The following contains information regarding regulatory considerations for entities that are registered with the Commodity Futures Trading Commission (CFTC). Entities that are dually registered with the Securities and Exchange Commission (SEC) as broker-dealers in securities should read this publication in conjunction with AICPA Accounting Guide *Brokers and Dealers in Securities*. This document has not been approved, disapproved, or otherwise acted upon by any senior technical committees of the AICPA or FASB and has no official or authoritative status.

Please be advised that information included herein may have been superseded or revised since the issuance of this publication. Readers should remain aware of regulatory developments that have occurred since the issuance of this publication. For further information on current regulations and guidance provided by the CFTC and the SEC, visit their websites at [www.cftc.gov](http://www.cftc.gov) and [www.sec.gov](http://www.sec.gov), respectively.
Introduction

This publication covers regulatory considerations for entities registered with the Commodity Futures Trading Commission (CFTC)—principally futures commission merchants (FCMs), introducing brokers (IBs), and retail foreign exchange dealers (RFEDs). The registration requirements for entities in each of these categories are determined by statute under the Commodity Exchange Act (CEA) and regulations thereto.

An FCM is generally defined by CFTC regulations as an entity that solicits or accepts orders from customers for the purchase or sale of any commodity for future delivery or a swap and accepts funds from such customers to margin or secure such transactions. CFTC regulations generally define an IB as an entity that solicits or accepts customer orders for the purchase or sale of any commodity for future delivery or a swap. The main differences between an FCM and an IB are that the IB is prohibited from carrying customer funds and engaging in proprietary trading. In addition, the capital requirements for FCMs are substantially greater than the capital requirements for an IB due to their different market roles.

CFTC regulations define an RFED as any person that is, or that offers to be, the counterparty to a retail forex transaction. The regulations, however, exclude entities registered with the Securities and Exchange Commission as brokers or dealers and certain other regulated financial entities from the RFED definition. The main differences between an FCM and an RFED is their capital requirements and that customer funds at an RFED are not protected by the special bankruptcy laws (segregation and secured amount) which protect futures customers. See the “Special Considerations for Retail Foreign Exchange Dealers” section of this publication for specific items relating to RFEDs.

An objective of CFTC regulation is to protect the integrity of the marketplace, and the funds of customers who use that marketplace, by ensuring that FCMs have the risk management programs, internal monitoring and controls, and liquidity and capital levels required to satisfy their obligations to customers and other participants in the futures and swaps industry.

The financial reporting requirements for FCMs and IBs are set forth by CFTC Regulation 1.10, Financial reports of futures commission merchants and introducing brokers. Audit requirements are set forth in CFTC Regulation 1.16, Qualifications and reports of accountants, under the CEA. Before undertaking the audit of an FCM or IB, the auditor should read the applicable regulations and have an understanding of the scope of the audit and the related reporting requirements. Auditors should also read the applicable SEC rules, which are available at www.sec.gov; these rules are also discussed in the AICPA Accounting Guide Brokers and Dealers in Securities.

FCMs that are members of the National Futures Association (NFA) and offer forex transactions to retail customers are subject to specific requirements. These requirements are discussed in the “Minimum Financial Requirements for FCMs” section of this publication.

Title VII of Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) addresses the financial regulation of over-the-counter (OTC) swaps by providing a comprehensive framework for the regulation of the OTC swaps markets. Under the framework for regulating swaps and security-based swaps, the CFTC was given regulatory authority over
swaps and the SEC was given regulatory authority over security-based swaps. Regulatory authority over mixed swaps was jointly given to the CFTC and SEC. In addition, the SEC was given antifraud authority over, and access to information from, certain CFTC regulated entities regarding security-based swap agreements.

Cleared swaps are trades negotiated OTC or traded via swap execution facilities or designated contract markets and cleared by derivatives clearing organizations. Cleared swaps are generally standardized contracts, and upon clearing, the derivatives clearing organization becomes the counterparty to both sides of the swap transaction. Derivatives clearing organizations require FCMs to meet margin requirements for both proprietary and customer-cleared swap transactions. Cleared swaps also are subject to daily settlement (mark-to-market\(^1\)) and margin calls.

**Applicable Regulations**

The primary sections of the CEA and CFTC regulations that are applicable to the audits of FCMs and IBs are as follows:

- Section 4d(a)(2), “Segregation requirements”
- Section 4d(f)(2), “Swaps segregation requirements”
- Section 4f(b), “Minimum financial requirements”
- Part 1 (17 CFR Ch 1 Part 1—General Regulations Under the CEA) including the following:
  - Regulation 1.10, *Financial reports of futures commission merchants and introducing brokers*
  - Regulation 1.11, *Risk management program for futures commission merchants*
  - Regulation 1.12, *Maintenance of minimum financial requirements by futures commission merchants and introducing brokers*
  - Regulation 1.14, *Risk assessment recordkeeping requirements for futures commission merchants*
  - Regulation 1.15, *Risk assessment reporting requirements for futures commission merchants*
  - Regulation 1.16, *Qualifications and reports of accountants*
  - Regulation 1.17, *Minimum financial requirements for futures commission merchants and introducing brokers* (also see NFA financial requirements)
  - Regulation 1.18, *Records for and relating to financial reporting and monthly computation by futures commission merchants and introducing brokers*

\(^1\) The terms *market value* and *mark-to-market* are used within this publication as operational terms. Accordingly, in practice they may not necessarily be synonymous to the terms *fair value* and *subsequently measured at fair value*, which are used within the financial statements in accordance with FASB *Accounting Standards Codification*® (ASC).
— Regulations 1.20–.30 and 1.49, collectively titled “Customers’ Money, Securities, and Property”
— Regulations 1.31–.39, collectively titled “Recordkeeping”

- Part 5 (17 CFR Ch 1 Part 5—Off-Exchange Foreign Currency Transactions)
- Part 22 (17 CFR Ch 1 Part 22—Cleared Swaps)
- Part 30 (17 CFR Ch 1 Part 30—Foreign Futures and Foreign Options Transactions), including Regulation 30.7, Treatment of foreign futures or foreign options secured amount
- Part 32 (17 CFR Ch 1 Part 32—Regulation of Commodity Option Transactions)

In addition to CFTC regulations, registrants must comply with the rules of their self-regulatory organizations (SROs) (for example, the NFA and the commodity exchanges), of which they are members. SROs are exchanges and registered futures associations that enforce financial and sales practice requirements for their members. When a registrant is a member of more than one SRO, the SROs may decide among themselves which of them will assume primary responsibility for these regulatory duties and, upon approval of the plan by the CFTC, be appointed the designated self-regulatory organization (DSRO) for that registrant.

SROs’ rules for registrants usually incorporate the CFTC’s regulatory requirements for such entities and establish additional rules that may be more stringent than the CFTC’s regulations. SROs’ rules that may be relevant to the auditor address the following:

- Minimum financial (capital) requirements
- Financial reporting requirements
- Books and records required to be prepared and kept by members
- Subordinated loan agreements
- Contract specifications, trading conditions, and delivery procedures for contracts traded on the exchange
- Minimum margin requirements for contracts and positions traded on the exchange
- The recording of customers’ trade orders
- Supervision of branch offices, associated persons (APs), and employees
- Investigations of alleged or apparent violations of the SROs’ rules, regulations, bylaws, and resolutions
- Investigations of complaints received from customers concerning the handling of the customers’ accounts and orders
- Disciplinary procedures and actions against members for violations of the SROs’ rules
- Arbitration of claims by customers, members, and nonmembers of SROs
- Dues, assessments, and fees payable to SROs by members

See exhibit 2 in this publication for a partial listing of NFA rules.
If the FCM is also a securities broker-dealer, an understanding of the interrelationship of these rules with the rules of the SEC and of the various securities SROs is necessary. See the AICPA Accounting Guide *Brokers and Dealers in Securities* and [www.sec.gov](http://www.sec.gov) for further information.

**Interpretations of CFTC Regulations and SRO Rules**

Published interpretations of certain regulations and rules of commodities regulatory bodies may be found in the following reference materials:

- CFTC’s Form 1-FR-FCM Instruction Manual
- Financial and Segregation Interpretations issued by the CFTC’s Division of Swap Dealer and Intermediary Oversight (DSIO) and its predecessors, the Division of Clearing and Intermediary Oversight and the Division of Trading Markets
- Staff letters written by the CFTC’s DSIO and Office of the General Counsel
- SEC’s Financial and Operational Combined Uniform Single (FOCUS) report forms and their general instructions (for FCMs that are dually registered as a broker-dealer)
- NFA guides to registration, membership, and recordkeeping requirements
- Interpretative instructions distributed by commodity exchanges and the NFA to their respective memberships
- Published commodities information services (for example, Commerce Clearing House, Prentice-Hall, and Commodity Futures Law Reporter)
- CFTC’s Dear FCM letters (periodic guidance on regulatory issues for FCMs)

Appropriate consideration should be given to specific interpretations requested and received from any regulatory agency since the prior financial statement date, and their effect, if any, on the current financial statements of the FCM.

**Explanation of Significant Rules**

**CFTC Regulation 1.16, Qualifications and reports of accountants**

CFTC Regulation 1.16 specifies the regulatory requirements for independent certified public accountants’ (CPA) qualifications and reports to be rendered on registrants’ and applicants’ financial statements or schedules.

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2 See exhibit 1 in this publication.
Qualifications of Accountants

CFTC Regulation 1.16(b)(1) provides that the CFTC will recognize any person as a CPA who is dually registered and in good standing as such under the laws of the place of his or her residence or principal office. In addition, the CPA engaged to conduct an examination of an FCM must be registered with the PCAOB and must have undergone a PCAOB examination. The CPA also may not be subject to a permanent or temporary bar to engage in the examination of public issuers or broker-dealers registered with the SEC resulting from the PCAOB’s disciplinary hearing.

Independence of Accountant

To be recognized for regulatory purposes as a CPA by the CFTC, the CPA must be independent from the entity being audited, the entity’s parent, subsidiary, and other affiliates. CFTC Regulation 1.16(b)(2) discusses the independence of a CPA and states that an accountant must be independent in fact. An interpretative letter, “CFTC Letter No. 14-40: Interpretation of Commission Regulation 1.16 Auditor Independence Standards for Audits of Futures Commission Merchants,” issued by the CFTC’s DSIO, provides guidance with respect to certain independence requirements. Although a CPA must apply certain PCAOB standards in conducting an examination of an FCM that a CPA is required to follow in conducting an examination of a broker-dealer, the application of those standards does not require the CPA of an FCM or a broker-dealer/FCM to comply with the following PCAOB rules in conducting an audit of a nonissuer in order to maintain compliance with CFTC Regulation 1.16:

• PCAOB Rule 3523, Tax Services for Persons in Financial Reporting Oversight Roles
• PCAOB Rule 3524, Audit Committee Pre-approval of Certain Tax Services
• PCAOB Rule 3525, Audit Committee Pre-approval of Non-audit Services Related to Internal Control Over Financial Reporting

Replacement of Accountant

The CFTC does not require registrant to initially designate its independent CPA by filing notice of the audit commitment with the CFTC or the entity’s SROs. However, a registrant is required to notify the CFTC and its DSRO of any replacement of the independent CPA engaged to conduct its annual audit.

Under CFTC Regulation 1.16(g)(1), a registrant must file written notice with the CFTC and its DSRO if the independent CPA who was previously engaged as the principal accountant to audit the FCM resigns, declines to stand for reelection after completion of the current audit, is dismissed as the entity’s CPA, or is replaced. Notice of the replacement of the CPA must be filed with the CFTC and the registrant’s DSRO within 15 business days after such occurrence.

