

FCMs to report certain events. The proposed time frames would be consistent with those currently provided in SEC rules applicable to securities brokers and dealers. The Commission also is proposing to amend reporting requirements for FCMs or IBs to streamline Commission procedures and to eliminate unnecessary filing requirements.

DATES: Comments must be received on or before September 8, 2003.

ADDRESSES: Comments may be sent to Commodity Futures Trading Commission, Three Lafayette Centre, 1155 21st Street, NW., Washington, DC 20581. Attn.: Secretariat. In addition, comments may be sent by facsimile to (202) 418-5521, or by electronic mail to secretary@cftc.gov. References should be made to "Proposed Rules for Risk-Based Capital."

FOR FURTHER INFORMATION CONTACT: Thomas J. Smith, Deputy Director, at (202) 418-5495 or Thelma Diaz, Special Counsel, at (202) 418-5137, Division of Clearing and Intermediary Oversight, Commodity Futures Trading Commission, Three Lafayette Centre, 1155 21st Street, NW., Washington, DC 20581. Electronic mail: (tsmith@cftc.gov) or (tdiaz@cftc.gov).

SUPPLEMENTARY INFORMATION:

I. Background—Financial Safeguards

As part of its regulatory responsibilities, the Commission monitors the financial integrity of the commodity futures and options markets and the intermediaries that market participants employ in their trading activities. The Commission's financial and related recordkeeping and reporting rules are part of a system of financial safeguards that also includes exchange and clearinghouse risk management and financial surveillance systems, exchange and clearinghouse rules and policies on clearing and settlements, and financial and operational controls and risk management employed by market intermediaries themselves.

Two primary financial safeguards under the Act are: (1) The requirement that FCMs segregate from their own assets all money and property belonging to their customers; and (2) the imposition of minimum capital requirements for FCMs and IBs.¹ The requirement that FCMs segregate customer funds is set forth in section 4d(a)(2) of the Act. Section 4d(a)(2) requires, among other things, that an FCM segregate from its own assets all money, securities, and other property held for customers as margin for their

commodity futures and option contracts, as well as any gains accruing to such customers from open futures and option positions.

Commission Rules 1.20 through 1.30, as well as 1.32 and 1.36 implement the segregation of funds provisions of section 4d(a)(2) of the Act for FCMs holding funds for customers trading on U.S. commodity futures and options markets.² These rules require FCMs to maintain, in segregated accounts, all of the money and other property deposited by customers to margin their futures and option positions on U.S. markets, as well as any funds accruing to such customers from open futures and option positions. The rules are intended to ensure that an FCM has readily available sufficient funds to meet its obligations, on a dollar-for-dollar basis, to its customers trading on U.S. futures and options markets at all times.

Rule 30.7 sets forth an FCM's obligation to secure funds of U.S.-domiciled customers trading on non-U.S. futures and options markets. Rule 30.7 requires an FCM to maintain in secured accounts funds and other property deposited by a U.S.-domiciled customer that represents required margin deposits for open futures and option positions on foreign markets, as well as any unrealized gains accruing on such open positions. The funds required to be segregated for customers trading on U.S. commodity markets pursuant to Section 4d(a)(2) and the funds required to be secured for customers trading on foreign commodity markets pursuant to Rule 30.7 hereinafter will be referred to jointly as the "Segregated Amount."

Section 4f(b) of the Act provides that in order to register as an FCM or IB a person must meet such minimum financial requirements as the Commission may by regulation prescribe. Commission rules that set forth the minimum financial and related reporting requirements for FCMs and IBs include Rules 1.10, 1.12, 1.16, 1.17, and 1.18. Commission Rules 1.10 and 1.16 set forth requirements for the periodic reporting of the financial condition of FCMs and IBs, while Commission Rule 1.12 requires "early warning" reporting of predefined events as they occur. The minimum requirements for the IB's or FCM's adjusted net capital, equity capital and subordinated agreements are set forth in Commission Rule 1.17. Rule 1.18 requires FCMs and IBs to prepare and to maintain formal adjusted net capital

computations as of the close of business each month.³

The Commission's minimum financial requirements protect customers and other market participants by requiring FCMs and IBs to maintain minimum levels of liquid assets in excess of their liabilities to finance their business activities. In the event of a shortfall in the Segregated Amount, the Commission's minimum net capital requirement provides protection to customers by requiring FCMs to maintain a minimum level of assets that are readily available to be contributed to cover the shortfall. The minimum capital requirement also protects customers and market participants by ensuring that the FCM remains solvent while waiting for margin calls to be met.

II. Proposed Risk-Based Capital Requirement for FCMs

A. The Commission's Current Capital Requirement

The Commission's net capital requirement is set forth in Rule 1.17(a)(1)(i)(A)–(D) and requires an FCM to maintain adjusted net capital equal to, or in excess of, the greatest of the following:

- a. \$250,000;
- b. Four percent of the Segregated Amount, less the market value of options purchased by customers for which the full premiums have been paid;
- c. The amount of adjusted net capital required by a registered futures association of which the FCM is a member;⁴ or
- d. For FCMs that also are registered with the SEC as securities brokers or dealers, the amount of net capital required by SEC Rule 15c3–1(a).⁵

In addition to the Commission's minimum capital requirements, FCMs also are subject to minimum capital requirements adopted by the self-regulatory organizations ("SROs") of which they are members.⁶ The SROs' capital requirements are required to be no less stringent than the Commission's minimum capital requirement.⁷

³ In addition, FCMs are required by Rules 1.14 and 1.15 to maintain and to provide to the Commission certain information regarding affiliated entities.

⁴ The NFA is a registered futures association that has adopted minimum capital rules for its member FCMs.

⁵ 17 CFR 240.15c3–1(a).

⁶ Rule 1.3(ee) defines an SRO as a contract market as defined in Rule 1.3(h) or a registered futures association under section 17 of the Act.

⁷ For example, New York Mercantile Exchange ("NYMEX") Rule 9.21 requires clearing members to maintain minimum net capital that is the greater of \$5,000,000 or the minimum capital required by Rule 1.17.

¹ 17 U.S.C. 1 *et seq.* (2000).

² Commission regulations may be found at 17 CFR Ch. 1 (2002).