FOR FURTHER INFORMATION CONTACT:

E. E. Crooks, Regulatory Support Staff, Animal and Plant Health Inspection Service, Plant Protection and Quarantine Programs, U.S. Department of Agriculture, Hyattsville, Md. 20782, 301-436-8249.

SUPPLEMENTARY INFORMATION: On June 30, 1978, the Animal and Plant Health Inspection Service published a proposed rule in the FEDERAL REGISTER (43 FR 28507) proposing to amend §§ 330.100 and 330.400 of the Federal plant pest regulations (7 CFR Part 330). Interested persons were given until July 20, 1978, to submit data, views, and arguments regarding the proposed rule. No comments were received during this comment period and, therefore, the proposed amendments to §§ 330.100 and 330.400 of the Federal plant pest regulations, are hereby adopted without change as set forth below, except for reference to a footnote, which was inadvertently omitted.

It does not appear that further public participation in rulemaking proceedings on these amendments would make additional information available to the Department. Therefore, under the administrative procedure provisions in 5 U.S.C. 553, it is found upon good cause that further notice and other public procedures concerning these amendments are unnecessary.

This amendment should be put into effect immediately in order to protect the United States from the introduction and dissemination of injurious plant pests and livestock or poultry diseases. Therefore, good cause is found for making the amendment effective less than 30 days after publication in the FEDERAL REGISTER.

Done at Washington, D.C., this 31st day of August 1978.

NOTE.—The Plant protection and quarantine programs, Animal and Plant Health Inspection Service, has determined that this document does not contain a major proposal requiring preparation of an inflation impact statement under Executive Order No. 11821, as amended, and OMB Circular A-107.

JAMES O. LEE, Jr.,
Deputy Administrator, Plant Protection and Quarantine Programs, Animal and Plant Health Inspection Service.

1. In § 330.100, paragraphs (i) and (j) are amended to read as follows:

§ 330.100 Definitions.

* * * * *

(i) *United States.* The States, the District of Columbia, Guam, the Northern Mariana Islands, Puerto Rico, and the Virgin Islands of the United States.

(j) *Continental United States.* The 49 States located on the continent of North America and the District of Columbia.

2. In § 330.400, the second sentence in paragraph (a) is deleted and the following inserted in lieu thereof:

§ 330.400 Garbage; quarantine, regulations on storage, and movement on certain means of conveyance.

(a) * * * Garbage which is on or unloaded from any means of conveyance arriving in the places listed below is subject to general surveillance for compliance with this section by Animal and Plant Health Inspection Service inspectors and to such disposal measures as authorized by section 105 of the Federal Plant Pest Act (7 U.S.C. 150dd), section 10 of the Plant Quarantine Act of 1912, as amended (7 U.S.C. 164a), section 2 of the Act of February 2, 1903, as amended (21 U.S.C. 111), and section 306 of the Act of June 17, 1930, as amended (19 U.S.C. 1306), to prevent the dissemination of plant pests and livestock or poultry diseases:

(1) The United States from any place outside thereof (except garbage derived from stores obtained only in the continental United States or Canada on board vessels or aircraft that move solely between continental United States ports or between continental United States ports and Canadian ports); (2) The continental United States from Hawaii or any territory or possession; (3) Any territory or possession from any other territory or possession or from Hawaii; and (4) Hawaii from any territory or possession.

(Sec. 106, 71 Stat. 33 (7 U.S.C. 150ee); secs. 8 and 9, 37 Stat. 318, as amended (7 U.S.C. 161, 162); sec. 102, 58 Stat. 735, as amended (7 U.S.C. 147a); sec. 306, 46 Stat. 689, as amended (19 U.S.C. 1306); sec. 2, 32 Stat. 792, as amended (21 U.S.C. 111); sec. 11, 23 Stat. 32, as added at 58 Stat. 734, as amended (21 U.S.C. 114a); 76 Stat. 663 (7 U.S.C. 450); secs. 101, 102, 83 Stat. 852, 853 (42 U.S.C. 4331, 4332); 39 FR 32319-32321; 37 FR 28464, 28477; 38 FR 19141.)

[FR Doc. 78-25433 Filed 9-7-78; 8:45 am]

[3410-02]

CHAPTER IX—AGRICULTURAL MARKETING SERVICE (MARKETING AGREEMENTS AND ORDERS; FRUITS, VEGETABLES, NUTS), DEPARTMENT OF AGRICULTURE

[Lemon Reg. 162]

PART 910—LEMONS GROWN IN CALIFORNIA AND ARIZONA

Limitation of Handling

AGENCY: Agricultural Marketing Service, USDA.

ACTION: Final rule.

SUMMARY: This regulation establishes the quantity of fresh California-Arizona lemons that may be shipped to market during the period September 10-16, 1978. Such action is needed to provide for orderly marketing of fresh lemons for this period due to the marketing situation confronting the lemon industry.

EFFECTIVE DATE: September 10, 1978.

FOR FURTHER INFORMATION CONTACT:

Charles R. Brader, 202-447-6393.

SUPPLEMENTARY INFORMATION: *Findings.* Pursuant to the marketing agreement, as amended, and order No. 910, as amended (7 CFR Part 910), regulating the handling of lemons grown in California and Arizona, effective under the Agricultural Marketing Agreement Act of 1937, as amended (7 U.S.C. 601-674), and upon the basis of the recommendations and information submitted by the Lemon Administrative Committee, and upon other information, it is found that the limitation of handling of lemons, as hereafter provided, will tend to effectuate the declared policy of the act.

The committee met on September 5, 1978, to consider supply and market conditions and other factors affecting the need for regulation and recommended a quantity of lemons deemed advisable to be handled during the specified week. The committee reports the demand for lemons continues good on 140's and larger, easier on 165's and smaller.

It is further found that it is impracticable and contrary to the public interest to give preliminary notice, engage in public rulemaking, and postpone the effective date until 30 days after publication in the FEDERAL REGISTER (5 U.S.C. 553), because of insufficient time between the date when information became available upon which this regulation is based and the effective date necessary to effectuate the declared policy of the act. Interested persons were given an opportunity to submit information and views on the regulation at an open meeting. It is necessary to effectuate the declared purposes of the act to make these regulatory provisions effective as specified, and handlers have been apprised of such provisions and the effective time.

§ 910.462 Lemon regulation 162.

Order. (a) The quantity of lemons grown in California and Arizona which may be handled during the period September 10, 1978, through September 16, 1978, is established at 235,000 cartons.

(b) As used in this section, "handled" and "carton(s)" mean the same as defined in the marketing order.

(Secs. 1-19, 48 Stat. 31, as amended; 7 U.S.C. 601-674.)

Dated: September 6, 1978.

CHARLES R. BRADER,
Deputy Director, Fruit and Vegetable Division, Agricultural Marketing Service.

[FR Doc. 78-25590 Filed 9-7-78; 12:06 pm]

[3410-02]

CHAPTER X—AGRICULTURAL MARKETING SERVICE (MARKETING AGREEMENTS AND ORDERS; MILK), DEPARTMENT OF AGRICULTURE

[Milk Order No. 133]

PART 1133—MILK IN THE INLAND EMPIRE MARKETING AREA

Order Suspending Certain Provisions

AGENCY: Agricultural Marketing Service, USDA.

ACTION: Suspension of rule.

SUMMARY: This action suspends for September, October, and November 1978 the limit on the amount of milk not needed for bottling use that may be moved (diverted) directly from farms to manufacturing plants and still be priced under the order. The suspension is based on a cooperative association's request considered at a public hearing held for this order on July 27, 1978, in Spokane, Wash. The action will enable members of the cooperative who have been regularly associated with the fluid market to continue to have their milk pooled and priced under the order pending a decision on the proposed order amendments that were considered at the hearing.

EFFECTIVE DATE: September 8, 1978.

FOR FURTHER INFORMATION CONTACT:

Maurice M. Martin, Marketing Specialist, Dairy Division, Agricultural Marketing Service, U.S. Department of Agriculture, Washington, D.C. 20250, 202-447-7183.

SUPPLEMENTARY INFORMATION: Prior document in this proceeding:

Notice of hearing issued July 10, 1978, published July 13, 1978 (43 FR 30066).

This order of suspension is issued pursuant to the provisions of the Agricultural Marketing Agreement Act of 1937, as amended (7 U.S.C. 601 et seq.), and of the order regulating the handling of milk in the Inland Empire marketing area.

It is hereby found and determined that for the months of September through November 1978 the following provisions of the order do not tend to effectuate the declared policy of the Act:

In § 1133.13(c) (1) and (2), the words "50 percent in any of the months of September through March and."

STATEMENT OF CONSIDERATION

This action, based on a public hearing held for this order on July 27, 1978, at Spokane, Wash., suspends for September, October, and November 1978 the limit on the amount of producer milk that may be diverted from pool plants to nonpool plants by a cooperative association or a proprietary handler operating a pool plant.

At the hearing, Northwest Dairymen's Association, a cooperative which handles most of the market's reserve milk supplies, proposed an increase in the limit on the amount of producer milk that may be diverted from pool plants to nonpool plants during the months of September through March. The proposal would increase the present 50-percent limit to 90 percent and permit unlimited diversions during April through August (when a 70-percent limit now applies). The cooperative proposed that emergency action be taken to effectuate its proposed amendments to the order. It indicated, however, that if the order could not be amended in time to accommodate its handling of reserve milk this September, the diversion limits should then be suspended, beginning with September, until final disposition is made of the hearing proceeding.

The need for the suspension stems from the adverse impact on the proponent cooperative that otherwise would occur beginning September 1978 when the basis of determining proponent's allowable diversions under the order will change. In the past, proponent's allowable diversions have been determined under the optional method provided by the order whereby two or more cooperative associations may have their allowable diversions computed on the basis of the combined deliveries of milk of their member producers. This option for computing allowable diversions permitted the proponent cooperative to perform its reserve supply function in the market and still maintain producer status for all its dairy farmer members who are associated with the fluid milk market.

At the hearing, proponent indicated that the present agreement with three other cooperatives for computing allowable diversions on a combined basis will not be renewed on its September 1, 1978, expiration date. As a result, beginning in September, the present order's diversion limits that are applicable to a single cooperative will not accommodate the quantity of milk that proponent must divert in handling the market's reserve supplies. Thus, the producer status of some of its member producers who have been regularly associated with the fluid market would be in jeopardy.

Whether or not the diversion provisions should be amended and to what extent is a matter to be determined after the hearing record and post-hearing briefs have been fully reviewed. In the interim, the suspension for the 3-month period is warranted, as it will tend to assure orderly marketing pending the outcome of the hearing proceeding. It is unlikely that suspension of the diversion limitations over this short period will have any appreciable effect on the availability of milk for the market. This action, however, will eliminate the possibility of producers who are regular suppliers of milk for the fluid market losing their producer status because of the present diversion limits and thus not having their milk priced under the order. Accordingly, this temporary suspension will permit the orderly disposal of the market's reserve milk supplies pending the completion of the hearing proceeding.

It is hereby found and determined that 30 days' notice of the effective date hereof is impractical, unnecessary, and contrary to the public interest in that:

(a) This suspension is necessary to reflect current marketing conditions and to maintain orderly marketing conditions in the marketing area in that substantial quantities of milk of producers who regularly supply the market otherwise would be excluded from the marketwide pool, thereby causing a disruption in the orderly marketing of milk;

(b) This suspension does not require of persons affected substantial or extensive preparation prior to the effective date; and

(c) The need for changing the diversion limits was considered at a public hearing held on July 27, 1978, where all interested parties had an opportunity to participate in this rulemaking proceeding.

It is therefore ordered that the aforesaid provisions of the order are hereby suspended for the months of September, October, and November 1978.

Effective date: September 9, 1978.

Signed at Washington, D.C., on: September 1, 1978.

P. R. "BOBBY" SMITH,
Assistant Secretary for Marketing Services.

[FR Doc. 78-25233 Filed 9-7-78; 8:45 am]

[3410-34]

Title 9—Animals and Animal Products

CHAPTER I—ANIMAL AND PLANT HEALTH INSPECTION SERVICE, DEPARTMENT OF AGRICULTURE

SUBCHAPTER D—EXPORTATION AND IMPORTATION OF ANIMALS (INCLUDING POULTRY) AND ANIMAL PRODUCTS

PART 94—RINDERPEST, FOOT-AND-MOUTH DISEASE, FOWL PEST (FOWL PLAGUE), NEWCASTLE DISEASE (AVIAN PNEUMOENCEPHALITIS), AFRICAN SWINE FEVER, AND HOG CHOLERA: PROHIBITED AND RESTRICTED IMPORTATIONS

Garbage

AGENCY: Animal and Plant Health Inspection Service, USDA.

ACTION: Final rule.

SUMMARY: This rule amends that section of Veterinary Services' regulations which was designed to control garbage, on or unloaded from certain means of conveyance arriving in the United States, that poses a threat of introducing injurious plant pests and livestock or poultry diseases. This amendment clarifies the intent of that section, amends the definitions of "Continental United States" and "United States," and makes certain editorial and style changes for clarity and ease of understanding.

EFFECTIVE DATE: September 8, 1978.

FOR FURTHER INFORMATION CONTACT:

Dr. James D. Roswurm, USDA, APHIS, VS, Federal Building, Room 819, Hyattsville, Md. 20782, 301-436-8499.

SUPPLEMENTARY INFORMATION: On June 30, 1978, the Animal and Plant Health Inspection Service published a proposed rule in the FEDERAL REGISTER (43 FR 28516-28517) proposing to amend § 94.5 of the regulations (9 CFR 94.5). Interested persons were given until July 20, 1978, to submit data, views, and arguments regarding the proposed rule. One comment, which was favorable to the proposal as written, was received, therefore, the proposed amendments to § 94.5 are hereby adopted without change as set forth below, except for reference to a footnote, which was inadvertently omitted.

It does not appear that further public participation in the rulemaking proceedings on these amendments would make additional information available to the Department. Therefore, under the administrative procedure provisions in 5 U.S.C. 553, it is found upon good cause that further notice and other public procedures concerning these amendments are unnecessary.

These amendments should be put into effect immediately in order to protect the United States from the introduction and dissemination of injurious plant pests and livestock or poultry diseases. Therefore, good cause is found for making the amendments effective less than 30 days after publication in the FEDERAL REGISTER.

Done at Washington, D.C., this 31st day of August 1978.

NOTE.—The Animal and Plant Health Inspection Service has determined that this document does not contain a major proposal requiring preparation of an inflation impact statement under Executive Order 11821 and OMB Circular A-107.

NORVAN L. MEYER,
Acting Deputy Administrator, Veterinary Services.

1. In § 94.5, paragraph (a) is amended to read:

§ 94.5 Garbage; regulations on storage and movement on certain means of conveyance.

(a) Garbage which is on or unloaded from any means of conveyance arriving in the places listed below is subject to general surveillance for compliance with this section by Animal and Plant Health Inspection Service inspectors and to such disposal measures as authorized by section 105 of the Federal Plant Pest Act (7 U.S.C. 150dd), section 10 of the Plant Quarantine Act of 1912, as amended (7 U.S.C. 164a), section 2 of the act of February 2, 1903, as amended (21 U.S.C. 111), and section 306 of the act of June 17, 1930, as amended (19 U.S.C. 1306), to prevent the dissemination of plant pests and livestock or poultry diseases:

(1) The United States from any place outside thereof (except garbage derived from stores obtained only in the continental United States or Canada on board vessels or aircraft that move solely between continental United States ports or between continental United States ports and Canadian ports);

(2) The continental United States from Hawaii or any territory or possession;

(3) Any territory or possession from any other territory or possession or from Hawaii; or

(4) Hawaii from any territory or possession.[3]

* * * * *

§ 94.5 [Amended]

2. In § 94.5(d), subparagraphs (7) and (8) are amended by inserting "the Northern Mariana Islands," immediately after "Guam," and before "Puerto Rico".

3. In § 94.5(d), a new subparagraph (9) is added to read as follows:

(d) * * *

(9) "Continental United States" means the 49 States located on the continent of North America and the District of Columbia.

(Sec. 106, 71 Stat. 33 (7 U.S.C. 150ee); secs. 8 and 9, 37 Stat. 318, as amended (7 U.S.C. 161, 162); sec. 102, 58 Stat. 735, as amended (7 U.S.C. 147a); sec. 306, 46 Stat. 689, as amended (19 U.S.C. 1306); sec. 2, 32 Stat. 792, as amended (21 U.S.C. 111); sec. 11, 23 Stat. 32, as added at 58 Stat. 734, as amended (21 U.S.C. 114a); 76 Stat. 663 (7 U.S.C. 450); secs. 101, 102, 83 Stat. 852, 853 (42 U.S.C. 4331, 4332); 39 FR 32319-32321; 37 FR 28464, 28477; 38 FR 19141.)

[FR Doc. 78-25432 Filed 9-7-78; 8:45 am]

[6351-01]

Title 17—Commodity and Securities Exchanges

CHAPTER I—COMMODITY FUTURES TRADING COMMISSION

PART 1—GENERAL REGULATIONS UNDER THE COMMODITY EXCHANGE ACT

Minimum Financial Requirements

AGENCY: Commodity Futures Trading Commission.

ACTION: Final rules.

SUMMARY: The rules (i) amend the minimum financial and related reporting requirements imposed upon futures commission merchants (FCM's) and change the computational formula used to determine whether a futures commission merchant meets the minimum financial requirements; (ii) establish an early warning system designed principally to give notice of a futures commission merchant's financial deterioration; and (iii) require all self-regulatory organizations under the jurisdiction of the Commodity Futures Trading Commission to adopt minimum financial and related reporting requirements with respect to their member futures commission merchants. The rules permit the responsibility for monitoring and auditing any FCM which is a member of more than one self-regulatory organization to be delegated to a single self-regulatory organization. The regulations are intended to accomplish the Commission's goal of establishing industry

self-regulation while (i) insuring adequate customer protection, (ii) safeguarding the integrity of the futures market system, (iii) increasing regulatory efficiency, (iv) eliminating the burden of undue multiple financial monitoring, auditing, and reporting imposed upon FCM's which are members of more than one self-regulatory organization, and (v) facilitating the development of a registered futures association under section 17 of the Commodity Exchange Act, as amended.

EFFECTIVE DATES: Amendments to §§ 1.3, 1.10, 1.17, and 1.18 and adoption of §§ 1.12 and 1.16—December 20, 1978; § 1.52 paragraphs (a) and (c) through (1)—January 31, 1979; § 1.52 paragraph (b)—June 30, 1979.

FOR FURTHER INFORMATION CONTACT:

John L. Manley, Chief Accountant, Division of Trading and Markets, Commodity Futures Trading Commission, 2033 K Street NW., Washington, D.C. 20581, 202-254-5218.

SUPPLEMENTAL INFORMATION: Notice is hereby given that the Commodity Futures Trading Commission has amended title 17, chapter I, part 1 of the Code of Federal Regulations to add new §§ 1.12, 1.16, and 1.52, and amend §§ 1.3, 1.10, 1.17, and 1.18 ("Minimum Financial Regulations"). In adopting these rules and rule changes, the Commission acted pursuant to the Commodity Exchange Act ("Act") and particularly sections 4c, 4f, 4g, 5a, 8a, 15, and 17 thereof. Before adopting the minimum financial regulations, the Commission considered all of the comments submitted which included comments from public participants in the futures markets, members of the futures industry, public accounting firms, professional associations, and each contract market.

I. INTRODUCTION

A. BACKGROUND

The Commission proposed in four parts substantial revisions to its financial regulatory structure applicable to FCM's and self-regulatory organizations. On October 6, 1976, the Commission proposed extensive revisions in the financial reporting requirements imposed upon FCM's under Commission regulations. 41 FR 45706 (October 15, 1976). On May 17, 1977, the Commission proposed substantial amendments to the minimum financial standards to which FCM's are subject under its regulation 1.17. 42 FR 27166 (May 26, 1977). On June 14, 1977, the Commission proposed an improved early warning system based upon the proposed amendments to its regulation 1.17. 42 FR 31740 (June 22, 1977). On July 27, 1977, the Commission proposed a regulation which would require each self-regulatory organization to adopt minimum financial and related reporting requirements with respect to its member FCM's and would permit the responsibility for monitoring and auditing the financial status of any FCM which is a member of more than one self-regulatory organization to be delegated to a single self-regulatory organization. 42 FR 39036 (August 1, 1977). In October 1977, the Commission held public hearings on these proposals.[1] In view of the extent and complexity of these proposed rules and to afford maximum opportunity for public comment on them, the Commission republished the proposals, as amended, and invited further public comment thereon for an additional 60 days. 43 FR 15072 (April 10, 1978).[2]

B. PURPOSE OF THE MINIMUM FINANCIAL REGULATIONS

The Commission finds that its responsibility to protect the integrity of the marketplace and the funds of customers who use that marketplace necessarily encompasses a duty to monitor developments in the commodity futures industry to determine whether the Commission's regulatory approach is adequate in light of recent and anticipated changes in the industry. The Commission believes that with the rapid and substantial increase in the number of registrants, the volume of commodity business that such registrants are doing, and the increased volatility of the futures markets in recent years, it is faced with the necessity of shifting its regulatory approach from direct regulation, relying primarily on direct auditing, to oversight regulation. In order to establish a structure under which oversight regulation may function effectively, the Commission has determined that substantial revisions to its regulations are necessary. The Commission further finds that to maximize the effectiveness of independent public accountants in this regulatory structure it is necessary to establish uniform computational criteria to determine the FCM's compliance with the Commission's minimum financial regulations.

