The prevailing theme of these comments is that there remain instances in which meeting a margin call within one day may not be possible, and is unrelated to any impaired financial capacity of the customer to ultimately meet the margin call.

FIA also expressed its view that it is not necessary to reduce the period

[41] 68 FR at 40843–4.

[42] The cited paragraphs also contain references to 1.17(a)(1)(ii)(A), which has been redesignated 1.17(a)(1)(iii)(A). The Commission therefore also proposed, and is now adopting, a technical amendment to correct the references in these paragraphs to read as 1.17(a)(1)(iii)(A).

[43] The Commission's approach is described in the **Federal Register** release proposing these amendments in 1995. 60 FR 63995, 63997, fn. 16. (Dec. 13, 1995). The proposed rules were adopted in 1996. 60 FR 19177 (May 1, 1996). These rules were therefore adopted prior to NFA's amendment of its capital rule, in 2000, to include a computation based upon maintenance margin.

[44] 68 FR at 40843.

[45] 68 FR at 40839–40.

currently applicable to customer accounts to achieve the Commission's objectives. FIA pointed out that margin-based capital requirements are sufficient to address the Commission's concerns articulated in the Proposing Release, particularly the fact that the futures industry has recently experienced significant increases in the number of products offered on futures markets, and the higher volatility associated with some of these products. Several of FIA's comments also questioned the Commission's assumption concerning the ease and convenience of meeting margin calls in one day through the electronic transfer of funds. First, FIA observed that an international client might receive a margin call after the closing hours of banks where its accounts are maintained, or during a holiday schedule applicable in the bank's location. FIA further stated that it might take more than the prescribed period to resolve funds that have been mistakenly misdirected. Finally, FIA pointed out that retail clients generally continue to meet margin calls by means of a check rather than a wire transfer.

Two FCMs and the NIBA commented that a number of small to medium business entities, including small commercial hedgers and agricultural interests, also meet margin calls through check payments. In many cases, according to one FCM, the cost of using a wire transfer could be a significant percentage of the margin call. If the FCM does not require that its customers incur such wire transfer fees, the FCM will incur a capital charge for serving this market. Another FCM commented that the costs of requiring payment by wire transfer, for which most bank charge substantial fees, would impose a burden on the market participation of these customers, and the increased cost associated with servicing this market segment could result in higher commissions and lower market access for the retail customer.

For those FCMs with a retail client base, therefore, FIA stated that it is impractical to expect the receipt of margin payment within less than three business days. FIA further noted that a number of U.S. futures contracts are denominated in a foreign currency, and it can take two business days to settle a wire transfer for many of these currencies. One FCM noted that even with only a moderate retail and foreign customer base, it anticipated having to double or triple its daily undermargined capital charge.

Apart from issues related to the use of wire transfers to meet margin calls, FIA and NFA also expressed concerns that the shorter time period contemplated by the Commission might be insufficient for institutional trading managers to meet their margin calls. FIA noted its understanding that the reconciliation process for trades executed on behalf of institutional trading managers can extend into the business day following the trade date, resulting from a number of factors, including late give-ins. Because these entities actively manage their cash assets, excess cash must be invested early in the day in order to enhance available yield, and these trading managers establish early morning cut-off times for the receipt of margin calls. Although trading managers generally receive preliminary margin calls before the early morning cut-off, the size of the call may not be confirmed until after the established cut-off time, thus possibly resulting in delays beyond the one-business-day period being proposed by the Commission.

Upon reviewing the comments received, the Commission has determined not to adopt the proposed amendments to Rules 1.17(c)(5)(viii) and (ix) that were set forth in the Proposing Release. The amendments were not proposed in response to observed specific deficiencies in the FCMs' processes for the collection of margin, and the Commission is persuaded that the existing Commission and exchange rules continue to reinforce the industry's own practices for collecting margin as soon as possible, while taking into consideration circumstances that may result in margin not being paid within one day of the issuance of a margin call which are commercially reasonable and not indicative of any impaired financial capacity of the recipient to ultimately meet the margin call.