3 AICPA, PCAOB Standards and Related Rules, Select Rules of the Board.
CFTC Regulation 1.16(g)(2) states the requirements for a notification of change of the CPA. Among the items required as an attachment to the notification is a letter from the former CPA addressed to the CFTC. In this letter, the former CPA states whether or not he or she agrees with the representations contained in the registrant’s notification of change of the CPA. Independent CPAs of FCMs, IBs, and RFEDs should be familiar with all of the requirements contained in CFTC Regulation 1.16.

Audit Objectives

Pursuant to CFTC Regulation 1.16(b)(1), a CPA engaged to conduct an examination of an FCM must be registered with the PCAOB and must have undergone an examination by the PCAOB, and may not be subject to a permanent or temporary bar to engage in the examination of public issuers or brokers or dealers registered with the SEC as a result of a PCAOB disciplinary hearing. CFTC Regulation 1.16(c)(2) requires the independent CPA’s report to state whether the audit of an FCM was made in accordance with the auditing standards adopted by the PCAOB. Audits of IBs and RFEDs are not subject to these PCAOB requirements. CFTC Regulation 1.16(d) requires the audits of IBs and RFEDs to be performed in accordance with generally accepted auditing standards (GAAS), which must include all procedures necessary under the circumstances to enable the independent CPA to express an opinion on the financial statements and schedules being audited.

Under CFTC Regulation 1.16(d), an audit must include a review and appropriate tests of the accounting system, the internal accounting controls, and the procedures for safeguarding customer and firm assets in accordance with the CEA and the CFTC’s regulations. An audit must also include all procedures necessary to enable the CPA to express an opinion on the financial statements and schedules. Schedules included in the Form 1-FR-FCM and Form 1-FR-IB must be covered by the audit opinion. The scope of the audit must be sufficient to provide reasonable assurance that any material inadequacies existing at the examination date in the accounting system, the internal accounting controls, or the procedures for safeguarding customer and firm assets will be discovered. The audit must also include reviews of the practices and procedures used by the client to produce the following:

- Periodic computations by the FCM or IB of its adjusted net capital and minimum financial requirements pursuant to CFTC Regulation 1.17
- Daily computations by the FCM of its section 4d(a)(2) segregation and Part 30 secured amount requirements

These objectives recognize the regulatory concern for safeguarding customers’ funds and property held by FCMs and for customers’ orders received by IBs and forwarded to FCMs for execution and processing.

Independent Accountant’s Reports

CFTC Regulation 1.16(c) establishes the regulatory requirements for an independent CPA’s report on a registrant’s financial statements and schedules. CFTC Regulation 1.16(c) describes the following:
• The technical requirements for the CPA’s report
• The representations the CPA must make regarding the audit he or she conducted
• The opinion required to be expressed by the CPA
• The CPA required statement regarding any exceptions taken by the CPA with respect to the financial statements and schedules
• The supplemental report required from the CPA on the audited entity’s internal controls and on whether any material inadequacies were found by the CPA to exist or to have existed since the date of the previous audit

The following must be done for the supplemental report for an audit of an FCM or IB:

• An FCM must submit the report to the CFTC in an electronic format using a form of user authentication assigned in accordance with procedures established by or approved by the CFTC. An IB is required to file its report with the NFA in an electronic format (for example, a PDF file).
• Disclose material inadequacies in internal control (including procedures for safeguarding customer assets) revealed through audit procedures designed and conducted for the purpose of expressing an opinion on the financial statements.
• Describe any material inadequacies that exist or have existed since the date of the previously audited financial statements unless corrected and reported to the CFTC and other regulators, as appropriate, by the FCM before the date of the financial statements.
• Indicate any corrective actions taken or proposed by the FCM regarding any material inadequacies cited.

If the audit of a registrant did not disclose any material inadequacies, the supplemental report on internal control is required to include a statement to that effect.

The independent CPA’s supplemental report on material inadequacies filed with the CFTC, under CFTC Regulation 1.16(c)(5), is deemed nonpublic information. The CFTC’s treatment of information included in a registrant’s financial reports filed with the CFTC is discussed under the section titled “Public and Nonpublic Treatment of Reported Information” within this publication.

Material Inadequacies in the Accounting System or Internal Controls

Material inadequacy defined. CFTC Regulation 1.16(d)(2) defines a material inadequacy in an applicant’s or registrant’s accounting system, internal accounting controls, and procedures for safeguarding customer and firm assets as any condition that contributed substantially to or, if appropriate corrective action is not taken, could reasonably be expected to

a. inhibit an applicant or registrant from promptly completing transactions or promptly discharging its responsibilities to customers or other creditors;

b. result in material financial loss;

c. result in material misstatement of financial statements and schedules; or,
d. result in violations of the CFTC’s segregation amount, secured amount, recordkeeping, or financial reporting requirements to an extent that could reasonably be expected to result in any of the conditions described previously.

Independent certified public accountant’s responsibility. The CPAs responsibility with respect to reporting material inadequacies is described in CFTC Regulation 1.16(e)(2). To comply with CFTC regulations, the CPA is required to review and conduct appropriate tests of the accounting system, control procedures, and procedures for safeguarding customer or firm assets existing at the date of the examination. If no matters involving internal control (including procedures for safeguarding customer or firm assets) are considered material inadequacies, the auditor should state this in his or her report on internal control.

However, if conditions believed to be material inadequacies exist or have existed during the year, the report should disclose the nature of the inadequacies and the corrective actions taken or proposed to be taken by the FCM unless corrected and reported to the CFTC and other regulators, as appropriate, by the FCM before the date of the financial statements. If control procedures implemented by management are asserted to correct an identified inadequacy, the CPAs considerations for referencing management’s corrective action (and the CPAs testing of such corrective action) in his or her report would also be evaluated for other reporting considerations as may be required.

CFTC Regulation 1.16(e)(2) requires that if, during the audit or interim work, the independent CPA determines that any material inadequacies exist in the components of internal control, procedures for safeguarding customer or firm assets, or as such material inadequacies are otherwise defined in CFTC Regulation 1.16(d), then he or she must call it to the attention of the chief financial officer or other appropriate officer of the FCM. In accordance with CFTC Regulation 1.12(d), an entity must, within 24 hours, provide notice of a material inadequacy to the CFTC and the FCM’s DSRO—or in the case of an IB, provide notice to the NFA (on behalf of the CFTC); the DSRO, if any; and every FCM carrying or intending to carry customer accounts for the IB.

The FCM must also furnish the CPA with a copy of the material inadequacy notice to the regulators within three business days. The CPA must inform the CFTC and the FCM’s DSRO if he or she (1) fails to receive the notice from the FCM within three business days or (2) disagrees with the statements contained in the notice of the FCM. In the case of an IB, the CPA must inform the NFA (on behalf of the CFTC), the DSRO, if any, and every FCM carrying or intending to carry customer accounts for the IB by reporting the material inadequacy within three business days thereafter as set forth in CFTC Regulation 1.16(e)(2). Such report from the CPA must, if the FCM failed to file a notice, describe any material inadequacies that exist. If the FCM filed a notice, the CPA must file a report detailing the aspects, if any, of the FCM’s notice with which the CPA does not agree.

Often a determination of a material inadequacy may require expanded audit procedures in the affected area, appropriate review at the decision-making level by management and the CPA, and possible consultation with counsel. The length and complexity of any necessary deliberations will depend on the circumstances, but should be completed in the shortest time possible.

There are situations in which the CPA becomes aware of a material inadequacy corrected during the period, but not reported by management to the CFTC and the FCM’s DSRO. In these situations, management’s failure to report the condition would constitute a material inadequacy
that should be included in the CPAs supplemental report on internal control. Pursuant to CFTC Regulation 1.16(c)(5), the supplemental report on internal control should be filed along with the annual audit report.

Consideration should be given to the possible need to consult with legal counsel and to modify the report based on the particular circumstances. The report should be modified if the FCM has not made the required notification of a material inadequacy or if the CPA does not agree with the statements therein.

As it relates to the supplemental report on internal control, consideration should be given to determining whether the suggestions for improving organization, procedures, or efficiency included in reports to management upon completion of the audit are required to be reported under CFTC Regulation 1.12(d).

**Explanation of Significant Regulations for Futures Commission Merchants**

**Definition of Customer and Proprietary Accounts**

CFTC Regulation 1.3(k) defines a *customer* as any person who uses an FCM, IB, commodity trading advisor, or commodity pool operator as an agent in connection with trading in any commodity interest. CFTC Regulation 30.1(c) defines a *foreign futures or foreign options customer* as any person located in the United States, its territories or possessions who trades in foreign futures or foreign options on, or subject to, the rules of any regulated foreign board of trade. The holder of a proprietary account (as defined in the following paragraph) is excluded from the CFTC’s regulatory definitions of customer and foreign futures or foreign options customer.

The holder of a proprietary account (as defined in the following paragraph) is excluded from the CFTC’s regulatory definitions of customer and foreign futures or foreign options customer.

CFTC Regulation 1.3(y) defines a *proprietary account* as a commodity futures, commodity option, or swap trading account carried on the books and records of an individual, a partnership, corporation, or other type of association

1. for one of the following persons or
2. of which 10 percent or more is owned by one or, in the aggregate, more than one of the following persons:
   1. Such individual himself, or such partnership, corporation, or association itself
   2. In the case of a partnership, a general partner in such partnership
   3. In the case of a limited partnership, a limited or special partner in such partnership whose duties include the management, the handling of customers’ trades or funds, the keeping of records pertaining to customers’ trades or funds, or the signing or co-signing checks or drafts on behalf of such partnership
iv. In the case of a corporation or association, an officer, a director, or 10 percent or more of the capital stock, of such organization;

v. An employee of such individual, partnership, corporation or association whose duties include the management, the handling of customers’ trades or funds, the keeping of records pertaining to customers’ trades or funds, or the signing or co-signing of checks or drafts on behalf of such individual, partnership, corporation or association

vi. A spouse or minor dependent living in the same household of any one of the foregoing persons

vii. A business affiliate that directly or indirectly controls such individual, partnership, corporation, or association

viii. A business affiliate that directly or indirectly is controlled by or is under common control with such individual, partnership, corporation or association

The funds of commodity and cleared swap customers of an FCM’s affiliate must be carried in customer segregated accounts by an FCM; however, the proprietary funds of an affiliate, as defined by CFTC Regulation 1.3(y), may not be carried by an FCM in a customer segregated account.

In the commodity futures and options industry, proprietary accounts are commonly classified and called “house accounts.” The term house accounts is used in the industry to describe both firm-owned trading accounts and noncustomer accounts, which are accounts owned not by the FCM, but by the persons described in CFTC Regulation 1.3(y).

The auditor of an FCM should be aware that the definitions of customer and proprietary accounts, as described previously for section 4d(a)(2) segregation purposes, are defined differently when used to compute an FCM’s minimum net capital requirement pursuant to CFTC Regulation 1.17. In computing an FCM’s adjusted net capital under CFTC Regulation 1.17, the term customer applies not only to section 4d(a)(2) segregated customers, but also to an FCM’s Part 30 foreign futures and foreign options customers. For the additional purpose of applying the CFTC’s risk-based minimum capital computation, the term customer account further includes accounts for foreign-domiciled persons trading on a foreign board of trade, where such account is not a proprietary account or a noncustomer account. For CFTC Regulation 1.17 purposes, the term proprietary account refers to accounts carried on an FCM’s books for the FCM itself or for control persons of the FCM. The term noncustomer account includes accounts that are not included in the definition of customer or proprietary, and accounts for foreign-domiciled persons trading on a foreign board of trade if the account is proprietary under the definition contained in CFTC Regulation 1.3(y), but not as defined in CFTC Regulation 1.17(b)(3).

