

# SECURITIES AND EXCHANGE COMMISSION

## 17 CFR Part 240

Release No. 34-64874; File No. S7-30-11

RIN 3235-AL19

### Retail Foreign Exchange Transactions

**AGENCY:** Securities and Exchange Commission.

**ACTION:** Interim final temporary rule; request for comments.

**SUMMARY:** Under section 742(c) of the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank Act”), certain foreign exchange transactions with persons who are not “eligible contract participants” (commonly referred to as “retail forex transactions,” and as further defined below) with a registered broker or dealer (“broker-dealer”) will be prohibited as of July 16, 2011, in the absence of the Commission adopting a rule to allow such transactions under terms and conditions prescribed by the Commission. The Commission is adopting interim final temporary Rule 15b12-1T to allow a registered broker-dealer to engage in a retail forex business until July 16, 2012, provided that the broker-dealer complies with the Securities Exchange Act of 1934 (“Exchange Act”), the rules and regulations thereunder, and the rules of the self-regulatory organization(s) of which the broker-dealer is a member (“SRO rules”), insofar as they are applicable to retail forex transactions.

**DATES:** Effective Date: Rule 15b12-1T is effective on July 15, 2011 and will remain in effect until July 16, 2012.

Comment Date: Comments on the interim final temporary rule should be received on or before September 13, 2011.

**ADDRESSES:** Comments may be submitted by any of the following methods:

Electronic comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/interim-final-temp.shtml>); or
- Send an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number S7-30-11 on the subject line; or
- Use the Federal eRulemaking Portal (<http://www.regulations.gov>). Follow the instructions for submitting comments.

Paper Comments:

- Send paper comments in triplicate to Elizabeth Murphy, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549.

All submissions should refer to File Number S7-30-11. This file number should be included on the subject line if e-mail is used. To help the Commission to process and review your comments more efficiently, please use only one method. The Commission will post all comments on its website: (<http://www.sec.gov/rules/interim-final-temp.shtml>). Comments are also available for website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549 on official business days between the hours of 10:00 a.m. and 3:00 p.m. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly.

**FOR FURTHER INFORMATION CONTACT:** Jo Anne Swindler, Assistant Director; Richard Vorosmarti, Special Counsel; or Angie Le, Special Counsel, at (202) 551-5777, Division of Trading and Markets, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549.

**SUPPLEMENTARY INFORMATION:** The Commission is adopting new Rule 15b12-1T under the Exchange Act as an interim final temporary rule. The rule will expire and no longer be effective on July 16, 2012. The Commission is soliciting comments on all aspects of this interim final temporary rule. The Commission will carefully consider any comments received and intends to take further action if it determines that further action is necessary or appropriate, either prior to or following the expiration of the rule. In making this determination, the Commission may consider a number of alternative approaches with respect to retail forex transactions, including proposing new rules for public comment; issuing a final rule amending the interim final temporary rule; issuing a final rule adopting the interim final temporary rule as final; or allowing the interim final temporary rule to expire without further action, which would allow the statutory prohibition to take effect.

## **I. Background**

On July 21, 2010, President Obama signed into law the Dodd-Frank Act.<sup>1</sup> As amended by the Dodd-Frank Act,<sup>2</sup> the Commodity Exchange Act (“CEA”) provides that a person for which there is a Federal regulatory agency,<sup>3</sup> including a broker-dealer registered under section 15(b) (except pursuant to paragraph (11) thereof) or 15C of the Exchange Act,<sup>4</sup> shall not enter into, or offer to enter into, a transaction described in section 2(c)(2)(B)(i)(I) of the CEA with a

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<sup>1</sup> Public Law 111–203, 124 Stat. 1376.

<sup>2</sup> Public Law 111–203, § 742(c)(2) (to be codified at 7 U.S.C. 2(c)(2)(E)).

<sup>3</sup> 7 U.S.C. 2(c)(2)(E)(i), as amended by § 742(c) of the Dodd-Frank Act, defines a “Federal regulatory agency” to mean the Commodity Futures Trading Commission (“CFTC”), the Securities and Exchange Commission, an appropriate Federal banking agency, the National Credit Union Association, and the Farm Credit Administration.

<sup>4</sup> 7 U.S.C. 2(c)(2)(B)(i)(II).

person who is not an “eligible contract participant”<sup>5</sup> except pursuant to a rule or regulation of a Federal regulatory agency allowing the transaction under such terms and conditions as the Federal regulatory agency shall prescribe<sup>6</sup> (“retail forex rule”).<sup>7</sup> Transactions described in CEA section 2(c)(2)(B)(i)(I) include “an agreement, contract, or transaction in foreign currency that . . . is a contract of sale of a commodity for future delivery (or an option on such a contract) or an option (other than an option executed or traded on a national securities exchange registered pursuant to section 6(a) of the Securities Exchange Act of 1934 (15 U.S.C. 78f(a)).”<sup>8</sup> A Federal regulatory agency’s retail forex rule must treat all agreements, contracts, and transactions in foreign currency described in CEA section 2(c)(2)(B)(i)(I) and all agreements, contracts, and transactions in foreign currency that are functionally or economically similar to agreements, contracts, or transactions described in CEA section 2(c)(2)(B)(i)(I), similarly.<sup>9</sup> Any retail forex

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<sup>5</sup> “Eligible contract participant” (“ECP”) is defined in CEA section 1a(18), as re-designated and amended by section 721 of the Dodd-Frank Act. See Public Law 111-203, § 721 (amending CEA section 1a). The CEA’s definition of ECP generally is comprised of regulated persons; entities that meet a specified total asset test (e.g., a corporation, partnership, proprietorship, organization, trust, or other entity with total assets exceeding \$10 million) or an alternative monetary test coupled with a non-monetary component (e.g., an entity with a net worth in excess of \$1 million and engaging in business-related hedging; or certain employee benefit plans, the investment decisions of which are made by one of four enumerated types of regulated entities); and certain governmental entities and individuals that meet defined thresholds. The Commission and the CFTC recently have proposed rules under the CEA that further define “eligible contract participant” with respect to transactions with major swap participants, swap dealers, major security-based swap participants, security-based swap dealers, and commodity pools. See Exchange Act Release No. 63452 (Dec. 7, 2010), 75 FR 80174 (Dec. 21, 2010). Because transactions that are the subject of this release are commonly referred to as “retail forex transactions,” this release uses the term “retail customer” to describe persons who are not ECPs.

<sup>6</sup> 7 U.S.C. 2(c)(2)(E)(ii)(I).

<sup>7</sup> As used in this release, “retail forex rule” refers to any rule proposed or adopted by a Federal regulatory agency pursuant to section 742(c)(2) of the Dodd-Frank Act.

<sup>8</sup> 7 U.S.C. 2(c)(2)(B)(i)(I).

<sup>9</sup> 7 U.S.C. 2(c)(2)(E)(iii)(II).

rule also must prescribe appropriate requirements with respect to disclosure, recordkeeping, capital and margin, reporting, business conduct, and documentation, and may include such other standards or requirements as the Federal regulatory agency determines to be necessary.<sup>10</sup>

This amendment to the CEA takes effect on July 16, 2011, which is 360 days from the date of enactment of the Dodd-Frank Act.<sup>11</sup> After that date, for purposes of CEA section 2(c)(2)(B), broker-dealers for which the Commission is the “Federal regulatory agency” may not engage in off-exchange retail forex futures and options with a customer except pursuant to a retail forex rule issued by the Commission.<sup>12</sup> This prohibition will not apply to (1) forex transactions with a customer who qualifies as an ECP, or (2) transactions that are spot forex contracts or forward forex contracts irrespective of whether the customer is an ECP.<sup>13</sup> However, consistent with other Federal regulatory agencies’ retail forex rules, Rule 15b12-1T applies to “rolling spot” transactions in foreign currency by broker-dealers.<sup>14</sup> The discussion of the

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<sup>10</sup> 7 U.S.C. 2(c)(2)(E)(iii)(I).

<sup>11</sup> See Public Law 111-203, § 754.