VI. Financial Reporting Requirements

The Proposing Release included amendments to Rule 1.10(b) to require each FCM to file an unaudited Form 1–FR–FCM, or FOCUS Report for an FCM also registered with the SEC as a securities broker or dealer, with the Commission and with the FCM's DSRO as of the end of each month, including the FCM's fiscal year end. Such financial reports are required to be filed within 17 business days of the end of each month.[46] The preparation of such monthly financial reports also would satisfy an FCM's requirement to prepare and to maintain a monthly formal computation of its adjusted net capital under Rule 1.18(b).[47] The Commission also proposed to facilitate Form 1–FR filings by FCMs and IBs by expanding the list of persons from whom the Commission would accept the oath or affirmation that is required by Rule 1.10(d)(4).[48] FIA, NFA and the JAC expressed support for the proposals to amend Rules 1.10(b), 1.10(d)(4) and 1.18. The Commission has determined to amend Rules 1.10(b) and 1.18 as proposed, but to revise the text amendments that were suggested for Rule 1.10(d)(4) in the Proposing Release.

A. Oath and Affirmation Requirements

Rule 1.10(d)(4) seeks to ensure that the required oath or affirmation is provided by persons that have authority to bind the FCM or IB, who also have an appropriate level of ongoing financial and/or managerial responsibility for the financial information provided in the reports filed with the Commission, and who should be bound by the personal attestation. Consistent with this purpose, Rule 1.10(d)(4) currently requires the signature of a chief operating officer, chief financial officer, general partner, or sole proprietor, if the FCM or IB is organized as a corporation, partnership or sole proprietorship, respectively.

As noted in the Proposing Release, the existing list of approved individuals in Rule 1.10(d)(4) does not address other organizational structures under which FCMs and IBs may conduct their business, specifically, limited liability companies (''LLCs''). All fifty states and the District of Columbia have passed statutes in recent years allowing formation of LLCs within their jurisdictions.[49] LLCs are unincorporated entities that, in accordance with the relevant LLC statute, may be managed by their members directly or by managers whose duties are defined by the statute and/or by agreement of the members.[50] While some LLCs include the positions of chief executive officer and chief financial officer, others do not. As of February 29, 2004, at least 40 of the 177 registered FCMs were organized as LLCs.

In response to the need to modernize Rule 1.10(d)(4), the Proposing Release suggested revisions to the rule that would be consistent with amendments then pending to Part 4 of the Commission's rules.[51] The proposed amendments focused on the authority of the signer to bind the FCM or IB, but the Commission believes that it is

[46] 68 FR at 40840, 40845.

[47] 68 FR at 40841, 40848.

[48] 68 FR at 40841, 40846.

[49] Susan P. Hamill, *The Origins Behind the Limited Liability Company,* 59 Ohio St. L.J. 1459 (1998).

[50] Larry E. Ribstein and Robert R. Keatinge, *Ribstein and Keatinge on Limited Liability Companies,* §§ 1.3, 1.6, and 8.2 (2003).

[51] 68 FR at 40841.

additionally appropriate to ensure that persons who submit financial information to the Commission hold positions within the firm that require meaningful familiarity with, and responsibility for, the ongoing operations and finances of the firm. The Commission has therefore determined to adopt amendments to Rule 1.10(d)(4) to designate, for each form of business organization, the officers or other individuals from whom the oath or affirmation would be required, as follows: if 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.[52] As amended, Rule 1.10(d)(4) uses some of the same terms that were adopted by the Commission when modernizing Commission Regulation 3.1(a) in 2001 to recognize the existence of limited liability companies.[53]

The Proposing Release also proposed to amend Rule 1.10(d)(4) to permit the oath or affirmation, if the registrant or applicant is registered with the SEC as a securities broker or dealer, to be provided by the representative authorized under SEC Rule 17a–5. The Commission adopts this amendment as proposed in the Proposing Release.

B. Filings With NFA and Other Reporting Requirements

The Commission proposed to amend Rule 1.10(c) to provide that an IB would file an unaudited Form 1–FR–IB solely with NFA.[54] The Proposing Release additionally invited comment on whether, and under what conditions, the Commission should amend its rules to permit IBs to file annual certified financial statements solely with NFA. NFA supported having IBs file solely with NFA both unaudited and audited financial reports, and no commenters objected to these proposals. Having considered these proposals, the Commission hereby amends Rule 1.10(c) to provide that IBs will file the unaudited Form 1–FRs required by Rule 1.10(b)(2)(i), and the annual certified financial statements required by Rule 1.10(b)(2)(ii), with NFA only.

