



FEDERAL RESERVE SYSTEM

12 CFR Part 240

Docket No. R-1428

RIN 7100-AD 79

Retail Foreign Exchange Transactions (Regulation NN)

AGENCY: Board of Governors of the Federal Reserve System

ACTION: Final Rule.

SUMMARY: The Board of Governors of the Federal Reserve System (“Board”) is adopting a final rule to permit banking organizations under its supervision to engage in off-exchange transactions in foreign currency with retail customers. The final rule also describes various requirements with which banking organizations must comply to conduct such transactions.

DATES: This rule is effective on May 13, 2013.

FOR FURTHER INFORMATION CONTACT: Scott Holz, Senior Counsel, Legal Division, (202) 452-2966.

SUPPLEMENTARY INFORMATION:

I. Background

On July 21, 2010, President Obama signed into law the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank Act).¹ As amended by section 742(c)(2) of the Dodd-Frank Act,² the Commodity Exchange Act (CEA) provides

¹ Pub. L. 111-203, 124 Stat. 1376.

² Dodd-Frank Act § 742(c)(2) (codified at 7 U.S.C. 2(c)(2)(E) (2011)).

that a United States financial institution³ for which there is a Federal regulatory agency⁴ shall not enter into, or offer to enter into, certain types of foreign exchange transactions described in section 2(c)(2)(B)(i)(I) of the CEA with a retail customer⁵ except pursuant to a rule or regulation of a Federal regulatory agency allowing the transaction under such terms and conditions as the Federal regulatory agency shall prescribe⁶ (a “retail forex rule”). Section 2(c)(2)(B)(i)(I) includes “an agreement, contract, or transaction in foreign currency that . . . is a contract of sale of a commodity for future delivery (or an option on such a contract) or an option (other than an option executed or traded on a national securities exchange registered pursuant to section 6(a) of the Securities Exchange Act of 1934 (15 U.S.C. 78f(a)).”⁷ A Federal regulatory agency’s retail forex rule must treat all such futures and options and all agreements, contracts, or transactions that are functionally or economically similar to such futures and options similarly.⁸

Retail forex rules must prescribe appropriate requirements with respect to disclosure, recordkeeping, capital and margin, reporting, business conduct, and documentation requirements, and may include such other standards or requirements as the Federal regulatory agency determines to be necessary.⁹ The Board’s rule applies to “banking institutions,” a term defined in section 240.2(b) to mean state member banks,

³ The CEA defines “financial institution” to include an agreement corporation, an Edge Act corporation, a depository institution (as defined in section 3 of the Federal Deposit Insurance Act), a financial holding company (as defined in section 2 of the Bank Holding Company Act of 1956), a trust company, or “a similarly regulated subsidiary or affiliate of an entity” described above. 7 U.S.C. 1a(21).

⁴ For purposes of the retail forex rules, “Federal regulatory agency” includes “an appropriate Federal banking agency.” 7 U.S.C. 2(c)(2)(E)(i)(III). The Board is an “appropriate Federal banking agency” under the CEA. 7 U.S.C. 1a(2).

⁵ A retail customer is a person who is not an “eligible contract participant” under the CEA. *See*, 7 U.S.C. 1a(18).

⁶ 7 U.S.C. 2(c)(2)(E)(ii)(I).

⁷ 7 U.S.C. 2(c)(2)(B)(i)(I).

⁸ 7 U.S.C. 2(c)(2)(E)(iii)(II).

⁹ 7 U.S.C. 2(c)(2)(E)(iii)(I).

uninsured state-licensed branches of foreign banks, financial holding companies, bank holding companies, savings and loan holding companies,¹⁰ agreement corporations, and Edge Act corporations.

On September 10, 2010, the Commodity Futures Trading Commission (CFTC) adopted a retail forex rule for persons subject to its jurisdiction.¹¹ After studying and considering the CFTC's retail forex rule, and consulting with the Office of the Comptroller of the Currency (OCC) and the Federal Deposit Insurance Corporation (FDIC), the Board approved for publication a notice of proposed rulemaking (NPR) for retail forex transactions effected by banking institutions on July 28, 2011. The NPR was published in the Federal Register on August 3, 2011,¹² and the comment period closed on October 11, 2011. In response to the NPR, the Board received six comments: three from individuals, one from a bank, and two from trade associations. One of the individual commenters did not address the rule, while another individual commenter expressed general support for the rule. The third individual (hereinafter "the individual commenter") and the bank (hereinafter "the bank commenter") generally supported the rule while requesting certain clarifications and changes. One trade association requested changes to reduce the burden on certain entities that would qualify as "retail forex customers" under the proposed regulation. The other trade association letter requested changes to address retail customers who use foreign exchange in connection with the

¹⁰ The Board's proposed rule did not explicitly cover savings and loan holding companies (SLHCs). They have been added to the regulation to reflect the transfer to the Board of regulatory responsibility for SLHCs on July 21, 2011.

¹¹ *Regulation of Off-Exchange Retail Foreign Exchange Transactions and Intermediaries*, 75 FR 55409 (Sept. 10, 2010) (Final CFTC Retail Forex Rule). The CFTC proposed these rules prior to the enactment of the Dodd-Frank Act. *Regulation of Off-Exchange Retail Foreign Exchange Transactions and Intermediaries*, 75 FR 3281 (Jan. 20, 2010) (Proposed CFTC Retail Forex Rule).

¹² 76 FR 46652 (August 3, 2011).

purchase or sale of a security denominated in a foreign currency. These comments are addressed in the Section-by-Section Analysis below. The Board is adopting a final rule that is substantially the same as the proposed rule, with certain clarifications as discussed below.

II. Section-by-Section Analysis

Section 240.1—Authority, Purpose, and Scope

This section authorizes a banking institution to conduct retail forex transactions.

The scope of the regulation covers branches and offices of banking institutions, although foreign branches and offices of these institutions are not subject to sections 240.3 and 240.5 through 240.16 unless the branch or office is dealing with a United States customer. Since sections 240.1 and 240.2 cover the authority, purpose and scope of the regulation and the definitions used in the regulation, if a banking institution's only retail forex transactions are conducted by a foreign branch or office and limited to non-U.S. customers, the only operative section of the regulation that would apply would be section 240.4. As described below, this section requires a banking institution that wishes to engage in retail forex transactions to notify the Board before commencing a retail forex business.

The regulation also covers subsidiaries of banking institutions that are organized under the laws of the United States or a U.S. state, unless the subsidiary is subject to the jurisdiction of another federal regulatory agency that is authorized to prescribe retail forex rules under section 2(c)(2)(E) of the Commodity Exchange Act.¹³ Subsidiaries of a

¹³ 7 U.S.C. 2(c)(2)(E). The federal regulatory authorities other than the Board are the CFTC, OCC, FDIC, the Securities and Exchange Commission, the National Credit Union Association, and the Farm Credit Administration.

banking institution that are organized under foreign law are not covered regardless of the nationality of the customer.

The rule is applicable to retail forex transactions engaged in by banking institutions on or after the effective date.

Section 240.2—Definitions

This section defines terms specific to retail forex transactions and to the regulatory requirements that apply to retail forex transactions.

The definition of “retail forex transaction” generally includes the following transactions in foreign currency between a banking institution and a person that is not an eligible contract participant:¹⁴ (i) a future or option on such a future;¹⁵ (ii) options not traded on a registered national securities exchange;¹⁶ and (iii) certain leveraged or margined transactions. This definition has several important features.

First, certain transactions in foreign currency are not “retail forex transactions,” and therefore are not subject to the prohibition in section 742(c)(2) of the Dodd-Frank Act. For example, a “spot” forex transaction where one currency is bought for another and the two currencies are exchanged within two days is not a “future” and would not meet the definition of a “retail forex transaction,” since actual delivery occurs as soon as practicable.¹⁷ Similarly, a “retail forex transaction” does not include a forward contract with a commercial entity that creates an enforceable obligation to make or take delivery,

¹⁴ The definition of “eligible contract participant” is found in section 1a(18) of the CEA and is discussed below.

¹⁵ 7 U.S.C. 2(c)(2)(B)(i)(I).

¹⁶ 7 U.S.C. 2(c)(2)(B)(i)(I).

¹⁷ See generally, *CFTC v. Int’l Fin. Servs. (New York), Inc.*, 323 F. Supp. 2d 482, 495 (S.D.N.Y. 2004) (distinguishing between foreign exchange futures contracts and spot contracts in foreign exchange, and noting that foreign currency trades settled within two days are ordinarily spot transactions rather than futures contracts); see also *Bank Brussels Lambert v. Intermetals Corp.*, 779 F. Supp. 741, 748 (S.D.N.Y. 1991).

provided the commercial counterparty has the ability to make delivery and accept delivery in connection with its line of business.¹⁸ In addition, “retail forex transaction” does not include an “identified banking product” or a part of an “identified banking product,” as defined in section 401(b) of the Legal Certainty for Bank Product Act of 2000.¹⁹ Finally, the definition does not include transactions executed on a securities exchange and banking institutions are ineligible to effect retail forex transactions on a designated contract market.

Second, the definition of “retail forex transaction” covers rolling spot forex transactions offered or entered into on a leveraged or margin basis (so-called *Zelener*²⁰ contracts), including without limitation such transactions traded on the Internet, through a mobile phone, or on an electronic platform. A rolling spot forex transaction normally requires delivery of currency within two days, like spot transactions. However, in practice, these contracts are indefinitely renewed every other day and no currency is actually delivered until one party affirmatively closes out the position.²¹ Therefore, the

¹⁸ See generally, *CFTC v. Int’l Fin. Servs. (New York), Inc.*, 323 F. Supp. 2d 482, 495 (S.D.N.Y. 2004) (distinguishing between forward contracts in foreign exchange and foreign exchange futures contracts); see also William L. Stein, *The Exchange-Trading Requirement of the Commodity Exchange Act*, 41 Vand. L.Rev. 473, 491 (1988). In contrast to forward contracts, futures contracts generally include several or all of the following characteristics: (i) standardized nonnegotiable terms (other than price and quantity); (ii) parties are required to deposit initial margin to secure their obligations under the contract; (iii) parties are obligated and entitled to pay or receive variation margin in the amount of gain or loss on the position periodically over the period the contract is outstanding; (iv) purchasers and sellers are permitted to close out their positions by selling or purchasing offsetting contracts; and (v) settlement may be provided for by either (a) cash payment through a clearing entity that acts as the counterparty to both sides of the contract without delivery of the underlying commodity; or (b) physical delivery of the underlying commodity. See, Edward F. Greene et al., *U.S. Regulation of International Securities and Derivatives Markets* § 14.08[2] (8th ed. 2006).

¹⁹ 7 U.S.C. 27(b).

²⁰ *CFTC v. Zelener*, 373 F.3d 861 (7th Cir. 2004); see also *CFTC v. Erskine*, 512 F.3d 309 (6th Cir. 2008).