Segregation of Customers’ Funds—CFTC Regulations 1.20–.30, 1.32, and 1.49

Section 4d(a)(2) of the CEA and CFTC Regulation 1.20, Futures customer funds to be segregated and separately accounted for, stipulates that an FCM must treat and deal with all money, securities, and property received by the FCM as belonging to such customers. Further, section 4d(a)(2) of the CEA and CFTC Regulation 1.20 require an FCM to account separately for (and segregate) such money, securities, and property and not to commingle such customers’
assets with the proprietary assets of the FCM or funds held by the FCM for noncustomers. Customers’ segregated assets may not be used to secure or guarantee the trades or contracts, or to secure or extend the credit of any person other than the customers for whom the assets are held. Typically FCMs require, as a prudent business practice, that customers’ assets exceed minimum amounts required by commodity exchanges or clearing organizations.

The CFTC’s segregation requirements apply to customers’ assets received by an FCM for the customers’ commodity futures and options trades executed on commodity futures and options exchanges. CFTC Regulations 1.20–30, 1.32, and 1.49 specify the manner in which an FCM must segregate, handle, and account for futures customers’ assets. These regulations are intended to accomplish the following objectives:

- Ensure that customers’ assets are properly safeguarded.
- Segregate and separately account for section 4d(a)(2) customers’ assets and commodity futures and options trading accounts from the assets, operations, and trading activities of the FCM and the FCM’s noncustomers.
- Ensure that FCMs monitor, at all times, their segregation requirements and total segregated assets available, and maintain adequate funds in segregated accounts to cover the overall amounts required to be held in segregated accounts and on a currency-by-currency basis as is required by CFTC Regulation 1.49.
- Require an FCM to document compliance by computing and preparing a daily record showing the total amount required to be segregated by the FCM under section 4d(a)(2) of the CEA, the total amount of funds on deposit in section 4d(a)(2) segregated accounts, and the excess or deficiency in segregated assets on deposit to cover the segregation requirement.
- Protect customer assets in case of the liquidation of an insolvent FCM.

CFTC Regulations 1.20–30, 1.32, 1.36, and 1.49 contain detailed and specific requirements which any auditor of an FCM should familiarize themselves with, including, but not limited to, the following:

- Each depository account for section 4d(a)(2) segregated assets is properly titled or named as such (CFTC Regulation 1.20).
- Each depository account for section 4d(a)(2) segregated assets is covered by a depository’s written acknowledgment that the funds are held in the account in accordance with sections 4d(a)(2) of the CEA (CFTC Regulation 1.20).
- All monies received by, or accruing to, an FCM incident to a section 4d(a)(2) customer’s commodity futures and options trading activity are treated and accounted for as accruing to such customer (CFTC Regulation 1.21, Care of money and equities accruing to futures customers).
- The assets of a section 4d(a)(2) commodity customer at an FCM are not used to purchase, margin, or settle the trades, contracts, or commodity options positions, or to secure or extend the credit of any person other than such customer and FCMs must maintain residual interest in customer segregated accounts sufficient to cover customer margin deficits (CFTC Regulation 1.22, Use of futures customer funds restricted).
The books and records of an FCM always accurately reflect the FCM’s interest in total assets on deposit in segregated accounts and FCMs must establish and maintain targeted residual interest in segregated accounts, which targeted residual interest may not be withdrawn beyond certain established limits without compliance with enhanced procedures (CFTC Regulation 1.23, Interest of futures commission merchant in segregated funds; additions and withdrawals).

FCMs invest customer segregated assets only in investments permissible under CFTC Regulation 1.25, Investment of customer funds, and in accordance with the recordkeeping and other requirements therein.

Investments of customer segregated assets and the proceeds from such investments are only made through, or deposited in, an account or accounts used for the deposit of customer segregated assets (CFTC Regulation 1.25).

Obligations purchased by an FCM as investments of customer segregated assets are separately accounted for as belonging to the FCM’s segregated commodity customers, and are held or deposited in an account properly segregated in accordance with section 4d(a)(2) of the CEA and the regulations thereunder (CFTC Regulation 1.26, Deposit of instruments purchased with futures customer funds).

Each FCM that invests customer segregated assets must maintain a record of such investments that shows, for each investment, the information required by CFTC Regulation 1.27, Record of investments.

The proceeds of any loan made by an FCM to a segregated commodity customer of the FCM to purchase, margin, guarantee, or secure the trades, contracts, or commodity options of such customer are treated, dealt with, and segregated by the FCM as belonging to such customer, and an FCM may not loan funds on an unsecured basis to finance customer trading (CFTC Regulation 1.30, Loans by futures commission merchants; treatment of proceeds).

Each FCM must prepare, by noon the next business day, a record, as of the close of previous business day, showing the total amount of customer assets required by the CEA to be deposited in segregated accounts, the total amount of assets deposited in section 4d(a)(2) segregated accounts, and the amount of the FCM’s residual interest in such segregated-customer assets (CFTC Regulation 1.32, Reporting of segregated account computation and details regarding the holding of futures customer funds).

Each FCM must maintain a record of all securities and property received from customers, in lieu of money, for purposes of margining, purchasing, guaranteeing, or securing the commodity or commodity option transactions of such customers (CFTC regulation 1.36, Record of securities and property received from customers).

Customer funds may be denominated in United States dollars or in a currency in which funds were deposited by a customer or converted at the instruction of a customer, or in which funds have accrued to a customer as a result of trading conducted on a designated contract market. Unless a customer provides instructions to the contrary, an FCM may hold customer funds in the United States, in any money-center country (defined in CFTC Regulation 1.49), or in the country of origin of the currency at a qualified depository under the terms of CFTC Regulation 1.49.
• Each day, each FCM must hold, in segregated accounts on behalf of commodity or option customers, sufficient U.S. dollars in the United States to meet all U.S. dollar obligations, and sufficient funds in each other currency to meet obligations in such currency; however, assets denominated in one currency may be held to meet obligations in another currency in accordance with CFTC Regulation 1.49, which provides that U.S. dollars held in the United States or in money-center countries may be used to meet obligations in any other currency, and funds in money-center currencies may be held in the United States or in money-center countries to meet obligations denominated in currencies other than the U.S. dollar. Each FCM shall ensure that sufficient records are maintained to demonstrate compliance with these requirements.

Depositary account name and acknowledgment. If an FCM deposits customer segregated assets with a bank, trust company, clearing organization, or another FCM, then CFTC Regulation 1.20(a) requires that the name or title of the depository account for such funds must clearly identify the funds in the account as belonging to the customers of the FCM and that the account be segregated in accordance with the CEA and the regulations thereunder.

In addition, for each such account, an FCM must obtain from the depository a signed acknowledgment that the depository has been informed that the assets deposited in the customer segregated account are those of commodity futures and options customers and are held pursuant to the CEA and the regulations thereunder. No depository that has received customer assets for deposit in a segregated account may use them for its own benefit.

Use of safekeeping or third-party custodial accounts for customer assets. FCMs may not deposit, hold, or maintain margin funds for customers in third-party accounts, except for cleared swaps transactions or for those FCMs not eligible to directly hold assets of their customers (for example, due to their affiliation with a customer that is an investment company registered with the SEC under the Investment Company Act of 1940).

Deposit of U.S. customers’ assets in foreign depositories. CFTC Regulation 1.49 permits FCMs to hold customer segregated funds outside of the United States subject to compliance with its requirements. In addition to the currency denomination requirements of CFTC Regulation 1.49, there are qualifications for depositories that may hold such funds. If located outside the United States, a qualified depository must be

   a. an FCM registered with the CFTC;

   b. a bank or trust company that has regulatory capital in excess of $1 billion; or

   c. a derivatives clearing organization.

Care and use of customer segregated assets. CFTC Regulation 1.21 requires an FCM to treat and account for all money received, directly or indirectly, or accrued to commodity futures and options customers, as segregated assets. The money received or accrued may be deposited in a customer segregated assets account and be treated as fully belonging to all of the FCM’s section 4d(a)(2) commodity futures and options segregated customers. The individual customers’ trading accounts responsible for the receipts or accruals must be credited for the specific amounts they are due.

Investment of customer segregated assets. CFTC Regulation 1.25 restricts an FCM’s investments of customer segregated assets to certain permissible investments, including, but not limited to (1) U.S. government securities, (2) certificates of deposit, and (3) interests in money market mutual
funds. CFTC Regulation 1.25 includes concentration and dollar-weighted average time-to-maturity limits, recordkeeping requirements, and restrictions on instrument features and investments in instruments issued by affiliates. See CFTC Regulation 1.25 for complete information.

All customer segregated investments must be deposited in customer segregated asset accounts maintained by the FCM. FCMs may transfer unencumbered assets, of the kind set forth in CFTC Regulation 1.25, from its own proprietary accounts directly into customer segregated accounts to increase funds segregated for the benefit of its commodity customers. Such FCM-owned investments in customer segregated accounts are considered customer funds until withdrawn from segregation. FCMs may transfer customer segregated investments from a segregated account to its own non-segregated account up to the extent of its residual financial interest in customers’ segregated funds (the amount of excess funds in segregation). CFTC Regulation 1.29, *Gains and losses resulting from investment of customer funds*, allows FCMs to retain any income resulting from investments of customer segregated assets if such investment is not made for any particular customer. However, FCMs bear sole responsibility for any losses resulting from the investment of customer segregated assets in instruments described in CFTC Regulation 1.25.

CFTC Regulations 1.25 and 1.27 require FCMs to prepare and maintain a complete and detailed record of each investment of customer segregated assets, including a daily record of the type of instrument, the instrument’s original cost and its current market value, records of transfers of customer segregated investments, and the disposition of proceeds from the sale or maturity of such investments.

In preparing its daily segregation record, an FCM must reflect the securities involved in a reverse repo at the lesser of (1) the current market value of the securities subject to the reverse repo or (2) the net amount to be realized by the FCM upon resale of the securities.

*Excess funds in segregation*. CFTC Regulations 1.11(e) and 1.23(c) require an FCM to establish and maintain a targeted residual interest (for example, excess funds) in the segregated funds accounts to reasonably ensure that the FCM remains in compliance with the segregated funds requirements at all times. In determining the amount of the targeted residual interest, the FCM should analyze all relevant factors affecting the amounts in segregated funds regularly, including but not limited to, the composition of the FCM’s customer base and its general creditworthiness, customer trading activity, the types of markets and products traded by the customers, the volatility and liquidity of the markets and products traded by customers, the FCM’s own liquidity and capital needs, and the historical trends in segregated fund balances and debit balances in customers’ accounts. In addition, policies and procedures, including the analysis and calculation of the targeted amount, must be designed and established in writing to reasonably ensure that the FCM maintains the targeted residual amounts in segregated funds at all times. Furthermore, the adequacy of the targeted residual interest and the process for establishing the targeted residual interest must be reassessed periodically and revised as necessary. An FCM’s residual interest in customer segregated assets is equal to the amount by which the total amount on deposit in segregated accounts exceeds the total amount of assets required to satisfy the FCM’s obligations to its commodity customers.
The FCM’s residual interest in customer segregated assets or excess assets in segregation is computed and shown on the FCM’s daily segregation record. The FCM’s excess assets in segregation and targeted residual interest are also shown on the FCM’s segregation statement that is included in the FCM’s Form-1-FR-FCM financial reports filed with the CFTC and the FCM’s DSRO.

Section 4d(a)(2) of the CEA and the regulations thereunder do not prevent an FCM from drawing upon assets in segregation to its own order to the extent of its residual financial interest, that is, the amount of excess assets in segregation. However, pursuant to CFTC Regulation 1.23(d), if such withdrawal(s) would exceed 25 percent of the FCM’s targeted residual interest, the FCM must obtain written approval from its senior management prior to the withdrawal, and file written notice with the CFTC and the FCM’s DSRO. Similarly, an FCM may add cash to customer segregated assets to ensure that sufficient assets are available to cover its obligations to its segregated commodity customers. CFTC Regulation 1.23 permits an FCM to add to customer segregated funds accounts the FCM’s own cash and unencumbered securities of the kind set forth in CFTC Regulation 1.25, but not any other asset.