<sup>12</sup> See 7 U.S.C. 2(c)(2)(B)(i)(II) and 7 U.S.C. 2(c)(2)(E)(ii)(I). On September 10, 2010, the CFTC adopted a retail forex rule for persons subject to its jurisdiction. See Regulation of Off-Exchange Retail Foreign Exchange Transactions and Intermediaries, 75 FR 55410 (Sept. 10, 2010) (“Final CFTC Retail Forex Rule”). The CFTC had proposed its rules regarding retail forex transactions prior to the enactment of the Dodd-Frank Act. See Regulation of Off-Exchange Retail Foreign Exchange Transactions and Intermediaries, 75 FR 3282 (Jan. 20, 2010) (“Proposed CFTC Retail Forex Rule”). The Federal Deposit Insurance Corporation (“FDIC”) and the Office of the Comptroller of the Currency (“OCC”) subsequently proposed similar rules. See Retail Foreign Exchange Transactions, 76 FR 28358 (May 17, 2011); Retail Foreign Exchange Transactions, 76 FR 22633 (Apr. 22, 2011) (“Proposed OCC Retail Forex Rule”). On July 6, 2011, the FDIC adopted final retail forex rules. See Retail Foreign Exchange Transactions, 76 FR 40779 (July 12, 2011) (“Final FDIC Retail Forex Rule”).

<sup>13</sup> See 7 U.S.C. 2(c)(2)(C)(i)(I) and 7 U.S.C. 2(c)(2)(C)(i)(II); see also Final FDIC Retail Forex Rule, supra note 12; Proposed OCC Retail Forex Rule, supra note 12.

<sup>14</sup> See Final FDIC Retail Forex Rule, supra note 12 (explaining that its retail forex rule applies to rolling spot forex transactions); Proposed OCC Retail Forex Rule, supra note 12 (stating that rolling spot forex transactions should be regulated as retail forex

definition of “retail forex transaction” below addresses the distinctions between rolling spot forex transactions and spot and forward forex contracts.

Prior to June 2011, the Commission had not been made aware of industry concerns with respect to the operation of section 742 of the Dodd-Frank Act in the absence of Commission rulemaking. In mid-June 2011, however, market participants for the first time brought to the attention of Commission staff the possibility that section 742 of the Dodd-Frank Act may have serious adverse consequences for certain securities markets in the absence of rulemaking by the Commission before the impending effective date of the provision (i.e., July 16, 2011).<sup>15</sup>

Although this correspondence from market participants brought this issue to the attention of Commission staff, the Commission understands that this is in fact a wider concern shared by several other market participants. One potential consequence concerns the ability of broker-dealers to facilitate the settlement of foreign securities transactions for retail customers. For example, a broker-dealer may purchase a foreign currency or exchange a foreign currency for U.S. dollars on behalf of a retail customer in connection with the customer’s purchase or sale of a security listed on a foreign exchange and denominated in the foreign currency. In particular, a representative of certain market participants informed the staff that section 742 could operate to preclude broker-dealers from continuing to engage in certain foreign exchange transactions that

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transactions); Final CFTC Retail Forex Rule, supra note 12 (stating that the CFTC has the authority to fully regulate “look-alike,” leveraged forex contacts, also called off-exchange Zelener contracts; as discussed below, Zelener contracts are also called rolling spot transactions); Proposed CFTC Retail Forex Rule, supra note 12 (“The [CFTC Reauthorization Act of 2008] amends the [CEA] to require that certain intermediaries for forex futures and options and for look-alike contracts (i.e., those at issue in Zelener) register in such capacity as the Commission shall determine . . .”).

<sup>15</sup> See Memorandum from P. Georgia Bullitt, Morgan Lewis, on Pershing LLC – Proposed Relief regarding transactions in Retail Foreign Exchange to James Brigagliano et al. (June 17, 2011) (available at <http://www.sec.gov/comments/other/other-initiatives/otherinitatives-56.pdf>) (“Morgan Lewis Memo”).

are inherent in certain of their customers' securities transactions, and that serve to minimize their customers' risk exposure to changes in foreign currency rates.<sup>16</sup>

The Commission further understands that there may be other situations in which broker-dealers engage in foreign exchange transactions in connection with facilitating the ordinary execution, clearance, or settlement of customers' securities transactions and that may warrant rulemaking by the Commission in order to avoid market disruption due to the potential application of section 742 of the Dodd-Frank Act. At the same time, the Commission notes that media coverage over the past few years has highlighted potentially abusive practices by some intermediaries in connection with retail forex transactions.<sup>17</sup> The Commission also notes that other regulators have expressed concerns with regard to the retail forex practices of the entities that they regulate.<sup>18</sup>

In order to provide the Commission with the opportunity to receive comments regarding practices in this area and to consider prescribing additional rules to address investor protection concerns (e.g., abusive sales practices, volatility and riskiness of the forex market)<sup>19</sup> as they

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<sup>16</sup> See id.

<sup>17</sup> See Gregory Zuckerman, Carrick Mollenkamp & Lingling Wei, Suspicion of Forex Gouging Spreads, The Wall Street Journal (Feb. 10, 2011) at A1 (describing allegations of overcharging of customers by custody banks in currency trades).

<sup>18</sup> See, e.g., Press Release, CFTC, CFTC Releases Final Rules Regarding Retail Forex Transactions (Aug. 30, 2010) (available at <http://www.cftc.gov/PressRoom/PressReleases/pr5883-10.html?dbk>) (noting that retail forex is the largest area of retail fraud that the CFTC oversees); see also the Financial Industry Regulatory Authority's ("FINRA") Regulatory Notice 08-66, (Retail Foreign Currency Exchange) (November 2008) ("FINRA Forex Notice") (describing the retail forex market as opaque, volatile, and risky).

<sup>19</sup> In one of its notices to members, FINRA identified several investor protection concerns, including, among other things, the following: "[t]he retail customer typically does not having pricing information and cannot determine whether the price quoted by the dealer is fair"; "the dealer acts as counterparty and establishes the price, which means that the dealer has a conflict of interest in the transaction"; "[p]rice comparisons are also

affect the regulatory treatment of retail forex transactions by broker-dealers – while also preserving potentially beneficial market practices identified to the Commission only weeks before the July 16, 2011 effective date for section 742 of the Dodd-Frank Act – the Commission today is adopting interim final temporary Rule 15b12-1T under the Exchange Act to enable broker-dealers to engage in a retail forex business under the existing regulatory regime for one year. By receiving comments regarding practices in this area, the Commission will be better positioned to determine, for example, the scope of retail forex business conducted by broker-dealers that may be beneficial and poses limited risk to customers and any aspects of the business that may pose substantial undue risks to customers. The Commission will carefully consider comments on what additional rulemaking may be necessary, if any.

## **II. Discussion**

The Commission is adopting interim final temporary Rule 15b12-1T to maintain the ability of broker-dealers to engage in a retail forex business during a one-year period under the existing regulatory framework that now applies to broker-dealers providing these services. The Commission solicits comment on each aspect of the rule and the nature and circumstances surrounding retail forex business conducted by broker-dealers. The Commission intends to carefully consider comments received to determine what further regulatory action, if any, would be appropriate. In making this determination, the Commission may consider a number of alternatives with respect to retail forex transactions, including proposing new rules for public comment; issuing a final rule amending the interim final temporary rule; issuing a final rule

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complicated by different compensation structures”; and “[t]he currency market is extremely volatile and retail forex customers are exposed to substantial currency risk.” See FINRA Forex Notice, supra note 18.



adopting the interim final temporary rule as final; or allowing the interim final temporary rule to expire without further action, which would allow the statutory prohibition to take effect.

**A. Rule 15b12-1T(a): Definitions**

Rule 15b12-1T(a) sets forth the definitions of terms specific to the interim final temporary rule. Many of the terms (i.e., broker, dealer, person, registered broker or dealer, and self-regulatory organization) have the same meanings as in the Exchange Act. The term “Act,” as used in the rule, refers to the Exchange Act.<sup>20</sup> The Commission chose these terms and definitions because their meanings are readily understood in the industry.