The Proposing Release included amendments that would permit an FCM's or IB's DSRO, or, as applicable, its designated examining authority under SEC rules, to approve the FCM's or IB's application for change in fiscal year under Rule 1.10(e), or an application for an extension of time to file an audited or unaudited financial statement under Rules 1.10(f) or 1.16(f), subject to specified conditions.[55] The Commission is adopting as final the proposed amendments to Rules 1.10(e) and (f) and 1.16(f), with some modifications from the versions set forth in the Proposing Release. These modifications have been made to reflect the amendments to Rule 1.10(c) that will require IBs to file their uncertified and certified financial reports solely with NFA.[56]

VII. Related Matters

A. Regulatory Flexibility Act

The Regulatory Flexibility Act (''RFA''), 5 U.S.C. 601 *et seq.,* requires that agencies, in proposing rules, consider the impact of those rules on small businesses. The Commission invited the public to comment on the Chairman's certification that these rules would not have a significant economic impact on a substantial number of small entities.[57] The Commission received no comments on the certification.

B. Paperwork Reduction Act

This rulemaking includes information collection requirements. As required by the Paperwork Reduction Act of 1995 (''PRA''),[58] the Commission submitted a copy of the proposed rule amendments to the Office of Management and Budget (''OMB'') for its review. No comments were received in response to the Commission's invitation in the proposed rules to comment on any potential paperwork burden associated with regulation.[59]

C. Cost-Benefit Analysis

Section 15(a) of the Act, as amended by section 119 of the CFMA, requires the Commission to consider the costs and benefits of its action before issuing a new regulation under the Act. By its terms, section 15(a) as amended does not require the Commission to quantify the costs and benefits of a new regulation or to determine whether the benefits of the regulation outweigh its costs. Rather, section 15(a) simply requires the Commission to ''consider the costs and benefits'' of its action.

Section 15(a) of the Act further specifies that costs and benefits shall be evaluated in light of five broad areas of market and public concern: protection of market participants and the public; efficiency, competitiveness, and financial integrity of futures markets; price discovery; sound risk management practices; and other public interest considerations. Accordingly, the Commission could in its discretion give greater weight to any one of the five enumerated areas and could in its discretion determine that, notwithstanding its costs, a particular rule was necessary or appropriate to protect the public interest or to effectuate any of the provisions or to accomplish any of the purposes of the Act.

The amended rules adopted by the Commission pertain to the minimum financial and related reporting requirements for FCMs and IBs.[60] The Commission is considering the costs and benefits of these various proposed rules in light of the specific provisions of section 15(a) of the Act, as follows:

1. *Protection of market participants and the public.* The amended rules for reporting requirements provide the benefit of aiding the Commission and DSROs to monitor the financial condition of futures intermediaries and to protect the customers of those firms and the markets. The Commission anticipates that the costs of compliance with the amended reporting requirements will be minimized by amended rules that will streamline filing requirements. In addition, the amended rules will ''grandfather'' in existing satisfactory subordination

[52] A limited liability partnership is a general partnership which, as a result of a filing with the secretary of state (and, in some cases, the maintenance of a certain level of insurance and the payment of an annual fee to the state) limits the vicarious liability of the partners. *See* Larry E. Ribstein and Robert R. Keatinge, *Ribstein and Keatinge on Limited Liability Companies,* § 16.28 (2003).

[53] Commission Regulation 3.1(a) specifies those ''principals'' that are required under the Act to register with the Commission. Rule 3.1(a)(1) includes as principals ''any director, the president, chief executive officer, chief operating officer, chief financial officer, the manager, managing member or those members vested with the management authority'' for a limited liability company or limited liability partnership.

[54] 68 FR at 40842, 40845.

[55] 68 FR at 40841–2, 40846–40847.

[56] Most significantly, the modified versions eliminate the requirement that IBs file with the Commission copies of their applications for changes in fiscal year or extended filing deadlines, or the notices approving or denying such applications.

[57] 68 FR at 40844.

[58] 44 U.S.C. 3507(d).

[59] 68 FR at 40844.