²¹ For example, in *Zelener*, the retail forex dealer retained the right, at the date of delivery of the currency to deliver the currency, roll the transaction over, or offset all or a portion of the transaction with another open position held by the customer. See *CFTC v. Zelener*, 373 F.3d 861, 869 (7th Cir. 2004).

contracts are economically more like futures than spot contracts, although some courts have held them to be spot contracts in form.²²

One of the trade association comment letters was submitted by the American Bankers Association and the Global Financial Markets Association's Global Foreign Exchange Division (hereinafter "the ABA/GFMA letter"). The comment letter sought clarification or relief that would result in the exemption of certain forex transactions by retail customers initiated solely for the purpose of completing a transaction in foreign securities. This comment letter was addressed to all of the federal regulatory agencies that have promulgated or proposed retail forex rules: the Board, CFTC, FDIC, OCC, and Securities and Exchange Commission. On July 18, 2012, the CFTC issued a final rule that included an interpretation regarding foreign exchange spot transactions that responded to the ABA/GFMA letter. Specifically, the CFTC defined a bona fide spot forex transaction to include the purchase or sale of an amount of foreign currency equal to the price of a foreign security where (i) the security and related foreign currency transactions are executed contemporaneously in order to effect delivery by the relevant securities settlement deadline, and (ii) actual delivery of the foreign currency occurs by such deadline. By interpreting the CEA to exclude these types of retail forex transactions effected in connection with securities purchases and sales, the CFTC has confirmed that the transactions are not subject to the provisions of the CEA that are referenced by section 742 of the Dodd-Frank Act. The Board believes that no amendment to the final rule is required to address this issue. The Board has also added a section to the final rule to clarify that the Board may modify the provisions of this rule for a specific retail forex

²² See, e.g., *CFTC v. Erskine*, 512 F.3d 309, 326 (6th Cir. 2008); *CFTC v. Zelener*, 373 F.3d 861, 869 (7th Cir. 2004).

transaction or a class of retail forex transactions if the Board determines that the modification is consistent with safety and soundness and protection of retail forex customers.

Section 240.2 defines several terms by reference to the CEA, including “eligible contract participant” (ECP). Foreign currency transactions with eligible contract participants are not considered retail forex transactions and are therefore not subject to this rule. The definition covers a variety of financial entities, governmental entities, certain businesses, and individuals that meet certain investment thresholds.²³

The comment letter filed by the Global Financial Markets Association’s Global FX Division (hereinafter “the GFMA letter”) and the bank commenter stated their belief that the definition of “eligible contract participant” is too narrow and unnecessarily requires banking institutions to provide retail protections to sophisticated customers who fail to qualify as ECPs because they do not meet the \$10 million asset threshold in the statutory definition. The trade association commenter and the bank commenter recommended that the definition of “retail forex customer” in section 240.2(n) carve out institutional non-ECPs represented by registered investment advisers. The trade association commenter also sought reduced burden for a commodity pool that is unable to prove that all of its participants are themselves ECPs. The GFMA letter also suggested that, if the Board does not exempt these entities from all aspects of the regulation, the Board at a minimum should allow what it calls “professional non-ECPs” to (1) opt out of disclosure requirements, including the profitable accounts ratio described in section

²³ The term ‘eligible contract participant’ is defined at 7 U.S.C. 1a(18) and generally requires a corporation, partnership, proprietorship, organization, trust or other entity to have total assets exceeding \$10 million and an individual to have more than \$10 million in assets invested on a discretionary basis.

240.6(e), (2) post reduced margin compared to retail customers, and (3) accommodate transaction execution flexibility not permissible under the proposed regulation.

The Board is not adopting the suggestion that a non-ECP be treated as an ECP based on its use of an investment adviser as it believes that CEA section 2(c)(2)(E) requires the application of retail forex rules to transactions with non-ECPs. Although large investment advisers may choose to avoid dealing with unsophisticated investors, the Board does not believe that the involvement of a large investment adviser is a substitute for the retail protections sought by Congress in enacting section 2(C)(2)(E) of the CEA.

The issue regarding the ECP status of commodity pools engaging in foreign exchange transactions was included in the CFTC's notice of proposed rulemaking regarding further definition of certain Dodd-Frank Act terms, including "eligible contract participant,"²⁴ and addressed in their final rule adopted April 6, 2012.²⁵ The CFTC's definition of ECP reduces the burden on commodity pools seeking to establish that all of their members are themselves ECPs. The Board is amending the definition of ECP in section 240.2 of the regulation to incorporate the CFTC's revised definition of ECP. This will allow banking institutions to use the same standard for ECP status as retail forex dealers subject to CFTC jurisdiction when dealing with commodity pools. Consistent with the provisions of the CEA and the CFTC's final rule, the Board is not adopting the commenters' suggestion that commodity pools be exempt from the statutory requirement of establishing that its members are themselves ECPs. The GFMA letter also sought clarification that a banking institution with a retail forex customer who later becomes an

²⁴ *Further Definition of "Swap Dealer," "Security-Based Swap Dealer," "Major Swap Participant" 'and "Eligible Contract Participant,"* 75 FR 80174 (December 21, 2010)(joint proposed rule with the SEC).

²⁵ 77 FR 30596 (May 23, 2012).

ECP may continue to treat the customer as a retail forex customer (i.e., as a non-ECP). The Board believes a banking institution may continue to comply with the regulation for such a customer. Indeed, a banking institution may apply the provisions of Regulation NN to transactions with any customer, although it is only required to apply the regulation to retail forex transactions with retail forex customers.

The Board received no comments on the proposed definitions other than “eligible contract participant.” In addition to modifying the definition of ECP, the Board is adding a definition of “savings and loan holding company.” In all other respects, this section is being adopted substantially as proposed.

Section 240.3—Prohibited Transactions

This section prohibits a banking institution and its related persons from engaging in fraudulent conduct in connection with retail forex transactions. This section also addresses potential conflicts of interest by prohibiting a banking institution from acting as counterparty to a retail forex transaction if the banking institution or its affiliate exercises discretion over the customer’s retail forex account.

The Board’s proposal used wording somewhat different from that used by the CFTC, OCC and FDIC. While the retail forex rules of other federal regulatory authorities state that a retail forex counterparty may not “cheat or defraud or attempt to cheat or defraud” any person, the Board’s proposal used the phrase “defraud or attempt to defraud.” The individual commenter recommended using “cheat or defraud” instead of “defraud,” which he believes would promote regulatory consistency across regulators. The Board notes that the phrase “cheat or defraud” is used in section 6b of the CEA

(“Contracts designed to defraud or mislead”)²⁶ and is amending its proposal to use the same language as the CEA and other regulators.

In addition, the Board’s proposal would prohibit a banking institution from “knowingly” making a false report or deceiving a person, while the other regulators prohibit their retail forex dealers from “willfully” engaging in these activities. The Board stated its belief that “knowingly” sets a more appropriate standard of proof. The individual commenter preferred the language used by other regulators, in part to improve regulatory consistency.

The Department of Justice’s (DOJ’s) US Attorneys’ Manual discusses the difference between “knowingly” and “willfully” with respect to 18 U.S.C. 1001, the federal criminal code’s general anti-fraud provision.²⁷ This discussion is consistent with a Supreme Court case concerning another provision of the criminal code.²⁸ Both the DOJ and the Court indicate that a “willful” violation requires proof that the defendant acted with knowledge that his or her conduct was unlawful, while a “knowing” violation requires knowledge of the facts constituting the offence, as distinguished from knowledge of the law. The Board believes that “knowingly” sets the more appropriate standard, as it will cover making a false report or deceptive behavior without requiring proof that the banking institution knew it was violating Regulation NN.

Section 240.4—Notification

²⁶ 7 U.S.C. 6b

²⁷ United States Attorneys’ Manual, Chapter 9.

²⁸ *Bryan_v. United States*, 524 U.S. 184 (1998).

This section requires a banking institution to notify the Board prior to engaging in a retail forex business. This notice includes information on customer due diligence (including credit evaluations, customer appropriateness, and “know your customer” documentation); new product approvals; haircuts for noncash margin; and conflicts of interest. In addition, the banking institution must certify that it has adequate written policies, procedures, and risk measurement and management systems and controls to engage in a retail forex business in a safe and sound manner and in compliance with the requirements of the Board’s retail forex rule. Once a banking institution has notified the Board pursuant to this provision, the Board will have sixty days to seek additional information or object to the notification in writing, or the notification will be deemed effective. If the Board asks for additional information, the notice will become effective sixty days after all the information requested is received by the Board, unless the Board objects in writing.

Although the statutory requirements with respect to futures and options contracts are currently in effect, some banking institutions may currently engage in retail forex transactions that would be covered by this rule, such as the so-called “Zelener contracts.” Banking institutions engaged in retail forex transactions as of the effective date of this rule who promptly notify the Board will have six months, or a longer period provided by the Board, to bring their operations into conformance with the rule. Under this rule, a banking institution that notifies the Board within 30 days of the effective date of the final retail forex rule, subject to an extension by the Board, and submits the information requested by the Board thereafter will be deemed to be operating its retail forex business

pursuant to a rule or regulation of a Federal regulatory agency, as required under the Commodity Exchange Act, for such period.²⁹

A banking institution need not join a futures self-regulatory organization as a condition of conducting a retail forex business.

The Board received no comments to this section and adopts it as proposed.

Section 240.5—Application and Closing Out of Offsetting Long and Short Positions

This section requires a banking institution to close out offsetting long and short positions in the same currency in a retail forex account. Nevertheless, a banking institution may offset retail forex transactions by the retail forex customer or the customer’s agent (other than the banking institution itself) pursuant to a customer’s specific instructions. Blanket instructions are not sufficient for this purpose, as they could obviate the general rule. However, offset instructions need not be given separately for each pair of orders in order to be “specific.” Instructions that apply to sufficiently defined sets of transactions could be specific enough. Offset instructions may be provided in writing or orally. The banking institution must create and maintain a record of each offset instruction.

The Board received no comments to this section and adopts it as proposed.

Section 240.6—Disclosure

This section requires a banking institution to provide retail forex customers with a risk disclosure statement similar to the one required by the CFTC’s retail forex rule, but tailored to address certain unique characteristics of retail forex in banking institutions. The prescribed risk disclosure statement describes the risks associated with retail forex

²⁹ 7 U.S.C. 2(c)(2)(E)(ii)(I).

transactions. The disclosure statement makes clear that a banking institution that wishes to use the right of set-off to collect margin for or cover losses arising out of retail forex transactions must include this right in the risk disclosure statement and obtain separate written acknowledgement (see discussion of set-off below in section 240.9).

The final rules of the CFTC, OCC, and FDIC require retail forex dealers to disclose to retail customers the percentage of retail forex accounts that earned a profit, and the percentage of such accounts that experienced a loss, during each of the most recent four calendar quarters.³⁰ The individual commenter suggested that this “profitable accounts ratio” could be manipulated, although he did not describe how this could be done, and recommended adoption of an objective and uniform calculation methodology for the ratio. The commenter also recommended that the calculation should be weighted by the amount of profit or loss to show the amount of profitability or loss, rather than just whether any account made any profit. The Board believes a calculation of the amount of profitability would be more likely to cause retail customers to believe that past performance is an indication of future results and is retaining the profitable accounts ratio and statement of profitable trades as proposed. In addition, the Board believes a uniform calculation of profitable accounts and statement of profitable trades for all retail forex dealers affords greater retail consumer protection by allowing comparison across different types of dealers. Finally, the Board notes that section 240.7(b) provides a calculation methodology for the profitable accounts ratio that is uniform across the bank regulatory agencies.³¹

³⁰ 17 CFR 5.5(e)(1), 12 CFR 48.6(e)(1), and 12 CFR 349.6(e)(1).