The term “retail forex business” is defined as “engaging in one or more retail forex transactions with the intent to derive income from those transactions, either directly or indirectly.”<sup>21</sup> This definition mirrors the definition contained in the FDIC’s final retail forex rules and the OCC’s proposed rules.<sup>22</sup> This term is intended to include retail forex transactions that may not generate income to the broker-dealer or a retail forex business that is ultimately not profitable. The Commission chose this definition because it focuses on the intent to engage in a series of forex transactions with a business purpose, whether or not the transactions result in income or profits.

The term “retail forex transaction” is defined as “any account, agreement, contract or transaction in foreign currency that is offered or entered into by a broker or dealer with a person that is not an eligible contract participant as defined in section 1a(18) of the Commodity Exchange Act (7 U.S.C. 1a(18)) and that is: (i) a contract of sale of a commodity for future

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<sup>20</sup> Exchange Act Rule 15b12-1T(a)(1).

<sup>21</sup> Exchange Act Rule 15b12-1T(a)(2).

<sup>22</sup> See Final FDIC Retail Forex Rule, supra note 12; Proposed OCC Retail Forex Rule, supra note 12 (each defining “retail forex business”).

delivery or an option on such a contract; (ii) an option, other than an option executed or traded on a national securities exchange registered pursuant to section 6(a) of the Act (15 U.S.C. 78(f)(a)); or (iii) offered, or entered into, on a leveraged or margined basis, or financed by a broker or dealer or any person acting in concert with the broker or dealer on a similar basis, other than: (A) a security that is not a security futures product as defined in section 1a(47) of the Commodity Exchange Act (7 U.S.C. 1a(47)); or (B) a contract of sale that: (1) results in actual delivery within two days; or (2) creates an enforceable, obligation to deliver between a seller and buyer that have the ability to deliver and accept delivery, respectively, in connection with their line of business.”<sup>23</sup> This definition is based on the CEA, incorporates the terms described in CEA sections 2(c)(2)(B) and 2(c)(2)(C),<sup>24</sup> and is substantially the same as the definition in the FDIC’s final section 349.2<sup>25</sup> and the OCC’s proposed section 48.2.<sup>26</sup> This definition has at least two important features.

First, certain transactions in foreign currency are excluded from the definition of the term “retail forex transaction.” For example, the CEA expressly excludes “a contract of sale [in foreign currency] that . . . results in actual delivery within 2 days.”<sup>27</sup> As defined by court decisions as well as the retail forex rules of other Federal regulatory agencies, this term refers to a “spot” forex transaction, in which one currency is purchased for another, the transaction is settled within two days, and actual delivery occurs as soon as practicable.<sup>28</sup> Similarly, based

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<sup>23</sup> Exchange Act Rule 15b12-1T(a)(3).

<sup>24</sup> 7 U.S.C. 2(c)(2)(B) and 7 U.S.C. 2(c)(2)(C).

<sup>25</sup> See Final FDIC Retail Forex Rule, supra note 12 (defining “retail forex transaction”).

<sup>26</sup> See Proposed OCC Retail Forex Rule, supra note 12 (defining “retail forex transaction”).

<sup>27</sup> See 7 U.S.C. 2(c)(2)(C)(i)(II).

<sup>28</sup> See generally *CFTC v. Int’l Fin. Servs. (New York), Inc.*, 323 F. Supp. 2d 482, 495 (S.D.N.Y. 2004) (distinguishing between foreign exchange futures contracts and spot

upon the language in the CEA,<sup>29</sup> a “retail forex transaction” does not include a contract of sale that creates an enforceable obligation to deliver between a buyer and seller that have the ability to deliver and accept delivery, respectively, in connection with their line of business.<sup>30</sup> This statutory language refers to a retail forex forward contract with a commercial entity that creates an enforceable obligation to make or take delivery, provided the commercial counterparty has the ability to make delivery and accept delivery in connection with its line of business.<sup>31</sup> In addition, consistent with the approach of other Federal regulatory agencies’ retail forex rules, the

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contracts in foreign exchange, and noting that spot transactions – unlike futures contracts – ordinarily call for settlement within two days); see also Bank Brussels Lambert v. Intermetals Corp., 779 F. Supp. 741, 748 (S.D.N.Y. 1991) (noting that the spot market is essentially the current market rather than the market for future delivery); Final FDIC Retail Forex Rule, supra note 12 (explaining that its retail forex rule does not apply to spot forex contracts); Proposed OCC Retail Forex Rule, supra note 12 (explaining that its retail forex rule does not apply to spot forex contracts); Final CFTC Retail Forex Rule, supra note 12 (defining “retail forex transaction” as any account, agreement, contract or transaction described in section 2(c)(2)(B) or 2(c)(2)(C) of the CEA; as discussed above, by its terms, CEA section 2(c)(2)(C)(i)(II) excludes what are referred to as spot forex transactions).

<sup>29</sup> See 7 U.S.C. 2(c)(2)(C)(i)(II).

<sup>30</sup> Exchange Act Rule 15b12-1T(a)(3)(iii)(B)(2).

<sup>31</sup> See generally CFTC v. Int’l Fin. Servs. (New York), Inc., 323 F. Supp. 2d at 495 (distinguishing between forward contracts in foreign exchange and foreign exchange futures contracts); see also William L. Stein, The Exchange-Trading Requirement of the Commodity Exchange Act, 41 Vand. L. Rev. 473, 491 (1988). In contrast to forward contracts, futures contracts generally include several or all of the following characteristics: (i) standardized nonnegotiable terms (other than price and quantity); (ii) parties are required to deposit initial margin to secure their obligations under the contract; (iii) parties are obligated and entitled to pay or receive variation margin in the amount of gain or loss on the position periodically over the period the contract is outstanding; (iv) purchasers and sellers are permitted to close out their positions by selling or purchasing offsetting contracts; and (v) settlement may be provided for by either (a) cash payment through a clearing entity that acts as the counterparty to both sides of the contract without delivery of the underlying commodity; or (b) physical delivery of the underlying commodity. See Edward F. Greene et al., U.S. Regulation of International Securities and Derivatives Markets § 14.08[2] (8th ed. 2006). See also Final FDIC Retail Forex Rule, supra note 12; Proposed OCC Retail Forex Rule, supra note 12 (each explaining that their retail forex rule would not apply to forex forward contracts).

definition does not include forex transactions executed or traded on an exchange or designated contract market.<sup>32</sup>

Second, a “rolling spot” forex transaction (also known as a Zelener contract),<sup>33</sup> including without limitation such a transaction traded on the Internet, through a mobile phone, or on an electronic platform, falls within the definition of “retail forex transaction,”<sup>34</sup> and thus is not excluded from the definition as a “spot” transaction. This interpretation is consistent with the approach of other Federal regulatory agencies acting pursuant to section 742 of the Dodd-Frank Act to treat all agreements, contracts, and transactions in foreign currency described in CEA section 2(c)(2)(B)(i)(I) and all agreements, contracts, and transactions in foreign currency that are functionally or economically similar to agreements, contracts, or transactions described in

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<sup>32</sup> See Final CFTC Retail Forex Rule, supra note 12; Final FDIC Retail Forex Rule, supra note 12; Proposed OCC Retail Forex Rule, supra note 12.

<sup>33</sup> See CFTC v. Zelener, 373 F.3d 861 (7th Cir. 2004); see also CFTC v. Erskine, 512 F.3d 309 (6th Cir. 2008) (discussing Zelener contracts).

