



# Commodity Futures Trading Commission

## Office of Public Affairs

Three Lafayette Centre

1155 21st Street, NW

Washington, DC 20581

[www.cftc.gov](http://www.cftc.gov)

## Questions and Answers Regarding Final Retail Foreign Exchange Rule

### What is a “retail forex transaction?”

A retail forex transaction is one between an eligible counterparty and a retail customer. Generally, retail customers are:

- Individuals with less than \$10 million in total assets, or less than \$5 million in total assets if entering into the transaction to manage risk, and who are not registered as futures or securities professionals;
- Companies, other than financial institutions and investment companies, with less than \$10 million in total assets, or a net worth less than \$1 million if entering into the transaction in connection with the conduct of their businesses; and
- Commodity pools that have less than \$5 million in total assets.

### How do the CFTC Reauthorization Act and Dodd-Frank Act affect the way retail forex transactions are regulated?

Prior to the passage of the CFTC Reauthorization Act of 2008 (CRA), which modifies the Commodity Exchange Act (CEA), the CEA required that, in order to offer to serve as a counterparty to a retail forex transaction, an entity had to be one of several regulated entities, such as a financial institution, an SEC-registered broker or dealer, an insurance company, a financial holding company, an investment bank or a CFTC-registered futures commission merchant (FCM). While the CFTC had the authority to pursue fraud actions against CFTC registrants and those forex entities that were not otherwise regulated, it had no statutory authority to write rules governing the activity.

The CRA amended the CEA and provided the Commission with authority to write and enforce the rules and regulations necessary to effectuate any of the provisions of the Act in connection with off-exchange retail foreign currency futures, options, and options on futures, as well as leveraged off-exchange forex contracts offered to or entered into with retail customers. The CFTC was also given authority to write and enforce rules regarding registration of those who solicit, exercise discretionary trading authority or operate (or solicit funds for) pools in connection with any of these types of transactions.

The Dodd-Frank Wall Street Reform and Consumer Protection Act, enacted on July 21, 2010, further modified the CEA in a number of ways. It requires that all off-exchange retail foreign currency transactions be done pursuant to the rules of a Federal regulatory agency. It also requires that unless Federal regulators prepare rules regarding off-exchange retail forex transactions within specified time periods, the transactions are prohibited. If any Federal regulatory agency had already proposed such rules prior to the enactment of the Dodd-Frank Act – as had the CFTC – the agency has 90 days following enactment to adopt final rules, or the same prohibition takes effect.

The Dodd-Frank Act directs Federal regulators to prescribe appropriate requirements with respect to:  
Disclosure;

- Recordkeeping;
- Capital and margin;
- Reporting;

- Business conduct;
- Documentation; and
- Such other standards or requirements as the Federal regulatory agency shall determine to be necessary.

For the CFTC, the Dodd-Frank Act reconfirms the Commission’s authority to regulate off-exchange retail forex transactions and establishes a date – October 19, 2010 – by which final rules must be in place. For other Federal regulators whose regulatees are expressly permitted to serve as counterparties (such as United States financial institutions and broker dealers), it requires the preparation of similar rules or such transactions by their regulatees are prohibited.

### **Who can offer off-exchange forex transactions to retail customers?**

Prior to the passage of the CRA, the CEA required that, to offer to serve as a counterparty to an off-exchange retail forex transaction, an entity had to be one of several regulated entities, such as:

- Financial institutions,
- SEC-registered brokers or dealers (or their affiliates),
- Insurance companies,
- Financial holding companies,
- Investment bank holding companies, or
- CFTC-registered FCMs (or their affiliates).

The CRA retained this “regulated entity” requirement with one significant addition: retail foreign exchange dealers (RFEDs) – were added to the list of entities permitted to serve as counterparties. RFEDs are a new category of CFTC-registered entity created by the CRA.

The Dodd-Frank Act further modifies the list of eligible counterparties by eliminating insurance companies and investment bank holding companies. Moreover, where the list of eligible counterparties previously included “financial institutions,” the Dodd-Frank Act specifically provides that among financial institutions, only United States financial institutions are permitted to act as counterparties.