³¹ *See*, 12 CFR 48.7(b) and 12 CFR 349.7(b).

As proposed, the risk disclosure must be provided as a separate document. The Board requested comment on whether banking institutions should be allowed to combine the retail forex risk disclosure with other disclosures that banking institutions make to their customers. The individual commenter supported the Board's proposal, which is consistent with the final rules adopted by the other bank regulatory agencies.

The individual commenter sought clarification as to whether the requirement in section 240.6(f) that the banking institution disclose "any fee, charge, or commission" imposed on the customer for retail forex transactions includes spreads. The final rules adopted by the OCC and FDIC both require disclosure of "any fee, charge, spread, or commission" and the individual commenter recommended that the Board add the word "spread" to its rules. The Board believes that spreads are covered by the proposed language, but is adding the word "spreads" to this section to make such coverage explicit.

The individual commenter also asked for confirmation that the disclosure of "any fee, charge, or commission" includes interest income on the retail forex account or retail forex transaction. The rate of interest income paid on cash margin is not a fee, charge, spread, or commission, and so is not required to be disclosed under section 240.6.

Section 240.7—Recordkeeping

This section specifies which documents and records a banking institution engaged in retail forex transactions must retain for examination by the Board. Banking institutions are required to maintain retail forex account records, financial ledgers, transactions records, daily records, order tickets, and records showing allocations and noncash margin, as well as records relating to possible violations of law. This section also prescribes document maintenance standards, including the manner and length of

maintenance. Finally, this section requires banking institutions to record and maintain transaction records and make them available to customers.

The individual commenter suggested that records required under this section be retained by the retail forex dealer forever, rather than the minimum five year period specified in section 240.7(h). The Board does not believe it is appropriate to require records be maintained indefinitely and notes that the five year period is consistent with retention requirements for many supervision and regulation records required by the Board.

This section is being adopted as proposed.

Section 240.8—Capital Requirements

The Board's retail forex rule does not change the Board's regulations regarding capital. This section generally requires that a banking institution that offers or enters into retail forex transactions must be "well capitalized" as defined in the Board's Regulations H, Y and LL³² or the banking institution must obtain an exemption from the Board. An uninsured state-licensed U.S. branch or agency of a foreign bank must apply the capital rules that are made applicable to it pursuant to section 225.2(r)(3) of the Board's Regulation Y.³³ An Edge corporation or agreement corporation must comply with the capital adequacy guidelines that are made applicable to an Edge corporation engaged in banking pursuant to section 211.12(c)(2) of the Board's Regulation K.³⁴

In addition, a banking institution must continue to hold capital against retail forex transactions as provided in the Board's regulations.

³² 12 CFR 208.43, 12 CFR 225.2(r), and 12 CFR 238.2(s).

³³ 12 CFR 225.2(r)(3).

³⁴ 12 CFR 211.12(c)(2).

The Board received no comments to this section and adopts it as proposed.

Section 240.9—Margin Requirements

Paragraph (a) requires a banking institution that engages in retail forex transactions, in advance of any such transaction, to collect from the retail forex customer margin equal to at least two percent of the notional value of the retail forex transaction if the transaction is in a major currency pair, and at least five percent of the notional value of the retail forex transaction otherwise. These margin requirements are identical to the requirements imposed by the retail forex rules of the CFTC, OCC, and FDIC. A major currency pair is a currency pair with two major currencies. The major currencies specified in the regulation are the U.S. Dollar (USD), Canadian Dollar (CAD), Euro (EUR), United Kingdom Pound (GBP), Japanese Yen (JPY), Swiss franc (CHF), New Zealand Dollar (NZD), Australian Dollar (AUD), Swedish Kronor (SEK), Danish Kroner (DKK), and Norwegian Krone (NOK),³⁵ as well as any other currency as determined by the Board.

Prior to implementation of the CFTC's rule, non-bank dealers routinely permitted customers to trade with 1 percent margin (leverage of 100:1) and sometimes with as little as 0.25 percent margin (leverage of 400:1). When the CFTC proposed its retail forex rule in January 2010, it proposed a margin requirement of 10 percent (leverage of 10:1). In response to comments, the CFTC reduced the required margin in the final rule to 2 percent (leverage of 50:1) for trades involving major currencies and 5 percent (leverage of 20:1) for trades involving non-major currencies. These margin requirements were also

³⁵ See National Futures Association, *Forex Transaction: A Regulatory Guide* 17 (Feb. 2011); New York Federal Reserve Bank, *Survey of North American Foreign Exchange Volume* tbl. 3e (Jan. 2011); Bank for International Settlements, *Report on Global Foreign Exchange Market Activity in 2010* at 15 tbl. B.6 (Dec. 2010).

adopted by the OCC and FDIC. The Board received no comments regarding the appropriate level of margin and is adopting the same requirements as the CFTC and other bank regulatory agencies.

Paragraph (b) specifies the acceptable forms of margin that customers may post, including margin pledged in excess of the requirements of paragraph (a). Banking institutions must establish policies and procedures providing for haircuts for noncash margin collected from customers and must review these haircuts annually. It may be prudent for banking institutions to review and modify the size of the haircuts more frequently.

Paragraph (c) requires a banking institution to collect additional margin from the customer or to liquidate the customer's position if the amount of margin held by the banking institution fails to meet the requirements of paragraph (a). The proposed rule requires the banking institution to mark the customer's open retail forex positions and the value of the customer's margin to the market daily to ensure that a retail forex customer does not accumulate substantial losses not covered by margin.

The retail forex regulations adopted by the OCC and FDIC both prohibit set-off, i.e., the bank forex dealer is prohibited from applying a retail forex customer's losses against any asset or liability of the retail forex customer other than money or property given as margin. Banks generally have broad rights to set off mutual debts to cover customer obligations. It is not clear that limiting a bank's right of set-off in these particular transactions would provide appropriate incentives for retail forex customers. The Board's proposed rule did not include this prohibition and no comments were received opposing this proposal. The Board is adopting these provisions as proposed.

In order to effectuate the prohibition against a bank retail forex dealer exercising a right of set-off, the OCC and FDIC require that each customer's retail forex transaction margin be held in a separate account that holds only that customer's retail forex transaction margin. As proposed, the Board is not requiring the use of a separate margin account, as it is not prohibiting a banking institution from exercising a right of set-off.

Section 240.10—Required reporting to customers

This section requires a banking institution engaging in retail forex transactions to provide each retail forex customer confirmations and monthly statements, and describes the information to be included.

The Board received no comments to this section and adopts it as proposed.

Section 240.11—Unlawful Representations

This section prohibits a banking institution and its related persons from representing that the Federal government, the Board, or any other Federal agency has sponsored, recommended, or approved retail forex transactions or products in any way. This section also prohibits a banking institution from implying or representing that it will guarantee against or limit retail forex customer losses or not collect margin as required by section 240.9. This section does not prohibit a banking institution from sharing in a loss resulting from error or mishandling of an order, and guaranties entered into prior to the effectiveness of the prohibition would only be affected if an attempt is made to extend, modify, or renew them. This section also does not prohibit a banking institution from hedging or otherwise mitigating its own exposure to retail forex transactions or any other foreign exchange risk.

The Board received no comments to this section and adopts it as proposed.

Section 240.12—Authorization to Trade

This section requires a banking institution to have specific authorization from a retail forex customer before effecting a retail forex transaction for that customer.

The Board received no comments to this section and adopts it as proposed.

Section 240.13—Trading and Operational Standards

This section largely follows the trading standards of the retail forex rules adopted by the CFTC, OCC and FDIC, which were developed to prevent some of the deceptive or unfair practices identified by the CFTC and the National Futures Association.

Under paragraph (a), a banking institution engaging in retail forex transactions is required to establish and enforce internal rules, procedures and controls to prevent front running, in which transactions in accounts of the banking institution or its related persons are executed before a similar customer order, and to establish settlement prices fairly and objectively.

Paragraph (b) prohibits a banking institution engaging in retail forex transactions from disclosing that it holds another person's order unless disclosure is necessary for execution or is made at the Board's request.

Paragraph (c) ensures that related persons of another retail forex counterparty do not open accounts with a banking institution without the knowledge and authorization of the account surveillance personnel of the other retail forex counterparty to which they are affiliated. Similarly, paragraph (d) ensures that related persons of a banking institution do not open accounts with other retail forex counterparties without the knowledge and authorization of the account surveillance personnel of the banking institution to which they are affiliated.

Paragraph (e) prohibits a banking institution engaging in retail forex transactions from (1) entering a retail forex transaction to be executed at a price that is not at or near prices at which other retail forex customers have executed materially similar transactions with the banking institution during the same time period, (2) changing prices after confirmation, (3) providing a retail forex customer with a new bid price that is higher (or lower) than previously provided without providing a new ask price that is similarly higher (or lower) as well, and (4) establishing a new position for a retail forex customer (except to offset an existing position) if the banking institution holds one or more outstanding orders of other retail forex customers for the same currency pair at a comparable price.

Paragraphs (e)(3) and (e)(4) do not prevent a banking institution from changing the bid or ask prices of a retail forex transaction to respond to market events. The Board understands that market practice among CFTC-registrants is not to offer requotes, but to simply reject orders and advise customers they may submit a new order (which the dealer may or may not accept). Similarly, a banking institution may reject an order and advise customers they may submit a new order.

Paragraph (e)(5) requires a banking institution to use consistent market prices for customers executing retail forex transactions during the same time. It also prevents a banking institution from offering preferred execution to some of its retail forex customers but not others.

The Board received no comments to this section and adopts it as proposed.

Section 240.14—Supervision

This section imposes on a banking institution and its agents, officers, and employees a duty to supervise subordinates with responsibility for retail forex transactions to ensure compliance with the Board's retail forex rule.

The Board received no comments to this section and adopts it as proposed.

Section 240.15—Notice of Transfers

This section describes the requirements for transferring a retail forex account. Generally, a banking institution must provide retail forex customers 30 days' prior notice before transferring or assigning their account. Affected customers may then instruct the banking institution to transfer the account to an institution of their choosing or liquidate the account. There are three exceptions to the above notice requirement: a transfer in connection with the receivership or conservatorship under the Federal Deposit Insurance Act; a transfer pursuant to a retail forex customer's specific request; and a transfer otherwise allowed by applicable law. A banking institution that is the transferee of retail forex accounts must generally provide the transferred customers with the risk disclosure statement of section 240.6 and obtain each affected customer's written acknowledgement within 60 days.

The Board received no comments to this section and adopts it as proposed.

Section 240.16—Customer Dispute Resolution

This section prohibits a banking institution from entering into any agreement or understanding with a retail forex customer in which the customer agrees, prior to the time a claim or grievance arises, to submit the claim or grievance to any settlement procedure.