<sup>34</sup> CEA section 2(c)(2)(E)(ii) refers to agreements, contracts, or transactions described in CEA section 2(c)(2)(B)(i)(I) (which is incorporated into subparts (i) and (ii) of the Commission’s definition of “retail forex transaction”). In addition, CEA section 2(c)(2)(E)(iii)(II) requires the Commission to treat similarly all agreements, contracts, and transactions in foreign currency described in CEA section 2(c)(2)(B)(i)(I) and all agreements, contracts, and transactions that are functionally or economically similar to agreements, contracts, or transactions described in CEA section 2(c)(2)(B)(i)(I). The Commission preliminarily believes that agreements, contracts, and transactions described in CEA section 2(c)(2)(C)(i) (including rolling spot forex transactions) are functionally or economically similar to agreements, contracts, or transactions described in CEA section 2(c)(2)(B)(i)(I). Therefore, the Commission is defining “retail forex transaction” to encompass the types of agreements, contracts, and transactions described in CEA section 2(c)(2)(C)(i), such as rolling spot forex transactions, and is reflected in subpart (iii) of the Commission’s definition. See also Final FDIC Retail Forex Rule, supra note 12; Proposed OCC Retail Forex Rule, supra note 12 (both concluding that rolling spot forex transactions are more like futures than spot contracts). Some courts have held these contracts to be spot contracts in form. See, e.g., CFTC v. Erskine, 512 F.3d 309, 326 (6th Cir. 2008); CFTC v. Zelener, 373 F.3d 861, 869 (7th Cir. 2004).

CEA section 2(c)(2)(B)(i)(I), similarly.<sup>35</sup> Like a spot forex transaction, a rolling spot forex transaction with a retail customer may initially require delivery of currency within two days. In practice, however, contracts with a retail customer for a rolling spot forex transaction may be indefinitely renewed every other day, and no currency is actually delivered until one party affirmatively closes out the position.<sup>36</sup> The Commission preliminarily believes that a contract with a retail customer for a rolling spot forex transaction is economically more similar to a retail forex future, as described in CEA section 2(c)(2)(B)(i)(I), than a spot forex contract.

**B. Rule 15b12-1T(b): Broker-dealers Engaged in a Retail Forex Business**

Rule 15b12-1T(b) allows any registered broker or dealer to engage in a retail forex business provided that such broker or dealer complies with the Exchange Act, the rules and regulations thereunder, and the SRO rules, including, but not limited to, the disclosure, recordkeeping (or documentation), capital and margin, reporting, and business conduct requirements, insofar as they are applicable to retail forex transactions. In order for broker-dealers to engage in retail forex transactions after July 16, 2011, the Commission must adopt rules prescribing appropriate requirements with respect to disclosure, recordkeeping, capital and margin, reporting, business conduct, documentation,<sup>37</sup> and such other standards or requirements that the Commission determines to be necessary.<sup>38</sup> Because broker-dealers engaging in a retail

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<sup>35</sup> 7 U.S.C. 2(c)(2)(E)(iii)(II); see also Final FDIC Retail Forex Rule, supra note 12; Proposed OCC Retail Forex Rule, supra note 12.

<sup>36</sup> For example, in Zelener, the retail forex dealer retained the right, at the date of delivery of the currency, to deliver the currency, roll the transaction over, or offset all or a portion of the transaction with another open position held by its customer. See CFTC v. Zelener, 373 F.3d 861, 868 (7th Cir. 2004).

<sup>37</sup> The Commission considers the documentation requirements as a subset of recordkeeping requirements. To avoid confusion, the Commission will refer to these requirements collectively as recordkeeping requirements.

<sup>38</sup> See Public Law 111-203, § 742(c)(2) (amending CEA section 2(c)(2)).

forex business are already subject to numerous regulatory requirements with respect to this business under the Exchange Act, the rules and regulations thereunder, and SRO rules, the Commission does not intend to create any new obligations under this interim final temporary rule for broker-dealers that are engaged in a retail forex business. The Commission provides below illustrative examples of obligations, including certain SRO requirements, applicable to broker-dealers' retail forex transactions.<sup>39</sup>

#### Disclosure Requirements

Broker-dealers that engage in a retail forex business must comply with the disclosure requirements in NASD Rule 2210.<sup>40</sup> NASD Rule 2210 requires all communications with the public by members of FINRA – including forex-related communications – to be based on principles of fair dealing and good faith, to be fair and balanced, and to provide a sound basis for evaluating the facts regarding the market generally and a customer's specific transaction.<sup>41</sup> NASD Rule 2210 further prohibits broker-dealers from making “any false, exaggerated, unwarranted or misleading statement or claim in any communication with the public.” As stated in the FINRA Forex Notice, a broker-dealer's communications with the public “must adequately disclose the risks associated with forex trading, including the risks of highly leveraged trading,” and a broker-dealer “must also make sure that [its] communications with the public are not misleading regarding, among other things: [t]he likelihood of profits or the risks of forex trading, including leveraged trading; [t]he firm's role in or compensation from the trade; [t]he firm's or the customer's access to the interbank currency market; or [t]he performance or accuracy of

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<sup>39</sup> In this connection, the Commission notes that in the FINRA Forex Notice, FINRA described specific FINRA rules that apply to retail forex activities of broker-dealers, which are referenced below. See FINRA Forex Notice, supra note 18.

<sup>40</sup> See id.

<sup>41</sup> See id.

electronic trading platforms or software sold or licensed by or through the firm to customers in connection with forex trading, including falsely advertising claims regarding slippage rates.”<sup>42</sup>

Further, FINRA stated in its regulatory notice to members that FINRA Rule 2010 (formerly NASD Rule 2110), which requires broker-dealers, in the conduct of their business, to observe high standards of commercial honor and just and equitable principles of trade, applies to all of a broker-dealer’s business, including its retail forex business.<sup>43</sup> FINRA stated, for example, that to comply with FINRA Rule 2010, a member firm must adequately disclose to its retail customers that the firm is acting as a counterparty to a transaction, the risks associated with forex trading, and the risks and terms of leveraged trading.<sup>44</sup>

#### Recordkeeping Requirements

Exchange Act Rules 17a-3 and 17a-4 require a broker-dealer to make, keep current, and preserve records regarding its business. For example, Exchange Act Rules 17a-3(a)(2) and 17a-3(a)(11) require a broker-dealer to make and keep current a general ledger, which provides details relating to all assets, liabilities, and nominal accounts.

A broker-dealer is also required to preserve, for a period of not less than three years, originals of all communications received and copies of all communications (and any approvals thereof) sent by the broker-dealer relating to its business as such, including all communications that are subject to SRO rules regarding communications with the public.<sup>45</sup> As discussed above,

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<sup>42</sup>

Id.

<sup>43</sup>

Id.

<sup>44</sup>

Id.

<sup>45</sup>

Exchange Act Rule 17a-4(b)(4). See Exchange Act Release No. 44992 (Oct. 26, 2001), 66 FR 55818 (Nov. 23, 2001).

communications with the public regarding retail forex are subject to NASD Rule 2210.<sup>46</sup> In addition, Exchange Act Rule 17a-4(b)(7) requires a broker-dealer to preserve, for a period of not less than three years, all written agreements (or copies thereof) entered into by the broker-dealer relating to its business as such, including agreements with respect to any account. Accordingly, broker-dealers must preserve, for a period of not less than three years, originals of all communications received and copies of all communications (and any approvals thereof) sent by the broker-dealer and any written agreements with respect to retail forex transactions.

Another example of recordkeeping requirements applicable to retail forex transactions derives from the Bank Secrecy Act (“BSA”), as amended by the USA PATRIOT Act and implemented under rules promulgated by the U.S. Treasury Department’s Financial Crimes Enforcement Network (“FinCEN”), which requires broker-dealers to make, keep, retain, and report certain records that have a high degree of usefulness for the purposes of criminal, tax, or regulatory matters.<sup>47</sup> Exchange Act Rule 17a-8 requires broker-dealers to comply with the reporting, recordkeeping, and record retention requirements of the BSA’s implementing regulations.<sup>48</sup>

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<sup>46</sup> See supra note 40 and accompanying text regarding NASD Rule 2210 (communications with the public).

<sup>47</sup> See 31 C.F.R. Chapter X (formerly 31 C.F.R. Part 103); see also 67 FR 44048 (July 1, 2002) (amendments to BSA regulations requiring that a broker-dealer report suspicious transactions).