In reaching the conclusion that this shift in regulatory approach is necessary, the Commission carefully considered a number of recommendations, including the recommendations of the Commission's staff. The Report of the Comptroller General of the United States to Congress on Improvements Needed in Regulation of Commodity Futures Trading (the "GAO Report")[3] recommended that the exchanges be delegated the primary responsibility for audits of FCM's and that the Commission "require FCM's to engage independent public accountants to make the required audits and to furnish reports on the results of these audits to the appropriate exchanges and to the Commission."[4] Similarly, the Commission's Advisory Committee on Commodity Futures Trading Professionals[5] recommended that the Commission "require that the yearend financial statements submitted by FCM's be certified by independent public accountants."[6] In addition, the Commission's Advisory Committee on Definition and Regulation of Market Instruments[7] recommended that any financial reports required of persons dealing in commodity option transactions and leverage transactions in gold or silver be certified annually by an independent public accountant.[8]

The Commission also finds that substantial revisions in the minimum financial regulations are necessary for reasons in addition to the need to change to an oversight role in the financial regulation of FCM's. At present the Commission, the Chicago Board of Trade (CBOT) and the Chicago Mercantile Exchange (CME) all have different requirements with respect to financial regulations and related reporting requirements of FCM's, and many FCM's are subject to more than one set of such requirements. In addition, over 50 FCM's, representing approximately 50 percent of all commodity customer business in the futures industry, are also registered with the Securities and Exchange Commission (SEC) as securities broker-dealers and are, therefore, subject to the minimum financial rules of that agency. As a result, many of these FCM's/broker-dealers are subject to as many as three different sets of financial regulations and corresponding audits to enforce these regu-

[1] In the matter of: Proposed Minimum Financial and Related Reporting Requirements, October 5 and 6, 1977.

[2] The comment period was subsequently extended for an additional 15 days. 43 FR 23729 (June 1, 1978).

[3] Report of the Comptroller General of the United States to Congress on Improvements Needed in Regulation of Commodity Futures Trading (June 24, 1975).

[4] Id., at 46.

[5] 40 FR 50558 (Oct. 30, 1975).

[6] Report of Commodity Futures Trading Commission Advisory Committee on Commodity Futures Trading Professionals (Aug. 5, 1976).

[7] 40 FR 50557 (Oct. 30, 1975).

[8] Report of the Advisory Committee on the Definition and Regulation of Market Instruments to the Commodity Futures Trading Commission: Recommended Policies on Commodity Option Transactions (July 6, 1976); Report of Advisory Committee on Definition and Regulation of Market Instruments to the Commodity Futures Trading Commission: Recommended Policies on Futures, Forward and Leverage Contracts and Transactions (July 16, 1976).

lations. The Commission finds that these duplicative financial and related reporting requirements impose unnecessary burdens upon FCM's; therefore, it is adopting revised minimum financial regulations that would establish uniform computational criteria for use in the commodities futures industry.

Another purpose for the revised financial regulations is to correct substantial deficiencies which have heretofore existed in the Commission's minimum capital rule. One such major deficiency has been that the computational criteria permitted FCM's to finance their operations almost exclusively with nonsubordinated, long-term debt; thus, an FCM could actually have been insolvent and have satisfied the Commission's rule as it existed prior to the revisions which the Commission is hereby adopting. Other deficiencies in the capital rule included the safety factors on open futures contracts, the definition of proprietary account, and the length of time unsecured deficits were allowed to be outstanding and be included as current assets. The safety factors for high-dollar value, low volatility, open futures contracts provided in regulation 1.17, were disproportionately high in terms of the risks involved in trading in such contracts compared to the safety factors on more volatile, low-dollar value contracts. The definition of the term "proprietary" as it was used in the minimum financial regulations resulted in unrealistic additional charges to capital of FCM's in relationship to the actual risk involved to these FCM's. Unsecured deficits were permitted to be outstanding up to 30 days and still be included as part of the firm's assets in calculating its capital position.

C. DELETION OF REFERENCES TO EXCHANGE-TRADED OPTIONS

The minimum financial regulations as proposed contained certain provisions relating to domestic exchange-traded commodity options. In view of the Commission's recently imposed restrictions with respect to transactions in commodity options and the fact that the Commission has not yet taken final action on the proposed regulations to govern domestic exchange programs for the trading of such options, reference to these options has been deleted from the regulations as adopted. The references to nontransferable commodity options have been retained.

In the event Congress authorizes exchange-traded commodity options, and rules are adopted relating to such options, the financial regulations as here adopted will be amended as necessary to reflect this development. Thus, in adopting the instant regulations, it is the Commission's intention to promulgate general financial provisions which may from time-to-time have to be amended to take into account specific developments (such as the initiation of exchange options programs) in the futures industry.

II. SECTION-BY-SECTION EXPLANATION AND DISCUSSION OF CERTAIN PORTIONS OF THE MINIMUM FINANCIAL REGULATIONS (INCLUDING, WHERE APPROPRIATE, COMMENTS THEREON)

A. § 1.3—GENERAL DEFINITIONS

§ 1.3(ff)—"DESIGNATED SELF-REGULATORY ORGANIZATION"

This term is defined to mean a self-regulatory organization ("SRO") of which a futures commission merchant is a member or, if the futures commission merchant is a member of more than one self-regulatory organization and such futures commission merchant is the subject of an approved plan under § 1.52, then a self-regulatory organization delegated the responsibility by such a plan for monitoring and auditing such futures commission merchant and for receiving the necessary financial reports as required pursuant to the minimum financial and related reporting requirements of the self-regulatory organizations. One contract market commented that the term "designated self-regulatory organization" should be defined to mean a self-regulatory organization which has been delegated responsibility pursuant to § 1.52 of these regulations.

This definition has been drafted to make it clear that if no cooperative plan is in effect pursuant to § 1.52 of these regulations, each self-regulatory organization of which the FCM is a member will have the obligations for requiring such FCM's compliance with its financial regulations; however, if such a plan is in effect, then these responsibilities will be delegated to one SRO. The Commission believes that this approach is necessary to ensure that if no cooperative plan is in effect, each SRO of which the FCM is a member will receive the necessary financial reports to carry out its obligations under these regulations. This approach, however, will permit the avoid- ance of duplicative reporting, auditing, and monitoring in the event a cooperative plan is adopted. Therefore, the Commission has determined to adopt the definition as proposed.

B. § 1.10—APPLICATION FOR REGISTRATION AND FINANCIAL REPORTS OF FUTURES COMMISSION MERCHANTS

§ 1.10(b)—FILING OF FINANCIAL REPORTS

A number of commentators felt that the CFTC and the SEC should agree upon one financial report and one net capital rule and designate a single regulator for each FCM/broker-dealer.

As was indicated in the FEDERAL REGISTER notices which accompanied the proposed amendments to § 1.17,[9] the Commission's staff and representatives of the SEC have initiated cooperative efforts in connection with their respective financial regulations. In part, as a result of such efforts, the Commission is, for example, incorporating by reference the SEC's safety factors or "haircuts" on securities. In addition, the Commission understands that the SEC's staff plans to recommend that its own Commission incorporate by reference the CFTC's safety factors on futures. If this step is taken, it will provide the requisite uniformity to permit those FCM's which are also registered with the SEC as securities broker-dealers to comply with the Commission's financial reporting requirements by simply filing copies of the SEC's FOCUS Report[10] with the self-regulatory organizations and the CFTC.[11] Inasmuch as it lacks the authority to enforce SEC regulations, the Commission does not believe that, consistent with its obligations under the Act, it could establish a program whereby this agency or the SEC would be delegated the sole regulator of an FCM/broker-dealer.

As proposed, § 1.10(b) would have required quarterly submission of a Form 1-FR by each person registered with the Commission as an FCM. While some of comments expressed support for this concept, the majority of commentators took the position that the requirement of four reports per year

[9] 42 FR 27168 (May 26, 1977), 43 FR 15076 (April 10, 1978).

[10] Financial and Operational Combined Uniform Single Report under the Securities Exchange Act of 1934.

[11] The Commission believes that, after these revisions are made, the few differences which might remain between its rule and that of the SEC would impact only those FCM's which also engage in a cash commodity, manufacturing or cooperative business/businesses in which few, if any, FCM/broker-dealers engage. In the case of each such difference of which the Commission is aware, the SEC's minimum financial requirements would be higher than the CFTC requirements; therefore, and FCM may be assured of compliance with the regulations of both agencies if it is in compliance with the SEC's. For example, under the Commission's proposed rule, unsecured receivables resulting from the marketing of commodities may, in certain circumstances, be included in an FCM's net capital; under the SEC's current rule, such receivables may not be so included. Therefore, provided the SEC amends its net capital rule as discussed above, if this difference should remain, an FCM/broker-dealer whose net capital satisfies the minimum requirements of the SEC would also satisfy those of the Commission in that net capital computed without including the unsecured receivables referred to above can never be greater than net capital computed by including such receivables.

was unnecessary, would be excessively costly to FCM's, and might serve to divert regulatory resources from firms experiencing financial difficulties to those in perfectly good financial standing.

In part, in response to the comments and consistent with its objective of shifting to an oversight role insofar as possible with respect to enforcement of the minimum financial regulations, the Commission has its regulations to permit each designated self-regulatory organization to determine the number of reports it receives from the FCM's that it regulates, so long as such organizations require at least two reports each year (at 6-month intervals) from each such FCM. The Commission believes that this approach is appropriate in light of the other surveillance and regulatory programs which have been established by self-regulatory organizations to govern their members. These programs include the daily monitoring of clearing member positions and the additional audits conducted by self-regulation organizations to determine their members' compliance with such organizations' rules. The quarterly reporting requirement has been retained with respect to those FCM's which are not members of any self-regulatory organization and subject only to the Commission's jurisdiction.

Pursuant to § 1.10(b) uncertified form 1-FR's must be filed within 45 days after the date for which the report is made. One commentator suggested that 45-day-old financial data might not be sufficiently current to form the basis of an effective regulatory system and that since most of the information required by form 1-FR must be prepared in conjunction with the required monthly capital computation,[12] a 30-day time period would not seem to be impractical. The Commission recognizes the virture of current financial reporting, and, in fact, originally proposed a 30-day period within which unaudited financial reports were to be filed. However, in response to numerous commentators who felt that this time frame was unduly burdensome the Commission amended its proposal,[13] and rather than return to its original proposal, the Commission has determined to retain the 45-day requirement. If, however, based upon experience with the minimum financial regulations, it becomes apparent that, because of the 45-day time period for filing financial information is not sufficiently timely to be used as intended the Commission may find it necessary to reduce the time within which unaudited financial reports may be filed.

§ 1.10(d)—CONTENTS OF FINANCIAL REPORTS

This section, among other things, describes the contents of various financial reports which must be submitted by an FCM.

One contract market noted in its comments that pursuant to this paragraph, FCM's will be required to submit a schedule of segregation requirements and funds on deposit in segregation in conjunction with their submission of financial statements. Designed self-regulatory organizations would, of course, receive these reports from their member or designated FCM's, and the commentator expressed the view that, because such organizations have no responsibility to enforce segregation requirements, (to which these reports pertain), they should not be required to verify the accuracy of these reports.

The Commission at present does not intend to require SRO's to enforce the Commission's segregation rules. However, since the information contained in the reports mentioned above is necessary to develop a statement of financial condition, the self-regulatory organizations will need such information to establish the FCM's compliance with the net capital requirements. Therefore, the Commission has determined to retain the requirements that FCM's submit this report to the designated self-regulatory organization.

Several commentators submitted their views with respect to the requirement of proposed § 1.10(d) which would have made it mandatory to file a quarterly statement of income (loss) with the Commission and the designated self-regulatory organization. In general, the comments were that the income statement would add an unwarranted expense for FCM's and could result in making confidential information concerning the operation of the firm available to the public.

As the section states, income statements will, except in certain specified circumstances, be treated as nonpublic by the Commission for purposes of the Freedom of Information Act and the Commission's rules promulgated thereunder.[14] With respect to the additional cost that might result from requiring FCM's to prepare quarterly income statements, the Commission has, in part, in response to the views, of the commentators, amended § 1.10(d) to eliminate all but the annual audited income statement, which the Commission believes is the minimum that can be required consistent with an effective regulatory program. Finally, the Commission wishes to emphasize that even though this section will become effective as of December 20, 1978, FCM's are not required thereby to submit income statements, certified or otherwise, for periods prior to the effective date of § 1.10.

It was further pointed out to the Commission that each certified form 1-FR filed pursuant to proposed § 1.10(d)(2), must contain certain financial statements which are not required to be included in the unaudited form 1-FR filed quarterly pursuant to proposed § 1.10(d)(1). Statements of changes in (1) financial position, (2) ownership equity, and (3) liabilities subordinated to claims of general creditors must be filed with the certified form 1-FR, but statements (2) and (3) above may be omitted from unaudited form 1-FR's. One commentator expressed the view that by requiring these two statements with the unaudited form 1-FR, the Commission's ability to monitor FCM's would be enhanced.

The Commission originally proposed that these two statements be included in the quarterly unaudited form 1-FR, and in response to the comments eliminated this requirement. However, in light of the further comments as to the value of the statement of changes in ownership equity and the fact that the inclusion of this statement would create no added burden for FCM's, since it is a reconciliation from the previous balance sheet (which would already have been prepared and filed as required under this section) to the current one, the final regulations will require (as originally proposed) the filing of this statement on a quarterly basis.

§ 1.10(f)—EXTENSION OF TIME FOR FILING FINANCIAL REPORTS

This section as proposed would have required that extension requests be

[12] § 1.18, 17 CFR 1.18.

[13] 42 FR 15076 (Apr. 10, 1978).

[14] The Freedom of Information Act, 5 U.S.C. 552, requires that the Commission make its records available upon request to members of the public, unless such records fall within any of the exemptions therein. Included among those exemptions are "trade secrets and commercial or financial information obtained from a person and privileged or confidential." 5 U.S.C. 552(b)(4). This language forms the basis upon which nonpublic treatment of income statements generally will be accorded. The Commission will shortly publish for comment proposed revisions to Form 1-FR and in that context will also propose necessary revisions to its Freedom of Information Act rules.

submitted to the Commission 15 days prior to the date that reports were due and provided that the Commission would respond to such requests within 10 days. Two commentators believe, among other things, that FCM's might not be in a position to determine, 15 days prior to the filing deadline whether they would require an extension. One commentator felt that the 15-day requirement might therefore provide an incentive for FCM's to file routinely (and possibly unnecessarily) for extensions to provide for unforeseen time delays. Another commentator expressed the view that the section should be amended to provide for an automatic stay upon application to the Commission for an extension of the time within which an FCM must file its financial reports.

The Commission agrees in part with these comments, and has amended the section as adopted to eliminate the 15-day requirement. It has further amended the section to provide that within 10 calendar days after receipt of the application for an extension of time the Commission shall: (i) Notify the applicant or registrant of the grant or denial of the requested extension; or (ii) indicate to the applicant or registrant that additional time is required to analyze the request, in which case the amount of time needed will be specified. In view of these amendments and the fact that the Commission intends to grant extensions under this section only in those rare situations where an applicant or registrant is able to demonstrate that undue hardship will be incurred in making a timely filing, the Commission does not believe that it would be appropriate to permit an automatic stay (upon application for extension) of the time for filing.

§ 1.10(g)—CONFIDENTIALITY OF REPORTS

As mentioned above, the section provides that income statements submitted pursuant to these regulations generally will be treated as nonpublic; however, three commentators felt that the provisions of the section were inadequate in that they failed to provide complete confidentiality for all financial data. The Commission disagrees. Section 1.10(g) is intended to implement the Freedom of Information Act, by permitting disclosure of information which by the terms of the FOIA is to be made public but generally providing for nonpublic treatment of financial information obtained which is entitled to exemption from mandatory disclosure under the Act.[15]

Another commentator wished to insure that independent accountants' reports regarding material inadequacies of FCM's internal control systems will also be deemed confidential if bound separately from the form 1-FR. The Commission, therefore, wishes to make clear its intention that such reports generally will be treated as nonpublic and considered "other statements and schedules" as provided in § 1.10(g).

C. § 1.12—MAINTENANCE OF MINIMUM FINANCIAL REQUIREMENTS BY FUTURES COMMISSION MERCHANTS

The early warning system set forth in § 1.12 (which replaces § 1.18(c)) is straightforward and does not, in general, require elaborate explanation. However, a brief clarification of certain aspects of the rule may prove helpful.

Initially, and perhaps most importantly, it should be pointed out that there would be no independent penalty for triggering the early warning system. In fact, in many instances, the occurrences which would trigger the provisions of § 1.12 would not constitute violations of the Act or any regulation thereunder. For example, under § 1.12(b), an FCM whose adjusted net capital drops below $150,000 ($75,000 for FCM's which are members of a self-regulatory organization) or 8⅓ percent of its aggregate indebtedness, but remains about $100,000 ($50,000 for member FCM's) and 6⅔ percent of its aggregate indebtedness (the minimum requirements of § 1.17), will be required to file notice of that fact with the Commission within 5 business days. However, the FCM would not be in violation of § 1.17, or any other Commission regulation, and no administrative sanction by the Commission would be possible. Further, when the early warning system is triggered by a violation of the Act or the regulations (e.g., when the FCM fails to maintain its books and records in a current status), prompt notification of the Commission in accordance with these regulations might be an indication that the FCM was attempting to comply with the regulations and could mitigate against the imposition of a sanction by the Commission in response to such violations.[16]

The fact that no independent penalty is provided for triggering the proposed early warning system is due to the basic nature and purpose of the system itself. In short, the system is designed to afford the Commission and the appropriate industry self-regulatory organizations sufficient advance notice of an FCM's problems to make possible such protective, or remedial as opposed to enforcement, action as may be needed to insure the safety of the FCM's customer's funds and the integrity of the marketplace. If, however, an FCM fails to give the notice requried by the proposed early warning system, effective protective action by the Commission and industry self-regulatory organizations may be precluded, and the risks to the FCM's customers and the futures market system may be increased. In such cases of failure to give notice, enforcement, as well as protective action would be appropriate. Accordingly, it is the Commission's intention to prosecute violations of the proposed early warning system vigorously.

§ 1.12(a)—NOTICE TO COMMISSION OF UNDERCAPITALIZATION

Pursuant to § 1.12(a) each FCM which knows or should have known that its adjusted net capital is at any time less than the minimum required by § 1.17, must give telegraphic notice of such fact to the Commission and the designated self-regulatory organization within 24 hours. And after giving such notice, the FCM must file certain financial statements with the Commission and the self-regulatory organization.

One contract market commented that the language "knows or should have known" is too harsh and should be changed to "knows or has reason to believe." The Commission wishes to point out that as originally proposed, this section would have been subject to the interpretation that a continuous determination of adjusted net capital would have been required. The present language amended the original proposal when the Commission republished its financial regulations for comment and makes clear that while the Commission does not intend to require continuous computations of adjusted net capital, it does expect FCM's to keep the necessary records and otherwise control the operation of their businesses so that they will be able to know when their adjusted net capital is below the minimum required by § 1.17. The Commission appreciates that pursuant to this requirement, those firms which may be close to falling below the minimum capital requirements will be required to make more frequent computations than those firms which are safely above such requirements, and believes that this result is consistent with the objective of attempting to insure the financial integrity of FCM's.