This provision differs from the applicable CFTC and OCC dispute settlement procedures, which permit mandatory pre-dispute settlement agreements under certain

conditions.³⁶ The Board proposed to prohibit a banking institution from entering into a pre-dispute settlement agreement with a retail forex customer, similar to the final rule adopted by the FDIC.

The Department of State has advised that transactions between the foreign branch or office of a banking institution and a U.S. customer could be cross-border transactions subject to the New York³⁷ and Panama Conventions.³⁸ These Conventions, implemented in the United States by chapters 2 and 3 of the Federal Arbitration Act (FAA),³⁹ create treaty obligations to enforce international commercial arbitration agreements and to recognize and enforce international commercial arbitral awards. The Board is amending section 240.16 to provide that it will not apply to transactions covered by chapters 2 or 3 of the FAA.

Section 240.17 -- Reservation of Authority.

This section allows the Board to modify certain requirements of this rule consistent with safety and soundness and the protection of retail forex customers. The Board understands the need for flexibility as foreign exchange trading procedures develop and to ensure that such products or trading procedures are subject to appropriate customer protection and safety and soundness standards.

Interagency Statement on Retail Sales of Nondeposit Investment Products

³⁶ See 17 CFR 166.5. The CFTC's regulation permits predispute dispute settlement agreements with a customer with certain restrictions such as that signing the agreement must not be made a condition for the customer to utilize the services offered by the CFTC registrant.

³⁷ Convention on the Recognition and Enforcement of Foreign Arbitral Awards (1970).

³⁸ Inter-American Convention on International Commercial Arbitration (1990).

³⁹ 9 U.S.C. 1 et seq. Chapter 2 of the FAA (secs. 201-208) contains provisions implementing the New York Convention, while Chapter 3 of the FAA (secs. 301 – 307) contains provisions implementing the Panama Convention.

For banking institutions, the requirements in the Board’s retail forex regulation overlap with applicable expectations contained in the Interagency Statement on Retail Sales of Nondeposit Investment Products (NDIP Policy Statement).⁴⁰ The NDIP Policy Statement sets out guidance regarding the Board’s expectations when a banking institution engages in the sale of nondeposit investment products to retail customers. The NDIP Policy Statement addresses issues such as disclosure, suitability, sales practices, compensation, and compliance. The Board views retail forex transactions as nondeposit investment products, but the terms “retail forex customer” in this rule and “retail customer” in the NDIP Policy Statement are not necessarily co-extensive. The Board requested comment on whether the proposed regulation created issues concerning application of the NDIP policy statement to retail forex transactions that the Board should address. The Board received no comments on this issue. As the Board noted in its proposal, after the effective date of the final rule, the Board will expect banking institutions engaging in or offering retail forex transactions to also comply with the NDIP Policy Statement to the extent such compliance does not conflict with the requirements of the Board’s final retail forex rule.

III. Regulatory Analysis

A. Regulatory Flexibility Act

In accordance with Section 4(a) of the Regulatory Flexibility Act, 5 U.S.C. 601 et seq. (RFA), the Board must publish a final regulatory flexibility analysis with this rulemaking. The RFA requires an agency either to provide a final regulatory flexibility analysis with a final rule for which a general notice of proposed rulemaking is required or

⁴⁰ See SR Letter 94-11 (Feb. 17, 1994); see also SR Letter 95-46 (Sept. 14, 1995).

to certify that the final rule will not have a significant economic impact on a substantial number of small entities. Based on this analysis and for the reasons stated below, the Board believes that the final rule would not have a significant economic impact on a substantial number of small entities. Nevertheless, the Board is publishing a final regulatory flexibility analysis.

1. *A succinct statement of the need for, and objectives of, the rule.*

Section 2(c)(2)(E) of the Commodity Exchange Act (7 U.S.C. 2(c)(2)(E)) prohibits a U.S. financial institution from conducting certain retail foreign exchange transactions unless done pursuant a rule or regulation of a Federal regulatory agency allowing such transactions. The Board is adopting a new regulation to allow banking institutions under its supervision to engage in retail foreign exchange transactions.

2. *A summary of the significant issues raised by the public comments in response to the initial regulatory flexibility analysis, a summary of the assessment of the agency of such issues, and a statement of any changes made in the proposed rule as a result of such comments.*

The Board requested comment on required reporting, disclosure, and recordkeeping requirements for all banking institutions engaging in retail foreign exchange transactions and has solicited comment on any approaches that would reduce the burden on all counterparties, including small entities. In response to the notice of proposed rulemaking, the Board received no comments with respect to RFA.

3. *A description of and an estimate of the number of small entities to which the rule will apply or an explanation of why no such estimate is available.*

Under regulations issued by the Small Business Administration, a banking institution is considered a “small entity” if it has assets of \$175 million or less.⁴¹ As of

⁴¹ U.S. Small Business Administration, Table of Small Business Size Matched to North American Industry Classification System Codes, 13 CFR 121.201.

June 30, 2012, there were approximately 368 small state member banks, 6 small Edge Act and agreement corporations, 48 small uninsured branches of foreign banks, 3,736 small bank holding companies, 213 small financial holding companies, and 229 small saving and loan holding companies. The Board is not aware of any small institutions engaged in retail forex transactions.

4. A description of the projected reporting, recordkeeping, and other compliance requirements of the rule, including an estimate of the classes of small entities which will be subject to the requirement and the type of professional skills necessary for preparation of the report or record.

A description of the projected recordkeeping and other compliance requirements can be found below in section B, “Paperwork Reduction Act,” under the following headings: Reporting Requirements, Disclosure Requirements, and Recordkeeping Requirements. The Board believes that there are no other compliance requirements for this rule.

5. A description of the steps the agency has taken to minimize the significant economic impact on small entities consistent with the stated objectives of applicable statutes, including a statement of the factual, policy, and legal reasons for selecting the alternative adopted in the final rule and why each one of the other significant alternatives to the rule considered by the agency which affect the impact on small entities was rejected.

The Board believes that no Federal rules duplicate, overlap, or conflict with the rule. The Board has solicited comments on the proposed rule and received relatively few comments. The Board did not receive any comments from small entities and is unaware of any small entities that will be affected by the rule. The Board’s rule is consistent with other banking regulators that also solicited comment on their rules. As noted in the supplementary information above, retail forex transactions are also subject to the

Interagency Statement on Retail Sales of Nondeposit Investment Products, but this rule would govern to the extent of a conflict.

B. *Paperwork Reduction Act*

In accordance with section 3512 of the Paperwork Reduction Act (PRA) of 1995 (44 U.S.C. 3501-3521), the Board may not conduct or sponsor, and a respondent is not required to respond to, an information collection unless it displays a currently valid Office of Management and Budget (OMB) control number. The Board reviewed the final rule under the authority delegated to the Board by OMB. The OMB control number for these information collections will be assigned. The Board received no comments regarding the Paperwork Reduction Act implications of its retail forex regulation.

Title of Information Collection: Reporting, recordkeeping, and disclosure requirements associated with Regulation NN.

Frequency of Response: On occasion.

Affected Public: Businesses or other for-profit.

Respondents: Agreement corporations, Edge Act corporations, state member banks, uninsured branches of foreign banks, financial holding companies, and bank holding companies (collectively, “banking institutions”).

Abstract: The information collection requirements of the final rule are found in §§ 240.4–240.7, 240.9–240.10, 240.13, 240.15–240.16.

Reporting Requirements

The reporting requirements in § 240.4 require that, prior to initiating a retail forex business, a banking institution provide the Board with prior notice. The notice must certify that the banking institution has written policies and procedures, and risk

measurement and management systems in controls in place to ensure that retail forex transactions are conducted in a safe and sound manner. The banking institution must also provide other information required by the Board, such as documentation of customer due diligence, new product approvals, and haircuts applied to noncash margins. A banking institution already engaging in a retail forex business may continue to do so, provided it requests an extension of time.

Disclosure Requirements

Section 240.5, regarding the application and closing out of offsetting long and short positions, requires a banking institution to promptly provide the customer with a statement reflecting the financial result of the transactions and the name of the introducing broker to the account. The customer may provide specific written instructions on how the offsetting transaction should be applied.

Section 240.6 requires that a banking institution furnish a retail forex customer with a written disclosure before opening an account that will engage in retail forex transactions for a retail forex customer and receive an acknowledgment from the customer that it was received and understood. It also requires the disclosure by a banking institution of its fees and other charges and its profitable accounts ratio.

Section 240.10 requires a banking institution to issue monthly statements to each retail forex customer and to send confirmation statements following transactions.

Section 240.13(b) allows disclosure by a banking institution that an order of another person is being held by them only when necessary to the effective execution of the order or when the disclosure is requested by the Board. Section 240.13(c) prohibits a banking institution engaging in retail forex transactions from knowingly handling the

account of any related person of another retail forex counterparty unless it receives proper written authorization, promptly prepares a written record of the order, and transmits to the counterparty copies all statements and written records. Section 240.13(d) prohibits a related person of a banking institution engaging in forex transactions from having an account with another retail forex counterparty unless it receives proper written authorization and copies of all statements and written records for such accounts are transmitted to the counterparty.

Section 240.15 requires a banking institution to provide a retail forex customer with 30 days' prior notice of any assignment of any position or transfer of any account of the retail forex customer. It also requires a banking institution to which retail forex accounts or positions are assigned or transferred to provide the affected customers with risk disclosure statements and forms of acknowledgment and receive the signed acknowledgments within 60 days.

The customer dispute resolution provisions in § 240.16 requires certain endorsements, acknowledgments, and signature language. It also requires that within 10 days after receipt of notice from the retail forex customer that they intend to submit a claim to arbitration, the banking institution will provide them with a list of persons qualified in the dispute resolution and that the customer must notify the banking institution of the person selected within 45 days of receipt of such list.

Recordkeeping Requirements

Sections 240.7 and 240.13(a) require that a banking institution engaging in retail forex transactions keep full, complete, and systematic records and establish and implement internal rules, procedures, and controls. Section 240.7 also requires that a

banking institution keep account, financial ledger, transaction and daily records, as well as memorandum orders, post-execution allocation of bunched orders, records regarding its ratio of profitable accounts, possible violations of law, records for noncash margin, and monthly statements and confirmations.

Section 240.9 requires policies and procedures for haircuts for noncash margin collected under the rule's margin requirements, and annual evaluations and modifications of the haircuts.

Estimated PRA Burden

Number of Respondents: 5 banking institutions; 2 service providers.

Estimated Average Hours per Response: 16 hours reporting burden; 787 hours disclosure burden; and 183 hours recordkeeping burden

Total Estimated Annual Burden: 6,870 hours (80 hours reporting burden; 5,509 hours disclosure burden; and 1,281 hours recordkeeping burden).

The Board has a continuing interest in the public's opinions of collections of information. At any time, comments regarding the burden estimate, or any other aspect of this collection of information, including suggestions for reducing the burden, may be sent to: Secretary, Board of Governors of the Federal Reserve System, 20th and C Streets, NW, Washington, DC 20551; and to the Office of Management and Budget, Paperwork Reduction Project, Washington, DC 20503.

C. *Plain Language*

Section 722 of the Gramm-Leach-Bliley Act requires the Board to use plain language in all proposed and final rules published after January 1, 2000. No commenters

suggested that the proposed rule was materially unclear, and the Board believes that the Final Rule is substantively similar to the proposed rule.