Pursuant to CFTC Regulation 1.16(d), the auditor should obtain an understanding of the FCM’s practices and procedures, and controls regarding compliance with the CFTC’s segregation regulations and section 4d(a)(2) of the CEA. The auditor should perform those tests that the auditor considers necessary to gain satisfaction that the FCM’s procedures and controls for segregation of section 4d(a)(2) customers’ assets provide reasonable assurance that the FCM is in compliance with the CFTC’s regulations for segregation under section 4d(a)(2) of the CEA.

If compliance has not been met or the controls and procedures are deemed inadequate, the auditor should consider the notification requirements under CFTC Regulation 1.16 concerning material inadequacies.

The CFTC has consistently taken a stringent enforcement approach to its regulations requiring FCMs to segregate customers’ assets. The CFTC’s DSIO expects commodity exchanges and the NFA to monitor their member FCMs’ compliance with the CFTC’s segregation and related recordkeeping regulations through execution of their programs for infield examination and ongoing surveillance of member compliance.

Enforcement actions resulting from rule violations may include significant fines and the banning of individuals from the commodities business for periods of time. Accordingly, industry practice and good business sense compel an FCM to hold sufficient assets in its customer segregated accounts to ensure that the total assets on deposit are sufficient to cover its obligations to its customers at all times.

An FCM’s transfer of additional cash into a customer segregated funds account should be irrevocably committed to deposit in the account and recognized by the recipient bank as immediately available, same-day funds. An FCM is required to comply with the CFTC’s segregation and related recordkeeping regulations at all times.
Foreign Futures and Foreign Options on Futures Customers—Part 30 of CFTC Regulations

Regulated foreign futures and foreign options are defined by CFTC Regulations 30.1(a) and 30.1(b) as commodity futures and options contracts traded on, or subject to the rules of, a foreign board of trade. It is unlawful for any person to engage in the offer and sale of any foreign futures contract or foreign options transaction for, or on behalf of, a foreign futures or foreign options customer, except in accordance with Part 30 of the CFTC’s Regulations. As defined in Part 30 of CFTC Regulations, a foreign futures or foreign options customer is a U.S. domiciled person or a foreign domiciled person who trades foreign futures and foreign options through an FCM. The FCMs’ Regulation 30.7 requirements for protection funds apply to all Regulation 30.7 customers whether U.S. domiciled or foreign domiciled.

In general, the CEA and CFTC regulations do not restrict the offer or sale of foreign exchange-traded futures and commodity option products to customers located in the United States. However, special procedures apply to the offer or sale of security index and foreign government debt products, excluding foreign exchange-traded security futures products and futures or options on narrow-based security indexes as defined in section 1a(35) of the CEA. Procedures and requirements include the following:

- **Foreign exchange-traded broad-based security index futures contracts (and options thereon):** The CFTC must first certify that foreign exchange-traded broad-based security index futures contract (or option thereon) meets the requirements of section 2(a)(1)(C)(ii) of the CEA. The procedure for requesting a CFTC certification is described in CFTC Regulation 30.13.

- **Foreign government debt obligations:** Debt obligations of a foreign government must be designated as an exempted security by the SEC under SEC Rule 3a12-8 before a futures contract or option thereon can be offered or sold in the United States.

**Foreign futures or foreign options secured amount.** CFTC Regulation 30.7 requires an FCM at all times to maintain in a separate account or accounts money, securities and property in an amount at least sufficient to cover or satisfy all of its obligations to Regulation 30.7 customers denominated as the foreign futures or foreign options secured amount. In computing Regulation 30.7 customer requirements, the FCM must reflect in the account that it maintains for each Regulation 30.7 customer the net liquidating equity for each such customer, as described in CFTC Regulation 30.7(f). In addition, CFTC Regulation 30.7(g) states that if an FCM draws funds from the separate accounts holding Regulation 30.7 customer funds, except for the benefit of Regulation 30.7 customers, and the withdrawal causes the FCM to not hold sufficient funds in the separate accounts meeting its targeted residual interest as required by CFTC Regulation 1.11, the FCM must deposit its own funds to restore the account balance to the targeted residual interest amount on the next business day, or, if appropriate, revise its targeted amount of residual interest pursuant to the policies and procedures required by the regulations.

In calculating its secured amount, an FCM must compute the secured amount for each of its Part 30 customers’ accounts and combine the results for the accounts into a single total.

**Commingling.** CFTC Regulation 30.7(e) stipulates that an FCM may not commingle the funds set aside as the foreign futures or foreign options secured amount held for Regulation 30.7
customers with the money, securities or property of such FCM, with any proprietary account of such FCM, or use such funds to secure or guarantee the obligations of, or extend credit to, such FCM or any proprietary account of such FCM. Additionally, an FCM may not commingle Regulation 30.7 customer funds with funds deposited by futures customers and held in segregated accounts pursuant to sections 4d(a) and 4d(b) of the CEA or with funds deposited by cleared swap customers and held in segregated accounts pursuant to section 4d(f) of the CEA, or with funds of any account holders of the futures commission merchant unrelated to trading foreign futures or foreign options.

*Daily computation of Regulation 30.7 customer secured amount requirement. CFTC Regulation 30.7(l) requires an FCM to prepare, as of the close of each business day, a Statement of Secured Amounts and Funds Held in Separate Accounts for Regulation 30.7 Customers, pursuant to CFTC Regulation 30.7 contained in the Form 1-FR-FCM, which is due to the CFTC and its DSRO by noon the following business day. Note that the FCM’s excess assets in secured accounts and targeted residual interest are also shown on the FCM’s secured amount statement that is included in the Form-1-FR-FCM.*

*Depository account name and acknowledgment. CFTC Regulation 30.7(b) requires that an FCM must deposit the foreign futures or foreign options secured amount under an account name that clearly identifies the funds as belonging to Regulation 30.7 customers. In addition, the FCM must obtain a written acknowledgment from each depository prior to, or contemporaneously with, the opening of an account by the FCM with such depository in accordance with CFTC Regulation 30.7(d).*

*Acceptable depositories. CFTC Regulation 30.7(b) requires that an FCM must deposit the foreign futures or foreign options secured amount with any of the following depositories, subject to the limitations of CFTC Regulation 30.7(c):*

   a. A bank or trust company located in the United States
   b. A bank or trust company located outside the United States that has in excess of $1 billion regulatory capital
   c. An FCM registered with the CFTC
   d. A derivatives clearing organization
   e. The clearing organization of any foreign board of trade
   f. A member of any foreign board of trade
   g. Such member’s or clearing organization’s designated depositories

*Limitation on holding foreign futures or foreign options secured amount. In accordance with CFTC Regulation 30.7(c), FCMs may not deposit or hold the foreign futures or foreign options secured amount in accounts maintained outside of the United States with any of the depositories listed in CFTC Regulation 30.7(b) except to meet margin requirements, including prefunding margin requirements, established by rule, regulation, or order of foreign boards of trade or foreign clearing organizations, or to meet margin calls issued by foreign brokers carrying the Regulation 30.7 customers’ foreign futures and foreign option positions. However, an FCM may deposit an additional amount of up to 20 percent of the total amount of funds necessary to meet margin and prefunding margin requirements to avoid daily transfers of funds between the FCM’s Regulation 30.7 accounts maintained in the United States and those maintained outside of the*
United States. In certain cases, this 120-percent limit may be lifted where customer funds deposited with a foreign bank or trust company that otherwise qualify as a depository under Regulation 30.7 are excluded from the calculation of this limit. Accountants should be aware of the regulatory relief provided in this area by consulting CFTC staff letters, including Staff Letter 14-138, issued on November 13, 2014, available on the CFTC’s website.

*Investments and deposits of Regulation 30.7 customer funds.* FCMs may invest Regulation 30.7 customer funds subject to, and in compliance with, the same terms and conditions as described under CFTC Regulation 1.25.

**Cleared Swaps**

The Dodd-Frank Act brought comprehensive regulation to the swaps marketplace. Swap dealers are subject to robust oversight. Standardized derivatives are required to trade on open platforms and must be submitted for clearing to central counterparties. Cleared swaps, if not self-cleared, may only be cleared through intermediaries that are registered with the CFTC as FCMs.

Part 22 of CFTC regulations defines swaps, security-based swaps and security-based swap agreements contained in the Dodd-Frank Act and provides detailed rules and interpretative guidance on what types of contracts are contemplated by these definitions. Swaps fall under the authority of the CFTC; security-based swaps are under the authority of the SEC; security-based swap agreements fall under the CFTC’s authority but also are subject to the SEC’s anti-fraud authority; and mixed swaps are subject to dual regulation by the CFTC and SEC.

Although substantive differences in the segregation regimes between futures and cleared swaps at the clearing level exist under CFTC Part 22 regulations, requirements with respect to collateral that is not posted to clearinghouses and maintained by FCMs for Cleared Swaps Customers replicate or incorporate by reference the same regulatory requirements applicable to the segregation of futures customer funds under section 4d(a)(2) of the CEA (for example, holding funds separate and apart from proprietary funds, limitations on the FCM’s use of customer funds, titling of depository accounts, acknowledgment letter from depository requirements, and limitations on investment of swap customers’ funds are contained in Part 22 regulations and NFA Financial Requirements sections 4 and 16).

The withdrawal limitation requirements, the daily segregation calculations and filing of such calculations as well as requirements for detailed depository and investment information are replicated for cleared swaps customer funds in NFA Financial Requirements section 16 and CFTC Regulation 22.2. In addition, definitions for marketable securities and the related securities haircuts are described in CFTC Regulation 22.2.

**Minimum Financial Requirements for FCMs and IBs**

Section 4f(b) of the CEA expressly contemplates that adequately financed FCMs are necessary to ensure customer protection. CFTC Regulation 1.17 was enacted by the CFTC as one of the regulations under the CEA that establishes minimum financial requirements for FCMs and IBs. That regulation specifies that the largest minimum financial requirement applicable should apply to an FCM or IB whether imposed by
• the CFTC;
• a registered futures association (RFA) of which it is a member (currently, the NFA is the only RFA); or
• the SEC, for FCMs dually registered as broker-dealers.

The following tables summarize an FCM’s and IB’s minimum capital requirements. The maximum amount applicable is required by these rules, which should be consulted to ensure compliance. Information regarding CFTC regulations for these and other financial requirements are available on the CFTC’s website. CFTC Regulation 5.7 establishes minimum net capital levels applicable to any retail foreign exchange dealer or FCM that engages in off-exchange forex transactions with retail participants.

<table>
<thead>
<tr>
<th>Summary of Minimum Capital Requirements for FCMs</th>
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<tbody>
<tr>
<td><strong>CFTC Regulation 1.17</strong></td>
</tr>
<tr>
<td>$1,000,000</td>
</tr>
<tr>
<td>The FCM’s risk-based capital requirement, computed as 8% of the total risk margin requirement for positions carried by the FCM in customer and noncustomer (excluding proprietary) accounts.</td>
</tr>
<tr>
<td>The amount of adjusted net capital required by an RFA of which it is a member.</td>
</tr>
<tr>
<td>If less than $2 million in adjusted net capital: $3,000 for each AP sponsored (including APs sponsored by guaranteed IBs).</td>
</tr>
<tr>
<td>$20,000,000 plus 5% of the FCM’s or RFED’s total retail forex obligation in excess of $10,000,000 (CFTC Reg. 5.7).</td>
</tr>
<tr>
<td>For FCMs dually registered as securities broker-dealers, the amount of net capital required by SEC Rule 15c3–1(a)</td>
</tr>
</tbody>
</table>
### Summary of Minimum Capital Requirements for IBs

<table>
<thead>
<tr>
<th>CFTC Regulation 1.17</th>
<th>NFA Financial Requirements Section 5</th>
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</thead>
<tbody>
<tr>
<td>$45,000</td>
<td>$45,000</td>
</tr>
<tr>
<td>The amount of adjusted net capital required by an RFA of which it is a member.</td>
<td>If less than $1 million in adjusted net capital: $6,000 per office operated</td>
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<tr>
<td></td>
<td>If less than $1 million in adjusted net capital: $3,000 for each AP sponsored</td>
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<tr>
<td>For IBs dually registered as securities broker-dealers, the amount of net capital required by SEC Rule 15c3–1(a)</td>
<td>For IBs dually registered as securities broker-dealers, the amount of net capital required by SEC Rule 15c3–1(a)</td>
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**Minimum capital requirements.** An FCM and IB are required by CFTC Regulation 1.17 to maintain adjusted net capital, as defined by CFTC Regulation 1.17(c)(5), equal to, or in excess of, the greatest of the amounts described in the tables in the prior paragraph.