<sup>48</sup> See Exchange Act Release No. 18321 (Dec. 10, 1981); 46 FR 61454 (Dec. 17, 1981); see also FINRA Rule 3310 (formerly NASD Rule 3011) (requiring FINRA member firms to establish and implement policies and procedures that can be reasonably expected to detect and cause the reporting of suspicious transactions). As FINRA noted, “FINRA member firms engaging in retail forex activities should ensure their Anti-Money Laundering Program addresses the risks associated with the business and includes procedures for monitoring, detecting, and reporting suspicious transactions associated with their retail forex activities.” FINRA Forex Notice, supra note 18.



### Net Capital and Margin Requirements

Each broker-dealer must comply with Exchange Act Rule 15c3-1, which prescribes minimum regulatory net capital requirements for broker-dealers and is applicable to all business activities of the broker-dealer, including forex. The Commission notes that, under Exchange Act Rule 15c3-1, any uncollateralized current exposure by a broker-dealer to retail forex transactions must be deducted when computing the firm's net capital. The provisions of the net capital rule dealing with contractual commitment charges under Rule 15c3-1(c)(2)(viii) also apply to commitments with respect to foreign currency. Further, pursuant to Exchange Act section 7, broker-dealer margin requirements are generally set according to Regulation T<sup>49</sup> and SRO margin rules.<sup>50</sup>

### Reporting Requirements

A broker-dealer is required to file with the Commission periodic financial and operational reports (i.e., FOCUS Reports), as prescribed in Exchange Act Rule 17a-5, that include relevant information regarding the broker-dealer, including information regarding its retail forex business,

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<sup>49</sup> 12 C.F.R. Part 220.

<sup>50</sup> In 2009, FINRA solicited comment on proposed FINRA Rule 2380 to establish a leverage limitation for retail forex. Specifically, proposed FINRA Rule 2380, as modified by Amendment No. 2, would prohibit any member firm from permitting a customer to: (1) initiate any forex position with a leverage ratio of greater than 4 to 1; and (2) withdraw money from an open forex position that would cause the leverage ratio for such position to be greater than 4 to 1. In addition, it would exempt from the proposed leverage limitation any security as defined in Exchange Act section 3(a)(10). See FINRA Regulatory Notice 09-06 (Retail Forex) (January 2009). FINRA filed Amendment No. 1 to the proposed rule change on August 27, 2009. See Letter from Gary L. Goldsholle, Vice President and Associate General Counsel, FINRA, to Elizabeth M. Murphy, Secretary, Commission (Aug. 27, 2009). On November 12, 2009, FINRA filed Amendment No. 2 to the proposed rule. Amendment No. 2 replaced and superseded Amendment No. 1 in its entirety. The proposed rule change, as modified by Amendment No. 2, was published for comment in the Federal Register on December 8, 2009. Exchange Act Release No. 61090 (Dec. 1, 2009), 74 FR 64776 (Dec. 8, 2009).

if any. In addition, FINRA has advised its member firms that a broker-dealer's expansion of its business to include retail forex transactions constitutes a material change in business operations pursuant to NASD Rule 1017(a), and broker-dealers must first apply for and receive approval from FINRA to conduct this activity.<sup>51</sup> Additionally, as discussed above, Exchange Act Rule 17a-8 requires broker-dealers to report to FinCEN certain enumerated types of transactions, including suspicious transactions in foreign currencies and foreign currency futures and options.<sup>52</sup>

#### Business Conduct Requirements

In the course of complying with certain Exchange Act requirements, rules and regulations thereunder, and SRO rules relating to business conduct, broker-dealers must address their retail forex business. For example, as discussed above, FINRA Rule 2010 (formerly NASD Rule 2110), which requires broker-dealers, in the conduct of their business, to observe high standards of commercial honor and just and equitable principles of trade, applies to all of a broker-dealer's business, including its retail forex business.<sup>53</sup> FINRA has noted that the following examples of conduct in relation to a retail forex business are prohibited under FINRA Rule 2010, including: misappropriating or mishandling customer funds; using, selling, or leasing electronic trading platforms that allow "slippage" of trade executions in a manner that disproportionately or unfairly affects the customer; manipulating or displaying false quotes; offering mock, or "demonstration," accounts that do not accurately reflect the risks of forex trading; making post-execution price adjustments that are inappropriate and unfavorable to the customer; soliciting

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<sup>51</sup> See FINRA Forex Notice, supra note 18 (emphasizing that a broker-dealer's expansion of business into retail forex constitutes a material change in business operations under NASD rules).

<sup>52</sup> See supra note 48 and accompanying text.

<sup>53</sup> See FINRA Forex Notice, supra note 18.

business for and introducing customers to a forex dealer without conducting adequate due diligence on the forex dealer, or in a way that misleads the customer about the forex dealer or forex trading, including how customer funds will be held; failing to conduct due diligence on any solicitors that introduce forex customers to the broker-dealer; and accepting forex-related trades from an entity or individual that solicits retail forex business on behalf of the firm in a misleading or deceptive way.<sup>54</sup>

Broker-dealers also need to address retail forex transactions in connection with the customer reserve bank account requirements under Exchange Act Rule 15c3-3. In calculating what amount, if any, a broker-dealer must deposit on behalf of its customers in a reserve bank account pursuant to Exchange Act Rule 15c3-3(e), the broker-dealer must use the formula set forth in Exchange Act Rule 15c3-3a. Specifically, the Commission staff has interpreted Exchange Act Rule 15c3-3 to require that the broker-dealer must include the net balance due to customers in non-regulated commodity accounts, reduced by any deposits of cash or securities with any clearing organization or clearing broker in connection with the open contracts in such accounts.<sup>55</sup>

Furthermore, Exchange Act section 15(b)(4)(E) authorizes the Commission to impose sanctions against a broker-dealer for failing reasonably to supervise another person subject to the firm's supervision who committed a violation of specified laws, including the CEA, unless the broker-dealer established procedures, and a system for applying such procedures, that would

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<sup>54</sup> See id.

<sup>55</sup> See Division of Market Regulation's Interpretations of Rule 15c3-3 under the Securities Exchange Act of 1934, Exchange Act Release No. 9922 (Jan. 2, 1973); see also FINRA Forex Notice, supra note 18 (stating that the requirement in Exchange Act Rule 15c3-3 applies to forex transactions).

reasonably be expected to prevent and detect, insofar as practicable, the violation of law.<sup>56</sup> Thus, broker-dealers engaged in a retail forex business should include in their policies and procedures mechanisms to prevent and detect potential violations of applicable laws and regulations in connection with that business.

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The examples provided above are not inclusive of all regulatory requirements administered by the Commission that are implicated by retail forex business conducted by broker-dealers. By providing these examples, the Commission does not intend to suggest that other provisions, rules and regulations, including antifraud provisions and SRO rules, may not apply to retail forex business. At the same time, this interim final temporary rule is not intended to impose new regulatory obligations for broker-dealers, in connection with such business.

**C. Rule 15b12-1T(c): Broker-dealers Deemed to be Acting Pursuant to a Commission Rule**

Rule 15b12-1T(c) provides that any registered broker or dealer that engages in a retail forex business in compliance with paragraph (b) of this rule on or after the effective date of this rule will be deemed, until July 16, 2012, to be acting pursuant to rule or regulation described in CEA section 2(c)(2)(E)(ii)(I), as amended by section 742 of the Dodd-Frank Act. This rule will allow broker-dealers that engage in a retail forex business to do so until July 16, 2012, subject to compliance with existing applicable requirements.

Rule 15b12-1T(c) applies to broker-dealers that prior to the effective date of the rule had entered into retail forex transactions that continue after the effective date. The rule also applies to broker-dealers that begin after the rule's effective date to engage in retail forex transactions. As the Commission explained above, FINRA has advised its member firms that a broker-dealer

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<sup>56</sup> See 15 U.S.C. 78o(b)(4)(E).

that expands into a retail forex business must first apply for and receive approval to conduct this activity, as a change in business operations pursuant to NASD Rule 1017(a).<sup>57</sup>

#### **D. Rule 15b12-1T(d): Expiration**

Rule 15b12-1T(d) provides that the rule will expire and no longer be effective on July 16, 2012. The Commission believes that the sunset date is appropriate because it will allow the existing regulatory framework for a retail forex business to continue for a defined period and thereby give the Commission sufficient time to determine what further appropriate steps, if any, to take with respect to a retail forex business.