List of Subjects in 12 CFR Part 240

Banks, banking, Consumer protection, Foreign currencies, Foreign exchange, Holding companies, Investments, Reporting and recordkeeping requirements.

For the reasons stated in the preamble, the Board amends 12 CFR Chapter II by adding new part 240 to read as follows:

PART 240 - RETAIL FOREIGN EXCHANGE TRANSACTIONS (REGULATION NN)

Sec.

- 240.1 Authority, purpose, and scope.
- 240.2 Definitions.
- 240.3 Prohibited transactions.
- 240.4 Notification.
- 240.5 Application and closing out of offsetting long and short positions.
- 240.6 Disclosure.
- 240.7 Recordkeeping.
- 240.8 Capital requirements.
- 240.9 Margin requirements.
- 240.10 Required reporting to customers.
- 240.11 Unlawful representations.
- 240.12 Authorization to trade.
- 240.13 Trading and operational standards.
- 240.14 Supervision.
- 240.15 Notice of transfers.
- 240.16 Customer dispute resolution.
- 240.17 Reservation of authority.

Authority: 7 U.S.C. 2(c)(2)(E), 12 U.S.C. 248, 321 - 338, 1813(q), 1818, 1844(b), 3106a, 3108.

§ 240.1 Authority, purpose and scope.

(a) *Authority.* This part is issued by the Board of Governors of the Federal Reserve System (the Board) under the authority of section 2(c)(2)(E) of the Commodity Exchange Act (7 U.S.C. 2(c)(2)(E)), sections 9 and 11 of the Federal Reserve Act (12 U.S.C. 321-338 and 248), section 5(b) of the Bank Holding Company Act of 1956 (12 U.S.C. 1844(b)), sections 9 and 13a of the International Banking Act of 1978 (12 U.S.C. 3106a and 3108), and sections 3(q) and 8 of the Federal Deposit Insurance Act (12 U.S.C. 1813(q) and 1818).

(b) *Purpose.* This part establishes rules applicable to retail foreign exchange transactions engaged in by banking institutions on or after May 13, 2013.

(c) *Scope.* Except as provided in paragraph (d) of this section, this part applies to banking institutions, as defined in section 240.2(b) of this part, and any branches or offices of those institutions wherever located. This part applies to subsidiaries of banking institutions organized under the laws of the United States or any U.S. state that are not subject to the jurisdiction of another federal regulatory agency authorized to prescribe rules or regulations under section 2(c)(2)(E) of the Commodity Exchange Act (7 U.S.C. (2)(c)(2)(E)).

(d) *International applicability.* Sections 240.3 and 240.5 through 240.16 do not apply to retail foreign exchange transactions between a foreign branch or office of a banking institution and a non-U.S. customer. With respect to those transactions, the foreign branch or office remains subject to any disclosure, recordkeeping, capital, margin, reporting, business conduct, documentation, and other requirements of applicable foreign law.

§ 240.2 Definitions.

For purposes of this part, the following terms have the same meaning as in the Commodity Exchange Act (7 U.S.C. 1 et seq.): “affiliated person of a futures commission merchant”; “associated person”; “contract of sale”; “commodity”; “futures commission merchant”; “future delivery”; “option”; “security”; and “security futures product.”

(a) *Affiliate* has the same meaning as in section 2(k) of the Bank Holding Company Act of 1956 (12 U.S.C. 1841(k)).

(b) *Banking institution* means:

(1) A state member bank (as defined in 12 CFR 208.2);

(2) An uninsured state-licensed U.S. branch or agency of a foreign bank;

(3) A financial holding company (as defined in section 2 of the Bank Holding Company Act of 1956; 12 U.S.C. 1841);

(4) A bank holding company (as defined in section 2 of the Bank Holding Company Act of 1956; 12 U.S.C. 1841);

(5) A savings and loan holding company (as defined in section 10 of the Home Owners Loan Act; 12 U.S.C. 1467a)

(6) A corporation operating under the fifth undesignated paragraph of section 25 of the Federal Reserve Act (12 U.S.C. 603), commonly known as “an agreement corporation;” and

(7) A corporation organized under section 25A of the Federal Reserve Act (12 U.S.C. 611 et seq.), commonly known as an “Edge Act corporation.”

(c) *Commodity Exchange Act* means the Commodity Exchange Act (7 U.S.C. 1 et seq.).

(d) *Eligible contract participant* has the same meaning as in the Commodity Exchange Act (7 U.S.C. 1 et seq.), as implemented in 17 CFR 1.3(m).

(e) *Forex* means foreign exchange.

(f) *Identified banking product* has the same meaning as in section 401(b) of the Legal Certainty for Bank Products Act of 2000 (7 U.S.C. 27(b)).

(g) *Institution-affiliated party* or *IAP* has the same meaning as in 12 U.S.C. 1813(u)(1), (2), or (3).

(h) *Introducing broker* means any person who solicits or accepts orders from a retail forex customer in connection with retail forex transactions.

(i) *Related person*, when used in reference to a retail forex counterparty, means:

(1) Any general partner, officer, director, or owner of ten percent or more of the capital stock of the retail forex counterparty;

(2) An associated person or employee of the retail forex counterparty, if the retail forex counterparty is not an insured depository institution;

(3) An IAP, if the retail forex counterparty is an insured depository institution;
and

(4) Any relative or spouse of any of the foregoing persons, or any relative of such spouse, who shares the same home as any of the foregoing persons.

(j) *Retail foreign exchange dealer* means any person other than a retail forex customer that is, or that offers to be, the counterparty to a retail forex transaction, except for a person described in item (aa), (bb), (cc)(AA), (dd), or (ff) of section 2(c)(2)(B)(i)(II) of the Commodity Exchange Act (7 U.S.C. 2(c)(2)(B)(i)(II)).

(k) *Retail forex account* means the account of a retail forex customer, established with a banking institution, in which retail forex transactions with the banking institution as counterparty are undertaken, or the account of a retail forex customer that is established in order to enter into such transactions.

(l) *Retail forex account agreement* means the contractual agreement between a banking institution and a retail forex customer that contains the terms governing the customer's retail forex account with the banking institution.

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

(n) *Retail forex counterparty* includes, as appropriate:

(1) A banking institution;

(2) A retail foreign exchange dealer;

(3) A futures commission merchant;

(4) An affiliated person of a futures commission merchant; and

(5) A broker or dealer registered under section 15(b) (except paragraph (11) thereof) or 15C of the Securities Exchange Act of 1934 (15 U.S.C. 78o(b), 78o-5) or a U.S. financial institution other than a banking institution, provided the counterparty is subject to a rule or regulation of a Federal regulatory agency covering retail forex transactions.

(o) *Retail forex customer* means a customer that is not an eligible contract participant, acting on his, her, or its own behalf and engaging in retail forex transactions.

(p) *Retail forex proprietary account* means a retail forex account carried on the books of a banking institution for one of the following persons; a retail forex account of which 10 percent or more is owned by one of the following persons; or a retail forex account of which an aggregate of 10 percent or more of which is owned by more than one of the following persons:

(1) The banking institution;

(2) An officer, director or owner of ten percent or more of the capital stock of the banking institution; or

- (3) An employee of the banking institution, whose duties include:
- (i) The management of the banking institution's business;
 - (ii) The handling of the banking institution's retail forex transactions;
 - (iii) The keeping of records, including without limitation the software used to make or maintain those records, pertaining to the banking institution's retail forex transactions; or
 - (iv) The signing or co-signing of checks or drafts on behalf of the banking institution;
- (4) A spouse or minor dependent living in the same household as of any of the foregoing persons; or
- (5) An affiliate of the banking institution;
- (q) *Retail forex transaction* means an agreement, contract, or transaction in foreign currency, other than an identified banking product or a part of an identified banking product, that is offered or entered into by a banking institution with a person that is not an eligible contract participant and that is:
- (1) A contract of sale of a commodity for future delivery or an option on such a contract; or
 - (2) An option, other than an option executed or traded on a national securities exchange registered pursuant to section 6(a) of the Securities Exchange Act of 1934 (15 U.S.C. 78f(a)); or
 - (3) Offered or entered into on a leveraged or margined basis, or financed by a banking institution, its affiliate, or any person acting in concert with the banking institution or its affiliate on a similar basis, other than:
 - (i) A security that is not a security futures product as defined in section 1a(47) of the Commodity Exchange Act (7 U.S.C. 1a(47)); or

(ii) A contract of sale that—

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

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

(iii) An agreement, contract, or transaction that the Board determines is not functionally or economically similar to an agreement, contract, or transaction described in paragraph (p)(1) or (p)(2) of this section.

§ 240.3 Prohibited transactions.

(a) *Fraudulent conduct prohibited.* No banking institution or its related persons may, directly or indirectly, in or in connection with any retail forex transaction:

(1) Cheat or defraud or attempt to cheat or defraud any person;

(2) Knowingly make or cause to be made to any person any false report or statement or cause to be entered for any person any false record; or

(3) Knowingly deceive or attempt to deceive any person by any means whatsoever.

(b) *Acting as counterparty and exercising discretion prohibited.* A banking institution that has authority to cause retail forex transactions to be effected for a retail forex customer without the retail forex customer's specific authorization may not (and an affiliate of such an institution may not) act as the counterparty for any retail forex transaction with that retail forex customer.

§ 240.4 Notification.

(a) *Notification required.* Before commencing a retail forex business, a banking institution shall provide the Board with prior written notice in compliance with this section. The notice will become effective 60 days after a complete notice is received by the Board, provided the Board does not request additional information or object in writing. In the event the Board requests additional information, the notice will become effective 60 days after all information requested by the Board is received by the Board unless the Board objects in writing.

(b) *Notification requirements.* A banking institution shall provide the following in its written notification:

(1) Information concerning customer due diligence, including without limitation credit evaluations, customer appropriateness, and “know your customer” documentation;

(2) The haircuts to be applied to noncash margin as provided in 240.9(b)(2);

(3) Information concerning new product approvals;

(4) Information on addressing conflicts of interest; and

(5) A resolution by the banking institution’s Board of Directors that the banking institution has established and implemented written policies, procedures, and risk measurement and management systems and controls for the purpose of ensuring that it conducts retail forex transactions in a safe and sound manner and in compliance with this part.

(c) *Treatment of existing retail forex businesses.* A banking institution that is engaged in a retail forex business on the effective date of this part may continue to do so, until and unless the Board objects in writing, so long as the institution submits the information required to be submitted under paragraphs (b)(1) through (5) of this section within 30 days of the effective date of this part, subject to an extension of time by the Board, and such additional information as requested by the Board thereafter.

(d) *Compliance with the Commodity Exchange Act.* A banking institution that is engaged in a retail forex business on the effective date of this part and complies with paragraph (c) of this section shall be deemed to be acting pursuant to a rule or regulation described in section 2(c)(2)(E)(ii)(I) of the Commodity Exchange Act (7 U.S.C. 2(c)(2)(E)(ii)(I)).

§ 240.5 Application and closing out of offsetting long and short positions.