An FCM must also comply with the minimum net capital requirements of SROs, such as the commodity exchanges and NFA, of which it is a member. Under CFTC Regulation 1.52, *Self-regulatory organization adoption and surveillance of minimum financial requirements*, an SRO’s minimum net capital requirements for an FCM must be at least as stringent as the minimum net capital requirement set by the CFTC. If an FCM is dually registered with the SEC as a securities broker-dealer, the FCM must comply with the greatest of the SEC’s, CFTC’s, or SRO’s minimum net capital requirement.

**Computation of risk-based capital requirement for FCMs.** An FCM’s risk-based capital requirement is based on margin requirements for the accounts of the FCM’s noncustomers and customers, as defined in CFTC Regulations 1.17(b)(4) and 1.17(b)(7), respectively. The requirement is equal to 8 percent of the total risk margin requirement (excluding proprietary accounts) as defined in 1.17(b)(8).

**Notification of Undercapitalization.** CFTC Regulation 1.12 requires an FCM or IB to notify the CFTC if it fails to maintain levels of liquid assets that are sufficient in an amount to support the risk of the business operations in which the entity is engaged. A determination as to whether an FCM or IB has sufficient liquid assets and is properly capitalized is based on computation of the following two amounts, pursuant to CFTC Regulation 1.17:

- The FCM’s or IB’s adjusted net capital, as defined by CFTC Regulation 1.17(c)(5), which is the net capital reduced for the market, credit, or operational risk inherent in the business in which it currently is engaged;
- The FCM’s or IB’s minimum capital requirement, as defined by CFTC Regulation 1.17(a)(1) and 1.17(a)(2).
Net capital. CFTC Regulation 1.17(c)(1) defines net capital as the amount by which the FCM’s current assets, as defined by CFTC Regulation 1.17(c)(2), exceed the FCM’s total liabilities, as defined by CFTC Regulation 1.17(c)(4).

In computing net capital, CFTC Regulation 1.17(c)(4) allows the deduction of certain liabilities from total liabilities. Among the items that may be deducted from total liabilities are liabilities subordinated to the claims of all general creditors pursuant to a satisfactory subordination agreement, as defined by CFTC Regulation 1.17(h).

CFTC Regulation 1.17(d) requires that an applicant or registrant have equity capital of no less than 30 percent of its debt-equity total, which consists of equity capital plus the unpaid principal amount of satisfactory subordinated debt that does not qualify as equity capital. Equity capital includes traditional owners’ equity accounts plus satisfactory subordinated debt with an initial term of at least 3 years and a remaining term of no less than 12 months and without certain types of accelerated maturity or special prepayment features. CFTC Regulation 1.17(e) imposes withdrawal restrictions on such equity capital.

Subordination agreements include subordinated loan agreements and subordinated secured demand note agreements. A subordinated loan agreement governs a loan of cash to an applicant or registrant, whereas a secured demand note agreement governs a loan evidenced by a secured demand note and a deposit of securities or cash with the applicant or registrant to secure payment of the secured demand note.

To qualify as a satisfactory subordination agreement allowing exclusion of the related subordinated debt from total liabilities for net capital computation purposes, a subordination agreement must meet certain minimum and nonexclusive requirements, including that the agreement

- be written;
- have a minimum term of one year;
- be for a specific dollar amount;
- effectively subordinate the lender’s right to prior payment of all claims of present and future creditors;
- give the applicant or registrant the right to deposit any cash proceeds in its own name in any bank, and the right to pledge or hypothecate the securities without notice;
- meet certain prepayment restrictions;
- suspend the repayment or maturity obligation if, after giving effect to the obligation, the applicant’s or registrant’s adjusted net capital would be less than
  - 120 percent of the minimum dollar capital requirement as specified in CFTC Regulation 1.17(a)(1)(i)(A) or 1.17(a)(1)(iii)(A),
  - 120 percent of an FCM’s minimum risk-based capital requirement as defined in CFTC Regulation 1.17(a)(1)(i)(B), and
  - the net capital specified in SEC Rule 15c3-1(d)(b)(8)(i) for an applicant or registrant that is dually registered as a securities broker-dealer.
All executed subordination agreements must be approved by the applicant’s or registrant’s DSRO before they can be treated as satisfactory subordination agreements in computing net capital. Standardized subordinated loan agreement forms and secured demand note agreement and related secured demand note collateral agreement forms are available from the DSRO. In addition, entities dually registered as securities broker-dealers may require a separate agreement and approval from their designated examining authority (DEA).

CFTC’s instructions for Form 1-FR-FCM and Form 1-FR-IB provide detailed descriptions of the computation of net capital. In determining regulatory capital under CFTC Regulation 1.17, net capital is reduced by charges required to be taken against net capital. The result is adjusted net capital.

For adjusted net capital computation purposes, CFTC Regulation 1.17 introduces the term noncustomer account, and defines the term proprietary account in a more limited way than described by CFTC Regulation 1.3(y). (See the “Definition of Customer and Proprietary Accounts,” section of this publication.) The distinctions among customer, noncustomer, and proprietary accounts become important when computing the charges to be taken against net capital for undermargined customer and noncustomer trading accounts and for open futures and options positions held in proprietary trading accounts.

CFTC Regulation 1.17(c)(5), which incorporates several provisions of SEC Rule 15c3-1, sets forth the various charges to be applied against net capital to compute adjusted net capital. Among these charges are deductions from net capital for the following:

- Cash commodity inventories, fixed price commitments, and forward contracts
- Forward contracts and account balances denominated in a foreign currency
- Securities owned
- Securities purchased under agreements to resell (reverse repo)
- Securities sold under agreements to repurchase (repos)
- Securities and commodity options
- Undermargined futures and options on futures trading accounts carried by an FCM
- Open commodity positions in proprietary accounts
- Unsecured receivables from foreign brokers
- Any deficiency in collateral for a secured demand note
- Any net capital benefit derived from filing a consolidated financial report, if the applicant or registrant is unable to obtain the opinion of counsel required by CFTC Regulation 1.17(f)(2)(ii) with respect to distribution of the affiliate’s net assets.

**Early warning level.** When computing its adjusted net capital and minimum net capital requirement, an FCM is also required to compute its early warning capital level. An FCM’s early warning capital level is defined by CFTC Regulation 1.12(b) as the greatest of

- 150 percent of the minimum dollar amount;
- 110 percent of its minimum risk-based capital requirement as defined in CFTC Regulation 1.17(a)(1)(i)(B);
• 150 percent of the amount of adjusted net capital required by an RFA, unless such amount has been determined by a margin-based capital computation; or
• the net capital specified in SEC Rule 17a-11(b) for an FCM that is dually registered as a securities broker-dealer.

NFA and commodity exchanges located in the United States may have early warning capital and early warning notification requirements that are at least as stringent as those of the CFTC.

A written notice must be filed within 24 hours from the time the FCM knew, or should have known, that its adjusted net capital was below its early warning level. The notice must be filed electronically via WinJammer4 with
• the CFTC;
• the FCM’s DSRO; and
• other SROs of which the FCM is a member, as required by the SRO’s rules.

Additionally, written notice must be filed with the SEC and related securities SRO if the FCM is a dually registered securities broker-dealer.

An FCM is also required to monitor its adjusted net capital position and net capital requirement, and to meet the capital rules of the CFTC and other regulatory bodies, as applicable, at all times. By monitoring the amount of adjusted net capital in excess of early warning levels and minimum capital requirements, the CFTC and the FCM’s DSRO are able to take action to protect customers before the time at which the FCM’s assets may be insufficient to satisfy customers’ claims in the event of liquidation.

**Undercapitalization.** If an FCM’s or IB’s adjusted net capital is less than the minimum net capital required by CFTC Regulation 1.17(a), including the requirements of an RFA, the FCM or IB must cease doing business as such until it can demonstrate to the CFTC its ability to comply with CFTC Regulation 1.17(a). In addition, the FCM may be required by the CFTC or the FCM’s DSRO to transfer all of its customer accounts to another FCM. The CFTC or the DSRO may exempt the FCM or IB from the cessation of business if the entity affirmatively demonstrates the ability to bring itself into capital compliance within 10 business days.

CFTC Regulation 1.12 requires an FCM or IB whose adjusted net capital is, at any time, less than the minimum capital required by CFTC Regulation 1.17 or by the capital rule of an RFA to which it is subject, to notify immediately the CFTC and other regulatory authorities of the undercapitalization. The FCM or IB must give such notice within 24 hours after it knew, or should have known, that its adjusted net capital was less than the minimum capital required. Pursuant to CFTC Regulation 1.12(a), after notifying the CFTC and other regulatory authorities of the undercapitalization, the FCM or IB must also file financial statements and a computation of minimum capital requirements with the CFTC and other regulators within 24 hours after giving notice of its undercapitalization.

**Equity capital requirement and restriction on withdrawal of equity capital.** CFTC Regulation 1.17(d) requires each applicant or registrant to maintain equity capital of not less than 30 percent

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of the entity’s debt-equity total, as defined in CFTC Regulation 1.17(d). Under CFTC Regulation 1.17(e), no equity capital may be withdrawn from an applicant or registrant, or from any of its consolidated subsidiaries or affiliates, if the withdrawal would reduce equity capital to less than 30 percent of the required debt-equity total, or would reduce the entity’s adjusted net capital to an amount less than the amounts specified by CFTC Regulation 1.17(e)(1). Commodity exchanges in the United States and other regulatory bodies may have similar equity capital requirements and withdrawal restrictions.

**Recordkeeping Requirements—CFTC Regulations 1.18, 1.31–1.37, and 1.57**

The principal recordkeeping regulations for FCMs are CFTC Regulations 1.18 and 1.31–1.37. In the case of an IB, the main recordkeeping regulations are CFTC Regulations 1.18, 1.31, 1.35, 1.37 and 1.57.

FCMs and IBs are required by CFTC regulations to prepare and maintain a variety of specific records and computations. CFTC Regulations 1.18 and 1.35(a) require FCMs to prepare and maintain full, complete, and systematic records, with all pertinent data and memoranda, of all transactions relating to their business of dealing in commodity futures, commodity options, and cash commodities.

CFTC Regulation 1.31, *Books and records; keeping and inspection*, states that all books and records required by the CEA and CFTC regulations thereunder must be maintained for five years from the dates of the records. Such books and records must be readily accessible during the first two years of the five-year period and be open to inspection by any representative of the CFTC or U.S. Department of Justice. CFTC Regulation 1.31 prescribes the acceptable forms or media on which such records may be maintained.

**Margin Requirements**

All open futures or options on futures positions carried by an FCM for trading accounts at the FCM are subject to margin requirements. As a result, an FCM is required to deposit funds with commodity exchange clearing organizations to satisfy margin requirements set by the clearing organizations to carry the FCM’s open positions. Similarly, the owner of a commodity futures or options trading account carried by an FCM must satisfy the margin requirements set by the FCM for the open positions held in the account. Margin deposits are performance bonds that provide protection to FCMs and to all futures and options market participants.