### **III. Request for Comment**

The Commission is requesting comments from all members of the public regarding all aspects of the interim final temporary rule and the current market practices involving retail forex transactions, as well as any investor protection or other concerns that should be addressed by Commission rulemaking. The Commission particularly requests comments from the point of view of broker-dealers that are presently engaged in a retail forex business, broker-dealers that plan to engage in such a business, customers that use retail forex transactions, and ECPs. Together with continued discussions with market participants and other regulators, the Commission considers this rulemaking to be an important avenue for gathering more information from affected parties about the current scope and nature of retail forex transactions. Such information will inform the Commission's thoughtful review of the appropriate regulatory framework for retail forex transactions before or beyond the expiration of the interim final rule. The Commission also seeks comment on the particular questions below, which have been designed to elicit a robust discussion of the uses and reasons for such transactions as they occur

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<sup>57</sup> See FINRA Forex Notice, *supra* note 18.

today, as well as the potential need for additional regulation. The Commission will carefully consider all comments received, and will benefit especially from detailed comments and comments responding to other commentary in the public file for this rulemaking.

#### Interim Final Temporary Rule

1. Should the Commission clarify or modify any of the definitions included in Rule 15b12-1T? If so, which definitions and what specific modifications are appropriate or necessary?
2. Are the requirements in Rule 15b12-1T sufficiently clear? Is additional guidance from the Commission necessary?
3. Rule 15b12-1T is an interim final temporary rule that is set to expire on July 16, 2012. Should the Commission extend the expiration date of the rule and if so, for how long?

#### Possible Permanent Rule Regulating a Retail Forex Business

4. Should the Commission propose new rules relating to the retail forex business operated by broker-dealers for public comment, issue a final rule amending the interim final temporary rule, issue a final rule adopting the interim final temporary rule as final, or allow the interim final temporary rule to expire without further action, which would allow the statutory prohibition to take effect? If further rulemaking is appropriate, what should those rules provide?
5. Should the Commission prohibit a broker-dealer from engaging in retail forex transactions altogether? Alternatively, should the Commission prohibit a broker-dealer from engaging in retail forex transactions other than forex transactions engaged in solely (1) to effect the purchase or sale of a foreign security or in order to

- clear or settle such purchase or sale, or (2) to facilitate distribution to customers of monies or securities received through corporate actions (e.g., coupons, dividends, class action settlements, and rights offerings) with respect to foreign securities?
- Should the Commission permit other retail forex transactions that otherwise facilitate customers' securities transactions and minimize risk exposure to customers from changes in foreign currency rates? Do investors have adequate recourse against broker-dealers for any misconduct related to retail forex transactions? Would retail forex customers be harmed if broker-dealers were unable to provide them with certain forex-related services? Which services? What benefits might retail forex customers receive in connection with forex-related services offered by broker-dealers, as compared to other intermediaries? Would the benefits outweigh potential harm?
6. Should the Commission adopt rules modeled on the Final CFTC Retail Forex Rule, the Final FDIC Retail Forex Rule, or the Proposed OCC Retail Forex Rule? If so, which aspects of those rules should the Commission consider adopting? What would be the associated costs and benefits?
  7. Should the Commission adopt final permanent rules governing retail forex transactions? If so, what should those rules address?
  8. Are there any requirements or prohibitions not covered in the Final CFTC Retail Forex Rule, the Final FDIC Retail Forex Rule, or the Proposed OCC Retail Forex Rule that the Commission should address? Do existing Exchange Act provisions, rules and regulations thereunder, and SRO rules governing broker-dealers appropriately protect retail forex customers of broker-dealers? Should the

Commission consider rulemaking to address any concerns that are not adequately addressed under the current regulatory framework?

9. What distinctive characteristics of retail forex transactions should the Commission take into consideration if it were to engage in further rulemaking relating to such transactions? Are there certain types of retail forex transactions (e.g., rolling spot transactions) that warrant Commission rulemaking to address specific disclosure and other investor protection concerns?<sup>58</sup>

Business Practices of Broker-dealers Engaged in Retail Forex Transactions

10. What is the extent of the retail forex business currently conducted by broker-dealers? Does the retail forex business currently conducted by broker-dealers consist solely or primarily of forex transactions to facilitate customers' securities transactions and minimize risk exposure to customers from changes in foreign currency rates? In general, what proportion of the retail forex business currently conducted by broker-dealers do such transactions account for? Please provide as comprehensive of a description as possible of the retail forex activities of broker-dealers.
11. For what other reasons do broker-dealers engage in retail forex transactions and what proportion of the retail forex business currently conducted by broker-dealers do such transactions account for? What benefits do these transactions provide to customers? What risks do customers face by engaging in such transactions?
12. Provide estimates of the absolute size of the retail forex business (in both dollar amounts and numbers of transactions) conducted by the broker-dealer. What does

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<sup>58</sup> See, e.g., Gregory Zuckerman, Carrick Mollenkamp & Lingling Wei, Suspicion of Forex Gouging Spreads, The Wall Street Journal (Feb. 10, 2011) at A1 (describing allegations of overcharging of customers by custody banks in currency trades).



this business represent as an estimated percent of the broker-dealer's total business?

As an estimated percent of its total forex business?

13. What is the estimated absolute size of the retail forex business (in both dollar amounts and numbers of transactions) conducted by broker-dealers overall? What does this business represent as a percent of their total business? As a percent of their total forex business?
14. What types of customers engage in retail forex transactions, including rolling spot forex transactions?
15. Is the existing regulatory framework for retail forex business as currently conducted by broker-dealers consistent with the protection of investors, the maintenance of fair, orderly, and efficient markets, and the facilitation of capital formation?
16. What disclosures do broker-dealers provide to their customers regarding forex transactions that are conducted to facilitate settlement of securities transactions? What disclosures do broker-dealers provide to customers regarding forex transactions that are conducted for other purposes (e.g., at the customer's request to hedge against currency exchange risk exposure associated with securities transactions, or to engage in speculative activity)? Do broker-dealers adequately and fully disclose the risks associated with forex trading? Do broker-dealers provide information to customers regarding pricing of forex transactions (e.g., pricing methodology, exchange rates for foreign currencies, how the price was calculated)? If so, is this information provided in advance of or following the forex transactions?
17. On what basis do broker-dealers price retail forex transactions? For example, do broker-dealers use the end-of-day currency exchange rate or some other benchmark?

- Do broker-dealers maintain policies and procedures that govern how forex transactions are handled and priced for retail forex customers? If broker-dealers do not provide pricing information to retail customers, what documentation does the broker-dealer maintain to demonstrate the price provided in retail forex transactions?
18. Are transaction-time records for retail forex transactions currently created and provided to retail customers? If not, what would be the cost to create transaction-time records for retail forex transactions? What would be the cost to report to customers the transaction time and/or the source or basis for the currency exchange rate provided on retail forex transactions?
19. For broker-dealers that provide custody services to retail customers, please describe any retail forex business conducted with respect to these custody services. What disclosures are provided to retail customers in connection with custody services? What pricing information is provided to retail customers in connection with forex transactions conducted in relation to custody services (e.g., pricing methodology, exchange rates for foreign currencies, how the price was calculated)? If pricing information is provided, is this information provided in advance of or following the forex transactions? On what basis do broker-dealers price retail forex transactions conducted in connection with custody services? Do broker-dealers maintain policies and procedures that govern how forex transactions are handled and priced in connection with custody services for retail forex customers? If broker-dealers do not provide pricing information to retail customers in connection with their custody business, what documentation do broker-dealers maintain to demonstrate to examiners the price provided in retail forex transactions?