(a) *Application of purchases and sales.* Any banking institution that –

(1) Engages in a retail forex transaction involving the purchase of any currency for the account of any retail forex customer when the account of such retail forex customer at the time of such purchase has an open retail forex transaction for the sale of the same currency;

(2) Engages in a retail forex transaction involving the sale of any currency for the account of any retail forex customer when the account of such retail forex customer at the time of such sale has an open retail forex transaction for the purchase of the same currency;

(3) Purchases a put or call option involving foreign currency for the account of any retail forex customer when the account of such retail forex customer at the time of such purchase has a short put or call option position with the same underlying currency, strike price, and expiration date as that purchased; or

(4) Sells a put or call option involving foreign currency for the account of any retail forex customer when the account of such retail forex customer at the time of such sale has a long put or call option position with the same underlying currency, strike price, and expiration date as that sold shall:

(i) Immediately apply such purchase or sale against such previously held opposite transaction with the same customer; and

(ii) Promptly furnish such retail forex customer with a statement showing the financial result of the transactions involved and the name of any introducing broker to the account.

(b) *Close-out against oldest open position.* In all instances in which the short or long position in a customer's retail forex account immediately prior to an offsetting purchase or sale is greater than the quantity purchased or sold, the banking institution shall apply such offsetting purchase or sale to the oldest portion of the previously held short or long position.

(c) *Transactions to be applied as directed by customer.* Notwithstanding paragraphs (a) and (b) of this section, the offsetting transaction shall be applied as directed by a retail forex customer's specific instructions. These instructions may not be made by the banking institution or a related person.

§ 240.6 Disclosure.

(a) *Risk disclosure statement required.* No banking institution may open or maintain an account for a retail forex customer for the purpose of engaging in retail forex transactions unless the banking institution has furnished the retail forex customer with a separate written disclosure statement containing only the language set forth in paragraph (d) of this section and the disclosures required by paragraphs (e), (f), and (g) of this section.

(b) *Acknowledgement of risk disclosure statement required.* The banking institution must receive from the retail forex customer a written acknowledgement signed and dated by

the customer that the customer received and understood the written disclosure statement required by paragraph (a) of this section.

(c) *Placement of risk disclosure statement.* The disclosure statement may be attached to other documents as the initial page(s) of such documents and as the only material on such page(s).

(d) *Content of risk disclosure statement.* The language set forth in the written disclosure statement required by paragraph (a) of this section shall be as follows:

Risk Disclosure Statement

Retail forex transactions generally involve the leveraged trading of contracts denominated in foreign currency with a banking institution as your counterparty. Because of the leverage and the other risks disclosed here, you can rapidly lose all of the funds or property you give the banking institution as margin for such trading and you may lose more than you pledge as margin.

You should be aware of and carefully consider the following points before determining whether such trading is appropriate for you.

(1) Trading foreign currencies is not on a regulated market or exchange—your banking institution is your trading counterparty and has conflicting interests. The retail forex transaction you are entering into is not conducted on an interbank market, nor is it conducted on a futures exchange subject to regulation by the Commodity Futures Trading Commission. The foreign currency trades you transact are trades with your banking institution as the counterparty. When you sell, the banking institution is the buyer. When you buy, the banking institution is the seller. As a result, when you lose money trading, your banking institution is making money on such trades, in addition to any fees, commissions, or spreads the banking institution may charge.

(2) Any electronic trading platform that you may use for retail foreign currency transactions with your banking institution is not a regulated exchange. It is an electronic connection for accessing your banking institution. The terms of availability of such a platform are governed only by your contract with your banking institution. Any trading platform that you may use to enter into off-exchange foreign currency transactions is only connected to your banking institution. You are accessing that trading platform only to transact with your banking institution. You are not trading with any other entities or customers of the banking institution by accessing such platform. The availability and operation of any such platform, including the consequences of the unavailability of the trading platform for any reason, is governed only by the terms of your account agreement with the banking institution.

(3) You may be able to offset or liquidate any trading positions only through your banking institution because the transactions are not made on an exchange, and your banking institution may set its own prices. Your ability to close your transactions or offset positions is limited to what your banking institution will offer to you, as there is no other market for these transactions. Your banking institution may offer any prices it wishes. Your banking institution may establish its prices by

offering spreads from third party prices, but it is under no obligation to do so or to continue to do so. Your banking institution may offer different prices to different customers at any point in time on its own terms. The terms of your account agreement alone govern the obligations your banking institution has to you to offer prices and offer offset or liquidating transactions in your account and make any payments to you. The prices offered by your banking institution may or may not reflect prices available elsewhere at any exchange, interbank, or other market for foreign currency.

(4) Paid solicitors may have undisclosed conflicts. The banking institution may compensate introducing brokers for introducing your account in ways that are not disclosed to you. Such paid solicitors are not required to have, and may not have, any special expertise in trading, and may have conflicts of interest based on the method by which they are compensated. You should thoroughly investigate the manner in which all such solicitors are compensated and be very cautious in granting any person or entity authority to trade on your behalf. You should always consider obtaining dated written confirmation of any information you are relying on from your banking institution in making any trading or account decisions.

(5) Retail forex transactions are not insured by the Federal Deposit Insurance Corporation.

(6) Retail forex transactions are not a deposit in, or guaranteed by, a banking institution.

(7) Retail forex transactions are subject to investment risks, including possible loss of all amounts invested.

Finally, you should thoroughly investigate any statements by any banking institution that minimize the importance of, or contradict, any of the terms of this risk disclosure. Such statements may indicate sales fraud.

This brief statement cannot, of course, disclose all the risks and other aspects of trading off-exchange foreign currency with a banking institution.

I hereby acknowledge that I have received and understood this risk disclosure statement.

Date

Signature of Customer

(e)(1) *Disclosure of profitable accounts ratio.* Immediately following the language set forth in paragraph (d) of this section, the statement required by paragraph (a) of this section shall include, for each of the most recent four calendar quarters during which the banking institution maintained retail forex customer accounts:

(i) The total number of retail forex customer accounts maintained by the banking institution over which the banking institution does not exercise investment discretion;

(ii) The percentage of such accounts that were profitable for retail forex customer accounts during the quarter; and

(iii) The percentage of such accounts that were not profitable for retail forex customer accounts during the quarter.

(2) *Statement of profitable trades.* (i) The banking institution's statement of profitable trades shall include the following legend: Past performance is not necessarily indicative of future results.

(ii) Each banking institution shall provide, upon request, to any retail forex customer or prospective retail forex customer the total number of retail forex accounts maintained by the banking institution for which the banking institution does not exercise investment discretion, the percentage of such accounts that were profitable, and the percentage of such accounts that were not profitable for each calendar quarter during the most recent five-year period during which the banking institution maintained such accounts.

(f) *Disclosure of fees and other charges.* Immediately following the language required by paragraph (e) of this section, the statement required by paragraph (a) of this section shall include:

(1) The amount of any fee, charge, spread, or commission that the banking institution may impose on the retail forex customer in connection with a retail forex account or retail forex transaction;

(2) An explanation of how the banking institution will determine the amount of such fees, charges, spreads, or commissions; and

(3) The circumstances under which the banking institution may impose such fees, charges, spreads, or commissions.

(g) *Set-off.* Immediately following the language required by paragraph (f) of this section, the statement required by paragraph (a) of this section shall include:

(1) A statement as to whether the banking institution will or will not retain the right to set off obligations of the retail forex customer arising from the customer's retail forex transactions, including margin calls and losses, against the customer's other assets held by the banking institution;

(2) If the banking institution states that it reserves its right to set off obligations of the retail forex customer arising from the customer's retail forex transactions against the customer's other assets, the banking institution must receive from the retail forex customer a written acknowledgement signed and dated by the customer that the customer received and understood the written disclosure required by paragraph (g)(1) of this section.

(h) *Future disclosure requirements.* If, with regard to a retail forex customer, the banking institution changes any fee, charge, or commission required to be disclosed under paragraph (f) of this section, then the banking institution shall mail or deliver to the retail forex customer a notice of the changes at least 15 days prior to the effective date of the change.

(i) *Form of disclosure requirements.* The disclosures required by this section shall be clear and conspicuous and designed to call attention to the nature and significance of the information provided.

(j) *Other disclosure requirements unaffected.* This section does not relieve a banking institution from any other disclosure obligation it may have under applicable law.

§ 240.7 Recordkeeping.

(a) *General rule.* A banking institution engaging in retail forex transactions shall keep full, complete and systematic records, together with all pertinent data and memoranda, of all transactions relating to its retail forex business, including:

- (1) *Retail forex account records.* For each retail forex account:
 - (i) The name and address of the person for whom such retail forex account is carried or introduced and the principal occupation or business of the person;
 - (ii) The name of any other person guaranteeing the account or exercising trading control with respect to the account;
 - (iii) The establishment or termination of the account;
 - (iv) A means to identify the person who has solicited and is responsible for the account or assign account numbers in such a manner as to identify that person;
 - (v) The funds in the account, net of any commissions and fees;

- (vi) The account's net profits and losses on open trades;
- (vii) The funds in the account plus or minus the net profits and losses on open trades, adjusted for the net option value in the case of open options positions;
- (viii) Financial ledger records that show separately for each retail forex customer all charges against and credits to such retail forex customer's account, including but not limited to retail forex customer funds deposited, withdrawn, or transferred, and charges or credits resulting from losses or gains on closed transactions; and
- (ix) A list of all retail forex transactions executed for the account, with the details specified in paragraph (a)(2) of this section.

(2) *Retail forex transaction records.* For each retail forex transaction:

- (i) The date and time the banking institution received the order;
- (ii) The price at which the banking institution placed the order, or, in the case of an option, the premium that the retail forex customer paid;
- (iii) The customer account identification information;
- (iv) The currency pair;
- (v) The size or quantity of the order;
- (vi) Whether the order was a buy or sell order;
- (vii) The type of order, if the order was not a market order;
- (viii) The size and price at which the order is executed, or in the case of an option, the amount of the premium paid for each option purchased, or the amount credited for each option sold;

(ix) For options, whether the option is a put or call, expiration date, quantity, underlying contract for future delivery or underlying physical, strike price, and details of the purchase price of the option, including premium, mark-up, commission, and fees;

(x) For futures, the delivery date; and

(xi) If the order was made on a trading platform:

(A) The price quoted on the trading platform when the order was placed, or, in the case of an option, the premium quoted;

(B) The date and time the order was transmitted to the trading platform; and

(C) The date and time the order was executed.

(3) *Price changes on a trading platform.* If a trading platform is used, daily logs showing each price change on the platform, the time of the change to the nearest second, and the trading volume at that time and price.

(4) *Methods or algorithms.* Any method or algorithm used to determine the bid or asked price for any retail forex transaction or the prices at which customers orders are executed, including, but not limited to, any mark-ups, fees, commissions or other items which affect the profitability or risk of loss of a retail forex customer's transaction.

(5) *Daily records* which show for each business day complete details of:

(i) All retail forex transactions that are futures transactions executed on that day, including the date, price, quantity, market, currency pair, delivery date, and the person for whom such transaction was made;

(ii) All retail forex transactions that are option transactions executed on that day, including the date, whether the transaction involved a put or call, the expiration date, quantity, currency pair, delivery date, strike price, details of the purchase price of the

option, including premium, mark-up, commission and fees, and the person for whom the transaction was made; and

(iii) All other retail forex transactions executed on that day for such account, including the date, price, quantity, currency and the person for whom such transaction was made.