Each commodity exchange clearing organization establishes margin requirements for the open futures and options on futures positions held by each of its clearing members at the clearing organization. A clearing organization may, at its discretion, require clearing members to deposit additional margin with the clearing organization.

The minimum margin required for open positions in a trading account carried by an FCM is set by the clearing organizations of the exchanges on which the contracts are traded. In addition, CFTC Regulation 1.58, *Gross collection of exchange-set margins*, requires that an FCM that carries an account for another FCM or foreign broker on an omnibus basis must collect—and each FCM having an omnibus account at another FCM must deposit—the margin required by the
exchange for each open position in the account on an individual contract, or gross basis, unless exchange rules specifically allow the position to be margined as a spread or hedged position.

Margin requirements differ for each open futures or options on futures position. Exchange rules specify the kinds of funds or assets that an FCM may accept to margin trading accounts. When calculating margins, exchanges generally use the Standard Portfolio Analysis of Risk Margin System (SPAN).

In periods of intense speculation and high trading volume, or during times of great market price volatility, commodity exchanges will often increase margin requirements. These increased margin requirements will remain in effect until the exchange determines that market conditions have returned to normal or warrant a change in margin requirements.

FCMs determine the margin requirements for the open positions in each of the trading accounts they carry. An FCM’s determination of the margin required in a trading account may vary according to the financial capabilities of each trading account owner, but may be no less than the exchange-set minimums.

On a daily basis, an FCM must monitor the trading accounts it carries and determine whether the accounts are properly margined. An FCM’s daily monitoring of the margin status of trading accounts is essential to the following:

- Ensuring the FCM’s compliance with exchange margin rules
- Managing the market and credit risk to the FCM inherent in the trading accounts the FCM carries
- Ensuring the FCM’s compliance with the minimum net capital requirements established by the CFTC and SROs, of which the FCM is a member

Trading accounts carried by an FCM that have insufficient funds on deposit with the FCM to satisfy exchange minimum margin requirements (accounts that are undermargined) may adversely affect the FCM’s regulatory net capital position. CFTC Regulations 1.17(c)(5)(viii) and 1.17(c)(5)(ix) require an FCM to compute and apply, against its net capital, a specified charge based on the amounts by which individual customer, noncustomer, and omnibus accounts at the FCM are undermargined. The CFTC’s Form 1-FR-FCM instructions and The Joint Audit Committee’s Margin Handbook (effective July 1999) describe how the charges for undermargined accounts under CFTC Regulation 1.17(c)(5)(viii) and 1.17(c)(5)(ix) must be computed by an FCM.

**Risk Management Program—CFTC Regulation 1.11**

An appropriate risk management program is essential for FCMs that accept customer money, securities, or property. FCMs must mitigate inherent risks associated with their business activities and as such, must develop and enforce risk management programs. At a minimum, these programs should define an FCM’s risk tolerance limits and consider market, credit, liquidity, operational, capital, and segregation risks, among others. The risk management policies and procedures should be developed to monitor and manage these risks and should discuss the appropriate actions to be taken in the event of breaches in limits and escalation processes. The risk management program and the written risk management policies and procedures, as well as
any material changes thereto, must be approved in writing by the FCM’s governing body. In addition, each FCM must furnish a copy of its written risk management policies and procedures to the CFTC and the FCM’s DSRO upon application for registration and thereafter upon request.

Risk exposure reports are required to be prepared on at least a quarterly basis and furnished to senior management and the CFTC. These reports must discuss all applicable risk exposures of the FCM, any recommended or completed changes to the risk management program, the recommended time frame for implementing changes, and the status of any incomplete implementation.

**Risk Assessment Rules—CFTC Regulations 1.14 and 1.15**

The CFTC’s risk assessment regulations aid evaluation of risk exposure resulting from the business activities of affiliates. CFTC Regulations 1.14 and 1.15 establish risk assessment recordkeeping requirements and risk assessment reporting requirements for FCMs.

The CFTC’s risk assessment regulations are designed to enhance the effectiveness of existing safeguards for customer funds by providing the CFTC with increased access to material information concerning the operations of an FCM’s affiliates whose activities may expose the FCM to financial or operational risks. The regulations recognize that an FCM’s operations and financial condition may be materially affected by, and only understood in conjunction with, the activities of affiliated entities, many of which may be unregulated. The reporting requirements for FCMs under the risk assessment regulations are intended to augment the CFTC’s ability to make informed judgments and responses during major market moves or other financial events affecting the commodities industry.

**Exemptions from CFTC Regulations 1.14 and 1.15.** FCMs that meet all of the following conditions are exempt from the requirements of CFTC Regulations 1.14 and 1.15. They (a) hold less than $6,250,000 of customer assets, (b) have adjusted net capital of less than $5,000,000, and (c) are not clearing members of any commodity exchange. Exemptions from some of the reporting requirements of CFTC Regulations 1.14 and 1.15 are provided for FCMs having affiliates that are subject to regulation by a federal banking agency, a state insurance commission or other similar state agency, or a foreign regulatory authority.

Besides the risk assessment regulations, the CFTC has other regulations that require FCMs to carry out certain risk management procedures. These procedures include supervising the activities of account executives and other employees, reconciling important operating and control accounts, maintaining current books and records, monitoring the FCM’s financial condition at all times, and ensuring compliance with the CFTC’s minimum financial requirements for an FCM.

**Recordkeeping requirements.** CFTC Regulation 1.14 requires an FCM that is part of a holding company to maintain records related to its financial risk exposure from the business activities of MAPs. A MAP, as described in CFTC Regulation 1.14(a)(2), is an affiliate of an FCM whose activities are likely to have a material effect on the financial condition or operations of the FCM. Under CFTC Regulation 1.14, each FCM is required to prepare and maintain, in accordance with CFTC Regulation 1.31, the following records:

- An organization chart that includes the FCM and each of its affiliated persons and identifies which of the affiliated persons are MAPs
• The FCM’s written policies, procedures, and systems for monitoring and controlling risks to the FCM’s financial condition or operations resulting from the activities of affiliates, and for managing the risks associated with the FCM’s proprietary and noncustomer clearing activities, along with a description of the FCM’s financing and capital sources.

• Fiscal year-end consolidated and consolidating financial statements for the highest level MAP within the FCM’s organizational structure.

On the organization chart, the FCM should identify which of the FCM’s MAPs file routine financial or risk exposure reports with the SEC, a federal banking agency, an insurance commissioner, or a foreign regulatory authority. The chart should also show which of the FCM’s MAPs, if any, are dealers and end users of financial instruments with off-balance sheet risk, such as swaps, options, futures contracts, and forward contracts.

An FCM’s written policies and procedures for managing the risks associated with the FCM’s proprietary and noncustomer clearing activities should address the risks and describe the controls relating to the FCM’s proprietary trading, the trading of the FCM’s affiliates, and the trading of the FCM’s officers, APs, and employees. The FCM’s written policies and procedures should also describe the FCM’s procedures for monitoring positions in trading accounts and policies relating to restrictions on trading activities.

Reporting requirements. CFTC Regulation 1.15 requires an FCM to file with the CFTC, within 60 calendar days after its registration is approved, a copy of the FCM’s organization chart and written policies, procedures, and systems required to be maintained under CFTC Regulation 1.14. An FCM must also file an updated organizational chart or revised risk management policies, procedures, and systems with the CFTC within 60 calendar days after the end of the fiscal quarter in which a material change in the FCM’s organizational chart or risk management policies, procedures, and systems has occurred.

The consolidated and consolidating financial statements required by CFTC Regulations 1.14 and 1.15 must be filed by an FCM with the CFTC within 105 days after an FCM’s fiscal year-end. The statements filed should include the consolidated and consolidating balance sheets and income statements, and consolidated cash flow statements for the highest level MAP in the FCM’s organizational structure, which should include the FCM and its other MAPs.

An FCM that is required to file, or has a MAP that is required to file, a Form 17-H risk assessment report with the SEC may file a copy of the Form 17-H with the CFTC to satisfy the CFTC’s reporting requirements for an organization chart and consolidated and consolidating financial statements. The FCM would still be required to file copies of its written risk management policies, procedures, and systems under CFTC Regulation 1.15. Also, if the Form 17-H does not designate all MAPs of the FCM, as required by CFTC Regulation 1.14(a)(1)(i), the FCM must supplement the copy of the Form 17-H filed with the CFTC to include those MAPs.

Notices Required From FCMs and IBs—CFTC Regulation 1.12

If an FCM or IB fails to comply with the financial and recordkeeping requirements of the CFTC or experiences significant events in its business, it may have to provide immediate notice by phone, to be confirmed in writing via WinJammer, to its DSRO and/or the CFTC, and the SEC.
and related securities SROs if the entity is a dually registered securities broker-dealer. CFTC Regulation 1.12 sets forth events or conditions that would require notification to regulatory authorities. Readers are encouraged to read the full text of CFTC Regulation 1.12 as a number of “notice events” were added in 2014. Examples of situations requiring notices to be filed include the following:

- The FCM’s or IB’s adjusted net capital is below the minimum adjusted net capital requirement.
- The FCM’s adjusted net capital is below the early warning level for adjusted net capital.
- The FCM’s funds deposited in a customer segregated, secured or cleared swaps account are less than the customer segregation requirement.
- The FCM’s excess funds in segregation, secured amount or cleared swaps are below the FCM’s target residual interest.
- The FCM experiences a material change in its operations or risk profile, including a change in senior management, the establishment or termination of a line of business, or a material adverse change in the FCM’s clearing arrangements.
- The FCM or IB discovers, or is notified by its independent CPA, that a material inadequacy, as defined by CFTC Regulation 1.16(d)(2), exists in its accounting system, internal accounting controls, or the procedures for safeguarding customer and firm assets.
- An account carried by the FCM is undermargined by an amount that exceeds the FCM’s adjusted net capital.
- The FCM’s net capital (or tentative net capital with an FCM that is a dually registered securities broker-dealer) has declined by 20 percent or more of the FCM’s net capital (or tentative net capital, as applicable) as last reported in financial reports filed with the CFTC.
- If a withdrawal of equity, an advance, or other action by a stockholder or partner of the FCM would cause a 30 percent or more reduction in the FCM’s excess adjusted net capital (or excess net capital, as defined by SEC rules, for an FCM that is a dually registered securities broker-dealer) as compared with its excess adjusted net capital (or excess net capital under SEC rules) as last reported in its financial reports filed with the CFTC, then the FCM must notify the CFTC and the DSRO of the reduction in excess net capital and its cause at least two business days before the event that would cause the reduction.
- The FCM has been notified by the SEC or SRO that it is the subject of a formal investigation.
- A copy of any examination report issued to the FCM by the SEC or SRO must be provided to the CFTC.
- Any correspondence received from the SEC or a securities SRO that raises issues with the adequacy of the FCM's capital position, liquidity to meet its obligations or otherwise operate its business, or internal controls must be provided to the CFTC.
Reporting Requirements

Financial Reports of FCMs, IBs and RFEDs

Filing of financial reports. CFTC Regulation 1.10(b) requires an FCM to file with the CFTC and the FCM’s DSRO an unaudited financial report as of the end of each month within 17 business days from the end of the reporting period. An independent IB must file with the IB’s DSRO an unaudited financial report semiannually as of the middle and the close of each fiscal year within 17 business days from the end of the reporting period. Similar to an FCM, an RFED must file an unaudited financial report monthly within 17 business days from the end of the reporting period, pursuant to CFTC Regulation 5.12(b).

Annual audited reports. Each financial report filed by an FCM as of its fiscal year-end must be audited by an independent CPA in accordance with CFTC Regulation 1.16 and filed within 60 calendar days of year-end. The annual report filed by an IB must be audited by an independent CPA in accordance with CFTC Regulation 1.16 and filed within 90 calendar days of year-end. RFEDs must also file an annual report audited by an independent CPA in accordance with CFTC Regulation 5.12(b) within 90 days of year-end. FCMs and RFEDs must file with the CFTC and their DSRO and IBs must file only with their DSRO. CFTC Regulation 1.10(d)(2) sets forth the financial statement disclosures and reconciliations required to be included in an FCM’s audited annual report.