§ 1.12(c)—CURRENT BOOKS AND RECORDS REQUIREMENT

This paragraph requires notification of the Commission and the self-regulatory organization in the event an FCM

[15] See e.g., discussion supra with respect to general nonpublic treatment of income statements.

[16] However, the mere fact that an FCM notifies the Commission immediately upon the occurrence of such violations would not preclude the Commission from taking appropriate enforcement action against the FCM, especially in the face of repeated or intentional violations.

does not keep current books and records required by the Commission's regulations.

Two commentators felt that the word current should be defined in this paragraph. The Commission does not believe it necessary to define this term within the financial regulations. However, to provide some guidance for individuals working with these rules the Commission interprets this term to mean that the books and records of original entry should be maintained in a form which will facilitate: (i) Posting of the general ledger as frequently as necessary to enable the FCM to make the computations necessary to ascertain compliance with the net capital rule and the segregation requirements of the Act and the Commission's regulations, and (ii) the recall and availability of required information on a timely basis.

D. § 1.16—QUALIFICATIONS AND REPORTS OF ACCOUNTANTS

Pursuant to § 1.10 the initial form 1-FR filed by an applicant for registration as an FCM and the form 1-FR filed each fiscal year thereafter must be certified by an independent public accountant. Section 1.16 details qualifications required of such independent public accountants and sets certain guidelines which must be followed in the conduct of the examination of an FCM's form 1-FR.

Accountants who certify financial statements which are to be filed with the Commission must adhere to the standards the Commission promulgates for such filings, and failure to do so can lead to withdrawal of the accountant's right to practice before the Commission pursuant to 17 CFR Part 14. Any accountant who has been barred from practicing before the Commission pursuant to 17 CFR Part 14 for this or any other reason will not be considered a qualified accountant for purposes of § 1.16.

Accountants should be aware that in order to conduct a proper audit under these rules, they must be familiar with the Act and the rules and regulations of the Commission and in particular with the segregation requirements, the recordkeeping requirements, and the minimum financial regulations applicable to FCM's. The accountant must assure himself that the daily computations of the segregation requirements are being made in accordance with such requirements. In addition, the accountant must ascertain that the periodic computations of the minimum capital requirements are being done in accordance with § 1.17 and are being computed monthly in accordance with § 1.18. The Commission anticipates that it will selectively review the FCM audits conducted by independent public accountants to monitor compliance with the auditing standard set forth in § 1.16.

§ 1.16(b)(2)—QUALIFICATIONS OF ACCOUNTANTS

Among other things, § 1.16(b)(2) requires that public accountants performing audits of FCM's be independent and states that an accountant will not be considered independent if he or his firm or a member thereof performs manual or automated bookkeeping services or assumes responsibility for maintenance of the accounting records, including accounting classification decisions, of an applicant or registrant or any of its affiliates. Two commentators felt that this requirement was inappropriate in that the standards and guidelines maintained by the accounting profession (which the commentators thought were adequate) do not include such a provision and because, in the opinion of the two commentators, an accountant who assumes responsibility for maintaining an FCM's accounting records could be considered independent for the purposes of submitting a certified form 1-FR. The Commission notes, on the other hand, that the regulation is designed to prohibit situations in which the same accountant would be auditing the records which he has also prepared for the FCM. The Commission believes that this standard is reasonable and after considering the comments thereon, has determined to retain this prohibition in the final rule.

§ 1.16(c)(5)—ACCOUNTANT'S REPORT OF MATERIAL INADEQUACIES

This paragraph would require that the independent public accountant give the Commission and the self-regulatory organization(s) a report of any material inadequacies found in the FCM's internal control systems. One contract market commented that material inadequacies found by the accountant which have already been corrected by the firm should not be required to be reported; from a regulatory point of view inadequacies which have been identified and remain uncorrected, should be the focal point of concern, rather than those which have occurred in the past but which have been corrected. The commentator went on to say that a firm may require more than 5 business days after giving notice of material inadequacies to file a written report stating corrective measures which have been or will be taken. It was noted that a firm may not even be able to identify the cause of the inadequacy within this time frame and, moreover, might be hard-pressed to take corrective measures in so short a time. A time frame of 20 business days was therefore suggested.

The Commission believes, on the contrary, that material inadequacies which have already been corrected should nonetheless be reported because the agency and the self-regulatory organizations have an obligation in the interest of the customers of the FCM's to evaluate these corrective measures to insure that they are sufficient. With respect to the 5 business day requirement for corrective measures, the Commission appreciates the problems that firms might encounter in meeting this schedule for certain material inadequacies; therefore, it wishes to make clear that its primary interest is to be informed of such inadequacies and of the steps which are being taken to correct them. In the event that corrective measures are in progress or that such measures have to be altered subsequent to the 5 business days, the Commission would expect to be provided this information and to be informed of subsequent developments.

§ 1.16(e)(2)—EXTENT AND TIMING OF AUDIT PROCEDURES

This section, among other things, requires an independent accountant who determines that any material inadequacies exist in the accounting system of the FCM to call such inadequacies to the attention of the FCM. The firm, in turn, has the responsibility to bring such matters to the attention of the Commission and the designated self-regulatory organization.

One commentator expressed the view that this section should contain clear guidelines as to what will constitute the calling of an applicant's or a registrant's attention to the problems listed in § 1.16(e)(2). The commentator also felt that the section should be clarified to specify the standards to be used in determining material inadequacies in the areas of the accounting system, internal accounting controls, procedures for safeguarding customer or firm assets, or the general auditing objectives contained in the section.

After considering this comment, the Commission has determined to retain the language of the section as proposed. The Commission believes that it is appropriate to give the accountant discretion based upon the facts which are available to him. This would appear to be true because the accountant is the closest independent person to the situation, and he should have the latitude to make such determinations. Further, the Commission believes that rather than making any elaborate attempt to define each situation that might arise, it is more appropriate to develop on a case-by-case basis a body of opinion as to what constitutes a material inadequacy.

E. § 1.17—MINIMUM FINANCIAL REQUIREMENTS—FUTURES COMMISSION MERCHANTS

As proposed this section would have required each FCM to maintain adjusted net capital equal to or in excess of: (i) The greater of $150,000 ($50,000 for a member of a designated self-regulatory organization) or 6⅔ percent of aggregate indebtedness, or (ii) in the case of a registrant electing to operate pursuant to the alternate capital requirement the greater of $150,000 ($50,000 for a member of a designated self-regulatory organization) or 4 percent of the funds required to be segregated pursuant to the Act and these regulations plus, for securities brokers and dealers, 4 percent of the aggregate debit items computed in accordance with the formula for determination of the reserve requirements of the SEC. The Commission received numerous comments with respect to various aspects of this proposal.

Section 15 of the Act basically requires the Commission in adopting any regulation to consider the public interest to be protected by the antitrust laws and to endeavor to take the least anticompetitive means of achieving the objectives and purposes of the Act. Several commentators objected to the distinction between members and nonmembers in the proposal as being anticompetitive. These commentators were most concerned that the proposed higher adjusted net capital requirement of a $150,000 (vis-a-vis $50,000 for members) would drive small nonmember FCM's out of business and establish a substantial barrier to entry into the futures business.

On the other hand, many exchanges and exchange members commented that any net capital requirement which did not make such a distinction would place exchange members at a competitive disadvantage (because of the cost of membership and the dues and fees members pay for self-regulation). They further contended that the distinction would be an express recognition of the advantages to the public and to marketplace that results from contract market membership. Advantages cited by the commentators included: (i) The frequency of full financial audits performed by self-regulatory organizations; (ii) daily monitoring of clearing member positions; (iii) audits of FCM's to determine compliance with exchange margin requirements; (iv) the speed and flexibility of a self-regulatory organization compared to a Federal agency; and (v) the surveillance and other regulatory programs for monitoring compliance with exchange rules. The contract markets and their members also pointed out that member firms contribute further to the self-regulatory effort through the time and effort by their officers or principals devoted to serving on self-regulatory organization committees (e.g., business conduct committees), which are concerned with the compliance effort of self-regulatory organizations.

A number of commentators also stated their views concerning the appropriate minimum dollar level for adjusted net capital. Many commentators recommended a substantially higher minimum level than that proposed by the Commission while others thought the proposed level was too high.

The Commission has carefully considered each of these comments and finds that, due to the risk related to the business of being an FCM and the obligations which a firm assumes by virtue of its handling the funds of customers, a certain minimum level of capital must be maintained by an FCM. Further, even though comprehensive computational criteria are provided in the minimum financial regulations, there are many unforeseen risks which cannot be measured by a capital rule. In addition, after carefully considering its obligations under section 15 of the Commodity Exchange Act, the Commission has concluded that a distinction between contract market members and nonmembers in the minimum financial regulations is justified. The Commission recognizes that this distinction may have anticompetitive implications. However, section 15 does not require the Commission to take the least anticompetitive regulatory approach if the purposes and objectives of the Act would be better served in some other way. Section 4f(2) of the Act expressly contemplates that adequately financed FCM's are necessary in order to assure customer protection. For this purpose, the self-policing role of self-regulatory organizations is an important adjunct to Commission oversight of the FCM community and can serve to minimize the dangers to the public resulting from financially unstable FCM's. In this connection, the Commission notes that § 1.52 specifically will require self-regulatory organizations to exercise their self-regulatory authority over the FCM members, through the adoption and enforcement of rules, incorporating those of the Commission. However, in order to ameliorate the impact of the new regulation on nonmember FCM's, the Commission has narrowed the proposed difference to adjusted net capital between members and nonmembers. The regulations as adopted reduce the dollar minimum for nonmembers from $150,000 (as proposed) to $100,000. Further, the Commission has elected to phase in the $100,000 dollar minimum for nonmembers; therefore, until June 30, 1979, such minimum will be $50,000 and, thereafter, such minimum will be $100,000. The Commission intends to reevaluate the size of this differential from time to time to determine whether a further narrowing of the differential, or indeed a widening in the differential, is warranted.

In taking this step, the Commission has also determined to raise the levels at which an FCM would be required to report its financial condition on a monthly basis to the Commission and the self-regulatory organizations in accordance with § 1.12(b). This reporting requirement will now be triggered when the FCM's adjusted net capital falls below 150 percent (instead of 120 percent as proposed) of the appropriate minimum dollar requirements.

A substantial number of commentators objected to the provision of § 1.17(a) which required firms computing capital under the alternative capital rule to add 4 percent of commodity funds required to be segregated to 4 percent of aggregate debit items computed in accordance with SEC regulations.[17] The commentators felt that this provision would, in effect, require FCM/broker-dealers to have more capital than any other FCM's in the futures industry placing them at a competitive disadvantage. The Commission believes that this comment has merit and, accordingly, has amended the final version of this section to permit registrants operating under the alternate capital rule to maintain the greatest of the minimum dollar amount required, 4 percent of the funds required to be segregated, or 4 percent of aggregate debit items computed pursuant to SEC requirements.[18]

§ 1.17(A)(4)—PROCEDURES WHEN NOT IN COMPLIANCE WITH § 1.17

Regulation 1.17(a)(4) required a registrant which cannot demonstrate compliance with the requirements of § 1.17 to transfer immediately all customer accounts and cease doing business (except transactions for liquidation purposes). However, if such registrant immediately demonstrates to the satisfaction of the Commission or the designated self-regulatory organization the ability to get into compliance, the Commission or the designated self-regulatory organization may allow the registrant up to 10 days in which to do so without having to transfer accounts and cease doing business. This paragraph is intended to provide a specific procedure in the event a registrant fails to comply with the requirement

[17] 15c3-3, 17 CFR 240.15c3-3.

[18] The other sections of the minimum financial regulations which provide for FCM's operating under § 1.17(g) have been revised to make them consistent with this revision of § 1.17(a)(1). See §§ 1.12(b), 1.12(d), 1.17(e), 1.17(g), and 1.17(h).

of paragraph (a)(4), and is not intended to limit or preclude action by the Commission or the designated self-regulatory organization for violations of any of the provisions of § 1.17. Thus, for example, the Commission or the designated self-regulatory organization might deem it appropriate to take action against a registrant which has not been in compliance with the requirements of § 1.17 regardless of the fact that such registrant is able to get into compliance within 10 business days.

§ 1.17(b)(1)—REFERENCE TO SEC REGULATIONS

Section 1.17(b)(1) provides that where an asset or liability is defined in the SEC's regulations and is not specifically defined in the CFTC's regulations the inclusion or exclusion of all or part of such asset or liability from the net capital computation shall be in accordance with the SEC's regulations. One contract market commented that this provision should apply only to those FCM's which are also registered with the SEC as broker-dealers so that FCM's who are not so registered would not be confused or unduly restricted by requirements tailored to the securities industry. The Commission notes that firms which are registered only as FCM's may well have assets or liabilities defined in SEC regulations (e.g., common stock) and sees no reason not to defer to that agency in matters relating to areas of its expertise. Consequently, the Commission does not believe that reference to the SEC's regulations will create confusion for those firms which are registered only as FCM's; in fact, the Commission believes that there is a greater potential for confusion in not doing so. Therefore, the provision of this section is adopted as proposed.

One commentator felt that the word value as used in §§ 1.17(c)(1) (iii) and (iv) should be further explained to differentiate between long and short positions in nontransferable commodity options and unlisted security options. The commentator also stated that the examples provided in the proposed regulations relate to long positions only and should be expanded to encompass the value attributable to commodity and security options held short in the account of the FCM. The Commission wishes to make clear that the word value as used in these two sections is intended to refer to both long and short option positions. Thus, the term has reference to the valuation of a "liability" (e.g., in the case of a short in-the-money option position) as well as the valuation of an asset.

§ 1.17(c)(2)—DEFINITION OF CURRENT ASSETS

The provision of § 1.17(c)(2)(i) excludes from current assets in computing net capital any unsecured [19] commodity futures or options account containing a deficit or debit ledger balance except for those which are the subject of margin calls outstanding one business day or less. One commentator felt that this section should be amended to be consistent with § 1.17(c)(5)(viii) which would permit the application of calls of margin and other required deposits which are outstanding 5 business days or less until December 31, 1979; 4 business days or less until December 31, 1980; and 3 business days or less thereafter. The Commission notes that a deficit as referred to in paragraph (c)(2)(i) arises when the equity in an account is depleted to the point that a receivable results. It is the Commission's belief that the risks posed to the firm by accounts which liquidate to a deficit are substantially different than the risks posed by accounts which have fallen below maintenance margin requirements (thereby necessitating a call for margin), but in which some equity remains. It should be noted in this connection, that other commentators felt that the 1-day provision of paragraph (c)(2)(i) was overly generous in view of the risks to the firm posed by unsecured deficits. Thus, the Commission has decided to retain the 1-day provision with respect to these accounts as proposed.

One commentator suggested that § 1.17(c)(2)(i) be amended to indicate that only the "net deficit" is to be excluded from current assets. The Commission believes that the language of this section as drafted is sufficiently clear to so indicate.

Finally, with respect to the comments concerning § 1.17(c)(2)(i), one commentator felt that a statement should be added to the regulation which would prohibit an FCM from including in current assets, accounts which are, in essence, "recalled". The commentator felt that the regulation as proposd would allow an FCM to call for margin when an account liquidated to a deficit; and, for the first business day or less thereafter, such account would be considered a current asset. Should the account be liquidated, resulting in an unsecured debit ledger balance, and FCM could call for margin again (it was argued) and still consider such unsecured account as a current asset for the first business day or less thereafter. While the Commission does not believe that additional language in the regulation is necessary it wishes to make clear that the intent is not to permit a "recall" for margin to restart the time period provided in this section or §§ 1.17(c)(5) (viii) and (ix).

The language is § 1.17(c)(2)(ii)(A) as proposed would have excluded from current assets all unsecured receivables, advances, and loans, except for receivables resulting from the marketing of inventories commonly associated with the business activities of the FCM and advances on fixed price purchase commitments which are outstanding in excess of 75 days from the date that they arise. One commentator noted that normal and accepted accounting procedures "age" accounts receivable by the month in which the transaction occurred. The commentator further noted that for the firm to attempt to "age" a substantial number of active accounts from the actual date of the transaction would be an extremely difficult task. The Commission appreciates the problem which the commentator has raised and, accordingly, has amended this section to provide for exclusion of receivables outstanding beyond 3 calendar months from the date on which they are accrued.

The language of § 1.17(c)(2)(ii)(B) as proposed would have excluded from net capital interest receivable, floor brokerage receivable, commissions receivable from other brokers or dealers, mutual fund concessions receivable and management fees receivable from registered investment companies in commodity pools which had been outstanding more than 30 days from the date they had arisen. Two commentators pointed out that a literal reading of the regulation as proposed would cause interest receivable on notes and bonds that pay interest semiannually and other accrued income (in the categories set forth in the regulation) not yet due, to be deducted from net capital. This was not the intent of the Commission in proposing this regulation and accordingly the language in the final version has been revised to

[19] Regulation 1.17(c)(3) provides that a receivable may be considered "secured" for purposes of including that receivable in current assets where the receivable is secured by collateral which is otherwise unencumbered and which can be readily converted into cash equal to or in excess of that part of the receivable which is shown in the FCM's records as secured and where one of the following items is present: (a) The collateral is in the possession or control of the FCM; or (b) the FCM has a legally enforceable, written security agreement, signed by the debtor, and has a perfected security interest in the collateral within the meaning of the laws of the State in which the collateral is located. The question of which collateral is readily marketable or can be readily converted into cash should be determined on a case-by-case basis, although the following should not be considered as readily convertible into cash: real estate, buildings, furniture and fixtures, exchange membership, goodwill, prepaid items, and securities without a ready market.

provide that such receivables be excluded if they are outstanding more than 30 days from the date they are due rather than (as proposed) from the date they arise.

The Commission wishes to make clear, however, that in so revising this paragraph it does not intend to create a different standard from the standard utilized by the SEC in its regulations. It is the Commission's understanding, in this connection, that the language in the corresponding SEC regulations contain the "30 days from the date they arise" language, but that this language has been interpreted to mean "when due" in circumstances like the ones described by the commentators.

§ 1.17(c)(5)—SAFETY FACTORS

The safety factors on inventory, fixed price commitments, and forward contracts are set out in § 1.17(c)(5)(ii). One contract market recommended that receipted (registered) inventory which meets the contract specifications of the underlying futures be allowed at full market value (not subject to a safety factor) where the receipted inventory is fully "covered" by such futures. It was noted that such receipted inventory is specifically required to meet contract specifications and is readily available for delivery on futures contracts. Additionally, there is added assurance of deliverability from the registration and inspection requirements of the contract market which employs such a system.

The Commission believes that this comment has merit and, accordingly, has added a new subsection (A) to § 1.17(c)(5)(ii) to provide that no safety factor for the purpose of computing net capital be charged against inventory which is currently registered as deliverable and covered by an open futures contract. The subsequent sections under paragraph (c)(5)(ii) have been relettered accordingly.

Several commentators expressed the view that the safety factor provided in proposed § 1.17(c)(5)(ii) for inventory and forward contracts in foreign currencies that are "covered" by futures contracts was too high in relation to the risks associated with these positions. Based upon the information presently available to it, the Commission agrees with these commentators and has removed the safety factors for such positions, from the final regulation.

One commentator noted that under current SEC rules all Government National Mortgage Association positions, including futures, carry a 3 percent "haircut" on the net position, and if the 5 percent safety factor (on inventory) provided in § 1.17(c)(5)(ii) were charged to capital in addition to the 3 percent SEC charge, a totally unfair capital charge would result. The Commission wishes to make clear that for purposes of this section securities that are "haircutted" under SEC regulations are not to be counted as inventory. Thus, there will be a double "haircut" or safety factor.

Under § 1.17(c)(5)(vi) the safety factor to be used by an applicant or registrant in computing adjusted net capital in the case of securities options is the same as that specified in appendix A of the SEC's net capital rule (15c3-1, 17 CFR 240.15c3-1). One commentator noted that all FCM's engaged in market making or specialist activities in securities options would be subject to the provisions of subparagraph (A)(6) or (C)(2)(x), and not appendix A of the SEC's net capital rule. Accordingly, it was suggested that the CFTC regulations be revised to incorporate the applicable deductions specified in the SEC's rule and that a reference to appendix A be deleted. Paragraph (c)(5)(vi) is included in § 1.17 primarily for those FCM's purchasing or selling options for speculative or cover purposes rather than for market makers. The Commission believes that the situation referred to by the commentator is adequately provided for in the CFTC financial regulations as currently drafted and refers the commentators to § 1.17(b)(1) which states that in the case of an asset or liability defined in the SEC net capital rule (15c3-1, 17 CFR 240.15c3-1) all or part of such asset or liability shall be included or excluded for purposes of computing adjusted net capital and aggregate indebtedness in accordance with such rule unless specifically stated otherwise in § 1.17. The commentator is further directed to § 1.17(c)(5)(xiv) which states that for securities broker-dealers the deductions specified in rule 15c3-1 (17 CFR 240.15c3-1) are applicable. In consideration of the above, the Commission has determined to adopt § 1.17(c)(5)(vi) as proposed.