(6) *Other records.* Written acknowledgements of receipt of the risk disclosure statement required by §240.6(b), offset instructions pursuant to §240.5(c), records required under paragraphs (b) through (f) of this section, trading cards, signature cards, street books, journals, ledgers, payment records, copies of statements of purchase, and all other records, data and memoranda that have been prepared in the course of the banking institution's retail forex business.

(b) *Ratio of profitable accounts.* (1) With respect to its active retail forex customer accounts over which it did not exercise investment discretion and that are not retail forex proprietary accounts open for any period of time during the quarter, a banking institution shall prepare and maintain on a quarterly basis (calendar quarter):

(i) A calculation of the percentage of such accounts that were profitable;

(ii) A calculation of the percentage of such accounts that were not profitable; and

(iii) Data supporting the calculations described in paragraphs (b)(1)(i) and (b)(1)(ii) of this section.

(2) In calculating whether a retail forex account was profitable or not profitable during the quarter, the banking institution shall compute the realized and unrealized gains or losses on all retail forex transactions carried in the retail forex account at any time during the quarter, and subtract all fees, commissions, and any other charges posted to the

retail forex account during the quarter, and add any interest income and other income or rebates credited to the retail forex account during the quarter. All deposits and withdrawals of funds made by the retail forex customer during the quarter must be excluded from the computation of whether the retail forex account was profitable or not profitable during the quarter. Computations that result in a zero or negative number shall be considered a retail forex account that was not profitable. Computations that result in a positive number shall be considered a retail forex account that was profitable.

(3) A retail forex account shall be considered “active” for purposes of paragraph (b)(1) of this section if and only if, for the relevant calendar quarter, a retail forex transaction was executed in that account or the retail forex account contained an open position resulting from a retail forex transaction.

(c) *Records related to possible violations of law.* A banking institution engaging in retail forex transactions shall make a record of all communications received by the banking institution or its related persons concerning facts giving rise to possible violations of law related to the banking institution’s retail forex business. The record shall contain: the name of the complainant, if provided; the date of the communication; the relevant agreement, contract, or transaction; the substance of the communication; and the name of the person who received the communication and the final disposition of the matter.

(d) *Records for noncash margin.* A banking institution shall maintain a record of all noncash margin collected pursuant to § 240.9. The record shall show separately for each retail forex customer:

- (1) A description of the securities or property received;
- (2) The name and address of such retail forex customer;

- (3) The dates when the securities or property were received;
- (4) The identity of the depositories or other places where such securities or property are segregated or held, if applicable;
- (5) The dates on which the banking institution placed or removed such securities or property into or from such depositories; and
- (6) The dates of return of such securities or property to such retail forex customer, or other disposition thereof, together with the facts and circumstances of such other disposition.

(e) *Order tickets.*

(1) Except as provided in paragraph (e)(2) of this section, immediately upon the receipt of a retail forex transaction order, a banking institution shall prepare an order ticket for the order (whether unfulfilled, executed or canceled). The order ticket shall include:

- (i) Account identification (account or customer name with which the retail forex transaction was effected);
- (ii) Order number;
- (iii) Type of order (market order, limit order, or subject to special instructions);
- (iv) Date and time, to the nearest minute, the retail forex transaction order was received (as evidenced by timestamp or other timing device);
- (v) Time, to the nearest minute, the retail forex transaction order was executed; and
- (vi) Price at which the retail forex transaction was executed.

(2) *Post-execution allocation of bunched orders.* Specific identifiers for retail forex accounts included in bunched orders need not be recorded at time of order placement or

upon report of execution as required under paragraph (e)(1) of this section if the following requirements are met:

(i) The banking institution placing and directing the allocation of an order eligible for post-execution allocation has been granted written investment discretion with regard to participating customer accounts and makes the following information available to customers upon request:

(A) The general nature of the post-execution allocation methodology the banking institution will use;

(B) Whether the banking institution has any interest in accounts which may be included with customer accounts in bunched orders eligible for post-execution allocation; and

(C) Summary or composite data sufficient for that customer to compare the customer's results with those of other comparable customers and, if applicable, any account in which the banking institution has an interest.

(ii) Post-execution allocations are made as soon as practicable after the entire transaction is executed;

(iii) Post-execution allocations are fair and equitable, with no account or group of accounts receiving consistently favorable or unfavorable treatment; and

(iv) The post-execution allocation methodology is sufficiently objective and specific to permit the Board to verify fairness of the allocations using that methodology.

(f) *Record of monthly statements and confirmations.* A banking institution shall retain a copy of each monthly statement and confirmation required by § 240.10.

(g) *Form of record and manner of maintenance.* The records required by this section must clearly and accurately reflect the information required and provide an adequate basis for the audit of the information. A banking institution must create and maintain

audio recordings of oral orders and oral offset instructions. Record maintenance may include the use of automated or electronic records provided that the records are easily retrievable, and readily available for inspection.

(h) *Length of maintenance.* A banking institution shall keep each record required by this section for at least five years from the date the record is created.

§ 240.8 Capital requirements.

(a) *Capital required for a state member bank.* A banking institution defined in section 240.2(b)(1) offering or entering into retail forex transactions must be well-capitalized as defined in section 208.43 of Regulation H (12 CFR 208.43).

(b) *Capital required for an uninsured state-licensed branch of a foreign bank.* A banking institution defined in § 240.2(b)(2) offering or entering into retail forex transactions must be well-capitalized under the capital rules made applicable to it pursuant to § 225.2(r)(3) of Regulation Y (12 CFR 225.2(r)(3)).

(c) *Capital required for financial holding companies and bank holding companies.* A banking institution defined in § 240.2(b)(3) or (4) offering or entering into retail forex transactions must be well-capitalized as defined in § 225.2(r) of Regulation Y (12 CFR 225.2(r)).

(d) *Capital required for savings and loan holding companies.* A banking institution defined in § 240.2(b)(5) offering or entering into retail forex transactions must be well-capitalized as defined in § 238.2(s) of Regulation LL (12 CFR 238.2(s)).

(e) *Capital required for an agreement corporation or Edge Act corporation.* A banking institution defined in § 240.2(b)(6) or (7) offering or entering into retail forex transactions must maintain capital in compliance with the capital adequacy guidelines that are made

applicable to an Edge corporation engaged in banking pursuant to § 211.12 (c)(2) of Regulation K (12 CFR 211.12(c)(2)).

§ 240.9 Margin requirements

(a) *Margin required.* A banking institution engaging, or offering to engage, in retail forex transactions must collect from each retail forex customer an amount of margin not less than:

(1) Two percent of the notional value of the retail forex transaction for major currency pairs and 5 percent of the notional value of the retail forex transaction for all other currency pairs;

(2) For short options, 2 percent for major currency pairs and 5 percent for all other currency pairs of the notional value of the retail forex transaction, plus the premium received by the retail forex customer; or

(3) For long options, the full premium charged and received by the banking institution.

(b)(1) *Form of margin.* Margin collected under paragraph (a) of this section or pledged by a retail forex customer for retail forex transactions in excess of the requirements of paragraph (a) of this section must be in the form of cash or the following financial instruments:

(i) Obligations of the United States and obligations fully guaranteed as to principal and interest by the United States;

(ii) General obligations of any State or of any political subdivision thereof;

(iii) General obligations issued or guaranteed by any enterprise, as defined in 12 U.S.C. 4502(10);

(iv) Certificates of deposit issued by an insured depository institution, as defined in section 3(c)(2) of the Federal Deposit Insurance Act (12 U.S.C. 1813(c)(2));

(v) Commercial paper;

(vi) Corporate notes or bonds;

(vii) General obligations of a sovereign nation;

(viii) Interests in money market mutual funds; and

(ix) Such other financial instruments as the Board deems appropriate.

(2) *Haircuts*. A banking institution shall establish written policies and procedures that include:

(i) Haircuts for noncash margin collected under this section; and

(ii) Annual evaluation, and, if appropriate, modification of the haircuts.

(c) *Major currencies*. (1) for the purposes of paragraphs (a)(1) and (a)(2) of this section, major currency means:

(i) United States Dollar (USD)

(ii) Canadian Dollar (CAD)

(iii) Euro (EUR)

(iv) United Kingdom Pound (GBP)

(v) Japanese Yen (JPY)

(vi) Swiss Franc (CHF)

(vii) New Zealand Dollar (NZD)

(viii) Australian Dollar (AUD)

(ix) Swedish Kronor (SEK)

(x) Danish Kroner (DKK)

(xi) Norwegian Krone (NOK), and

(xii) Any other currency as determined by the Board.

(d) *Margin calls; liquidation of position.* For each retail forex customer, at least once per day, a banking institution shall:

(1) Mark the value of the retail forex customer's open retail forex positions to market;

(2) Mark the value of the margin collected under this section from the retail forex customer to market;

(3) Determine whether, based on the marks in paragraphs (d)(1) and (d)(2) of this section, the banking institution has collected margin from the retail forex customer sufficient to satisfy the requirements of this section; and

(4) If, pursuant to paragraph (d)(3) of this section, the banking institution determines that it has not collected margin from the retail forex customer sufficient to satisfy the requirements of this section then, within a reasonable period of time, the banking institution shall either:

(i) Collect margin from the retail forex customer sufficient to satisfy the requirements of this section; or

(ii) Liquidate the retail forex customer's retail forex transactions.

§ 240.10 Required reporting to customers.

(a) *Monthly statements.* Each banking institution must promptly furnish to each retail forex customer, as of the close of the last business day of each month or as of any regular monthly date selected, except for accounts in which there are neither open positions at the end of the statement period nor any changes to the account balance since the prior statement period, but in any event not less frequently than once every three months, a statement that clearly shows:

(1) For each retail forex customer:

(i) The open retail forex transactions with prices at which acquired;

(ii) The net unrealized profits or losses in all open retail forex transactions marked to the market;

(iii) Any money, securities or other property held as margin for retail forex transactions; and

(iv) A detailed accounting of all financial charges and credits to the retail forex customer's retail forex accounts during the monthly reporting period, including: money, securities, or property received from or disbursed to such customer; realized profits and losses; and fees, charges, and commissions.

(2) For each retail forex customer engaging in retail forex transactions that are options:

(i) All such options purchased, sold, exercised, or expired during the monthly reporting period, identified by underlying retail forex transaction or underlying currency, strike price, transaction date, and expiration date;

(ii) The open option positions carried for such customer and arising as of the end of the monthly reporting period, identified by underlying retail forex transaction or underlying currency, strike price, transaction date, and expiration date;

(iii) All such option positions marked to the market and the amount each position is in the money, if any;

(iv) Any money, securities or other property held as margin for retail forex transactions; and

(v) A detailed accounting of all financial charges and credits to the retail forex customer's retail forex accounts during the monthly reporting period, including: money, securities, or property received from or disbursed to such customer; realized profits and losses; premiums and mark-ups; and fees, charges, and commissions.