[60] Section 4f(b) of the Act prohibits persons from becoming registered as FCMs or IBs if they do not meet the minimum financial requirements set forth in either the Commission's regulations or in such Commission-approved requirements as may be established by the contract markets and derivatives transaction execution facilities of which the FCM or IB is a member.

agreements, meaning that FCMs or IBs would incur no costs to comply with proposed amendments to Rule 1.17, unless such agreements would be amended or renewed for other reasons.

2. *Efficiency and competition.* As stated above, the Commission anticipates that the amended rules will benefit efficiency by eliminating duplicate filings and otherwise streamlining reporting requirements for FCMs and IBs. The amended rules should have no effect, from the standpoint of imposing costs or creating benefits, on competition in the futures and options markets.

3. *Financial integrity of futures markets and price discovery.* The amended rules contribute to the benefit of ensuring that FCMs and IBs can meet their financial obligations to customers and other market participants, thus contributing to the financial integrity of the futures and options markets as a whole. The amended rules should have no effect, from the standpoint of imposing costs or creating benefits, on the price discovery function of such markets.

4. *Sound risk management practices.* The amended rules for capital requirements seek to reflect appropriately the level of risk that different activities and obligations of FCMs and IBs may pose to their financial condition. The amended rules may therefore contribute to the sound risk management practices of futures intermediaries.

5. *Other public interest considerations.* The Commission believes that the amended rules are beneficial in that they harmonize Commission and SEC rules with respect to time frames for reporting conditions that may be potentially adverse to the financial condition of the FCM or IB.

The Commission invited, but did not receive, public comment on its application of the cost-benefit provision. After considering these factors, the Commission has determined to issue this final rule.

List of Subjects in 17 CFR Part 1

Brokers, Commodity futures, Reporting and recordkeeping requirements.

■ For the reasons presented above, the Commission hereby amends 17 CFR part 1 as follows:

PART 1—GENERAL REGULATIONS UNDER THE COMMODITY EXCHANGE ACT

■ 1. The authority citation for part 1 continues to read as follows:

Authority: 7 U.S.C. 1a, 2, 5, 6, 6a, 6b, 6c, 6d, 6e, 6f, 6g, 6h, 6i, 6j, 6k, 6l, 6m, 6n, 6o, 6p, 7, 7a, 7b, 8, 9, 12, 12a, 12c, 13a, 13a–1, 16, 16a, 19, 21, 23, and 24, as amended by the Commodity Futures Modernization Act of 2000, appendix E of Pub. L. 106–554, 114 Stat. 2763 (2000).

■ 2. Section 1.10 is amended by revising paragraphs (b)(1), (b)(2)(i), (c), (d)(4), (e), and (f) to read as follows:

§ 1.10 Financial reports of futures commission merchants and introducing brokers.

* * * * *

(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 90 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 unless the introducing broker elects, pursuant to paragraph (e)(1) of this section, to file a Form 1–FR–IB semiannually as of the middle and the close of each calendar year. Each Form 1–FR–IB must be filed no later than 17 business days after the date for which the report is made.

* * * * *

(c) *Where to file reports.* (1) A report filed by an introducing broker pursuant to paragraph (b)(2)(i) or (b)(2)(ii) of this section need be filed only with, and will be considered filed when received by, the National Futures Association. Other reports 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 and by the designated self-regulatory organization, if any; and reports required to be filed by this section by an applicant for registration will be considered filed when received by the National Futures Association and by the regional office of the Commission with jurisdiction over the state in which the applicant's principal place of business is located.

(2) Any report filed pursuant to paragraph (b)(1) or (b)(4) of this section or § 1.12(a) which need not be certified in accordance with § 1.16 may be submitted to the Commission in electronic form using a Commission-assigned Personal Identification Number, and otherwise in accordance with instructions issued by the Commission, if the futures commission merchant, introducing broker 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.

(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 a registrant 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) * * *

(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 or part IIA. In the case of a Form 1–FR filed via electronic transmission in accordance with procedures established by the Commission, such transmission must be accompanied by the Commission-assigned Personal Identification Number of the authorized signer and such Personal Identification Number 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 examining 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 or part IIA (FOCUS report), for any period within the time specified in 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(l)(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(l)(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 subparagraph (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.

* * * * *

■ 3. Section 1.12 is amended by revising paragraphs (a)(1), (b)(1), (b)(2), (b)(3), (b)(4), (c), (d), (e), (f), (h) and (i)(1) to read as follows:

§ 1.12 Maintenance of minimum financial requirements by futures commission merchants and introducing brokers.