The Commission has received a number of comments with respect to § 1.17(c)(5)(viii) which requires a safety factor for under-margined customer futures accounts to the extent of the amount of funds required in each such account to meet the maintenance margin requirement of the applicable board of trade after application of calls for margin or other required deposits which are outstanding 5 business days or less until December 31, 1979, 4 business days or less until December 31, 1980, and 3 business days or less thereafter.

A number of commentators disagree with the scaling down of the length of time margin calls would be allowed to remain outstanding before a charge is made to net capital. While these commentators generally support the 5-day requirement, they believe the transition to 3 days is too severe and would not allow sufficient time for firms to collect margins through the mails. In part, in response to these commentators and to insure that the futures industry and, where applicable, the banking industry has ample time in which to perfect the capability to comply with this requirement, the Commission has lengthened the time for phasing in the reduction in the number of days for the collection of margin. Thus, margin could remain uncollected before a charge is made to net capital for up to 5 business days until December 31, 1980, 4 business days until December 31, 1982, and 3 business days thereafter.

Based upon the comments received in response to this section (§ 1.17(c)(5)(viii)), it is apparent that some commentators may not be entirely clear as to the appropriate method for counting days provided in this section. While the Commission believes the language of the regulation is sufficiently clear, it wishes to provide the following example of how such counting would be done. On Monday, market action occurs against a customer position, which results in a determination that the customer's account is under-margined, and the margin call must be sent on Tuesday. In this situation, Wednesday would be the first day the margin call would be outstanding; Thursday would be the second day; Friday the third; the following Monday the fourth; and the following Tuesday would be the fifth day. Thus, if no margin were received by the close of business on the second Tuesday, the firm would be required (on that day) to make a charge to capital. In this example, if the margin call were not made until Thursday, the firm would still be required to make a charge to capital if the funds are not received by the close of business on the second Tuesday. Of course, if a margin call is not made, a charge to capital for the under-margined amount is made immediately.

One contract market pointed out that, generally, FCM's are not accustomed to "aging" calls for margin. The commentator went on to state that it had discussed the length of time necessary to allow for reprograming the firm computers and service bureaus and had found that the necessary programs can probably be completed within 3 months. It was urged that the Commission take this time period into account when considering the promulgation of any final rule. The Commission has done this and is hereby adopting the minimum financial regulations but postponing their effective date until December 20, 1978.

Pursuant to § 1.17(c)(5)(ix) a safety factor charge to capital would be required for omnibus and noncustomer accounts to the extent that they are under-margined in excess of 2 days. The Commission received two comments in response to this section. The first comment was from an FCM which felt that omnibus accounts should be included within § 1.17(c)(5)(viii) (customer under-margined safety factors) and thereby given a longer period of time to allow margin to go uncollected before a charge is made to net capital. The second comment from a contract market which expressed the view that a call for margin, with respect to these types of accounts, should be permitted to be outstanding for no more than 1 day before a charge to the firm's net capital would be required. The contract market based its view on the belief that a clearing member's settlements with his correspondent should be no slower than his settlements with clearing associations. In view of these conflicting comments and its own belief that the 2-day requirement as proposed is a reasonable one, the Commission has determined to adopt the regulation as proposed.

The provisions of § 1.17(c)(5)(x) require certain reductions from net capital for proprietary futures held by the FCM which are not "covered" (as defined in § 1.17(j)). Three contract markets commented that the concept of covered transactions in the provisions governing safety factors on open futures contracts held in proprietary accounts should be expanded to include straddles, spreads, and arbitrage transactions; because, this would take into account the reduced risks associated with such transactions. The Commission wishes to point out that this paragraph is keyed to the margin requirements of the contracts markets; therefore, if an exchange wished to recognize the reduced risks of such transactions by lowering its margin requirements, it would be free to do so.

It should be noted that one exchange felt that it would be impractical to expect clearing organizations to lower margin requirements regarding these positions; since it is virtually impossible to monitor positions on other exchanges on a daily basis, which would be necessary in order for the clearing organizations to lower their margin requirements to recognize such transactions. On the contrary, the Commission believes than an exchange may, in its rules, provide for special recognition of these transactions in the margin calculation, and require their members as a condition for such special margin treatment, to provide the necessary information to monitor straddles, spreads, and arbitrage transactions, in other markets. Based upon the foregoing, the Commission is not inclined at present to amend its definition of the term "cover".

§ 1.17(c)(6)—AGGREGATE INDEBTEDNESS

The language of § 1.17(c)(6) defines the term aggregate indebtedness. Two contract markets urged the Commission to exclude noncustomer accounts from the definition of aggregate indebtedness. It was argued that these funds served to protect the customers of the firm and that their inclusion in aggregate indebtedness would be detrimental to the financial strength of the industry. It was also argued that these accounts would be moved to other firms (thereby becoming customer segregated funds on the books of those other firms) to avoid the additional capital charge that would be made necessary if such accounts were included in the FCM's own liabilities.

The Commission believes that since these funds in noncustomer accounts are not segregated and are clearly debt of the firm, there is no justification to exclude such funds from the definition of aggregate indebtedness. It should also be noted, that transfers of accounts (as described above) might create additional expenses for the FCM's and this factor could serve as a counter-incentive with respect to such transfers. Therefore, after considering these comments, the Commission has determined to adopt the regulations as proposed.

§ 1.17(d)—DEBT-EQUITY RATIO

As set forth in proposed § 1.17(d) an FCM was not to permit the total amount of its satisfactory subordination agreements to exceed 70 percent of its debt-equity total, as defined. Several commentators took the position that it would be inappropriate to penalize a firm that maintains capital in the form of satisfactory subordination agreements, which is in excess of the minimum required by the regulations. The Commission believes this comment has merit. Accordingly, the language in this section has been revised to provide that the required debt-equity total means equity capital (as defined) including the outstanding principal amount of satisfactory subordination agreements meeting the requirements of equity capital less the excess of the applicant's or registrant's adjusted net capital over the minimum required by (and computed in accordance with) § 1.17.

§ 1.17(e)—WITHDRAWAL RESTRICTIONS ON EQUITY CAPITAL

For purposes of calculating net capital of an FCM which does business as a partnership, the proposed regulations would have excluded the commodity and securities trading accounts of partners from the equity of the partnership. Some of the contract markets and FCM's took the position that this regulation could have a very detrimental impact upon partnership FCM's which hold sizable amount of their equity in the form of partners' trading accounts. They stated that since the equity contained in such trading accounts is available to satisfy the claims of general creditors of an FCM, it should be given the same treatment as capital invested in firm trading accounts for purposes of the minimum financial requirements.

The Commission believes that these comments have merit and has amended the final regulation as adopted to permit partners to include their trading accounts in partnership capital. However, if an FCM chooses to include partnership trading accounts in firm capital, the regulations require the partnership trading accounts to be considered as equity capital for all purposes of the financial regulations including the withdrawal restrictions on equity capital in § 1.17(e).

§ 1.17(h)—SATISFACTORY SUBORDINATION AGREEMENTS

The content of § 1.17(h) details the requirements for satisfactory subordination agreements. Two commentators felt that nonbroker-dealer FCM's should be permitted to use warehouse receipts as security for secured demand notes. While the Commission feels that this comment possibly has merit, it does not feel that the commentators provided sufficient information to form the basis for making changes in the section as proposed. However, as experience with the financial regulations is grained and/or in light of further information, the Commission is willing to consider this suggestion further with a possible view to later amendment of the financial regulations. For the present, it seems desirable to promulgate the financial regulations as proposed and avoid possible delay in their implementation pending resolution of this matter.

Several commentators raised questions with respect to § 1.17(h)(3)(vi) concerning the filing requirements for proposed subordination agreements. The commentators held differing opinions on this subject, and after considering their comments, the Commission has determined to adopt the section largely as proposed. There has, however, been one revision to make it clear, consistent with the Commission's philosophy of assuming an oversight role with respect to enforcement of financial regulations for members of self-regulatory organizations, that proposed subordination agreements are to be submitted to and examined by either the Commission or the designated self-regulatory organization. Thus, in the case of FCM's which are members of designated self-regulatory organizations, a satisfactory subordination agreement would be one which the designated self-regulatory organization has found acceptable and which has become effective in the form found acceptable. It should be noted, that in no event could such subordination agreements contain provisions which are contrary to the Act or the regulations thereunder.

Pursuant to § 1.17(h)(4) a registrant is permitted (under certain circumstances to utilize "debt" in computing its net capital which is not subordinated debt meeting the requirements of § 1.17(h).

This exemption is to permit an applicant whose net capital is less than the required minimum (under these regulations or the applicable rules of the designated self-regulatory organization) to provide for an infusion of new funds in the form of non-subordinated debt.[20] One commentator expressed the view that this objective was not entirely clear from the language of the proposed rules. The Commission believes this comment has merit and has, therefore, added clarifying language to § 1.17(h)(4).

F. § 1.18—RECORDS FOR AND RELATING TO FINANCIAL REPORTING AND REQUIRED MONTHLY COMPUTATION

This section has been revised to provide a new § 1.18(b) which requires each applicant or registrant to make and keep as a record in accordance with § 1.31, formal computations of its adjusted net capital and of its minimum financial requirements pursuant to § 1.17 as of the close of business each month. Some commentators objected to the monthly requirement on the basis of cost. The Commission believes that it is imperative that an early warning system be established in the commodity futures industry, and it further believes that the monthly computations provide the basis for the early warning system proposed in § 1.12. It should be pointed out, in this context, that the Commission previously amended § 1.18 (as proposed) in response to comments received following initial publication of this regulation by extending the time within which the monthly computations were to be completed from 10 business days to 30 calendar days.[21]

G. § 1.52—SELF-REGULATORY ORGANIZATION ADOPTION AND SURVEILLANCE OF MINIMUM FINANCIAL REQUIREMENTS

This section requires all self-regulatory organizations to adopt minimum financial and related reporting requirements with respect to their member FCM's. The regulation also permits the responsibility for monitoring and auditing an FCM which is a member of more than one self-regulatory organization to be delegated to a single self-regulatory organization.

The Commission wishes to emphasize that in order for a plan (delegating regulatory responsibility pursuant to § 1.52(b)) submitted by two or more self-regulatory organizations to be approved, it would not be necessary for that plan to cover all FCM's which are members of more than one of these self-regulatory organizations. For example, assume that self-regulatory organizations A and B have 25 members in common, 5 of which are also members of self-regulatory organization C. If agreements could be reached between A and B on only 15 of their 25 joint members, and among A, and B, and C for only 3 of their 5 members in common, then a plan could be submitted covering those 18 FCM's on which agreement was reached. In addition, if self-regulatory organization C would not agree to a plan for the delegation of responsibility for the two remaining FCM's it has in common with A and B, but A and B could agree on such a plan, then self-regulatory organizations A and B could submit their plan for those two FCM's.

One contract market expressed the view that, even in light of the delegation provision of § 1.52, because of the relationship between the contract market and the clearing organization, each exchange must retain its right to review its members on a nonroutine basis. It was pointed out, for example, that this relationship gives rise to financial risks to a contract market in the event a member firm fails to meet its obligation to the clearing organization. The Commission agrees with this comment but notes that one objective of the minimum financial regulations is to eliminate unwarranted duplication of regulation. Accordingly, the Commission intends to monitor this area to insure that self-regulatory organizations do not abuse their positions by unduly subjecting their membership to multiple regulation.

One contract market suggested that in light of the self-regulatory requirements to be imposed pursuant to § 1.52, exchanges should be permitted to charge surveillance fees of their members who do not adequately support such contract market through business conducted thereon. The Commission expects that the cost of surveillance will be allocated among self-regulatory organizations in accordance with the plans for establishing designated self-regulatory organizations. The Commission, of course, would expect self-regulatory organizations to fund their surveillance programs as necessary, and this might include the charging of fees to their members. The Commission does not believe that this practice would be inconsistent with the requirements of the Act and the regulations thereunder, provided such fees are reasonably related to the services provided and do not discriminate to an unjustifiable degree among categories of an exchanges' members.

Another contract market suggested that § 1.52 be amended to provide that responsibility for administering a joint enforcement or auditing program may be delegated to any type of responsible organization. The regulation, as adopted, does not preclude self-regulatory organizations from cooperating to utilize the services of a single auditing group or CPA firm. Similarly, the self-regulators would be free to establish a centralized surveillance or monitoring program. The Commission, however, wishes to emphasize that such joint efforts cannot shift the responsibility of insuring enforcement of a designated self-regulatory organization's rules, and cannot alter such organization's obligations under the financial regulations. Only a delegation, in accordance with a plan submitted to and approved by the Commission pursuant to § 1.52, to another contract market or a registered futures association under section 17 of the Act may relieve a contract market of its affirmative action responsibilities for enforcement of its minimum financial regulations.

One exchange again expressed the view that the Commission lacks the authority to require a contract market to adopt and enforce financial and related reporting requirements for its FCM members. Basically, the exchange contended that § 1.52 is: (1) Contrary to the provisions of sections 4f(2) and 5a(9) of the Act, (2) beyond the Commission's general rulemaking authority conferred by section 8a(5) of the Act, and (3) inconsistent with the letter and spirit of section 8a(7) of the Act. The Commission disagrees.

Section 8(a)(5) of the Act broadly empowers the Commission to make and promulgate such rules and regulations as in the Commission's judgment "are reasonably necessary to effectuate any of the provisions or to accomplish any of the purposes of (the) Act." The exchange asserts that this provision is simply procedural in nature and does not provide independent authority for the promulgation of substantive regulations such as rule 1.52. To the contrary, section 8a(5) enables the Commission not only to adopt regulations to effectuate a particular statutory provision but also to impose requirements to accomplish the Act's purposes even in the absence of a specific statutory source.[22]

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[20] See 43 FR 15072, at 15076 (Apr. 10, 1976)

[21] See 43 FR 15072, at 15080 (Apr. 10, 1978).

[22] See *Ames* v. *Merrill Lynch*, 567 F. 2d 1174, 1177-8 (2d Cir. 1977). See also *Board of Trade Clearing Corporation* v. *United States*, Comm. Fut. L. Rep. (CCH) ¶20,534, pp. 22,206-22 207 (D.D.C. 1978), appeal pending, No. 78-1263 (D.C. Cir. 1978).

A fundamental purpose of the Act is to protect the national public interest in transactions involving contracts for the future delivery of a commodity. Section 3 of the Act, 7 U.S.C. 5. For this purpose, the Act imposes certain requirements both on boards of trade which wish to provide a marketplace for trading commodity futures contracts and futures commission merchants who solicit and accept customer funds for trading. For example, sections 4 and 4h of the Act provide that futures trading may lawfully take place only through the facilities of boards of trade that the Commission has designated as contract markets. Under section 5(g) of the Act, designation may only be achieved if the board of trade demonstrates that trading in the commodity for which designation is sought will not be contrary to the public interest. Futures commission merchants are required to be registered with the Commission and to refrain from fraudulent conduct in executing customer orders. Sections 4b and 4d(1) of the Act.

The Act specifically seeks to protect the public from financially irresponsible futures commission merchants who handle customers funds. Section 4d(2) requires that futures commission merchants segregate customer funds from the funds of the firm. And, to assure that future commission merchants have adequate capital resources, section 4f(2) expressly empowers the Commission to prescribe minimum financial requirements for futures commission merchants as a condition to registration. That section further provides that the financial requirements imposed by the Commission will be considered met if the futures commission merchant is a member of a contract market and conforms to those financial standards and related reporting requirements set by contract market rules that have been approved by the Commission as adequate to effectuate the purposes of section 4f(2). Under section 5a(9) of the Act, the contract market is required to enforce these rules.[23] Thus, section 4f(2) explicitly contemplates that contract markets have a role to effectuate the public interest considerations to be served by assuring the financial responsibility of FCM's.

The exchange suggests that since section 4f(2) permits contract markets to impose financial standards on their member FCM's, the Commission may not require contract markets to do so. But this interpretation implies a limitation on the Commission's power that is contrary to the express provisions of section 8a(5). As institutions operating under the aegis of federal law, contract markets have not only the responsibilities made explicit by the Act, but are required to comply with those which the Commission imposes as necessary to effectuate the purposes of the Act. Thus, § 1.52 will further the Act's express purposes of assuring that FCM's remain financially sound by requiring that contract markets monitor and enforce against their members exchange rules incorporating the Commission's financial requirements.[24] As the Commission has stated previously:

> The most important theoretical basis for exchange self-regulation is that exchanges can move more promptly and more effectively in certain situations than can an agency of the Government.[25]

The exchange also argued that adoption of § 1.52 would be inconsistent with section 8(a)(7) of the Act. That section empowers the Commission to alter or supplement the rules of any contract market under certain conditions. The exchange contends that since its present financial rules have been approved by the Commission under section 4f(2), the Commission in effect would be attempting by rulemaking to alter existing contract market rules and to supplement other contract market rules without complying with the procedural requirements set forth in section 8a(7). However, Commission approval of a rule of a particular contract market, whether under section 4(f)(2) or under section 5(a)(12), does not preclude the Commission in the future from adopting a rule applicable to all contract markets which would impose additional or different requirements than those set forth in the exchange rule that the Commission had previously approved. To view the matter differently would subordinate the Commission's general rulemaking authority to that of the governing board of a single exchange whose judgment may differ from that which the Commission may subsequently make in discharging its responsibilities under the Act.

Timing of Implementation of the Minimum Financial Regulations

The Commission has received a number of comments with respect to a timetable for implementing the financial regulations, and after carefully considering all such comments has determined that the following schedule for such implementation will be followed.

December 20, 1978—Effective date of §§ 1.3, 1.10, 1.12, 1.16, 1.17, and 1.18. This will mean that all FCM's with a fiscal year end coinciding with the calendar year will have to file certified financial statements as of December 31, 1978.

January 31, 1979—Effective date for all of § 1.52 except paragraph (b). This will mean that all self-regulatory organizations must submit minimum financial and related reporting rules to the Commission for approval on or before January 31, 1979.

March 31, 1979—Commission target date for approval of regulations submitted by self-regulatory organizations and all self-regulatory organization plans for delegation of responsibility of FCM's who are members of more than one SRO to one designated SRO. § 1.52.

June 30, 1979—Effective date for paragraph (b) of § 1.52. Self-regulatory organizations plans and regulations must be effective.

In consideration of the foregoing, the Commission hereby amends 17 CFR Part 1 as follows:

1. By amending § 1.3 to include new paragraphs (ee) and (ff) to read as follows:

§ 1.3 Definitions.

* * * * *

(ee) *Self-regulatory organization.* This term means a contract market (as defined in § 1.3(h)), or a registered futures association under section 17 of the Act.

(ff) *Designated self-regulatory organization.* This term means a self-regulatory organization of which a futures commission merchant is a member or, if the futures commission merchant is a member of more than one self-regulatory organization and such futures commission merchant is the subject of an approved plan under § 1.52, then a self-regulatory organization delegated the responsibility by such a plan for monitoring and auditing such futures commission merchant for compliance with the minimum financial and related reporting requirements of the self-regulatory organizations of which the futures commission merchant is a member, and for receiving the financial reports necessitated by such minimum financial and related reporting requirements from such futures commission merchant.

2. By revising § 1.10 to read as follows:

§ 1.10 Application for registration and financial reports of futures commission merchants.

(a) *Application for registration.* (1) Application for registration as a futures commission merchant shall be

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[23] Contract market rules adopted under § 1.52 are to be submitted for Commission approval under section 4f(2). Upon approval the contract market would be required to enforce the rules in accordance with section 5a(9). Futures association rules would also be submitted for Commission approval and enforced under section 17 of the Act.

[24] As contemplated by section 4f(2), rule 1.52 permits contract markets to impose additional requirements on their members, subject to Commission approval.