20. Do broker-dealers provide retail customers alternatives for obtaining prevailing prices on retail forex transactions? For example, do broker-dealers inform customers that the customer can choose whether the broker-dealers will handle retail forex transactions at rates set under a “standing instruction” (i.e., non-negotiated trades, where a customer provides the broker-dealer discretion with respect to handling the forex transaction) or as a negotiated trade? Where a broker-dealer provides a “standing instruction” process for customers, what methods are used to determine the appropriate exchange rate? Do retail customers receive the interbank rate or some other rate?
21. What conflicts of interest exist in connection with broker-dealers handling and pricing of retail forex transactions? How do broker-dealers manage these conflicts of interest? Do broker-dealers disclose when they are acting as a counterparty to a forex transaction with a retail customer?
22. What compensation structures do broker-dealers apply to retail forex transactions (e.g., per trade commissions, spreads, both)? Do broker-dealers charge retail forex customers rolling fees or additional transaction fees, such as maintenance charges, software licensing fees, commissions paid to introducing brokers or other third-party service providers? Are there breakpoints offered to retail customers based on, for example, volume or number of trades? If so, are the breakpoints available to all retail customers?
23. What fees are charged by broker-dealers for each type of retail forex trade? What is the prevailing market rate for retail forex transactions? How does this differ from the

- prevailing market rate for forex transactions with ECPs? Does the prevailing market rate differ for standing instruction fees and negotiated trade fees?
24. Do broker-dealers disclose all compensation charged to retail customers? At what point during the customer relationship are compensation disclosures made (e.g., prior to any forex transactions, following a forex transaction)? What is the scope and breadth of those disclosures? Should the Commission consider rules that would expand broker-dealers' disclosure obligations?
25. In light of the authority provided under section 742 of the Dodd-Frank Act for the Commission to consider any other standards or requirements in connection with retail forex transactions that it determines to be necessary, when a broker-dealer solicits business for and introduces customers to a forex dealer, what due diligence does the broker-dealer conduct about the forex dealer? What policies and procedures do broker-dealers have in place, if any, regarding supervision of unregistered solicitors that introduce forex customers to the broker-dealer and that are employees or agents of the broker-dealer?
26. What policies and procedures do broker-dealers have in place regarding advertisements and marketing materials related to forex services offered to retail customers?
27. Do broker-dealers provide information to customers regarding access to the interbank currency market?
28. What disclosures do broker-dealers make to retail customers regarding the performance and accuracy (including slippage rates) of electronic trading platforms or

- software sold or licensed by or through the firm to customers in connection with forex trading?
29. What information do retail customers believe is important for them to receive from broker-dealers regarding their forex transactions?
30. What business conduct concerns do retail customers have regarding the manner in which their broker-dealers handle and price forex transactions?
31. Do broker-dealers provide structured products to retail customers that require forex transactions at maturity? In connection with these types of products, how are the foreign exchange conversion fees calculated and disclosed? Is the cost of the conversion embedded in the transaction itself, or must investors pay additional fees for conversion?
32. What alternatives for handling forex transactions outside of broker-dealers are available to retail investors? Would a transition of retail forex business out of broker-dealers be efficient or costly from the standpoint of customers?

#### **IV. Other Matters**

The Administrative Procedure Act generally requires an agency to publish notice of a proposed rulemaking in the Federal Register.<sup>59</sup> This requirement does not apply, however, if the agency “for good cause finds . . . that notice and public procedure are impracticable, unnecessary, or contrary to the public interest.”<sup>60</sup> Further, the Administrative Procedure Act also generally requires that an agency publish an adopted rule in the Federal Register 30 days before it becomes effective.<sup>61</sup> This requirement, however, does not apply if the agency finds good

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<sup>59</sup> See 5 U.S.C. 553(b).

<sup>60</sup> Id.

<sup>61</sup> See 5 U.S.C. 553(d).

cause for making the rule effective sooner.<sup>62</sup> The Commission, for the reasons discussed above and below, finds that notice and solicitation of comment before the effective date of Rule 15b12-1T is impracticable, unnecessary, and contrary to the public interest.<sup>63</sup>

It was not until mid-June 2011 that market participants first informed the Commission of a possible disruption of a potentially important forex service provided by broker-dealers to retail investors if the Commission did not act swiftly to adopt a rule allowing retail forex transactions by July 16, 2011, the effective date of section 742 of the Dodd-Frank Act.<sup>64</sup> As noted above, one representative of certain market participants stated that “it would expose both broker-dealers and their retail customers to needless operational, price, credit and other risks if the [Commission did] not allow broker-dealers to engage in foreign exchange activity that is ancillary to the broker-dealer’s ordinary securities execution, clearing, settlement and booking activity.”<sup>65</sup> The Commission believes that Congress, in enacting section 742 of the Dodd-Frank Act, may not have intended to prohibit certain types of foreign exchange activity, which might be beneficial to retail investors. To allow the existing regulatory framework for retail forex transactions to continue for a defined period, to avoid potentially unintended consequences from broker-dealers immediately discontinuing their retail forex business, and to provide the Commission sufficient time to determine the appropriate regulatory framework regarding retail forex transactions, the Commission is adopting on an interim final temporary basis Rule 15b12-1T. The Commission

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<sup>62</sup> Id.

<sup>63</sup> This finding also satisfies the requirements of 5 U.S.C. 808(2), allowing the rules to become effective notwithstanding the requirement of 5 U.S.C. 801 (if a federal agency finds that notice and public comment are “impractical, unnecessary or contrary to the public interest,” a rule “shall take effect at such time as the federal agency promulgating the rule determines”).

<sup>64</sup> See Morgan Lewis Memo, supra note 15.

<sup>65</sup> Id.

does not intend to create new regulatory obligations for broker-dealers in adopting this interim final temporary rule. The Commission further emphasizes that it is requesting comment on all aspects of the rule. The Commission will carefully consider the comments it receives.

## **V. Paperwork Reduction Act**

The Commission notes that interim final temporary Rule 15b12-1T does not create new regulatory obligations for broker-dealers, and therefore does not impose any new “collections of information” within the meaning of the Paperwork Reduction Act of 1995 (“PRA”),<sup>66</sup> nor does it create any new filing, reporting, recordkeeping, or disclosure reporting requirements for broker-dealers that are or plan to be engaged in a retail forex business. Accordingly, the Commission did not submit the interim final temporary rule to the Office of Management and Budget for review in accordance with the PRA. The Commission requests comment on its conclusion that there are no collections of information.

## **VI. Economic Analysis**

### **A. Introduction**

Exchange Act section 23(a)(2) requires the Commission, when adopting rules under the Exchange Act, to consider the impact that any new rule would have on competition, and prohibits the Commission from adopting any rule that would impose a burden on competition that is not necessary or appropriate in furtherance of the purposes of the Exchange Act. Furthermore, section 2(b) of the Securities Act of 1933 and Exchange Act section 3(f) require the Commission, when engaging in rulemaking where it is required to consider or determine whether an action is necessary or appropriate in the public interest, to also consider, in addition to the

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<sup>66</sup> 44 U.S.C. 3501 et seq.

protection of investors, whether the action will promote efficiency, competition, and capital formation.

As noted above, section 742(c) of the Dodd-Frank Act amended the CEA to prohibit broker-dealers from engaging in retail forex transactions after July 16, 2011, absent rulemaking by the Commission to allow such transactions. If there is no such rulemaking in place, then certain transactions that may be considered beneficial to retail investors, such as hedging transactions and securities conversion trades that take more than two days to settle, may no longer be conducted by broker-dealers. Retail investors who transact in foreign securities through a broker-dealer may find it difficult to minimize their currency risk exposure if risk-minimizing hedging transactions are moved outside the broker-dealer.

The Commission is adopting interim final temporary Rule 15b12-1T to allow broker-dealers to engage in a retail forex business for one year. This rule keeps in place the regulatory framework that currently exists for broker-dealers, and preserves the ability of broker-dealers to provide, among other services, hedging and conversion trades, to retail investors while the Commission considers what further appropriate steps to take, if any.