(a) * * *

(1) Give telephonic notice, to be confirmed in writing by facsimile notice, as set forth in paragraph (i) of this section that the applicant's or registrant's adjusted net capital is less than required by § 1.17 or by other capital rule, identifying the applicable capital rule. The notice must be given immediately after the applicant or registrant knows or should know that its adjusted net capital is less than required by any of the aforesaid rules to which the applicant or registrant is subject; and

* * * * *

(b) * * *

(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, or

(4) For securities brokers or dealers, the amount of net capital specified in Rule 17a–11(c) of the Securities and Exchange Commission (17 CFR 240.17a–11(c)), must file written notice to that effect as set forth in paragraph (i) of this section within 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 facsimile notice of such fact, specifying the books and records which have not been made or which are not current, and within forty-eight (48) hours after giving such notice file a written report 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 this chapter, of the existence of any material inadequacy, as specified in § 1.16(d)(2) of this chapter, such applicant or registrant must give facsimile notice of such material inadequacy within twenty-four (24) hours, and within forty-eight (48) hours after giving such notice file a written report stating what steps have been and are being taken to correct the material inadequacy.

(e) Whenever any self-regulatory organization learns that a member registrant has failed to file a notice or written report as required by § 1.12, that self-regulatory organization must immediately report this failure by telephone, confirmed in writing immediately by facsimile notice, as provided in paragraph (i) of this section.

(f)(1) Whenever a clearing organization determines that any position it carries for one of its clearing members which is registered as a futures commission merchant or as a leverage transaction merchant must be liquidated immediately, transferred immediately or that the trading of any account of such futures commission merchant or such leverage transaction merchant shall be only for the purposes of liquidation, because that clearing member has failed to meet a call for margin or to make other required deposits, the clearing organization must immediately give telephonic notice, confirmed in writing immediately by facsimile notice, of such a determination to the principal office of the Commission at Washington, DC.

(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 telephonic notice, confirmed in writing immediately by facsimile notice, of such a determination to the principal office of the Commission at Washington, DC.

(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 give telephonic notice, confirmed in writing immediately by facsimile notice, of such a determination to the designated self-regulatory organization and the principal office of the Commission at Washington, DC. 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 (f)(3), 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 his own account, all such accounts shall be combined. A designated self-regulatory organization may grant an exemption from the provisions of this paragraph to a futures commission merchant with respect to any particular account on a continuous basis provided

the designated self-regulatory organization documents the reasons for granting such an exemption and continues to monitor any such account.

(4) A futures commission merchant shall report immediately by telephone, confirmed immediately in writing by facsimile notice, 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 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 report immediately by telephone, confirmed immediately in writing by facsimile notice, 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 and 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.

* * * * *

(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, or that the total amount set aside on behalf of customers trading on non-United States markets, is less than the total amount of such funds required by the Act and the Commission's rules to be on deposit in segregated or secured amount accounts on behalf of such customers, the registrant must report such deficiency immediately by telephone notice, confirmed immediately in writing by facsimile notice, to the registrant's designated self-regulatory organization and the principal office of the Commission in Washington, DC, to the attention of the Director and the Chief Accountant of the Division of Clearing and Intermediary Oversight.

(i)(1) Every notice and written report required to be given or filed by this section (except for notices required by paragraph (f) of this section) by a futures commission merchant, an applicant for registration as a futures commission merchant or a self-regulatory organization must be filed with the regional office of the Commission with jurisdiction over the state in which the applicant's or registrant's principal place of business is located, with the designated self-regulatory organization, if any, with the Securities and Exchange Commission, if such applicant or registrant is a securities broker or dealer, and with the National Futures Association, if the firm is an applicant. In addition, every notice required to be given by this section must also be filed with the principal office of the Commission in Washington, DC. Each statement of financial condition, each statement of the computation of the minimum capital requirements pursuant to § 1.17 of this part, and each schedule of segregation requirements and funds on deposit in segregation required by this section must be filed in accordance with the provisions of § 1.10(d) of this part unless otherwise indicated.

* * * * *

■ 4. Section 1.16 is amended by revising paragraph (f) to read as follows:

§ 11.16 Qualifications and reports of accountants.