[25] Commission guideline II, CCH, Comm. Fut. L. Rep. ¶ 20,042.

filed on form 7-R in accordance with the instructions contained therein. The initial application for registration shall be accompanied by a form 8-R executed and filed by each sole proprietor and by each natural person who is a general partner, officer, director, or branch office manager of the applicant, or who performs similar functions, or is any other controlling person of the applicant; except that an accompanying form 8-R need not be filed by an individual who is registered as a floor broker or an associated person or has applied for registration as a floor broker or an associated person and such application has not been withdrawn or denied. Any natural person (other than a floor broker or associated person) who subsequently becomes a general partner, officer, director, or branch office manager of the registrant, or performs similar functions, or becomes any other controlling person of the registrant, shall promptly execute and file a form 8-R. Each form 8-R shall be filed in accordance with the instructions contained therein. Individuals who were previously required to submit biographical information on form 94 or who have filed a form 8-R as required by this section shall file a current form 8-R, upon request by the Commission.

(2) Except as provided in paragraph (a)(3) of this section, each person who files an application for registration as a futures commission merchant, and who is not so registered at the time of such filing, must, concurrently with the filing of such application file either: (i) A form 1-FR certified by an independent public accountant in accordance with § 1.16 as of a date not more than 45 days prior to the date on which such report is filed, or (ii) a form 1-FR as of a date not more than 45 days prior to the date on which such report is filed and a form 1-FR certified by an independent public accountant in accordance with § 1.16 as of a date not more than 1 year prior to the date on which such report is filed. Each such person must include with such financial report a statement describing the source of his current assets and representing that his capital has been contributed for the purpose of operating his business and will continue to be used for such purpose.

(3) The provisions of paragraph (a)(2) of this section do not apply to any person succeeding to and continuing the business of another futures commission merchant. Each such person who files an application for registration as a futures commission merchant and who is not so registered at the time of such filing must file a form 1-FR as of the first monthend following the date on which his registration is approved. Such report must be filed with the Commission and the designated self-regulatory organization, if any, not more than 45 days after the date for which the report is made.

(b) *Filing of financial reports.* (1) Except as provided in paragraph (b)(3) of this section, each person registered as a futures commission merchant must file a form 1-FR for each fiscal quarter of each fiscal year unless the registrant elects pursuant to paragraph (e)(2) of this section to file a form 1-FR for each calendar quarter of each calendar year. Each form 1-FR must be filed no later than 45 days after the date for which the report is made: *Provided, however,* That any form 1-FR which must be certified by an independent public accountant pursuant to paragraph (b)(2) of this section must be filed no later than 90 days after the close of each registrant's fiscal year. This paragraph (b)(1) will be applicable to all fiscal quarters ending after the effective date of this section but in no event more than 90 days after such effective date.

(2) The form 1-FR filed pursuant to paragraph (b)(1) of this section as of the close of the registrant's fiscal year must be certified by an independent public accountant in accordance with § 1.16. A registrant who has elected to file its forms 1-FR for each calendar quarter of each calendar year pursuant to paragraph (e)(2) of this section, must nonetheless file a form 1-FR so certified as of the close of such registrant's fiscal year.

(3) The provisions of paragraphs (b)(1) and (b)(2) of this section may be met by any person registered as a futures commission merchant who is a member of a designated self-regulatory organization and conforms to minimum financial standards and related reporting requirements set by such designated self-regulatory organization in its bylaws, rules, regulations, or resolutions and approved after the effective date of these regulations by the Commission pursuant to section 4f(2) of the Act and § 1.52: *Provided, however,* That each such registrant shall promptly file with the Commission a true and exact copy of each financial report which it files with such designated self-regulatory organization.

(4) Upon receiving written notice from any representative of the Commission or any self-regulatory organization of which it is a member, an applicant or registrant must, monthly or at such times as specified, furnish the Commission and the self-regulatory organization, if any, requesting such information with a form 1-FR and/or such other financial information as requested by the representative of the Commission or the self-regulatory organization. Each such form 1-FR or such other information must be furnished within the time period specified in the written notice.

(c) *Where to file reports.* The reports provided for in this § 1.10 will be considered filed when received by the regional office of the Commission nearest the principal place of business of the applicant or registrant and by the designated self-regulatory organization, if any; *Provided, however,* That information required of an applicant or registrant pursuant to paragraph (b)(4) of this section need be furnished only to the self-regulatory organization requesting such information and the Commission.

(d) *Contents of financial reports.* (1) Each form 1-FR filed pursuant to this § 1.10 which is not required to be certified by an independent public accountant must be completed in accordance with the instructions to the form and contain: (i) A statement of financial condition as of the date for which the report is made; (ii) a statement of changes in ownership equity for the period between the date of the most recent statement of financial condition filed with the Commission (or the beginning of the fiscal quarter immediately following the effective date of this rule but in no event more than 90 days after such effective date) and the date for which the report is made; (iii) a statement of the computation of the minimum capital requirements pursuant to § 1.17 and a schedule of segregation requirements and funds on deposit in segregation, as of the date for which the report is made; and (iv) in addition to the information expressly required, such further material information as may be necessary to make the required statements and schedules not misleading.

(2) Each form 1-FR filed pursuant to this § 1.10 which is required to be certified by an independent public accountant must be completed in accordance with the instructions to the form and contain: (i) A statement of financial condition as of the date for which the report is made; (ii) statements of income (loss), changes in financial position, changes in ownership equity, and changes in liabilities subordinated to claims of general creditors, for the period between the date of the most recent certified statement of financial condition filed with the Commission (or the beginning of the fiscal year immediately following the effective date of this rule but in no event more than 1 year after such effective date) and the date for which the report is made: *Provided,* That for an applicant filing pursuant to paragraph (a)(2) of this section the period must be the year ending as of the date of the statement of financial condition; (iii) a statement of the computation of the minimum capital requirements pursuant to § 1.17

and a schedule of segregation requirements and funds on deposit in segregation, as of the date for which the report is made; (iv) appropriate footnote disclosures; and (v) in addition to the information expressly required, such further material information as may be necessary to make the required statements not misleading.

(3) The statements required by paragraphs (d)(2)(i) and (d)(2)(ii) of this section may be presented in accordance with generally accepted accounting principles in the certified reports filed as of the close of the registrant's fiscal year pursuant to paragraph (b)(2) of this section or accompanying the application for registration pursuant to paragraph (a)(2) of this section, rather than in the format specifically prescribed by these regulations: *Provided*, the statement of financial condition is presented in a format as consistent as possible with the form 1-FR and a reconciliation is provided reconciling such statement of financial condition to the statement of the computation of the minimum capital requirements pursuant to § 1.17. Such reconciliation must be certified by an independent public accountant in accordance with § 1.16.

(4) Attached to each form 1-FR filed pursuant to this § 1.10 must be an oath or affirmation that to the best knowledge and belief of the individual making such oath or affirmation the information contained in the form 1-FR is true and correct. If the applicant or registrant is a sole propreitorship, then the oath or affirmation must be made by the proprietor; if a partnership, by a general partner; or if a corporation, by the chief executive officer or chief financial officer.

(e) *Election of fiscal year.* (1) Any applicant or registrant wishing to establish a fiscal year other than the calendar year may do so by notifying the Commission and the designated self-regulatory organization, if any, of its election of such fiscal year in writing, concurrently with the filing of the form 1-FR pursuant to paragraph (a)(2) of this section or within 90 days of the effective date of this section, but in no event may such fiscal year end more than one year from the date of the form 1-FR filed pursuant to paragraph (a)(2) of this section or more than one year from the effective date of this regulation. An applicant or registrant which does not so notify the Commission and the designated self-regulatory organization, if any, will be deemed to have elected the calendar year as its fiscal year. A registrant must continue to use its elected fiscal year, calendar or otherwise, unless a change in such fiscal year is approved upon written application to the principal office of the Commission in Washington, D.C., and written notice of such change is given to the designated self-regulatory organization, if any.

(2) Any applicant or registrant may elect to file its form 1-FR for each calendar quarter in lieu of each fiscal quarter by notifying the Commission and the designated self-regulatory organization, if any, of its election, in writing, concurrently with the filing of the form 1-FR pursuant to paragraph (a)(2) of this section or within 90 days after the effective date of this section. Any registrant wishing to change such election or to make such election other than concurrently with the filing of the form 1-FR pursuant to paragraph (a)(2) of this section or within 90 days of the effective date of this section may do so only if such change or election is approved by the Commission upon written application to the principal office of the Commission in Washington, D.C., and written notice of such change is given to the designated self-regulatory organization, if any.

(f) *Extension of time for filing reports.* In the event any applicant or registrant finds that it cannot file its report for any period within the time specified in paragraphs (b)(1), or (b)(4) of this section or paragraph (b) of § 1.12 without substantial undue hardship, it may file with the principal office of the Commission in Washington, D.C., an application for an extension of time to a specified date which may not be more than 90 days after the date as of which the financial statements were to have been filed. The application must state the reasons for the requested extension and must contain an agreement to file the report on or before the specified date. The application must be received by the Commission before the time specified in paragraphs (b)(1), or (b)(4) of this section or paragraph (b) of § 1.12 for filing the report. Notice of such application must be given to the designated self-regulatory organization, if any, concurrently with the filing of such application with the Commission. Within 10 calendar days after receipt of the application for an extension of time, the Commission shall: (i) Notify the applicant or registrant of the grant or denial of the requested extension; or (ii) indicate to the applicant or registrant that additional time is required to analyze the request, in which case the amount of time needed will be specified. (See § 1.16(f) for extension of the time for filing certified financial statements.)

(g) *Nonpublic treatment of reports.* All of the forms 1-FR filed pursuant to this section will be public: *Provided, however,* That if the statement of financial condition, the computation of the minimum capital requirements pursuant to § 1.17, and the schedule of segregation requirements and funds on deposit in segregation are bound separately from the other financial statements (including the statement of income (loss)), footnote disclosures and schedules of form 1-FR, trade secrets and certain other commercial or financial information on such other statements and schedules will be treated as nonpublic for purposes of the Freedom of Information Act and part 145 of this chapter. All information on such other statements, footnote disclosures and schedules will, however, be available for official use by any official or employee of the United States or any State, by any self-regulatory organization of which the person filing such report is a member, and by any other person to whom the Commission believes disclosure of such information is in the public interest. Nothing in this paragraph (g) will limit the authority of any self-regulatory organization to request or receive any information relative to its members' financial condition, the independent accountant's opinion filed pursuant to this § 1.10 will be deemed pubic information.

3. By adopting a new § 1.12 to read as follows:

§ 1.12 Maintenance of minimum financial requirements by futures commission merchants.

(a) Each person registered as a futures commission merchant, or who files an application for registration as a futures commission merchant, who knows or should have known that its adjusted net capital at any time is less than the minimum required by § 1.17 or by the capital rule of any self-regulatory organization to which such person is subject, if any, must:

(1) Give telegraphic notice as set forth in paragraph (f) of this section that such applicant's or registrant's adjusted net capital is less than is required by § 1.17 or by such other capital rule, identifying the applicable capital rule. This notice must be given within 24 hours after such applicant or registrant knows or should have known that its adjusted net capital is less than required by any of the aforesaid rules to which such applicant or registrant is subject; and (2) within 24 hours after giving such notice file a statement of financial condition, a statement of the computation of the minimum capital requirements pursuant to § 1.17 (computed in accordance with the applicable capital rules), and a schedule of segregation requirements and funds on deposit in segregation, all as of the date such applicant's or registrant's adjusted net capital is less than the minimum required.

(b) Each person registered as a futures commission merchant, or who files an application for registration as a futures commission merchant, who knows or should have known that its adjusted net capital at any time is less than (1) the greater of 150 percent of the appropriate minimum dollar amount required by §1.17 or 8⅓ percent of aggregate indebtedness or (2) if the applicant or registrant is operating pursuant to §1.17(g), the greatest of 150 percent of the appropriate minimum dollar amount required by § 1.17(g), or 6 percent of the funds required to be segregated pursuant to section 4d(2) of the act and these regulations, or for securities brokers or dealers, 6 percent of aggregate debit items computed in accordance with the formula for determination of reserve requirements (§ 240.15c3-3 of this title); such applicant or registrant must file written notice to that effect as set forth in paragraph (f) of this section within five (5) business days of such event. Such applicant or registrant must also file a form 1-FR or such other financial statement designated by the Commission and/or the designated self-regulatory organization, if any, as of the close of business for the month during which such event takes place and as of the close of business for each month thereafter until three (3) successive months have elapsed during which the applicant's or registrant's adjusted net capital is at all times equal to or in excess of the minimums set forth in this paragraph (b) which are applicable to such applicant or registrant. Each financial statement required by this paragraph (b) must be filed within 30 calendar days after the end of the month for which such report is being made.

(c) If an applicant or registrant at any time fails to make or keep current the books and records required by these regulations, such applicant or registrant must, on the same day such event occurs, give telegraphic notice of such fact, specifying the books and records which have not been made or which are not current, and within 5 business days after giving such notice file a written report stating what steps have been and are being taken to correct the situation.

(d) Whenever any applicant or registrant discovers or is notified by an independent public accountant, pursuant to § 1.16(e)(2) of these regulations, of the existence of any material inadequacy, as specified in § 1.16(d)(2) of these regulations, such applicant or registrant must give telegraphic notice of such material inadequacy within 3 business days, and within 5 business days after giving such notice file a written report stating what steps have been and are being taken to correct the material inadequacy.

(e) Whenever any self-regulatory organization learns that a member registrant has failed to file a notice or written report as required by this § 1.12, such self-regulatory organization must immediately report such failure as provided in paragraph (f) of this section.

(f) Every notice and written report required to be given or filed by this section must be filed with the regional office of the Commission for the region in which the applicant or registrant has its principal place of business, with the designated self-regulatory organization, if any, and with the Securities and Exchange Commission, if such applicant or registrant is a securities broker or dealer. In addition, every notice required to be given by this section must also be filed with the principal office of the Commission in Washington, D.C. Each statement of financial condition, each statement of the computation of the minimum capital requirements pursuant to § 1.17, and each schedule of segregation requirements and funds on deposit in segregation required by this section must be filed in accordance with the provisions of § 1.10(d) of these regulations, unless otherwise indicated.

4. By adding a new § 1.16 as follows:

§ 1.16 Qualifications and reports of accountants.

(a) *Definitions*—(1) *Accountant's report.* The term "accountant's report," when used in regard to financial statements and schedules, means a document in which an independent licensed or certified public accountant indicates the scope of the audit (or examination) which he has made and sets forth his opinion regarding the financial statements and schedules taken as a whole or an assertion to the fact that an overall opinion cannot be expressed. When an overall opinion cannot be expressed, the reasons therefore must be stated.

(2) *Audit or examination.* The terms "audit" and "examination," when used in regard to financial statements and schedules, mean an examination of the statements and schedules by an accountant in accordance with generally accepted auditing standards for the purposes of expressing an opinion thereon.

(3) *Certified.* The term "certified," when used in regard to financial statements and schedules, means audited and reported upon with an opinion expressed by an independent certified public accountant or independent licensed public accountant.

(b) *Qualifications of accountants.* (1) The Commission will recognize any person as a certified public accountant who is duly registered and in good standing as such under the laws of the place of his residence or principal office. The Commission will recognize any person as a licensed public accountant who was duly licensed on or before December 31, 1970, and is in good standing as such under the laws of the place of his residence or principal office.

(2) The Commission will not recognize any certified public accountant or licensed public accountant as independent who is not in fact independent. For example, an accountant will not be considered independent with respect to any applicant or registrant or any parent, subsidiary, or other affiliate of such applicant or registrant (i) in which, during the period of his professional engagement to examine the financial statements and schedules being reported on or at the date of his report, he or his firm or a member thereof had, or was committed to acquire, any direct financial interest or any material indirect financial interest, or (ii) with which, during the period of his professional engagement to examine the financial statements and schedules being reported on, at the date of his report or during the period covered by the financial statements, he or his firm or a member thereof was connected as a promoter, underwriter, voting trustee, director, officer, or employee, except that a firm will be deemed independent with respect to an applicant or registrant and its affiliates if a former employee or officer of such applicant or registrant or any such affiliate is employed by the firm and such individual has completely disassociated himself from the applicant or registrant and its affiliates and does not participate in auditing financial statements and schedules of the applicant or registrant or its affiliates covering any period of his employment by the applicant or registrant or its affiliates. An accountant will not be considered independent if he or his firm or a member thereof performs manual or automated bookkeeping services or assumes responsibility for maintenance of the accounting records, including accounting classification decisions, of such applicant or registrant or any of its affiliates. For the purposes of this § 1.16(b), the term "member" means all partners in the firm and all professional employees participating in the audit or located in the office of the firm participating in a significant portion of the audit.

(3) In determining whether an accountant may in fact not be independent with respect to a particular applicant or registrant, the Commission will give appropriate consideration to all relevant circumstances, including evidence bearing on all relationships between the accountant and that applicant or registrant or any affiliate thereof, and will not confine itself to the relationship existing in connection with the filing of reports with the Commission.

(c) *Accountant's reports.*—(1) *Technical requirements.* The accountant's report (i) must be dated, (ii) must be signed manually, (iii) must indicate the city and State where issued and (iv) must identify without detailed enumeration the financial statements covered by the report.

(2) *Representations as to the audit.* The accountant's report (i) must state whether the audit was made in accordance with generally accepted auditing standards, and (ii) must designate any auditing procedures deemed necessary by the accountant under the circumstances of the particular case which have been omitted and the reasons for their omission. However, nothing in this paragraph (c)(2) shall be construed to imply authority for the omission of any procedure which independent accountants would ordinarily employ in the course of an audit made for the purposes of expressing the opinion required by paragraph (c)(3) of this section.

(3) *Opinion to be expressed.* The accountant's report must state clearly: (i) The opinion of the accountant with respect to the financial statements and schedules covered by the report and the accounting principles and practices reflected therein and (ii) the opinion of the accountant as to the consistency of the application of the accounting principles, or as to any changes in such principles which have material effect on the financial statements and schedules.

(4) *Exceptions.* Any matters to which the accountant takes exception must be clearly identified, such exceptions specifically and clearly stated, and to the extent practicable, the effect of each exception on related financial statements and schedules given.

(5) *Accountant's report on material inadequacies.* A registrant must file concurrently with the annual audit report a supplemental report by the accountant describing any material inadequacies found to exist or found to have existed since the date of the previous audit. An applicant must file concurrently with the audit report a supplemental report by the accountant describing any material inadequacies found to exist as of the date of the form 1-FR being filed. The supplemental report must indicate any corrective action taken or proposed by the applicant or registrant in regard thereto. If the audit did not disclose any material inadequacies, the supplemental report must so state.

(d) *Audit objectives.* (1) The audit must be made in accordance with generally accepted auditing standards and must include a review and appropriate tests of the accounting system, the internal accounting control, and the procedures for safeguarding customer and firm assets in accordance with the provisions of the Act and the regulations thereunder, since the prior examination date. The audit must include all procedures necessary under the circumstances to enable the independent licensed or certified public accountant to express an opinion on the financial statements and schedules. The scope of the audit and review of the accounting system, the internal controls, and procedures for safeguarding customer and firm assets must be sufficient to provide reasonable assurance that any material inadequacies existing at the date of the examination in (i) the accounting system, (ii) the internal accounting controls, and (iii) the procedures for safeguarding customer and firm assets (including the segregation requirements of section 4d(2) of the Act and these regulations) will be discovered. Additionally, as specified objectives the audit must include reviews of the practices and procedures followed by the registrant in making (*a*) periodic computations of the minimum financial requirements pursuant to § 1.17 and (*b*) daily computations of the segregation requirements of section 4d(2) of the Act and these regulations.

(2) A material inadequacy in the accounting system, the internal accounting controls, the procedures for safeguarding customer and firm assets, and the practices and procedures referred to in paragraph (d)(1) of this section which is to be reported in accordance with paragraph (e)(2) of this section includes any conditions which contributed substantially to or, if appropriate corrective action is not taken, could reasonably be expected to:

(i) Inhibit an applicant or registrant from promptly completing transactions or promptly discharging his responsibilities to customers or other creditors;

(ii) Result in material financial loss;

(iii) Result in material misstatement of the applicant's or registrant's financial statements and schedules; or

(iv) Result in violations of the Commission's segregation, recordkeeping or financial reporting requirements to the extent that could reasonably be expected to result in the conditions described in paragraphs (d)(2)(i), (ii), or (iii) of this section.

(e) *Extent and timing of audit procedures.* (1) The extent and timing of audit procedures are matters for the independent public accountant to determine on the basis of his review and evaluation of existing internal controls and other audit procedures performed in accordance with generally accepted auditing standards and the audit objectives set forth in paragraph (d) of this section. In determining the extent of testing, consideration must be given to the materiality of an area and to the possible effect on the financial statements and schedules of a material misstatement in a related account.