CFTC Regulation 1.10(d)(3) allows the audited annual report to be presented in a format in accordance with generally accepted accounting principles (GAAP) rather than in the Form 1-FR format. If the report is presented in a format in accordance with GAAP, the report must include a reconciliation of total assets and liabilities on the statement of financial condition to current assets and total liabilities on the statement of the computation of the minimum capital requirements. This reconciliation, which is required to be a part of the audited annual report, should be prepared in the format prescribed by the CFTC’s Form 1-FR instructions.

The annual audit for subsequent years must be as of the same date unless the DSRO (or designated examining authority [DEA] if the entity is dually registered with the SEC as a broker-dealer) issues prior written approval for a change of the entity’s reporting year, and the entity has provided a copy of such written approval to the CFTC, in accordance with CFTC Regulation 1.10(e)(2). For further information, see the “CFTC Regulation 1.16, Qualifications and reports of accountants” section of this publication.

Use of Form 1-FR. Except for FCMs’ year-end audited reports and financial reports filed by FCMs that are dually registered securities broker-dealers, FCMs and RFEDs are required to file their monthly financial reports on CFTC Form 1-FR-FCM. IBs are required to file their semi-annual financial reports on CFTC Form 1-FR-IB.

Use of FOCUS reports. An entity that is dually registered with the SEC as a broker-dealer may file SEC Form X-17A-5 (a FOCUS report) under the Securities Exchange Act of 1934 instead of Form 1-FR. However, all information that is required to be furnished on, and submitted with, Form 1-FR must be provided with the FOCUS report.
Contents of financial reports. CFTC Regulation 1.10(d) specifies the financial statements and other information that must be included in a financial report filed with the CFTC. The required financial statements and other information are as follows:

a. Oath or affirmation
b. Statement of financial condition
c. Statement of income (loss)
d. Statement of cash flows (for year-end audited reports, unless such statement is required to be filed by an SRO's rules or is requested in a special call)
e. Statement of changes in ownership equity
f. Statement of changes in liabilities subordinated to the claims of general creditors pursuant to a satisfactory subordination agreement
g. Notes to financial statements
h. Such further information as may be necessary for items (c) through (g) to make the required statements and schedules not misleading and fairly stated in relation to the financial statements as a whole (for example, omitting appropriate disclosures regarding unconsolidated subsidiaries)
i. Statement of the computation of the minimum capital requirements
j. For FCMs only, statement of segregation requirements and funds in segregation for customers trading on U.S. commodity exchanges
k. For FCMs only, statement of segregation requirements and funds in segregation for customers’ dealer options accounts
l. For FCMs only, statement of secured amounts and funds held in separate accounts for foreign futures and foreign options customers
m. For FCMs only, statement of cleared swaps customer segregation requirements and funds in cleared swaps customer accounts
n. Reconciliations, including appropriate explanation of any material differences between the computation of minimum capital requirements, segregation requirements and funds in segregation for customers trading on U.S. commodity exchanges, segregation requirements and funds in segregation for customers’ dealer options accounts, secured accounts and funds held in separate accounts for foreign futures and foreign options customers and cleared swaps customer segregation requirements and funds in cleared swaps customer accounts included in the original unaudited 1-FR filing and the corresponding computations contained in the audited financial statements (or a statement that no material differences exist, pursuant to CFTC Regulation 1.10(d)(2)(vi) or SEC Rule 17a-5(d)(4))
o. Supplemental report by the CPA describing any material inadequacies that exist or have existed since the date of the previous audit, and indicating any corrective action taken or proposed by the registrant in regard thereto (or a statement that the audit did not disclose any material inadequacies)
For FCMs and IBs that are dually registered securities broker-dealers, the annual audited financial statements must also contain supplemental schedules and information as required by SEC Rule 17a-5, as discussed in the AICPA Accounting Guide *Brokers and Dealers in Securities*.

FCMs that have issued securities to the public may also be subject to the disclosure rules that apply to publicly held companies. Such rules require that comprehensive financial information (including a statement of income or operations and a statement of cash flows) be disseminated to stockholders.

FCMs and RFEDs must file their annual audited reports with the CFTC and their DSRO (IBs only file with their DSRO) electronically via WinJammer; these reports include the independent CPA’s report on the audited financial statements and schedules in the report, the supplemental report on material inadequacies, and the registrant’s oath or affirmation. An entity may also be required to file its audited annual report with other regulatory bodies or governmental agencies depending on the nature and location of the entity’s operations.

**Consolidation of Subsidiaries**

CFTC Regulation 1.17(f)(1) and the instructions to the Form 1-FR require an FCM or IB to consolidate the assets and liabilities of any subsidiary or affiliated company in the FCM’s or IB’s financial report if the FCM or IB guarantees, endorses, or assumes, either directly or indirectly, the obligations or liabilities of the subsidiary or affiliate company. If, however, the effect of consolidating any subsidiary or affiliate company is to increase the FCM’s or IB’s excess adjusted net capital and the FCM or IB wants the increase to be recognized as an increase in its excess net capital, an opinion that states that the net assets of the subsidiary or affiliate can be liquidated and distributed to the FCM or IB within 30 calendar days, and that includes the other representations required by CFTC Regulation 1.17(f)(2), must be obtained from outside legal counsel as of the date of the financial statements. No FCM or IB may rely on any benefit from consolidation of a subsidiary or affiliate to meet its minimum net capital requirement. If the proper legal opinion is obtained, such a benefit may only be recognized to increase reported excess net capital. In the case of a subsidiary consolidation, any benefit to be reported from consolidation should be reduced by the value attributable to any minority interest in the subsidiary not owned by the FCM or IB.

The opinion of outside legal counsel must be renewed with each annual audit and retained by the FCM or IB. No increase in excess net capital is permitted as a result of consolidating a subsidiary or affiliate unless such a legal opinion is obtained.

**Extension of Time for Filing Audited Report**

Pursuant to CFTC Regulation 1.16(f), if an FCM cannot meet the 60-calendar-day deadline for filing its year-end audited report without substantial undue hardship, the FCM may file an application for an extension of time with its DSRO, or its DEA if the FCM is a dually registered securities broker-dealer, and a copy must be filed with the applicable regional office of the CFTC. If an IB cannot meet the 90-calendar-day deadline for filing its year-end audited report without substantial undue hardship, the IB may file an application for an extension of time with
its DSRO, or its’ DEA if the IB is a dually registered securities broker-dealer. An IB does not need to file a copy of the extension request with the CFTC.

The application for an extension of time to file an audited report must fully describe the reasons that would result in substantial undue hardship for the FCM or IB. The request must be approved or denied in writing, and the FCM must immediately file a copy of any such approval or denial with the CFTC. If the request has been approved, such approval will not be deemed effective until the CFTC receives the required copy of the written approval notice. An IB need not file a copy of any such approval or denial with the CFTC.

The DSRO or DEA may specify other conditions for requests of extension of time.

Special or Accelerated Financial Reports

An FCM or IB may also be required by its DSRO to file financial reports on a special call or an accelerated basis. In such instances, CFTC Regulation 1.10(b)(3) requires the FCM or IB to file with the CFTC a true and exact copy of each financial report it files with its DSRO.

Any SRO, such as an exchange or the NFA, of which an FCM or IB is a member, may ask the FCM or IB for financial reports or other financial information even though the SRO is not the FCM’s or IB’s DSRO. An SRO or the CFTC may ask FCMs or IBs for financial reports or information in addition to the routine required filings, as per CFTC Regulation 1.10(b)(4).

Public and Nonpublic Treatment of Reported Information

Under CFTC Regulations 1.10(g) and 5.12(h), the following portions of audited and unaudited financial reports filed with the CFTC by FCMs, IBs, and RFEDs will be considered public information and made available to the public on request:

- The amount of adjusted net capital
- The amount of the minimum net capital requirement
- The amount of adjusted net capital in excess of its minimum net capital requirement
- The amount of the RFED’s retail foreign exchange obligations owed to its retail forex customers
- The following statements and footnote disclosures thereof
  - The Statement of Financial Condition in the audited annual financial report
  - The Statements of Segregation Requirements and Funds in Segregation for customers trading on U.S. commodity exchanges and for customers’ dealer options accounts (for FCMs only)
  - The Statement of Secured Amounts and Funds held in Separate Accounts for foreign futures and foreign options customers (for FCMs only)
  - The Statement of Cleared Swaps Customer Segregation Requirements and Funds in Cleared Swaps Customer Accounts (for FCMs only)
• The independent CPA’s opinion filed with a certified annual financial report
• The list, if any, in audited or unaudited FCM financial reports of “guaranteed IBs”

The CFTC posts the following portions of unaudited monthly financial reports filed by FCMs on its website:

• The amount of the FCM’s adjusted net capital
• The amount of the FCM’s minimum net capital requirement
• The amount of the FCM’s adjusted net capital in excess of its minimum net capital requirement
• Customers’ assets in segregation, segregation required and excess funds in segregation for customers trading on U.S. commodity exchanges and for customers’ dealer options accounts
• Target residual interest in customer segregated accounts
• Funds in separate CFTC Regulation 30.7 accounts, customer amounts required under Regulation 30.7 and excess funds in separate accounts for foreign futures and foreign options customers
• Target residual interest in CFTC Regulation 30.7 accounts
• Funds in customer cleared swaps accounts, cleared swaps required and excess cleared swaps
• Target residual interest in cleared swaps accounts
• Total amount of retail foreign exchange obligations

As a matter of administrative convenience, an applicant or registrant may submit with its certified annual financial report an additional copy that has been marked “public” and contains only the information that is publicly available upon request under CFTC Regulation 1.10(g).

An applicant or registrant may request in writing that the CFTC afford confidential treatment under the Freedom of Information Act to any information that it submits that is supplemental to the “public” information previously described. In so doing, the applicant or registrant should specify the grounds on which confidential treatment is being requested. Confidential treatment may be requested only on the grounds that disclosure is specifically exempted by a statute, would reveal the entity’s trade secrets or confidential commercial or financial information, would constitute a clearly unwarranted invasion of the entity’s personal privacy, or would reveal investigatory records compiled for law enforcement purposes.

Pursuant to CFTC Regulation 1.10(g)(5), the independent CPA’s opinion on the public portion of an applicant’s or registrant’s financial report filing will be deemed public information.

Pursuant to CFTC Regulation 145.5(d)(1)(viii), the independent CPA’s supplemental report on material inadequacies filed under CFTC Regulation 1.16(c)(5) will be deemed nonpublic information.
Financial Statements to Be Furnished to Customers

Although CFTC regulations do not require an FCM to provide its customers with copies of the FCM’s financial statements, an FCM that is a dually registered broker-dealer may have to do so in accordance with SEC Rule 17a-5(c). CFTC regulations do require, however, that an FCM make certain financial information publicly available on the FCM’s website in accordance with CFTC Regulation 1.55(o).

SEC Rule 17a-5(c) requires securities broker-dealers who carry customers to semiannually mail to all customers (as defined by Rule 17a-5(c)) carried by the broker-dealer a statement of financial condition with appropriate notes, including the net capital and required net capital pursuant to SEC Rule 15c3-1 (the uniform net capital rule). There is an exemption available to broker-dealers in SEC Rule 17a-5(c)(5) that permits a broker-dealer to instead furnish to customers a financial disclosure and provide a mechanism for the statements to be provided via website or toll-free telephone number upon the customer’s request. For more information, see the AICPA Accounting Guide Brokers and Dealers in Securities.