* * * * *

(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 § 240.17–a5(*l*)(1)of this title, for an extension of time to file audited annual financial statements. 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)(i).

(C) Any copy that under this paragraph (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 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(*l*)(1) of this title, for an extension of time to file audited annual financial statements. 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) *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.

* * * * *

■ 5. Section 1.17 is amended by:

■ a. revising paragraphs (a)(1)(i)(B) and (b)(4),

■ b. adding new paragraphs (b)(7) and (b)(8), and

■ c. revising paragraphs (e)(1)(i), (e)(1)(ii), (h)(2)(vi)(C)(*1*) and (*2*), (h)(2)(vii)(A)(*1*) and (*2*), (h)(2)(vii)(B)(*1*) and (*2*), (h)(2)(viii)(A)(*1*) and (*2*), (h)(3)(ii)(A) and (B), (h)(3)(v)(A) and (B) and (h)(3)(vii), to read as follows:

§ 1.17 Minimum financial requirements for futures commission merchants and introducing brokers.

(a)(1)(i) * * *

(B) The futures commission merchant's risk-based capital requirement computed as follows:

(*1*) Eight percent of the total risk margin requirement (as defined in § 1.17(b)(8)) for positions carried by the futures commission merchant in customer accounts (as defined in § 1.17(b)(7)), plus

(*2*) Four percent of the total risk margin requirement (as defined in § 1.17(b)(8)) for positions carried by the futures commission merchant in noncustomer accounts (as defined in § 1.17(b)(4)).

* * * * *

(b) * * *

(4) ''Noncustomer account'' means a commodity futures or option account 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(y) of this title, but is not a proprietary account as defined in § 1.17(b)(3).

* * * * *

(7) ''Customer account'' means a commodity futures or option account carried on the books of the applicant or registrant which is either:

(i) An account that is included in the definition of customer (as defined in § 1.17(b)(2)), or

(ii) An account for a foreign-domiciled person trading on a foreign board of trade, where such account for the foreign-domiciled person is not a proprietary account (as defined in § 1.17(b)(3)) or a noncustomer account (as defined in § 1.17(b)(4)(ii)).

(8) ''Risk margin'' for an account means the level of maintenance margin or performance bond that the futures commission merchant is required to collect under the rules of an exchange, or the rules of a clearing organization if the level of margin to be collected is not determined by the rules of an exchange, from the owner of a customer account or noncustomer account, 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.

* * * * *

(e)(1) * * *

(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;

* * * * *

(h) * * *

(2) * * *

(vi) * * *

(C) * * *

(*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;

* * * * *

(vii) * * *

(A) * * *

(*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;

* * * * *

(B) * * *

(*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;

* * * * *

(viii) * * *

(A) * * *

(*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;

* * * * *

(h) * * *

(3) * * *

(ii) * * *

(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;

* * * * *

(v) * * *

(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;

* * * * *

(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.

* * * * *

■ 6. Section 1.18 is amended by revising paragraph (b) to read as follows:

§ 1.18 Records for and relating to financial reporting and monthly computation by futures commission merchants and introducing brokers.

* * * * *

(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 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 or Part IIA (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.

* * * * *

Issued in Washington, DC, on August 5, 2004, by the Commission.

Jean A. Webb,

Secretary of the Commission.

[FR Doc. 04–18349 Filed 8–11–04; 8:45 am]

BILLING CODE 6351–01–P

COMMODITY FUTURES TRADING COMMISSION

17 CFR Part 30

RIN 3038–AB45

Foreign Futures and Foreign Options Transactions

AGENCY: Commodity Futures Trading Commission.

ACTION: Final rule.

SUMMARY: The Commodity Futures Trading Commission (Commission or CFTC) is amending part 30 of the Commission's regulations to clarify the circumstances under which a foreign futures and options broker (FFOB) that is a member of a foreign board of trade must register or obtain an exemption from registration. The Commission has amended Rule 30.4(a) to clarify that FFOBs are not required to register as futures commission merchants (FCMs) pursuant to Rule 30.4, or to seek exemption from registration under Rule 30.10, if they only carry the following types of U.S.-related accounts that trade on or are subject to the rules of non-U.S. exchanges: Customer omnibus accounts for U.S. FCMs; U.S. affiliate accounts that are proprietary to the FFOB; and/or U.S. accounts that are proprietary to a U.S. FCM. In addition, an FFOB that has U.S. bank branches will be eligible for a Rule 30.10 comparability exemption or exemption from registration under Rule 30.4 based upon compliance with conditions specified in Rule 30.10(b)(1)–(6) and thereby will be able to carry any U.S.-related account for trades on non-U.S. exchanges. The Commission has also deleted Rule 30.4(e), which required an FCM registered under part 30 to maintain a U.S. office.