(2) If during the course of an audit or interim work, the independent public accountant determines that any material inadequacies exist in the accounting system, in the internal accounting control, in the procedures for safeguarding customer or firm assets, or as otherwise defined in paragraph (d) of this section, he must call such inadequacies to the attention of the applicant or registrant, who has the responsibility to inform the Commission and the designated self-regulatory organization, if any, in accordance with paragraph (d) of § 1.12. The applicant or registrant must also furnish the accountant with a copy of said notice to the Commission within 3 business days. If the accountant fails to receive such notice from the applicant or registrant within 3 business days, or if he disagrees with the statements contained in the notice of the applicant or registrant, the accountant must inform the Commission and the designated self-regulatory organization, if any, by reporting the material inadequacy within 3 business days thereafter. Such report from the accountant must, if the applicant or registrant failed to file a notice, describe the material inadequacies found to exist. If the applicant or registrant filed a notice, the accountant must file a report detailing the aspects, if any, of the applicant's or registrant's notice with which the accountant does not agree.

(f) *Extension of time for filing audited reports.* (1) In the event any applicant or registrant finds that it cannot file its certified financial statements and schedules for any year within the time specified in § 1.10 without substantial undue hardship, it may file with the principal office of the Commission in Washington, D.C., an application for extension of time to a specified date not more than 90 days after the date as of which the certified financial statements and schedules were to have been filed. Notice of such application must be sent to the designated self-regulatory organization, if any. The application must be made by the applicant or registrant and must: (i) State the reasons for the requested extension; (ii) indicate that the inability to make a timely filing is due to circumstances beyond the control of the applicant or registrant, if such is the case, and describe briefly the nature of such circumstances; (iii) be accompanied by the latest available formal computation of his adjusted net capital and minimum financial requirements computed in accordance with § 1.17; (iv) be accompanied by the latest available computation of required segregation and by a computation of the amount of money, securities, and property segregated on behalf of customers as of the date of the latest available computation; (v) contain an agreement to file the report on or before the date specified by the applicant or registrant in the application; (vi) be received by the principal office of the Commission in Washington, D.C., and by the designated self-regulatory organization, if any, prior to the date on which the report is due; and (vii) be accompanied by a letter from the independent public accountant answering the following questions:

A. What specifically are the reasons for the extension request?

B. On the basis of that part of your audit to date, do you have any indication that may cause you to consider commenting on any material inadequacies in the accounting system, internal accounting controls or procedures for safeguarding customer or firm assets?

C. Do you have any indication from the part of your audit completed to date that would lead you to believe that the firm was or is not meeting the minimum capital requirements specified in § 1.17 or the segregation requirements of section 4d(2) of the Act and these regulations, or has any significant financial or recordkeeping problems?

(2) Within 10 calendar days after receipt of an application for extension of time, the Commission shall: (i) Notify the applicant or registrant of the grant or denial of the requested extension; or (ii) Indicate to the applicant or registrant that additional time is required to analyze the request, in which case the amount of time needed will be specified.

(3) On the written request of any designated self-regulatory organization, or an applicant or registrant, or on its own motion, the Commission may grant an extension of time or an exemption from any of the certified financial reporting requirements of this chapter either unconditionally or on specified terms and conditions.

(g) *Replacement of accountant.* (1) In the event (i) the independent public accountant who was previously engaged as the principal accountant to audit an applicant's or registrant's financial statements resigns (or indicates he declines to stand for re-election after the completion of the current audit) or is dismissed as the applicant's or registrant's principal accountant, (ii) another independent accountant is engaged as principal accountant, or (iii) an independent accountant on whom the principal accountant expresses reliance in his report regarding a subsidiary resigns (or formally indicates he declines to stand for re-election after completion of the current audit) or is dismissed or another independent public accountant is engaged to audit that subsidiary, the applicant or registrant shall file written notice of such occurrence with the Commission at its principal office in Washington, D.C., and with the designated self-regulatory organization, if any, not more than 15 business days after such occurrence.

(2) Such notice must state (i) the date of such resignation (or declination to stand for re-election, dismissal or engagement) and (ii) whether, in connection with the audits of the two most recent fiscal years and any subsequent interim period preceding such resignation, dismissal or engagement, there were any disagreements with the former accountant on any matter of accounting principles or practices, financial statements disclosure, auditing scope or procedures, or compliance with the applicable rules of the Commission, which, if not resolved to the satisfaction of the former accountant, would have caused him to make reference in connection with his report to the subject matter of the disagreements (if so, describe such disagreements). The disagreements required to be reported in this paragraph (g)(2) include both those resolved to the former accountant's satisfaction and those not resolved to the former accountant's satisfaction. Disagreements contemplated by this paragraph (g)(2) are those which occur at the decision-making level, i.e., between personnel of the registrant responsible for presentation of its financial statements and schedules and personnel of the accounting firm responsible for rendering its report. The notice must also state whether the accountant's report on the financial statements and schedules for any of the past 2 years contained an adverse opinion or a disclaimer of opinion or was qualified as to uncertainties, audit scope, or accounting principles (if so, describe the nature of each such adverse opinion, disclaimer of opinion, or qualification). The applicant or registrant must also request the former accountant to furnish the applicant or registrant with a letter addressed to the Commission stating whether he agrees with the statements contained in the notice of the applicant or registrant and, if not, stating the respects in which he does not agree. Each copy of the notice and accountant's letter must be manually signed by the sole proprietor or a general partner or a duly authorized corporate officer of the applicant or registrant, as appropriate, and by the accountant.

(3) If (i) within the 24 months prior to the date of the most recent audited financial statement, a notice has been filed pursuant to paragraph (g)(1) of this section reporting a change of accountants, (ii) included in such filing there is a reported disagreement on any matters of accounting principles or practices, financial statements disclosure, auditing scope, or noncompliance with the applicable rules of the Commission, (iii) during the fiscal year in which the change in accountants took place or during the subsequent fiscal year, there have been any transactions or events similar to those which involved a reported disagreement, and (iv) such transactions or events are material and were accounted for or disclosed in a manner different from that which the former accountant apparently would have concluded was required, the existence and nature of the disagreements and also the effect on the financial statements must be stated in a written notice to the Commission at its principal office in Washington, D.C., and the designated self-regulatory organization, if any, if the method which the former accountant apparently would have concluded was required had been followed. These disclosures need not be made if the method asserted by the former accountant ceases to be generally accepted because of authoritative standards or interpretations subsequently issued. The notice required by this paragraph (g)(3) must be filed by the applicant or registrant concurrently with the financial statements and schedules to which it pertains.

5. By amending § 1.17 to read as follows:

§ 1.17 Minimum financial requirements—futures commission merchants

(a)(1) Except as provided in paragraph (a)(2) of this section, each person registered as a futures commission merchant must maintain adjusted net capital equal to or in excess of (i) the greater of $50,000 (after June 30, 1979, $100,000 for each person registered as a futures commission merchant who is not a member of a designated self-regulatory organization) or 6⅔ percent of aggregate indebtedness, or, (ii) in the case of a registrant electing to operate pursuant to paragraph (g) of this section, the greatest of $50,000 (after June 30, 1979, $100,000 for each person registered as a futures commission merchant who is not a member of a designated self-regulatory organization), or 4 percent of the funds required to be segregated pursuant to the Act and these regulations, or for securities brokers and dealers, 4 percent of aggregate debit items computed in accordance with the formula for determination of reserve requirements (exhibit A to rule 15c3-3, 17 CFR 240.15c3-3).

(2) The requirements of paragraph (a)(1) of this section shall not be applicable if the registrant is a member of a designated self-regulatory organization and conforms to minimum financial standards and related reporting requirements set by such designated

self-regulatory organization in its bylaws, rules, regulations or resolutions approved by the Commission pursuant to section 4f(2) of the Act and § 1.52 after the effective date of this regulation.

(3) No person applying for registration as a futures commission merchant shall be so registered unless such person affirmatively demonstrates to the satisfaction of the Commission that it complies with the financial requirements of this § 1.17. Each registrant must be in compliance with this § 1.17 at all times and must be able to demonstrate such compliance to the satisfaction of the Commission and/or the designated self-regulatory organization.

(4) A registrant who is not in compliance with this § 1.17 or unable to demonstrate compliance with this § 1.17 as required by paragraph (a)(3) of this section, must transfer all customer accounts and immediately cease doing business as a futures commission merchant until such time as the registrant is able to demonstrate such compliance. *Provided, however,* The registrant may trade for liquidation purposes only unless otherwise directed by the Commission and/or the designated self-regulatory organization. *Provided, further,* That if such registrant immediately demonstrates to the satisfaction of the Commission or the designated self-regulatory organization the ability to achieve compliance, the Commission or the designated self-regulatory organization may allow such registrant up to a maximum of 10 business days in which to achieve compliance without having to transfer accounts and cease doing business as required above. Nothing in this paragraph (a)(4) shall be construed as preventing the Commission or the designated self-regulatory organization from taking action against a registrant for non-compliance with any of the provisions of this section.

(b) For the purposes of this section:

(1) Where the applicant or registrant has an asset or liability which is defined in Securities Exchange Act rule 15c3-1 (§ 240.15c3-1 of this title) the inclusion or exclusion of all or part of such asset or liability for the computation of adjusted net capital and aggregate indebtedness shall be in accordance with § 240.15c3-1 of this title, unless specifically stated otherwise in this § 1.17.

(2) "Customer" means customer (as defined in § 1.3(k)) and option customer (as defined in § 32.1(c)).

(3) "Proprietary account" means a commodity futures or options account carried on the books of the applicant or registrant for the applicant or registrant itself, or for general partners in the applicant or registrant.

(4) "Noncustomer account" means a commodity futures or option account carried on the books of the applicant or registrant which is not included in the definition of customer (as defined in § 1.17(b)(2)) or proprietary account (as defined in § 1.17(b)(3)).

(5) "Commodity option", "options customer", and, "striking price", have the same meaning as in part 32 of these regulations.

(6) "Business day" means any day other than a Sunday, Saturday, or holiday.

(c) Definitions: For the purposes of this section:

(1) "Net capital" means the amount by which current assets exceed liabilities. In determining "net capital":

(i) Unrealized profits shall be added and unrealized losses shall be deducted in the accounts of the applicant or registrant, including unrealized profits and losses on fixed price commitments and forward contracts;

(ii) All long and all short positions in listed security options shall be marked to their market value and all long and all short securities and commodities positions shall be marked to their market value;

(iii) The value attributed to any nontransferable commodity option shall be the difference between the option's striking price and the market value for the actual commodity or futures contract which is the subject of the option. In the case of a call commodity option, if the market value for the actual commodity or futures contract which is the subject of the option is less than the striking price of the option, it shall be given no value. In the case of a put commodity option, if the market value for the actual commodity or futures contract which is the subject of the option is more than the striking price of the option, it shall be given no value; and

(iv) The value attributed to any unlisted security option shall be the difference between the option's exercise value or striking value and the market value of the underlying security. In the case of an unlisted call, if the market value of the underlying security is less than the exercise value or striking value of such call, it shall be given no value; and, in the case of an unlisted put, if the market value of the underlying security is more than the exercise value or striking value of the unlisted put, it shall be given no value.

(2) The term "current assets" means cash and other assets or resources commonly identified as those which are reasonably expected to be realized in cash or sold during the next 12 months. "Current assets" shall:

(i) Exclude any unsecured commodity futures or option account containing a ledger balance and open trades, the combination of which liquidates to a deficit or containing a debit ledger balance only: *Provided, however,* deficits or debit ledger balances in unsecured customers', non-customers' and proprietary accounts, which are the subject of calls for margin or other required deposits which are outstanding one business day or less, may be included in current assets;

(ii) Exclude all unsecured receivables, advances and loans except for:

(A) Receivables resulting from the marketing of inventories commonly associated with the business activities of the applicant or registrant and advances on fixed price purchases commitments: *Provided,* Such receivables or advances are outstanding no longer than 3 calendar months from the date that they are accrued;

(B) Interest receivable, floor brokerage receivable, commissions receivable from other brokers or dealers (other than syndicate profits), mutual fund concessions receivable and management fees receivable from registered investment companies and commodity pools: *Provided,* Such receivables are outstanding no longer than thirty (30) days from the date they are due; and dividends receivable outstanding no longer than thirty (30) days from the payable date;

(C) Receivables from "clearing organizations," option clearing organizations, foreign clearing organizations and securities clearing organizations;

(D) Receivables from registered futures commission merchants or brokers, resulting from commodity futures or option transactions, except those specifically excluded under paragraph (c)(2)(i) of this section;

(E) Insurance claims which arise from a reportable segment of the applicant's or registrant's overall business activities, as defined in generally accepted accounting principles, other than in the commodity futures, commodity option, security and security option segments of the applicant's or registrant's business activities which are not outstanding more than 3 calendar months after the date they are recorded as a receivable;

(F) All other insurance claims not subject to paragraph (c)(2)(ii)(E) of this section, which are not older than seven (7) business days from the date the loss giving rise to the claim is discovered; insurance claims which are not older than twenty (20) business days from the date the loss giving rise to the claim is discovered and which are covered by an option of outside counsel that the claim is valid and is covered by insurance policies presently in effect; insurance claims which are older than twenty (20) business days from the date the loss giving rise to the claim is discovered and which are covered by an opinion of outside counsel that the claim is valid and is covered by insurance policies presently in effect and which have been acknowledged in writing by the insurance carrier as due and payable: *Provided*, Such claims are not outstanding longer than twenty (20) business days from the date they are so acknowledged by the carrier;

(iii) Exclude all prepaid expenses and deferred charges;

(iv) Exclude all inventories except for:

(A) Readily marketable spot commodities; or spot commodities which "adequately collateralize" indebtedness under paragraph (c)(7) of this section;

(B) Securities which are considered "readily marketable" (as defined in § 240.15c3-1(c)(11) of this title) or which "adequately collateralize" indebtedness under paragraph (c)(7) of this section;

(C) Work in process and finished goods which result from the processing of commodities at market value;

(D) Raw materials at market value which will be combined with spot commodities to produce a finished processed commodity; and

(E) Inventories held for resale commonly associated with the business activities of the applicant or registrant;

(v) Include fixed assets and assets which otherwise would be considered noncurrent to the extent of any indebtedness excluded in accordance with paragraph (c)(6)(v) of this section: *Provided*, Such liabilities are not excluded from liabilities in the computation of net capital under paragraph (c)(4)(v) of this section;

(vi) Exclude all assets doubtful of collection or realization less any reserves established therefor;

(vii) Include, in the case of future income tax benefits arising as a result of unrealized losses, the amount of such benefits not exceeding the amount of income tax liabilities accrued on the books and records of the applicant or registrant, but only to the extent such benefits could have been applied to reduce accrued tax liabilities on the date of the capital computation, had the related unrealized losses been realized on that date;

(viii) Include guarantee deposits with clearing organizations and stock in clearing organizations to the extent of its margin value; and

(ix) Exclude exchange memberships.

(3) A loan or advance or any other form of receivable shall not be considered "secured" for the purposes of paragraph (c)(2) of this section unless the following conditions exist:

(i) The receivable is secured by readily marketable collateral which is otherwise unencumbered and which can be readily converted into cash equal to or in excess of that part of the receivable which is shown in the applicant's or registrant's records as secured; and

(ii)(A) The readily marketable collateral is in the possession or control of the applicant or registrant; or

(B) The applicant or registrant has a legally enforceable, written security agreement, signed by the debtor, and has a perfected security interest in the readily marketable collateral within the meaning of the laws of the State in which the readily marketable collateral is located.

(4) The term "liabilities" means the total money liabilities of an applicant or registrant arising in connection with any transaction whatsoever, including economic obligations of an applicant or registrant that are recognized and measured in conformity with generally accepted accounting principles. "Liabilities" also include certain deferred credits that are not obligations but that are recognized and measured in conformity with generally accepted accounting principles. For the purposes of computing "net capital", the term "liabilities":

(i) Excludes liabilities of an applicant or registrant which are subordinated to the claims of all general creditors of the applicant or registrant pursuant to a satisfactory subordination agreement, as defined in paragraph (h) of this section;

(ii) Excludes the amount of money, securities and property due to commodity futures or option customers which is held in segregated accounts in compliance with the requirements of the Act and these regulations: *Provided, however*, That such exclusion may be taken only if such money, securities and property held in segregated accounts have been excluded from current assets in computing net capital;

(iii) Includes, in the case of an applicant or registrant who is a sole proprietor, the excess of liabilities which have not been incurred in the course of business as a futures commission merchant over assets not used in the business;

(iv) Excludes the lesser of any deferred income tax liability related to the items in (A), (B), and (C) below, or the sum of (A), (B), and (C) below:

(A) The aggregate amount resulting from applying to the amount of the deductions computed in accordance with paragraph (c)(5) or paragraph (g) of this section, the appropriate Federal and State tax rate(s) applicable to any unrealized gain on the asset on which the deduction was computed;

(B) Any deferred tax liability related to income accrued which is directly related to an asset otherwise deducted pursuant to this section;

(C) Any deferred tax liability related to unrealized appreciation in value of any asset(s) which has been otherwise excluded from current assets in accordance with the provisions of this section; and

(v) Excludes liabilities which would be classified as long term in accordance with generally accepted accounting principles to the extent of the net book value of plant, property and equipment which is used in the ordinary course of any trade or business of the applicant or registrant which is a reportable segment of the applicant's or registrant's overall business activities, as defined in generally accepted accounting principles, other than in the commodity futures, commodity option, security and security option segments of the applicant's or registrant's business activities: *Provided*, That such plant, property and equipment is not included in current assets pursuant to paragraph (c)(2)(v) of this section: *And provided further*, That the exclusion provided for in this paragraph (c)(4)(v) does not apply when computing aggregate indebtedness pursuant to paragraph (c)(6) of this section.

(5) The term "adjusted net capital" means net capital less:

(i) The amount by which any advances paid by the applicant or registrant on cash commodity contracts and used in computing net capital exceeds 95 percent of the market value of the commodities covered by such contracts;

(ii) In the case of all inventory, fixed price commitments and forward contracts, except for inventory and forward contracts in those foreign currencies which are purchased or sold for future delivery on or subject to the rules of a contract market and covered by an open futures contract for which there will be no charge, the applicable percentage of the net position specified below:

(A) Inventory which is currently registered as deliverable on a contract market and covered by an open futures contract.—No charge.

(B) Inventory which is covered by an open futures contract or commodity option.—5 percent of the market value.

(C) Inventory which is not covered.—20 percent of the market value.

(D) Fixed price commitments (open purchases and sales) and forward contracts which are covered by an open futures contract or commodity option.—10 percent of the market value.

(E) Fixed price commitments (open purchases and sales) and forward contracts which are not covered by an open futures contract or commodity option.—20 percent of the market value.