Special Considerations for Retail Foreign Exchange Dealers

Persons offering to be or acting as counterparties to retail forex transactions, but not primarily or substantially engaged in the exchange-traded futures business, are required to register with the CFTC as RFEDs.

The reporting requirements for RFEDs are set forth by CFTC Regulation 5.12, Financial reports of retail foreign exchange dealers, and are similar to those of an FCM. CFTC Regulation 5.1(k) defines a retail forex customer.

RFEDs must collect and maintain security deposits for each transaction in accordance with NFA Financial Requirements Section 12.

FCM members of the NFA that offer forex transactions to retail customers and those considered FDMs, as defined by NFA Bylaw 306, are subject to the greater of the following specific capital requirements.

<table>
<thead>
<tr>
<th>Summary of Minimum Capital Requirements For Retail Foreign Exchange Dealers (RFEDs)</th>
</tr>
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<tbody>
<tr>
<td><strong>CFTC Regulation 5.7</strong></td>
</tr>
<tr>
<td>$20,000,000</td>
</tr>
<tr>
<td>$20,000,000 plus 5% of the FCM’s or RFED’s total retail forex obligation in excess of $10,000,000</td>
</tr>
</tbody>
</table>

35
<table>
<thead>
<tr>
<th>Any amount required under CFTC Regulation 1.17</th>
<th>Any other amount required by Financial Requirements Section 1</th>
</tr>
</thead>
<tbody>
<tr>
<td>The amount of adjusted net capital required by an RFA of which it is a member</td>
<td></td>
</tr>
</tbody>
</table>

*Effective January 4, 2016, this minimum capital calculation will change, and as such, NFA Financial Requirements Section 11 should be consulted.

Under CFTC Regulation 1.16(d), an audit must include a review and appropriate tests of the accounting system, the internal accounting controls, and the procedures for safeguarding customer and firm assets in accordance with the CEA and the CFTC’s regulations. An audit must also include all procedures necessary to enable the CPA to express an opinion on the financial statements and schedules. For an RFED, schedules included in the Form 1-FR-FCM must be covered by the audit opinion. The scope of the audit must be sufficient to provide reasonable assurance that any material inadequacies existing at the examination date in the accounting system, the internal accounting controls, or the procedures for safeguarding customer and firm assets will be discovered. The audit of an RFED must also include reviews of the practices and procedures used by the client to produce the periodic computations by the RFED of its adjusted net capital and minimum financial requirements pursuant to CFTC Regulation 5.7.
Exhibit 1

CFTC’s Financial and Segregation Interpretations Nos. 1–14

Interpretation No. 1, “Safety Factors on Undermargined Accounts,” explains how to compute the charges required by Commodity Futures Trading Commission (CFTC) Regulations 1.17(c)(5)(viii) and (ix) to be taken by a futures commission merchant (FCM) against net capital for undermargined customer, noncustomer, and omnibus accounts carried by the FCM.

Interpretation No. 2-1, “Use of Customer’s Funds for the Purchase of Obligations Under Repurchase Agreements,” is superseded by revisions to CFTC Regulation 1.25, Investment of customer funds.

Interpretation No. 3-1, “Interpretation Relating to Receivables Secured by Warehouse Receipts or Electronic Shipping Certificates or Secured by Commissions Withheld from Customer Account Executives,” superseding Interpretation No. 3, was issued to provide more comprehensive guidance to FCMs with respect to receivables arising from customer and noncustomer financing described therein, and which is secured by commodity warehouse receipts or electronic shipping certificates deliverable for futures contracts on a designated contract market. This Interpretation also reconfirms the Division’s earlier interpretation as to receivables secured by commissions withheld from customer account executives.

Interpretations No. 4-1, “Advisory Interpretation for Self-Regulatory Organization Surveillance Over Members’ Compliance With Minimum Financial, Segregation, Reporting, and Related Recordkeeping Requirements,” and No. 4-2, “Risk-Based Auditing,” address self-regulatory organization’s (SRO’s) responsibilities with respect to in-field examinations and ongoing surveillance over members’ compliance with the SRO’s and CFTC’s financial, segregation, and related recordkeeping regulations. In doing so, the interpretations set forth the minimum standards believed necessary by the CFTC’s Division of Swap Dealer and Intermediate Oversight for a satisfactory program of in-field examinations and ongoing surveillance by an SRO over its members’ compliance.

Interpretation No. 4-2, “Risk-Based Auditing,” requires designated self-regulatory organizations (DSROs) to continue to comply with Interpretation 4-1 and the addenda in conducting financial and sales practice/compliance examinations of member FCMs. However, in order to reflect risk-based auditing, the division will deem any DSRO that fully implements the risk-based auditing procedures set forth in paragraphs 1–9 of the interpretation, in lieu of those required by paragraphs 26–32 and 44 of Interpretation 4-1, to be in compliance with Interpretation 4-1 and the addenda. All other paragraphs of Interpretation 4-1 and the addenda will continue to be in effect during the interim period. (An SRO that implements the risk-based auditing approach will not be required to perform a biennial full scope financial audit of each of its member FCMs that carry customer funds.) Accordingly, that portion of paragraph 2.1 of addendum A that provides that a sales practice/compliance audit is to be conducted during the biennial full scope financial audit will no longer be applicable.

Addendum A, “SRO Sales Practice Audit and Compliance Responsibilities,” to Interpretation No. 4-2, CFTC Interpretative Letter 93-90, discusses the standards and SRO responsibilities applicable to an SRO’s program for sales practice and compliance audits of its members, Comm.

Addendum B, “Coordinating Financial Rule Enforcement Programs Conducted by Self-Regulatory Organizations Over Dually-Registered FCM or IBs,” to Interpretation No. 4-2 sets forth the conditions under which a futures SRO may rely upon the compliance work of a securities SRO in fulfilling its obligation to carry out an effective compliance and rule enforcement program, pursuant to the division’s Interpretation No. 4-2, over members that are dually registered as both FCMs and securities broker-dealers, Comm. Fut. L. Rep. (CCH) ¶7114D (Division of Trading and Markets, October 31, 1995).

Interpretation No. 5, “Interpretation Relating to Unsecured Accounts Receivable Included in Current Assets,” explains conditions under which an FCM’s unsecured receivables resulting from services rendered in the ordinary course of the FCM’s business may be treated as current assets for net capital computation purposes under CFTC Regulation 1.17(c)(2)(ii)(A).

Interpretation No. 6, “Interpretations Relating to the Annual Report Required of Commodity Pool Operators,” clarifies CFTC Regulations 4.22(c) and 4.22(d) about distribution by a commodity pool operator of audited annual reports to pool participants and the CFTC. Interpretation No. 6 also explains the CFTC’s policy regarding the CFTC’s disclosure to the public of information contained in annual reports of pools filed with the CFTC.

Interpretation No. 7-1, “Investment of Funds Representing an FCM’s Residual Financial Interest in Customers’ Segregated Funds,” explains the conditions under which an FCM may invest funds representing its residual financial interest in customer-segregated funds simultaneously with customer-segregated funds.

Interpretation No. 8, “Proper Accounting, Segregation and Net Capital Treatment of Exchange-Traded Options Transactions,” describes how options on futures contracts in customers’ accounts should be marked-to-market\(^5\) each day with the market value of options purchased being included in customer account equity and the market value of options granted being deducted from customer account equity. The interpretation also provides guidance about how to treat, for net capital purposes, long options purchased for a customer’s account not having sufficient equity in the account to cover the options purchase.

Interpretation No. 9, “Money Market Deposit Accounts and NOW Accounts,” explains the division’s position that FCMs may not deposit customer funds into NOW accounts or money market deposit accounts unless it is demonstrated to the CFTC that there is a lawful mechanism by which the account holder can obtain such funds immediately upon demand.

Interpretation No. 10-1, Amendment to Interpretation No. 10, “Treatment of Funds Deposited in Safekeeping Accounts,” restricts the use of third party custodial accounts by customers of FCMs and sets forth the circumstances under which an FCM may allow customers to use such accounts for segregated funds used to margin the customer’s trading account at the FCM.

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\(^5\) The terms *market value* and *mark-to-market* are used within this publication as operational terms. Accordingly, in practice, they may not necessarily be synonymous to the terms *fair value* and *subsequently measured at fair value*, which are used within the financial statements in accordance with FASB Accounting Standards Update (ASU) No. 2012-04, *Technical Corrections and Improvements.*
Interpretation No. 11, “Investments of Customer Regulated Funds, Treatment of Due Bills, Unsecured Receivables,” states that due bills issued by a bank to an FCM when the bank is unable to deliver immediately the securities intended to be purchased by the FCM are not proper investments of customers’ segregated funds, cannot be considered a part of an FCM’s segregated funds, and must be treated as a noncurrent unsecured receivable for net capital purposes.

Interpretation No. 12, “Deposit of Customer Funds in Foreign Depositories,” is superseded by CFTC Regulation 1.49, Denomination of customer funds and location of depositaries.

Interpretation No. 13, “Accounting for Checks Received From a Parent or an Affiliated Entity for Regulatory Compliance Purposes,” states the division’s position that the preclearance recognition of funds represented by checks received from a parent or affiliated entity, or drawn on an intra-company account, is improper for regulatory accounting and compliance purposes, including for purposes of recognizing such funds as net capital, funds in segregation, or funds in a separate account. The interpretation states that, for regulatory and compliance purposes, accounting for such transactions must be based upon the actual location of the funds rather than the mere possession of uncollected checks for such funds.

Interpretation No. 14, “Accounting for Deposits and Contractual Obligations Between an FCM and Its Introducing Brokers and Associated Persons,” addresses several issues relating to transactions and contractual obligations between FCMs and introducing brokers (IBs) and associated persons (APs) it uses to service the accounts of its customers. The issues addressed include the following:

- The proper classification of IBs’ and APs’ trading accounts for purposes of compliance with the CFTC’s segregation of funds regulations
- An FCM’s treatment of security deposits received from IBs and APs
- An IB’s treatment, for net capital purposes, of a security deposit with an FCM
- Accrual and payment of commissions and fees payable by an FCM to IBs and APs

This information is available at the CFTC Web site at: www.cftc.gov/industryoversight/intermediaries/intermediaryguidance.html.
Exhibit 2

Partial Listing of NFA Interpretative Notices Applicable to FCMs

The applicable rule and its relevant interpretations are listed subsequently. These interpretations are available at www.nfa.futures.org.

RULE 2-4, JUST AND EQUITABLE PRINCIPLES OF TRADE.

- Guideline for the Disclosure by FCMs and IBs of Costs Associated with Futures Transactions

RULE 2-9, SUPERVISION.

- FCM and IB Anti-Money Laundering Program
- Self-Audit Questionnaires
- Supervision of Telemarketing Activity
- Supervisory Procedures for E-Mail and the Use of Web Sites
- NFA’s Review and Approval of Certain Radio and Television Advertisements
- Supervision of Branch Offices and Guaranteed IBs
- Enhanced Supervisory Requirements
- Supervision of the Use of Automated Order-Routing Systems
- Ethic Training Requirements

RULE 2-10, RECORDKEEPING.

- The Allocation of Block Orders for Multiple Accounts
- Orders Eligible For Post-Execution Allocation

RULE 2-29, COMMUNICATIONS WITH THE PUBLIC AND PROMOTIONAL MATERIAL

- Communications with the Public and Promotional Material
- Review of Promotional Material Prior to its First Use
- Use of Promotional Material Containing Hypothetical Performance Results
- Deceptive Advertising (1996)
- Deceptive Advertising (1998)
- High Pressure Sales Tactics
- Review and Approval of Certain Radio and Television Advertisements

RULE 2-30, CUSTOMER INFORMATION AND RISK DISCLOSURE.

- Customer Information and Risk Disclosure (Board of Directors)
- Customer Information and Risk Disclosure (Staff)
Interpretations related to other NFA guidance

- *Registration Requirements; Branch Offices*