EFFECTIVE DATE: September 13, 2004.

FOR FURTHER INFORMATION CONTACT: Lawrence B. Patent, Deputy Director, or Susan A. Elliott, Special Counsel, Compliance and Registration Section, Division of Clearing and Intermediary Oversight, Commodity Futures Trading Commission. Three Lafayette Centre, 1155 21st Street, NW., Washington, DC 20581. Telephone: (202) 418–5439 or (202) 418–5464, or electronic mail: *lpatent@cftc.gov* or *selliott@cftc.gov.*

SUPPLEMENTARY INFORMATION:

I. Background

The Commission has adopted final rules that were first published for comment on August 26, 1999,[1] and republished on April 6, 2004.[2] The Commission proposed amending part 30 of its rules to clarify when foreign futures and options brokers that are members of a foreign board of trade or affiliates of U.S. FCMs must register under the Act or obtain an exemption from registration under the Act.

The Commission's part 30 rules govern, generally, the solicitation and sale of foreign futures [3] and foreign option [4] contracts to customers [5] located in the U.S. Rule 30.4(a) requires any person who solicits or accepts orders and money for foreign futures or foreign option contracts from foreign futures or foreign options customers [6] to register as an FCM under the Act. Rule 30.10 permits any person to seek exemption from any provision of part 30.

Under Rule 30.10 and Appendix A thereto, the CFTC may exempt an FFOB from compliance with certain rules, including those rules pertaining to registration, provided that a comparable regulatory system exists in the firm's home country and that certain safeguards are in place to protect U.S. investors. This exemption process requires that the CFTC issue an Order pursuant to Rule 30.10 granting general relief to the foreign regulator or self-regulatory organization and that individual firms be granted confirmation of relief upon proper application. Generally, a firm that confirms relief under Rule 30.10 must be located outside the U.S. and this relief permits a firm to solicit or accept orders from U.S.-located customers for trading on or subject to the rules of exchanges located outside of the U.S.

II. Final Rules

A. Registration Exemptions

As explained in the rule proposal, the Commission believes that it can provide clarity to its registration requirements under part 30 by specifically addressing, in Rule 30.4, when registration by an FFOB is *not* required. Thus, the Commission has amended Rule 30.4(a)

[1] 64 FR 46613 (August 26, 1999).

[2] 69 FR 17998 (April 6, 2004). The reproposal was substantially the same, except that the 1999 proposal required an entity with a U.S. bank branch applying for a Rule 30.10 exemption to file a specified set of representations with the National Futures Association (NFA), while the 2004 reproposal listed the representations as conditions for compliance with the exemption, in order to reduce the paperwork necessitated by the rule amendments.

[3] ''Foreign futures'' as defined in part 30 means ''any contract for the purchase or sale of any commodity for future delivery made, or to be made, on or subject to the rules of any foreign board of trade.'' Commission Rule 30.1(a).

[4] ''Foreign option'' as defined in part 30 means ''any transaction or agreement which is or is held out to be of the character of, or is commonly known to the trade as, an ''option'', ''privilege'', ''indemnity'', ''bid'', ''offer'', ''put'', ''call'', ''advance guaranty'', or ''decline guaranty'', made or to be made on or subject to the rules of any foreign board of trade.'' Commission Rule 30.1(b).

[5] Pursuant to Commission Rule 30.1(c), ''Foreign futures or foreign options customer'' means ''any person located in the United States, its territories or possessions who trades in foreign futures or foreign options: *Provided,* That an owner or holder of a proprietary account as defined in paragraph (y) of [Commission Rule 1.3] shall not be deemed to be a foreign futures or foreign options customer within the meaning of §§ 30.6 and 30.7 of this part.''

[6] *See* n. 5, *supra.*