

financial statements and the certified financial statements cover the full period from the as of date of the previous certified financial statements. In addition, SEC rules provide for DEA approval in connection with changes to the fiscal year or "as of" date for the annual audited financial statements of a broker or dealer.²⁵

The Commission is proposing to amend Rule 1.10(e) to provide that a DSRO may approve an FCM's or IB's application for a change in fiscal year, provided that the FCM or IB files with the Commission a copy of its application, and also files a copy of its DSRO's written approval or denial of a change in fiscal year end, in order to permit Commission staff to know when certified annual financial reports are to be filed.²⁶ The Commission also is proposing that any dual registrant that has filed a notice or application with its DEA to request a change to its fiscal year or "as of" date would not need to file a separate application with its DSRO, but the dual registrant would need to file with its DSRO and the Commission a copy of the notice or application filed by the registrant with its DEA. Further, immediately upon the approval or denial of the request to change the dual registrant's fiscal year or "as of" date, the dual registrant would be required to file a copy of such approval or denial with the Commission and its DSRO.

F. Filings by Introducing Brokers of Form 1-FR With NFA

Commission Rule 1.10(b) requires an IB to file with the Commission and with NFA on a semiannual basis an unaudited Form 1-FR-IB, or its FOCUS Report if the IB is also registered with the SEC as a securities broker or dealer. The IBs are required to file the unaudited financial reports within 17 business days of the as of date of the reports.

The Commission currently has direct access to a database maintained by NFA that includes the financial information reported by IBs on a Form 1-FR-IB or FOCUS Report. Therefore, the Commission is proposing to amend Rule

1.10(c) to provide that an IB must file an unaudited Form 1-FR-IB solely with NFA.²⁷

Furthermore, the Commission invites comment on whether, and under what conditions, it should amend its rules to permit IBs to file annual certified financial statements solely with NFA. NFA would input the financial information into the database and would provide copies of the annual reports to the Commission upon request.

V. Early Warning Requirements

Commission Rule 1.12 requires an FCM to file notices and meet other requirements if certain predefined financial events occur that may raise concerns regarding the FCM's ability to continue its normal operations and to safeguard customer funds. The requirements in Rule 1.12 are generally referred to as "early warning requirements."

A. Adjusted Net Capital That Is Below the Early Warning Level

An FCM whose adjusted net capital falls below a level specified in Rule 1.12(b), the early warning level, is required to meet the notice and monthly filing requirements that are set forth in 1.12(b)(4).²⁸ The FCM must file written notice within five business days with the Commission and its DSRO, and the FCM must also file a Form 1-FR-FCM or FOCUS Report as of the close of business for the month in which the FCM's adjusted net capital is less than the required early warning level. Rule 1.12(b) further requires the FCM to continue to file monthly Forms 1-FR-FCM or FOCUS Reports, as opposed to filing quarterly reports that would ordinarily be required under Rule 1.10, until the end of a period of three successive months during which the adjusted net capital of the FCM remains

at a level equal to or greater than the early warning level.

The Commission is proposing to eliminate the monthly filing requirement in Rule 1.12(b), because this provision will become unnecessary if Rule 1.10 is amended to require that all FCMs file monthly financial reports with the Commission and with their DSRO. The Commission also is retaining the requirement under Rule 1.12(b) that the FCM provide notice to the Commission and to the firm's DSRO that its adjusted net capital has fallen below 150 percent of its minimum capital requirement. In addition, the Commission is proposing to amend Rule 1.12(b) to provide that the early warning notice be filed with the Commission and with the firm's DSRO within 24 hours, instead of within five business days. This amendment would make the Commission's rule consistent with the SEC's early warning rule, which also requires that notice be provided promptly, within 24 hours.²⁹

The JAC has requested that the Commission eliminate the early warning requirement since FCMs will be required to file monthly financial reports under the amended rules. The Commission, however, is concerned that eliminating the early warning notice requirement will diminish the DSRO's and Commission's ability to react promptly to potential financial crises at an FCM that has experienced a decrease in capital. The Commission, however, invites interested parties to comment on this aspect of the proposal, including on whether the 150 percent early warning level is appropriate or whether it should be adjusted or eliminated.

B. Failure To Maintain Current Books and Records and of Material Inadequacy in Internal Accounting Controls

Rule 1.12(c) requires an FCM or IB to notify the Commission if it fails to maintain current books and records that it is required to keep pursuant to Commission regulations. The FCM or IB must give such notice on the same day that the event occurs that causes it to not maintain current books and records. The notice must specify the books and records that have not been made or that are not current. The FCM or IB also is required to file a written report setting forth the steps taken, or that are being taken, to correct the situation within five business days of filing the initial notice.

Rule 1.12(d) requires an FCM or IB to notify the Commission within three business days of discovering or being

²⁷ The proposed amendment will be similar to existing provisions in 1.10(c) that provide that guarantee agreements need be filed solely with the NFA.

²⁸ The level of adjusted net capital that is required under Rule 1.12(b) equals the greatest of the following:

- a. \$375,000;
- b. Six percent of the Segregated Amount, less the market value of options purchased by customers for which the full premiums have been paid;
- c. 150 percent of the amount of adjusted net capital required by a registered futures association of which the FCM is a member; or
- d. for FCMs that also are registered with SEC as securities brokers or dealers, the amount of net capital required by SEC Rule 17a-11(b).

The Commission is proposing a technical amendment to Rule 1.12(b) to correct the reference to SEC Rule 17a-11(b), which the SEC has redesignated as 17a-11(c). 58 FR 37655 (July 13, 1993.)

²⁵ SEC Rule 17a-5(m) requires that a securities broker or dealer notify its DEA and the SEC offices located in Washington, DC and the region where the broker or dealer has its principal place of business "in the event any broker-dealer finds it necessary to change its fiscal year." The notice must contain a detailed explanation for the change, and any change in the "as of" date for the annual audit financial statements must be approved by the DEA under SEC Rule 17a-5(d)(1)(i).

²⁶ Rule 1.10(b)(1)(ii) requires that FCMs file reports that are "as of the close of its fiscal year" and filed "no later than 90 days after the close" of the fiscal year, or, if the FCM is also registered as a securities broker or dealer, no later than the 60 day period provided under SEC Rule 17a-5(d)(5).

²⁹ SEC Rule 17a-11(c), (17 CFR 240.17a-11(c)).