(iii) [Reserved]

(iv) [Reserved]

(v) In the case of securities and obligations used by the applicant or registrant in computing net capital, and in the case of securities in segregation pursuant to section 4d(2) of the act and these regulations which were not deposited by customers, the percentages specified in § 240.15c3-1(c)(2)(vi) of this title ("securities haircuts") and 100 percent of the value of "nonmarketable securities" as specified in § 240.15c3-1(c)(2)(vii) of this title, or where appropriate, for securities brokers or dealers the percentages specified in § 240.15c3-1(f) of this title;

(vi) In the case of securities options used by the applicant or registrant in computing net capital, the deductions specified, in § 240.15c3-1 appendix A of this title, after effecting certain adjustments to net capital for listed and unlisted options as set forth in such appendix;

(vii) In the case of an applicant or registrant who has open contractual commitments, as hereinafter defined, the deductions specified in § 240.15c3-1(c)(2)(viii) of this title;

(viii) For undermargined customer commodity futures accounts the amount of funds required in each such account to meet maintenance margin requirements of the applicable board of trade or if there are no such maintenance margin requirements clearing organization margin requirements applicable to such positions, after application of calls for margin, or other required deposits which are outstanding 5 business days or less until December 31, 1980, four business days or less until December 31, 1982, and three business days or less thereafter. If there are no such maintenance margin requirements or clearing organization margin requirements on such accounts, then the amount of funds required to provide margin equal to the amount necessary after application of calls for margin, or other required deposits outstanding five days or less until December 31, 1980, 4 days or less until December 31, 1982, and 3 days or less thereafter to restore original margin when the original margin has been depleted by 50 percent or more. Provided, to the extent a deficit is excluded from current assets in accordance with paragraph (c)(2)(i) of this section such amount shall not also be deducted under this paragraph (c)(5)(viii);

(ix) For undermargined non-customer and omnibus commodity futures accounts the amount of funds required in each such account to meet maintenance margin requirements of the applicable board of trade or if there are no such maintenance margin requirements clearing organization margin requirements applicable to such positions, after application of calls for margin, or other required deposits which are outstanding 2 business days or less. If there are no such maintenance margin requirements or clearing organization margin requirements, then the amount of funds required to provide margin equal to the amount necessary after application of calls for margin, or other required deposits outstanding two days or less to restore original margin when the initial margin has been depleted by 50 percent or more. Provided, to the extent a deficit is excluded from current assets in accordance with paragraph (c)(2)(i) of this section such amount shall not also be deducted under this paragraph (c)(5)(ix);

(x) In the case of open futures contracts held in proprietary accounts carried by the applicant or registrant which are not covered by a position held by the applicant or registrant or which are not the result of a "changer trade" made in accordance with the rule of a contract market:

(A) For an applicant or registrant which is a clearing member of a contract market for the positions on such contract market cleared by such member, the applicable margin requirement of the applicable clearing organization;

(B) For an applicant or registrant which is a member of a contract market 150 percent of the applicable maintenance margin requirement of the applicable board of trade or clearing organization, whichever is greater;

(C) For all other applicants or registrants, 200 percent of the applicable maintenance margin requirement of the applicable board of trade or clearing organization whichever is greater; or

(D) For open contracts for which there is no applicable maintenance margin requirements, 200 percent of the applicable initial margin requirement.

Provided, The equity in any such proprietary account shall reduce the deduction required by this paragraph (c)(5)(x) if such equity is not otherwise includable in adjusted net capital;

(xi) In the case of an applicant or registrant which is a taker of a commodity option, the amount of any commodity option premium which has been used to increase adjusted net captial (however, in the case of an applicant or registrant which is a grantor of a commodity option, the safety factor may be reduced by the amount of any commodity option premium which has not been previously recognized as income); and

(xii) In the case of a commodity option which is carried long by the applicant or registrant as a taker of a commodity option which has value and such value is used to increase adjusted net capital, ten percent of the market value of the commodity which is the subject of such option but in no event more than the value attributed to such option.

(xiii) Five percent of all unsecured receivables includable under paragraph (c)(2)(ii)(D) of this section used by the applicant or registrant in computing "net capital" and which are not receivable from (A) a registered futures commission merchant, or (B) a broker or dealer which is registered as such with the Securities and Exchange Commission.

(xiv) For securities brokers and dealers, all other deductions specified in § 240.15c3-1 of this title.

(6) The term "aggregate indebtedness" means "liabilities" as defined in paragraph (c)(4) of this section excluding:

(i) Indebtednesss adequately collateralized by spot commodities which are carried long by the applicant or registrant and indebtedness adequately collateralized by securities which are carried long by the applicant or registrant and which have not been sold, or by securities which collateralize a secured demand note pursuant to paragraph (h) of this section;

(ii) Indebtedness arising in connection with an advance to a non-proprietary account when such indebtedness is adequately collateralized by spot commodities eligible for delivery on a contract market and when such spot commodities are "covered";

(iii) Advances received by the applicant or registrant against bills of lading issued in connection with the shipment of commodities sold by the applicant or registrant;

(iv) Equity balances in the accounts of general partners;

(v) Long-term debt adequately collateralized by assets acquired for use in the ordinary course of the trade or business of an applicant or registrant, but no other long-term debt adequately collateralized by assets of the applicant or registrant shall be excluded unless the sole recourse of the creditor for nonpayment of such liability is to such asset;

(vi) Liabilities which are effectively subordinated to the claims of creditors (but which are not subject to a satisfactory subordination agreement as defined in paragraph (h) of this section) by other than customers of the applicant or registrant prior to such subordination, and such subordinations by customers as may be approved by the applicable designated self-regulatory organization or if the applicant or registrant is not a member of a designated self-regulatory organization, then the Commission; and

(vii) Deferred tax liabilities, not already excluded in paragraph (c)(4)(iv) of this section.

(7) "Liabilities" are "adequately collateralized" when, pursuant to a legally enforceable written instrument, such liabilities are secured by identified assets that are otherwise unencumbered and the market value of which exceeds the amount of such liabilities.

(8) The term "contractual commitments" shall include underwriting, when issued, when distributed, and delayed delivery contracts; and the writ-

ing or endorsement of security puts and calls and combinations thereof; but shall not include uncleared regular way purchases and sales of securities. A series of contracts of purchase or sale of the same security, conditioned, if at all, only upon issuance, may be treated as an individual commitment.

(d) Each applicant or registrant shall have equity capital (inclusive of satisfactory subordination agreements which qualify under this paragraph (d) as equity capital) of not less than 30 percent of the required debt-equity total, provided, an applicant or registrant may be exempted from the provisions of this paragraph (d) for a period not to exceed 90 days or for such longer period which the Commission may, upon application of the applicant or registrant, grant in the public interest or for the protection of investors. For the purposes of this paragraph (d):

(1) Equity capital means a satisfactory subordination agreement entered into by a partner or stockholder which has an initial term of at least 3 years and has a remaining term of not less than 12 months if: (A) It does not have any of the provisions for accelerated maturity provided for by paragraphs (h)(2) (ix)(A), (h)(2)(x)(A), or (h)(2)(x)(B) of this section, and is maintained as capital subject to the provisions restricting the withdrawal thereof required by paragraph (e) of this section, or (B) the partnership agreement provides that capital contributed pursuant to a satisfactory subordination agreement as defined in paragraph (h) of this section shall in all respects be partnership capital subject to the provisions restricting the withdrawal thereof required by paragraph (e) of this section, and

(i) In the case of a corporation, the sum of its par or stated value of capital stock, paid in capital in excess of par, retained earnings, unrealized profit and loss, and other capital accounts.

(ii) In the case of a partnership, the sum of its capital accounts of partners (inclusive of such partners' commodity and securities accounts subject to the provisions of paragraph (e) of this section), and unrealized profit and loss.

(iii) In the case of a sole proprietorship, the sum of its capital accounts of the sole proprietorship and unrealized profit and loss.

(2) Debt-equity total means equity capital as defined in paragraph (d)(1) of this section plus the outstanding principal amount of satisfactory subordination agreements.

(3) Required debt-equity total means debt-equity total as defined in paragraph (d)(2) of this section, less the excess of the applicant's or registrant's adjusted net capital over the minimum required by this § 1.17.

(e) No equity capital of the applicant or registrant or a subsidiary's or affiliate's equity capital consolidated pursuant to paragraph (f) of this section, whether in the form of capital contributions by partners (including amounts in the commodities and securities trading accounts of partners which are treated as equity capital but excluding amounts in such trading accounts which are not equity capital and excluding balances in limited partners' capital accounts in excess of their stated capital contributions), par or stated value of capital stock, paid-in capital in excess of par or stated value, retained earnings or other capital accounts, may be withdrawn by action of a stockholder or partner or by redemption or repurchase of shares of stock by any of the consolidated entities or through the payment of dividends or any similar distribution, nor may any unsecured advance or loan be made to a stockholder, partner, sole proprietor, or employee if, after giving effect thereto and to any other such withdrawals, advances, or loans and any payments of payment obligations (as defined in paragraph (h) of this section) under satisfactory subordination agreements and any payments of liabilities excluded pursuant to paragraph (c)(4)(v) of this section which are scheduled to occur within 6 months following such withdrawal, advance or loan, either adjusted net capital of any of the consolidated entities would be less than: (1) The greater of 120 percent of the appropriate minimum dollar amount required by § 1.17, or 10 percent of aggregate indebtedness, or (2) if the applicant or registrant is operating pursuant to § 1.17(g) the greatest of 120 percent of the appropriate minimum dollar amount required by § 1.17(g) or 7 percent of the amount required to be segregated pursuant to the Act and these regulations or for securities brokers or dealers, 7 percent of the aggregate debit items computed pursuant to § 240.15c3-3 of this title, or in the case of any applicant or registrant included within such consolidation, if equity capital of the applicant or registrant (inclusive of satisfactory subordination agreements which qualify as equity under paragraph (d) of this section) would be less than 30 percent of the required debt-equity total as defined in paragraph (d) of this section. *Povided,* That this provision shall not preclude an applicant or registrant from making required tax payments or preclude the payment to partners of reasonable compensation. The Commission may, upon application of the applicant or registrant, grant relief from this paragraph (e) if the Commission deems it to be in public interest or for the protection of nonproprietary accounts.

(f)(1) Every applicant or registrant, in computing its net capital and aggregate indebtedness pursuant to this section must, subject to the provisions of paragraphs (f)(2) and (f)(4) of this section, consolidate in a single computation, assets and liabilities of any subsidiary or affiliate for which it guarantees, endorses, or assumes directly or indirectly the obligations or liabilities. The assets and liabilities of a subsidiary or affiliate whose liabilities and obligations have not been guaranteed, endorsed, or assumed directly or indirectly by the applicant or registrant may also be so consolidated if an opinion of counsel is obtained as provided for in paragraph (f)(2) of this section.

(2)(i) If the consolidation, provided for in paragraph (f)(1) of this section, of any such subsidiary or affiliate results in the increase of the applicant's or registrant's adjusted net capital and/or increases the applicant's or registrant's percentage of adjusted net capital to aggregate indebtedness or increases the applicant's or registrant's adjusted net capital and/or decreases the minimum adjusted net capital requirement called for by paragraph (g)(1) of this section and an opinion of counsel called for in paragraph (f)(2)(ii) of this section has not been obtained, such benefits shall not be recognized in the applicant's or registrant's computation required by this section.

(ii) Except as provided for in paragraph (f)(2)(i) of this section, consolidation shall be permitted with respect to any subsidiaries or affiliates which are majority owned and controlled by the applicant or registrant and for which the applicant or registrant can demonstrate to the satisfaction of the Commission, and the designated self-regulatory organization, if any, by an opinion of counsel that the net asset values, or the portion thereof related to the parent's ownership interest in the subsidiary or affiliate, may be caused by the applicant or registrant or an appointed trustee to be distributed to the applicant or registrant within 30 calendar days. Such opinion must also set forth the actions necessary to cause such a distribution to be made, identify the parties having the authority to take such actions, identify and describe the rights of other parties or classes of parties, including but not limited to customers, general creditors, subordinated lenders, minority shareholders, employees, litigants, and governmental or regulatory authorities, who may delay or prevent such a distribution and such other assurances as the Commission or the designated self-regulatory organization by rule or interpretation may require. Such opinion must be current and periodically renewed in connection with the applicant's or registrant's annual audit pursuant to § 1.10 or upon any material change in circumstances.

(3) In preparing a consolidated computation of adjusted net capital and/or aggregate indebtedness pursuant to this section, the following minimum and nonexclusive requirements shall be observed:

(i) Consolidated adjusted net capital shall be reduced by the estimated amount of any tax reasonably anticipated to be incurred upon distribution of the assets of the subsidiary or affiliate.

(ii) Liabilities of a consolidated subsidiary or affiliate which are subordinated to the claims of present and future creditors pursuant to a satisfactory subordination agreement shall be deducted from consolidated adjusted net capital unless such subordination extends also to the claims of present or future creditors of the parent applicant or registrant and all consolidated subsidiaries.

(iii) Subordinated liabilities of a consolidated subsidiary or affiliate which are consolidated in accordance with paragraph (f)(3)(ii) of this section may not be prepaid, repaid, or accelerated if any of the entities included in such consolidation would otherwise be unable to comply with the provisions of paragraph (h) of this section.

(iv) Each applicant or registrant included within the consolidation shall at all times be in compliance with the adjusted net capital requirement to which it is subject.

(4) No applicant or registrant shall guarantee, endorse, or assume directly or indirectly any obligation or liability of a subsidiary or affiliate unless the obligation or liability is reflected in the computation of adjusted net capital and/or aggregate indebtedness pursuant to this section except as provided in paragraph (f)(2)(i) of this section.

(g) A registrant may elect not to be subject to the limitations of paragaph (a) of this section respecting aggregate indebtedness as defined in paragraph (c)(6) of this section. *Provided*, That in order to qualify to operate under this paragraph (g), such registrant must at all times maintain adjusted net capital equal to the greatest of $50,000 (after June 30, 1979, $100,000 for each person registered as a futures commission merchant who is not a member of a designated self-regulatory organization), or 4 percent of the funds required to be segregated by the act and these regulations or for securities brokers or dealers, 4 percent of the aggregate debit items computed in accordance with the formula for determination of reserve requirements (exhibit A to Securities Exchange Act Rule 15c3-3, § 240.15c3-3 of this title), and shall notify the designated self-regulatory organization, if any, and the Regional Office of the Commission in which the registrant has its principal place of business, in writing, of its election to operate under this provision. Once a registrant has determined to operate pursuant to the provisions of this paragaph (g), it must continue to do so unless a change in such election is approved by the Commission upon application thereto.

(1) A broker or dealer electing to operate pursuant to this paragraph (g) shall be subject to § 240.15c3-1(f) of this title in lieu of paragraph (c)(5)(v) of this section.

(2) A broker or dealer who is registered as such with the Securities and Exchange Commission and who is exempt from the provisions of § 240.15c3-3 of this title pursuant to paragraph (k)(1) or (k)(2)(i) of that section may not elect to use the alternative contained in this paragraph (g).

(h) The term satisfactory subordination agreement ("subordination agreement") means an agreement which contains the minimum and nonexclusive requirements set forth below.

(1) Certain definitions for purposes of this section:

(i) A subordination agreement may be either a subordinated loan agreement or a secured demand note agreement.

(ii) The term "subordinated loan agreement" means the agreement or agreements evidencing or governing a subordinated borrowing of cash.

(iii) The term "collateral value" of any securities pledged to secure a secured demand note means the market value of such securities after giving effect to the percentage deductions specified in paragraph (c) of this section.

(iv) The term "payment obligation" means the obligation of an applicant or registrant in respect to any subordination agreement: (A) To repay cash loaned to the applicant or registrant pursuant to a subordinated loan agreement; or (B) to return a secured demand note contributed to the applicant or registrant or to reduce the unpaid principal amount thereof and to return cash or securities pledged as collateral to secure the secured demand note; and (C) "payment" shall mean the performance by an applicant or registrant of a payment obligation.

(v) (A) The term "secured demand note agreement" means an agreement (including the related secured demand note) evidencing or governing the contribution of a secured demand note to an applicant or registrant and the pledge of securities and/or cash with the applicant or registrant as collateral to secure payment of such secured demand note. The secured demand note agreement may provide that neither the lender, his heirs, executors, administrators, or assigns shall be personally liable on such note and that in the event of default the applicant or registrant shall look for payment of such note solely to the collateral then pledged to secure the same.

(B) The secured demand note shall be a promissory note executed by the lender and shall be payable on the demand of the applicant or registrant to which it is contributed: *Provided, however*, That the making of such demand may be conditioned upon the occurrence of any of certain events which are acceptable to the designated self-regultory organization and the Commission.

(C) If such note is not paid upon presentment and demand as provided for therein, the applicant or registrant shall have the right to liquidate all or any part of the securities then pledged as collateral to secure payment of the same and to apply the net proceeds of such liquidation, together with any cash then included in the collateral, in payment of such note. Subject to the prior rights of the applicant or registrant as pledgee, the lender, as defined in § 1.17(h)(i)(v)(F) may retain ownership of the collateral and have the benefit of any increases and bear the risks fo any decreases in the value of the collateral and may retain the right to vote securities contained within the collateral and any right to income therefrom or distributions thereon, except the applicant or registrant shall have the right to receive and hold as pledgee all dividends payable in securities and all partial and complete liquidating dividends.

(D) Subject to the prior rights of the applicant or registrant as pledgee, the lender may have the right to direct the sale of any securities included in the collateral, to direct the purchase of securities with any cash included therein, to withdraw excess collateral or to substitute cash or other securities as collateral: *Provided*, That the net proceeds of any such sale and the cash so substituted and the securities so purchased or substituted are held by the applicant or registrant as pledgee, and are included within the collateral to secure payment of the secured demand note: *And provided further*, That no such transaction shall be permitted, if, after giving effect therto, the sum of the amount of any cash, plus the collateral value of the securities, then pledged as collateral to secure the secured demand note would be less than the unpaid principal amount of the secured demand note.

(E) Upon payment by the lender, as distinguished from a reduction by the lender which is provided for in paragraph (h)(2)(vi)(C) of this section or reduction by the applicant or registrant as provided for in paragraph (h)(2)(vii) of this section, of all or any part of the unpaid principal amount of the secured demand note, the applicant or registrant shall issue to the lender a subordinated loan agreement in the amount of such payment (or in the case of an pplicant or registrant that is a partnership, credit a capital account of the lender), or issue preferred or common stock of the applicant or registrant in the amount of such payment, or any combination of the foregoing, as provided for in the secured demand note agreement.

(F) The term "lender" means the person who lends cash to an applicant or registrant pursuant to a subordinated loan agreement and the person who contributes a secured demand note to an applicant or registrant pursuant to a secured demand note agreement.

(2) Minimum requirements for subordination agreements:

(i) Subject to paragraph (h)(1) of this section, a subordination agreement shall mean a written agreement between the applicant or registrant and the lender, which:

(A) Has a minimum term of 1 year, except for temporary subordination agreements provided for in paragraph (h)(3)(v) of this section, and

(B) Is a valid and binding obligation enforceable in accordance with its terms (subject as to enforcement to applicable bankruptcy, insolvency, reorganization, moratorium, and other similar laws) against the applicant or registrant and the lender and their respective heirs, executors, administrators, successors, and assigns.

(ii) *Specific amount.* All subordination agreements shall be for a specific dollar amount which shall not be reduced for the duration of the agreement except by installments as specifically provided for therein and except as otherwise provided in this paragraph (h)(2) of this section.

(iii) *Effective subordination.* The subordination agreement shall effectively subordinate any right of the lender to receive any payment with respect thereto, together with accrued interest or compensation, to the prior payment or provision for payment in full of all claims of all present and future creditors of the applicant or registrant arising out of any matter occurring prior to the date on which the related payment obligation matures, except for claims which are the subject of subordination agreements which rank on the same priority as or junior to the claim of the lender under such subordination agreements.

(iv) *Proceeds of subordinated loan agreements.* The subordinated loan agreement shall provide that the cash proceeds thereof shall be used and dealt with by the applicant or registrant as part of its capital and shall be subject to the risks of the business.

(v) *Certain rights of the borrower.* The subordination agreement shall provide that the applicant or registrant shall have the right to:

(A) Deposit any cash proceeds of a subordinated loan agreement and any cash pledged as collateral to secure a secured demand note in an account or accounts in its own name in any bank or trust company;

(B) Pledge, repledge, hypothecate and rehypothecate, any or all of the securities pledged as collateral to secure a secured demand note, without notice, separately or in common with other securities or property for the purpose of securing any indebtedness of the applicant or registrant; and

(C) Lend to itself or others any or all of the securities and cash pledged as collateral to secure a secured demand note.