### **What is the scope of the CFTC’s jurisdiction with regard to off-exchange forex transactions?**

While the CEA permits several types of entities to act as counterparties to retail forex transactions, the question of who regulates the activity depends on the type of entity offering to be the counterparty. For example, SEC-registered brokers or dealers doing retail forex transactions are regulated by the SEC and financial institutions are regulated by banking regulators. The CEA provides that the CFTC has jurisdiction over FCMs, RFEDs, or entities that are not otherwise regulated.

None of the provisions of the CRA affect forex futures or options traded on exchanges, so trading of foreign currency futures and options on organized exchanges continues to be permitted under existing rules. Similarly, transactions entered into by sophisticated parties (i.e., transactions on the inter-bank market), or conducted through foreign exchange windows (where customers exchange one currency for another) are unaffected by the provisions of the CRA.

## What do the rules require?

Following the CRA’s and Dodd-Frank Act’s mandates, the CFTC has adopted final rules applicable to off-exchange retail forex transactions and the entities that offer, solicit, provide advice regarding, or operate pools involving such transactions. The final rules are based, in large part, on the CFTC’s existing regulations for commodity interest transactions and commodity interest intermediaries, as well as rules of the National Futures Association (NFA) that are already in effect with respect to retail forex transactions offered by NFA’s members. Broadly speaking, the final rules require:

- Registration of various parties engaging in retail forex business,
- Distribution of disclosure documents to customers and potential customers regarding risk and potential conflicts of interest,
- Making and keeping of various records,
- Maintenance of prescribed minimum amounts of capital, and
- Trading and operational standards.

## Who has to register under the new regulations?

Entities that wish to serve as counterparties to off-exchange retail forex transactions – and that are not among the otherwise regulated entities enumerated in the CEA – will have to register with the CFTC either as FCMs or RFEDs.

- Those that wish to engage in retail forex transactions, but would be primarily or substantially involved in on-exchange business, will be required to register as FCMs.
- Those that will serve primarily as retail forex counterparties are required to register as RFEDs.

Additionally, for the first time, entities other than RFEDs and FCMs that intermediate retail forex transactions will be required to register with the CFTC, as applicable, as introducing brokers (IBs), commodity trading advisors (CTAs), commodity pool operators (CPOs) or associated persons (APs) of such entities.

## What are the financial requirements and to whom do they apply?

The new rules implement the \$20 million minimum net capital standard established in the CRA for those registering as RFEDs or offering retail forex transactions as FCMs. The capital requirement includes an additional volume-based minimum capital amount calculated on the amount an FCM or RFED owes as counterparty to retail forex transactions.

## Do the new rules have a leverage requirement?

The proposed rules included a requirement that FCMs and RFEDs serving as counterparties in off-exchange forex transactions collect from retail customers a security deposit of 10 percent of the notional value of the transaction. This requirement has often been referred to as a “10 to 1 leverage” requirement.

The leverage requirement in the proposed rule has been replaced in the final rules with a mechanism whereby the Commission sets parameters (the release specifies a minimum 2 percent security deposit in the case of major currencies and 5 percent of the notional value of the transaction for all other currencies) and the Commission periodically reviews the appropriateness of those parameters. NFA is authorized to set specific security deposit levels within those parameters, and is required to review periodically and adjust as necessary both the particular

security deposit levels and the designation of which currencies are “major” currencies, in light of such factors as changes in volatility.

### **Are there other areas where the final rules are significantly different from the proposed rules?**

The other major difference between the proposed rules and the final rules concerns IBs. The proposed rules included a requirement that a person who registers as an IB to introduce retail forex accounts must be guaranteed by a registered FCM or RFED (and that the IB could be guaranteed by only one FCM or RFED). This proposal has been replaced in the final rules with the same requirement that currently applies to IBs who introduce futures and commodity interest accounts. Thus, a forex IB may choose either to meet the minimum net capital requirements applicable to futures and commodity options IBs, or to enter into a guarantee agreement with an FCM or an RFED.

### **When do the rules become final?**

The rules are effective as of October 18, 2010.