#### **B. Benefits and Impact on Efficiency, Competition, and Capital Formation**

Rule 15b12-1T is intended to minimize market disruptions that may occur when section 724(c) of the Dodd-Frank Act goes into effect. Absent rulemaking by the Commission, broker-dealers would be required to exit the retail forex business. Consequently, retail customers who transact with a broker-dealer for their foreign investments may need to find another service provider for their foreign exchange transactions, which could interrupt the customers' ability to trade in forex, depending on the availability of retail forex-related services outside of broker-dealers.



The interim final temporary rule preserves retail customers' access to the forex markets through broker-dealers. To the extent that this provides hedging opportunities for foreign investments or otherwise promotes an efficient investment opportunity set by, for example, permitting the continued use of forex in connection with clearing trades in foreign securities, economic benefits accrue to retail investors, assuming that no close substitutes exist or that retail access to forex is not easily available elsewhere.

Furthermore, by preserving a channel for retail customers to access forex transactions, the interim final temporary rule prevents any loss of competition in the retail forex space that could result if broker-dealers were required to exit the business. Potential effects of reduced competition include, but are not limited to, higher customer fees for retail forex transactions charged by remaining service providers, as well as reduced availability of forex services to retail customers if customers no longer have access to these transactions through broker-dealers.

### **C. Costs and Impact on Efficiency, Competition, and Capital Formation**

Because Rule 15b12-1T preserves the regulatory regime that is in place prior to the effective date of section 742(c) of the Dodd-Frank Act, the rule imposes no new regulatory burdens beyond those that already exist for broker-dealers engaged in a retail forex business. The Commission recognizes, however, that broker-dealers will face regulatory costs and requirements associated with operating in the retail forex market, which are costs and requirements that they already shoulder from doing business. These include costs related to disclosure, recordkeeping and documentation, capital and margin, reporting, and business conduct. For example, a broker-dealer that presently engages in forex transactions with retail customers incurs costs associated with establishing, maintaining, and implementing policies and procedures to comply with regulatory requirements; preparing disclosure documents;

establishing and maintaining forex-related business records; and preparing filings with the Commission, which may include legal and accounting fees.

As discussed above, the Commission is aware of potentially abusive practices that may be occurring in the retail forex market. To the extent that such practices continue, for example, lack of disclosure about fees and forex pricing, or insufficient capital or margin requirements, the retail forex market may bear costs associated with the inefficient provision of retail forex services. The Commission believes, however, that the cost of market disruption that may occur if the Commission does not promulgate the interim final temporary rule is greater than the cost of maintaining the current regulatory regime while the Commission seeks comment and evaluates whether a more comprehensive regulatory regime is necessary.

Because the regulatory requirements for broker-dealers operating in the retail forex market will remain unchanged, Rule 15b12-1T will impose no new burden on competition. Similarly, since the rule preserves an existing regulatory structure, the Commission does not expect any potential impairment of the capital formation process. Finally, because the rule allows hedging transactions, securities conversions, and other transactions that allow investors to continue to have access to these vehicles, the Commission believes that the interim temporary final rule will promote efficiency.

## **VII. Regulatory Flexibility Certification**

The Commission hereby certifies that pursuant to 5 U.S.C. 605(b) the interim final temporary rule contained in this release will not have a significant economic impact on a substantial number of small entities. The interim final temporary rule applies to broker-dealers that may engage in retail forex transactions. However, the Commission does not intend for the interim final temporary rule to impose new regulatory obligations, costs, or burdens on such

broker-dealers. While the rule applies to broker-dealers that may be small businesses, any costs or regulatory burdens incurred as a result of the rule are the same as those incurred by small broker-dealers prior to the effective date of section 742 of the Dodd-Frank Act. Broker-dealers have already incurred those costs and regulatory burdens through establishing compliance with the rules adopted by the Commission under the Exchange Act applicable to broker-dealers. Further, the interim final temporary rule does not change the burdens on small broker-dealers relative to large broker-dealers. Accordingly, the interim final temporary rule should not have a significant economic impact on a substantial number of small entities. The Commission requests comment on its conclusion that Rule 15b12-1T should not have a significant economic impact on a substantial number of small entities.

#### **VIII. Statutory Basis and Text of Amendments**

The Commission is adopting Exchange Act Rule 15b12-1T pursuant to section 2(c)(2) of the Commodity Exchange Act, as well as pursuant to the Exchange Act, as amended.

#### **List of Subjects in 17 CFR Part 240**

Brokers, Consumer protection, Currency, Reporting and recordkeeping requirements.

In accordance with the foregoing, the Securities and Exchange Commission is amending Title 17, chapter II of the Code of Federal Regulations as follows:

#### **PART 240 – GENERAL RULES AND REGULATIONS, SECURITIES EXCHANGE ACT OF 1934**

1. The general authority citation for Part 240 is revised to read as follows:

Authority: 15 U.S.C. 77c, 77d, 77g, 77j, 77s, 77z-2, 77z-3, 77eee, 77ggg, 77nnn, 77sss, 77ttt, 78c, 78d, 78e, 78f, 78g, 78i, 78j, 78j-1, 78k, 78k-1, 78l, 78m, 78n, 78n-1, 78o, 78o-4, 78p, 78q, 78s, 78u-5, 78w, 78x, 78ll, 78mm, 80a-20, 80a-23, 80a-29, 80a-37, 80b-3, 80b-4, 80b-11, and 7201 et. seq.; 18 U.S.C. 1350; 12 U.S.C. 5221(e)(3); and 7 U.S.C. 2(c)(2)(E), unless

otherwise noted.

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2. Add § 240.15b12-1T to read as follows:

**§ 240.15b12-1T Brokers or dealers engaged in a retail forex business.**

(a) Definitions. In addition to the definitions in this section, the following terms have the same meaning as in the Securities Exchange Act of 1934 (15 U.S.C. 78a et seq.): “broker,” “dealer,” “person,” “registered broker or dealer,” and “self-regulatory organization.”

(1) Act means the Securities Exchange Act of 1934 (15 U.S.C. 78a et seq.).

(2) Retail forex business means engaging in one or more retail forex transactions with the intent to derive income from those transactions, either directly or indirectly.

(3) Retail forex transaction means any account, agreement, contract or transaction in foreign currency that is offered or entered into by a broker or dealer with a person that is not an eligible contract participant as defined in section 1a(18) of the Commodity Exchange Act (7 U.S.C. 1a(18)) and that is:

(i) A contract of sale of a commodity for future delivery or an option on such a contract;

(ii) An option, other than an option executed or traded on a national securities exchange registered pursuant to section 6(a) of the Act (15 U.S.C. 78(f)(a)); or

(iii) Offered, or entered into, on a leveraged or margined basis, or financed by a broker or dealer or any person acting in concert with the broker or dealer on a similar basis, other than:

(A) A security that is not a security futures product as defined in section 1a(47) of the Commodity Exchange Act (7 U.S.C. 1a(47)); or

(B) A contract of sale that:

(1) Results in actual delivery within two days; or

(2) Creates an enforceable obligation to deliver between a seller and buyer that have the ability to deliver and accept delivery, respectively, in connection with their line of business.

(b) Any registered broker or dealer may engage in a retail forex business provided that such broker or dealer complies with the Act, the rules and regulations thereunder, and the rules of the self-regulatory organization(s) of which the broker or dealer is a member, including, but not limited to, the disclosure, recordkeeping, capital and margin, reporting, business conduct, and documentation requirements, insofar as they are applicable to retail forex transactions.

(c) Any registered broker or dealer that is engaged in a retail forex business in compliance with paragraph (b) of this section on or after the effective date of this section shall be deemed, until the date specified in paragraph (d) of this section, to be acting pursuant to a rule or regulation described in section 2(c)(2)(E)(ii)(I) of the Commodity Exchange Act (7 U.S.C. 2(c)(2)(E)(ii)(I)).

(d) This section will expire and no longer be effective on July 16, 2012.

By the Commission.

Elizabeth M. Murphy  
Secretary

Dated: July 13, 2011