(b) *Confirmation statement.* Each banking institution must, not later than the next business day after any retail forex transaction, send:

(1) To each retail forex customer, a written confirmation of each retail forex transaction caused to be executed by it for the customer, including offsetting transactions executed during the same business day and the rollover of an open retail forex transaction to the next business day;

(2) To each retail forex customer engaging in forex option transactions, a written confirmation of each forex option transaction, containing at least the following information:

(i) The retail forex customer's account identification number;

(ii) A separate listing of the actual amount of the premium, as well as each mark-up thereon, if applicable, and all other commissions, costs, fees and other charges incurred in connection with the forex option transaction;

(iii) The strike price;

(iv) The underlying retail forex transaction or underlying currency;

(v) The final exercise date of the forex option purchased or sold; and

(vi) The date the forex option transaction was executed.

(3) To each retail forex customer engaging in forex option transactions, upon the expiration or exercise of any option, a written confirmation statement thereof, which statement shall include the date of such occurrence, a description of the option involved, and, in the case of exercise, the details of the retail forex or physical currency position which resulted therefrom including, if applicable, the final trading date of the retail forex transaction underlying the option.

(c) Notwithstanding the provisions of paragraphs (b)(1) through (3) of this section, a retail forex transaction that is caused to be executed for a pooled investment vehicle that engages in retail forex transactions need be confirmed only to the operator of such pooled investment vehicle.

(d) *Controlled accounts.* With respect to any account controlled by any person other than the retail forex customer for whom such account is carried, each banking institution shall promptly furnish in writing to such other person the information required by paragraphs (a) and (b) of this section.

(e) *Introduced accounts.* Each statement provided pursuant to the provisions of this section must, if applicable, show that the account for which the banking institution was introduced by an introducing broker and the name of the introducing broker.

§ 240.11 Unlawful representations.

(a) *No implication or representation of limiting losses.* No banking institution engaged in retail foreign exchange transactions or its related persons may imply or represent that it will, with respect to any retail customer forex account, for or on behalf of any person:

- (1) Guarantee such person or account against loss;
- (2) Limit the loss of such person or account; or

(3) Not call for or attempt to collect margin as established for retail forex customers.

(b) *No implication of representation of engaging in prohibited acts.* No banking institution or its related persons may in any way imply or represent that it will engage in any of the acts or practices described in paragraph (a) of this section.

(c) *No Federal government endorsement.* No banking institution or its related persons may represent or imply in any manner whatsoever that any retail forex transaction or retail forex product has been sponsored, recommended, or approved by the Board, the Federal government, or any agency thereof.

(d) *Assuming or sharing of liability from bank error.* This section shall not be construed to prevent a banking institution from assuming or sharing in the losses resulting from the banking institution's error or mishandling of a retail forex transaction.

(e) *Certain guaranties unaffected.* This section shall not affect any guarantee entered into prior to the effective date of this part, but this section shall apply to any extension, modification or renewal thereof entered into after such date.

§ 240.12 Authorization to trade.

(a) *Specific authorization required.* No banking institution may directly or indirectly effect a retail forex transaction for the account of any retail forex customer unless, before the transaction occurs, the retail forex customer specifically authorized the banking institution to effect the retail forex transaction.

(b) A retail forex transaction is "specifically authorized" for purposes of this section if the retail forex customer specifies:

- (1) The precise retail forex transaction to be effected;
- (2) The exact amount of the foreign currency to be purchased or sold; and

(3) In the case of an option, the identity of the foreign currency or contract that underlies the option.

§ 240.13 Trading and operational standards.

(a) *Internal rules, procedures, and controls required.* A banking institution engaging in retail forex transactions shall establish and implement internal rules, procedures, and controls designed, at a minimum, to:

(1) Ensure, to the extent reasonable, that each order received from a retail forex customer that is executable at or near the price that the banking institution has quoted to the customer is entered for execution before any order in any retail forex transaction for:

(i) A proprietary account;

(ii) An account in which a related person has an interest, or any account for which such a related person may originate orders without the prior specific consent of the account owner, if the related person has gained knowledge of the retail forex customer's order prior to the transmission of an order for a proprietary account;

(iii) An account in which a related person has an interest, if the related person has gained knowledge of the retail forex customer's order prior to the transmission of an order for a proprietary account; or

(iv) An account in which a related person may originate orders without the prior specific consent of the account owner, if the related person has gained knowledge of the retail forex customer's order prior to the transmission of an order for a proprietary account;

(2) Prevent banking institution related persons from placing orders, directly or indirectly, with another person in a manner designed to circumvent the provisions of paragraph (a)(1) of this section; and

(3) Fairly and objectively establish settlement prices for retail forex transactions.

(b) *Disclosure of retail forex transactions.* No banking institution engaging in retail forex transactions may disclose that an order of another person is being held by the banking institution, unless the disclosure is necessary to the effective execution of such order or the disclosure is made at the request of the Board.

(c) *Handling of retail forex accounts of related persons of retail forex counterparties.* No banking institution engaging in retail forex transactions shall knowingly handle the retail forex account of any related person of another retail forex counterparty unless the banking institution:

(1) Receives written authorization from a person designated by such other retail forex counterparty with responsibility for the surveillance over such account;

(2) Prepares immediately upon receipt of an order for the account a written record of the order, including the account identification and order number, and records thereon to the nearest minute, by time-stamp or other timing device, the date and time the order is received; and

(3) Transmits on a regular basis to the other retail forex counterparty copies of all statements for the account and of all written records prepared upon the receipt of orders for the account pursuant to paragraph (c)(2) of this section.

(d) *Related person of banking institution establishing account at another retail forex counterparty.* No related person of a banking institution working in the banking institution's retail forex

business may have an account, directly or indirectly, with another retail forex counterparty unless the other retail forex counterparty:

(1) Receives written authorization to open and maintain the account from a person designated by the banking institution of which it is a related person with responsibility for the surveillance over the account pursuant to paragraph (a)(2) of this section;

(2) Prepares immediately upon receipt of an order for the account a written record of the order, including the account identification and order number, and records thereon to the nearest minute, by time-stamp or other timing device, the date and time the order is received; and

(3) Transmits on a regular basis to the banking institution copies of all statements for the account and of all written records prepared by the other retail forex counterparty upon receipt of orders for such account pursuant to paragraph (d)(2) of this section.

(e) *Prohibited trading practices.* No banking institution engaging in retail forex transactions may:

(1) Enter into a retail forex transaction, to be executed pursuant to a market or limit order at a price that is not at or near the price at which other retail forex customers, during that same time period, have executed retail forex transactions with the banking institution;

(2) Adjust or alter prices for a retail forex transaction after the transaction has been confirmed to the retail forex customer;

(3) Provide a retail forex customer a new bid price for a retail forex transaction that is higher than its previous bid without providing a new asked price that is also higher than its previous asked price by a similar amount;

(4) Provide a retail forex customer a new bid price for a retail forex transaction that is lower than its previous bid without providing a new asked price that is also lower than its previous asked price by a similar amount; or

(5) Establish a new position for a retail forex customer (except one that offsets an existing position for that retail forex customer) where the banking institution holds outstanding orders of other retail forex customers for the same currency pair at a comparable price.

§ 240.14 Supervision.

(a) *Supervision by the banking institution.* A banking institution engaging in retail forex transactions shall diligently supervise the handling by its officers, employees, and agents (or persons occupying a similar status or performing a similar function) of all retail forex accounts carried, operated, or advised by the banking institution and all activities of its officers, employees, and agents (or persons occupying a similar status or performing a similar function) relating to its retail forex business.

(b) *Supervision by officers, employees, or agents.* An officer, employee, or agent of a banking institution must diligently supervise his or her subordinates' handling of all retail forex accounts at the banking institution and all the subordinates' activities relating to the banking institution's retail forex business.

§ 240.15 Notice of transfers.

(a) *Prior notice generally required.* Except as provided in paragraph (b) of this section, a banking institution must provide a retail forex customer with 30 days' prior notice of any assignment of any position or transfer of any account of the retail forex customer. The notice must include a statement that the retail forex customer is not

required to accept the proposed assignment or transfer and may direct the banking institution to liquidate the positions of the retail forex customer or transfer the account to a retail forex counterparty of the retail forex customer's selection.

(b) *Exceptions.* The requirements of paragraph (a) of this section shall not apply to transfers:

(1) Requested by the retail forex customer;

(2) Made by the Federal Deposit Insurance Corporation as receiver or conservator under the Federal Deposit Insurance Act or other law; or

(3) Otherwise authorized by applicable law.

(c) *Obligations of transferee banking institution.* A banking institution to which retail forex accounts or positions are assigned or transferred under paragraph (a) of this section must provide to the affected retail forex customers the risk disclosure statements and forms of acknowledgment required by this part and receive the required signed acknowledgments within sixty days of such assignments or transfers. This requirement shall not apply if the banking institution has clear written evidence that the retail forex customer has received and acknowledged receipt of the required disclosure statements.

§ 240.16 Customer dispute resolution.

(a) No banking institution shall enter into any agreement or understanding with a retail forex customer in which the customer agrees, prior to the time a claim or grievance arises, to submit any claim or grievance regarding any retail forex transaction or disclosure to any settlement procedure.

(b) *Election of forum.* (1) Within 10 business days after the receipt of notice from the retail forex customer that the customer intends to submit a claim to arbitration, the

banking institution shall provide the customer with a list of persons qualified in dispute resolution.

(2) The customer must, within 45 days after receipt of such list, notify the banking institution of the person selected. The customer's failure to provide such notice shall give the banking institution the right to select a person from the list.

(c) *Enforceability.* A dispute settlement procedure may require parties using the procedure to agree, under applicable state law, submission agreement, or otherwise, to be bound by an award rendered in the procedure if the agreement to submit the claim or grievance to the procedure was made after the claim or grievance arose. Any award so rendered by the procedure will be enforceable in accordance with applicable law.

(d) *Time limits for submission of claims.* The dispute settlement procedure used by the parties may not include any unreasonably short limitation period foreclosing submission of a customer's claims or grievances or counterclaims.

(e) *Counterclaims.* A procedure for the settlement of a retail forex customer's claims or grievances against a banking institution or employee thereof may permit the submission of a counterclaim in the procedure by a person against whom a claim or grievance is brought if the counterclaim:

(1) Arises out of the transaction or occurrence that is the subject of the retail forex customer's claim or grievance; and

(2) Does not require for adjudication the presence of essential witnesses, parties, or third persons over which the settlement process lacks jurisdiction.

(f) *Cross-border transactions.* This section shall not apply to transactions within the scope of sections 202, 302, and 305 of the Federal Arbitration Act (9 U.S.C. 202, 302, and 305).

§ 240.17 Reservation of authority.

The Board may modify the disclosure, recordkeeping, capital and margin, reporting, business conduct, documentation, or other standards or requirements under this part for a specific retail forex transaction or a class of retail forex transactions if the Board determines that the modification is consistent with safety and soundness and the protection of retail forex customers.

By order of the Board of Governors of the Federal Reserve System, April 3, 2013.

**Margaret McCloskey Shanks,
Deputy Secretary of the Board.**

BILLING CODE 6210-01-P

[FR Doc. 2013-08163 Filed 04/08/2013 at 8:45 am; Publication Date: 04/09/2013]