(vi) *Collateral for secured demand notes.* Only cash and securities which are fully paid for and which may be publicly offered or sold without registration under the Securities Act of 1933, and the offer, sale, and transfer of which are not otherwise restricted, may be pledged as collateral to secure a secured demand note. The secured demand note agreement shall provide that if at any time the sum of the amount of any cash, plus the collateral value of any securities, then pledged as collateral to secure the secured demand note is less than the unpaid principal amount of the secured demand note, the applicant or registrant must immediately transmit written notice to that effect to the lender, the designated self-regulatory organization, if applicable, and the Commission. The secured demand note agreement shall also require that following such transmittal:

(A) The lender, prior to noon of the business day next succeeding the transmittal of such notice, may pledge as collateral additional cash or securities sufficient, after giving effect to such pledge, to bring the sum of the amount of any cash plus the collateral value of any securities, then pledged as collateral to secure the secured demand note, up to an amount not less than the unpaid principal amount of the secured demand note; and

(B) Unless additional cash or securities are pledged by the lender as provided in (A) above, the applicant or registrant at noon on the business day next succeeding the transmittal of notice to the lender must commence sale, for the account of the lender, of such of the securities then pledged as collateral to secure the secured demand note and apply so much of the net proceeds thereof, together with such of the cash then pledged as collateral to secure the secured demand note as may be necessary to eliminate the unpaid principal amount of the secured demand note: *Provided, however,* That the unpaid principal amount of the secured demand note need not be reduced below the sum of the amount of any remaining cash, plus the collateral value of the remaining securities, then pledged as collateral to secure the secured demand note. The applicant or registrant may not purchase for its own account any securities subject to such a sale; and

(C) The secured demand note agreement may also provide that, in lieu of the procedures specified in the provisions required by (B) above, the lender with the prior written consent of the applicant or registrant and the designated self-regulatory organization or if the applicant or registrant is not a member of a designated self-regulatory organization, then the Commission may reduce the unpaid principal amount of the secured demand note: *Provided,* That after giving effect to such reduction the adjusted net capital of the applicant or registrant would not be less than 10 percent of aggregate indebtedness or in the case of an applicant or registrant operating pursuant to paragraph (g) of this section, adjusted net capital would not be less than the greater of 7 percent of the funds required to be segregated pursuant to the Act and these regulations, or for securities brokers or dealers, 7 percent of the aggregate debit items computed in accordance with § 240.15c3-3 of this title. *Provided, further,* That no single secured demand note shall be permitted to be reduced by more than 15 percent of its original principal amount and after such reduction no excess collateral may be withdrawn. No designated self-regulatory organization shall consent to a reduction of the principal amount of a secured demand note if, after giving effect to such reduction, adjusted net capital would be less than 120 percent of the appropriate minimum dollar amount required by this section.

(vii) *Permissive prepayments.* An applicant or registrant at its option but not at the option of the lender, may, if the subordination agreement so provides, make a payment of all or any portion of the payment obligation thereunder prior to the scheduled maturity date of such payment obligation (hereinafter referred to as a "prepayment"), but in no event may any prepayment be made before the expiration of 1 year from the date such subordination agreement became effective: *Provided, however,* That the foregoing restriction shall not apply to temporary subordination agreements which comply with the provisions of subparagraph (h)(3)(v) of this section. No prepayment shall be made, if, after giving effect thereto (and to all payments of payment obligations under any other subordinated agreements then outstanding, the maturity or accelerated maturities of which are scheduled to fall due within 6 months after the date such prepayment is to occur pursuant to this provision, or on or prior to the date on which the payment obligation in respect to such prepayment is scheduled to mature disregarding this provision, whichever date is earlier) without reference to any projected profit or loss of the applicant or registrant, either the adjusted net capital of the applicant or registrant is less than 10 percent of its aggregate indebtedness or in the case of an applicant or registrant operating pursuant to paragraph (g) of this section, its adjusted net capital is less than the greater of 7 percent of the funds required to be segregated pursuant to the Act and these regulations or for securities brokers or dealers, 7 percent of the aggregate debit items computed in accordance with § 240.15c3-3 of this title or its adjusted net capital is less than 120 percent of the appropriate minimum dollar amount required by this section. Notwithstanding the above, no prepayment shall occur without the prior written approval of the designated self-regulatory organization and the Commission.

(viii) *Suspended repayment.* (A) The payment obligation of the applicant or registrant in respect of any subordination agreement shall be suspended and shall not mature if, after giving effect to payment of such payment obligation (and to all payments of payment obligations of the applicant or registrant under any other subordination agreement(s) then outstanding which are scheduled to mature on or before such payment obligation), either the adjusted net capital of the applicant or registrant would be less than 8⅓ percent of aggregate indebtedness, or in the case of an applicant or registrant operating pursuant to paragraph (g) of this section, adjusted net capital would be less than the greater of 6 percent of the funds required to be segregated pursuant to the Act and these regulations or for securities brok- ers or dealers, 6 percent of the aggregate debit items computed in accordance with § 240.15c3-3 of this title, or its adjusted net capital would be less than 120 percent of the minimum dollar amount required by this section: *Provided,* That the subordination agreement may provide that if the payment obligation of the applicant or registrant thereunder does not mature and is suspended as a result of the requirement of this paragraph (h)(2)(viii) of this section for a period of not less than 6 months, the applicant or registrant shall then commence the rapid and orderly liquidation of its business, but the right of the lender to receive payment, together with accrued interest or compensation, shall remain subordinate as required by the provisions of this section.

(B) Whenever a subordination agreement provides that an applicant or registrant shall commence a rapid and orderly liquidation, as permitted in paragraph (h)(2)(viii)(A), the date on which the liquidation commences shall be the maturity date for each subordination agreement of the applicant or registrant then outstanding, but the rights of the respective lenders to receive payment, together with accrued interest or compensation, shall remain subordinate as required by the provisions of this section.

(ix) *Accelerated maturity.* Obligation to repay to remain subordinate:

(A) Subject to the provisions of paragraph (h)(2)(viii) of this section, a subordination agreement may provide that the lender may, upon prior written notice to the applicant or registrant and the designated self-regulatory organization or if applicant or registrant is not a member of a designated self-regulatory organization, then the Commission, given not earlier than 6 months after the effective date of such subordination agreement, accelerate the date on which the payment obligation of the borrower, together with accrued interest or compensation, is scheduled to mature to a date not earlier than 6 months after giving of such notice, but the right of the lender to receive payment, together with accrued interest or compensation, shall remain subordinate as required by the provisions of this paragraph (h)(2) of this section.

(B) Notwithstanding the provisions of paragraph (h)(2)(viii) of this section, the payment obligation of the applicant or registrant with respect to a subordination agreement, together with accrued interest and compensation, shall mature in the event of any receivership, insolvency, liquidation pursuant to the Securities Investor Protection Act of 1970 or otherwise, bankruptcy, assignment for the benefit of creditors, reorganization whether or not pursuant to the bankruptcy laws, or any other marshalling of the assets and liabilities of the applicant or registrant, but the right of the lender to receive payment, together with accrued interest or compensation, shall remain subordinate as required by the provisions of paragraph (h)(2) of this section.

(x) *Accelerated maturity of subordination agreements on event of default and event of acceleration.* Obligation to repay to remain subordinate:

(A) A subordination agreement may provide that the lender may, upon prior written notice to the applicant or registrant and the designated self-regulatory organization or, if the applicant or registrant is not a member of a designated self-regulatory organization, the Commission, of the occurrence of any event of acceleration (as hereinafter defined) given no sooner than 6 months after the effective date of such subordination agreement, accelerate the date on which the payment obligation of the applicant or registrant, together with accrued interest or compensation, is scheduled to mature, to the last business day of a calendar month which is not less than 6 months after notice of acceleration is received by the applicant or registrant and the designated self-regulatory organization, or if the applicant or registrant is not a member of a designated self-regulatory organization, then the Commission. Any subordination agreement containing such events of acceleration may also provide that, if upon such accelerated maturity date the payment obligation of the applicant or registrant is suspended as required by paragraph (h)(2)(viii) of this section and liquidation of the applicant or registrant has not commenced on or prior to such accelerated maturity date, notwithstanding paragraph (h)(2)(viii) of this section, the payment obligation of the applicant or registrant with respect to such subordination agreement shall mature on the day immediately following such accelerated maturity date and in any such event the payment obligations of the applicant or registrant with respect to all other subordination agreements then outstanding shall also mature at the same time but the rights of the respective lenders to receive payment, together with accrued interest or compensation, shall remain subordinate as required by the provisions of paragraph (h)(2) of this section. Events of acceleration which may be included in a subordination agreement complying with this paragraph (h)(2)(x) of this section shall be limited to:

(*1*) Failure to pay interest or any installment of principal on a subordination agreement as scheduled;

(*2*) Failure to pay when due other money obligations of a specified material amount;

(*3*) Discovery that any material, specified representation or warranty of the applicant or registrant which is included in the subordination agreement and on which the subordination agreement was based or continued was inaccurate in a material respect at the time made;

(*4*) Any specified and clearly measurable event which is included in the subordination agreement and which the lender and the applicant or registrant agree, (a) is a significant indication that the financial position of the applicant or registrant has changed materially and adversely from agreed upon specified norms; or (b) could materially and adversely affect the ability of the applicant or registrant to conduct its business as conducted on the date the subordination agreement was made; or (c) is a significant change in the senior management of the applicant or registrant or in the general business conducted by the applicant or registrant from that which obtained on the date the subordination agreement became effective;

(5) Any continued failure to perform agreed covenants included in the subordination agreement relating to the conduct of the business of the applicant or registrant or relating to the maintenance and reporting of its financial position; and

(*B*) Notwithstanding the provisions of paragraph (h)(2)(viii) of this section, a subordination agreement may provide that, if liquidation of the business of the applicant or registrant has not already commenced, the payment obligation of the applicant or registrant shall mature, together with accrued interest or compensation, upon the occurrence of an event of default (as hereinafter defined). Such agreement may also provide that, if liquidation of the business of the applicant or registrant has not already commenced, the rapid and orderly liquidation of the business of the applicant or registrant shall then commence upon the happening of an event of default. Any subordination agreement which so provides for maturity of the payment obligation upon the occurrence of an event of default shall also provide that the date on which such event of default occurs shall, if liquidation of the applicant or registrant has not already commenced, be the date on which the payment obligation of the applicant or registrant with respect to all other subordination agreements then outstanding shall mature but the rights of the respective lenders to receive payment, together with accrued interest or compensation, shall remain subordinate as required by the provisions of paragraph (h)(2) of this section. Events of default which may be included in a subordination agreement shall be limited to:

(1) The making of an application by the Securities Investor Protection Corporation for a decree adjudicating that customers of the applicant or registrant are in need of protection under the Securities Investor Protection Act of 1970 and the failure of the applicant or registrant to obtain the dismissal of such application within 30 days;

(2) Failure to meet the minimum capital requirements of the designated self-regulatory organization, or of the Commission, throughout a period of 15 consecutive business days, commencing on the day the borrower first determines and notifies the designated self-regulatory organization, if any, of which he is a member and the Commission; or any self-regulatory organization or the Commission first determines and notifies the applicant or registrant of such fact;

(3) The Commission shall revoke the registration of the applicant or registrant;

(4) The self-regulatory organization shall suspend (and not reinstate within 10 days) or revoke the applicant or registrant's status as a member thereof;

(5) Any receivership, insolvency, liquidation pursuant to the Securities Investor Protection Act of 1970 or otherwise, bankruptcy, assignment for the benefit of creditors, reorganization whether or not pursuant to bankruptcy laws, or any other marshalling of the assets and liabilities of the applicant or registrant. A subordination agreement which contains any of the provisions permitted by this subparagraph (2)(x) shall not contain the provision otherwise permitted by paragraph (h)(2)(ix)(A) of this section.

(3) *Miscellaneous provisions*—(i) *Prohibited cancellation.* The subordination agreement shall not be subject to cancellation by either party; no payment shall be made with respect thereto and the agreement shall not be terminated, rescinded or modified by mutual consent or otherwise if the effect thereof would be inconsistent with the requirements of paragraph (h) of this section.

(ii) *Notice of maturity or accelerated maturity.* Every applicant or registrant shall immediately notify the designated self-regulatory organization and the Commission if, after giving effect to all payments of payment obligations under subordination agreements then outstanding which are then due or mature within the following 6 months without reference to any projected profit or loss of the applicant or registrant, either the aggregate indebtedness of the applicant or registrant would exceed 8⅓ percent of its adjusted net capital, or its adjusted net capital would be less than 120 percent of the minimum dollar amount required by § 1.17 or in the case of an applicant or registrant who is operating pursuant to paragraph (g) of § 1.17, its adjusted net capital would be less than the greater of 6 percent of the funds required to be segregated pursuant to the Act and these regulations or for securities brokers or dealers, 6 percent of the aggregate debit items computed in accordance with § 240.15c3-3 of this title.

(iii) *Certain legends.* If all the provisions of a satisfactory subordination agreement do not appear in a single instrument, then the debenture or other evidence of indebtedness shall bear on its face an appropriate legend stating that it is issued subject to the provisions of a satisfactory subordination agreement which shall be adequately referred to and incorporated by reference.

(iv) *Legal title to securities.* All securities pledged as collateral to secure a secured demand note must be in bearer form, or registered in the name of the applicant or registrant or the name of its nominee or custodian.

(v) *Temporary subordinations.* To enable an applicant or registrant to participate as an underwriter of securities or undertake other extraordinary activities and remain in compliance with the adjusted net capital requirements of this section, an applicant or registrant shall be permitted, on no more than three occasions in any 12-month period to enter into a subordination agreement on a temporary basis which has a stated term of no more than 45 days from the date the subordination agreement became effective. *Provided,* That this temporary relief shall not apply to any applicant or registrant if the adjusted net capital of the applicant or registrant is less than 10 percent of its aggregate indebtedness or in the case of an applicant or registrant operating pursuant to paragraph (g) of this section, its adjusted net capital is less than the greater of 7 percent of the funds required to be segregated pursuant to the Act and these regulations or for securities brokers or dealers, 7 percent of the aggregate debit items computed in accordance with § 240.15c3-3 of this title, or its adjusted net capital is less than 120 percent of the appropriate minimum dollar amount required by this section, or the amount of equity capital as defined in paragraph (d) of this section is less than the limits specified in paragraph (d) of this section. Such temporary subordination agreement shall be subject to all the other provisions of this section.

(vi) *Filing.* Two copies of any proposed subordination agreement (including nonconforming subordination agreements) shall be filed with the Commission at least 10 days prior to the proposed execution date of the agreement or at such other time as the Commission for good cause shall accept such filing. Copies of the proposed agreement shall be filed in such quantities and at such time as the designated self-regulatory organization may require with the designated self-regulatory organization, if any, of which the applicant or registrant is a member. The applicant or registrant shall also file with said parties a statement setting forth the name and address of the lender, the business relationship of the lender to the applicant or registrant and whether the applicant or registrant carried funds or securities for the lender at or about the time the proposed agreement was so filed. All agreements shall be examined at the Commission or the designated self-regulatory organization with whom such agreements are required to be filed prior to their becoming effective. No proposed agreement shall be a satisfactory subordination agreement for the purposes of this section unless and until the designated self-regulatory organization or the Commission has found the agreement acceptable and such agreement has become effective in the form found acceptable.

(vii) *Subordination agreements in effect prior to adoption.* Any subordination agreement which has been entered into prior to the effective date of this section and which has been deemed to be satisfactorily subordinated pursuant to this section previously in effect or the adjusted net capital rules of a self-regulatory organization shall continue to be deemed a satisfactory subordination agreement until the maturity of such agreement. *Provided,* That no renewal of an agreement which provides for automatic or optional renewal by the applicant or registrant or lender shall be deemed to be a satisfactory subordination agreement unless such renewal agreement meets the requirements of this section, within 6 months of the effective date of this section. *Provided further,* That all subordination agreements must meet the requirements of this rule within 5 years of the effective date of this section.

(4) A designated self-regulatory organization and the Commission may allow debt with a maturity date of 1 year or more to be treated as meeting the provisions of this paragraph (h): *Provided,* (i) Such exemption shall only be given when the registrant's adjusted net capital is less than the minimum required by this § 1.17 or by the capital rule of the designated self-regulatory organization to which such registrant is subject;

(ii) That such debt did not exist prior to its use under this paragraph (h)(4);

(iii) Such exemption shall be for a period of 30 days or such lesser period as the designated self-regulatory organization and the Commission may determine;

(iv) Such exemption shall not be allowed more than once in any 12 month period; and

(v) At all times during such exemption the registrant shall make a good faith effort to comply with the provisions of this § 1.17 or the capital rule of the designated self-regulatory organization to which such registrant is subject exclusive of any benefits derived from this paragraph (h)(4).

(i) [Reserved]

(j) For the purposes of this section "cover" is defined as follows:

(1) *General definition.* Cover shall mean transactions or positions in a contract for future delivery on a board of trade or a commodity option where such transactions or positions normally represent a substitute for transactions to be made or positions to be taken at a later time in a physical marketing channel, and where they are economically appropriate to the reduction of risks in the conduct and management of a commercial enterprise, and where they arise from:

(i) The potential change in the value of assets which a person owns, produces, manufactures, processes, or merchandises or anticipates owning, producing, manufacturing, processing, or merchandising.

(ii) The potential change in the value of liabilities which a person owes or anticipates incurring, or

(iii) The potential change in the value of services which a person provides, purchases or anticipates providing or purchasing. Notwithstanding the foregoing, no transactions or positions shall be classified as cover for the purposes of this section unless their purpose is to offset price risks incidental to commercial cash or spot operations and such positions are established and liquidated in accordance with sound commercial practices and unless the provisions of paragraphs (j)(2) and (3) of this section have been satisfied.

(2) *Enumerated cover transactions.* The definition of covered transactions and positions in paragraph (j)(1) of this section includes, but is not limited to, the following specific transactions and positions:

(i) Ownership or fixed-price purchase of any commodity which does not exceed in quantity the sales of the same commodity for future delivery on a board of trade or the purchase of a put commodity option of the same commodity for which the market value for the actual commodity or futures contract which is the subject of the option is less than the striking price of the option.

(ii) Fixed-price sale of any commodity which does not exceed in quantity the purchase of the same commodity for future delivery on a board of trade or the purchase of a call commodity option of the same commodity for which the market value for the actual commodity or futures contract which is the subject of such option is more than the striking price of the option; and

(iii) Ownership or fixed price contracts of a commodity described in paragraphs (j)(2)(i) and (j)(2)(ii) of this section may also be covered other than by the same quantity of the same cash commodity, provided that the fluctuations in value of the position for future delivery or commodity option are substantially related to the fluctuations in value of the actual cash position.

(3) *Nonenumerated cases.* Upon specific request, the Commission may recognize transactions and positions other than those enumerated in paragraph (j)(2) of this section as cover in amounts and under the terms and conditions as it may specify. Any applicant or registrant who wishes to avail itself of the provisions of this paragraph (j)(3) must apply to the Commission in writing at its principal office in Washington, D.C. giving full details of the transaction including detailed information which will demonstrate that the transaction is economically appropriate to the reduction of risk exposure attendant to the conduct and management of a commercial enterprise.

6. By amending § 1.18 to read as follows:

§ 1.18 Records for and relating to financial reporting and monthly computation.

* * * * *

(b) Each applicant or registrant must make and keep as a record in accordance with § 1.31, formal computations of its adjusted net capital and of its minimum financial requirements pursuant to § 1.17 or the requirements of the designated self-regulatory organization to which it is subject as of the close of business each month. Such computations must be completed and made available for inspection by any representative of the Commission or designated self-regulatory organization, if any, within 30 days after the date for which the computations are made, commencing the first month-end after the date the application for registration is filed or the first month-end after the effective date of this section.

(c) [Revoked]

7. By adding a new § 1.52, to read as follows:

§ 1.52 Self-regulatory organization adoption and surveillance of minimum financial requirements.

(a) Each self-regulatory organization must adopt and submit for Commission approval, rules prescribing minimum financial and related reporting requirements for all its members who are registered futures commission merchants and shall submit for Commission approval any modification or other amendments to such rules. Such requirements must be the same as, or more stringent than, those contained in §§ 1.10 and 1.17, and the definition of adjusted net capital must be the same as that prescribed in § 1.17(c): *Provided, however,* A designated self-regulatory organization may determine the number of form 1-FR's it receives from its member registrants so long as it requires at least semiannual form 1-FR's, one of which must be certified in accordance with § 1.16 for each such registrant.

(b) Each self-regulatory organization shall have in effect and enforce rules submitted to the Commission pursuant to paragraph (a) of this section and approved by the Commission.

(c) Any two or more self-regulatory organizations may file with the Commission a plan for delegating to a designated self-regulatory organization, for any registered futures commission merchant which is a member of more than one such self-regulatory organization, the responsibility of:

(1) Monitoring and auditing for compliance with the minimum financial and related reporting requirements adopted by such self-regulatory organizations in accordance with paragraph (a) of this section; and

(2) Receiving the financial reports necessitated by such minimum financial and related reporting requirements.

Such a plan may also delegate the responsibility of examining the books and records kept by such registered futures commission merchant relating to its business of dealing in commodity futures and cash commodities, insofar as such business relates to its dealing on contract markets, as required by § 1.51(a)(3).

(d) Any plan filed under this § 1.52 may contain provisions for the allocation of expenses reasonably incurred by the designated self-regulatory organization among the self-regulatory organizations participating in such a plan.

(e) A plan's designated self-regulatory organization must report to that plan's other self-regulatory organizations any violation of such other self-regulatory organizations' rules and regulations for which the responsibiity to monitor, audit or examine has been delegated to such designated self-regulatory organization under this § 1.52.

(f) The self-regulatory organizations may, among themselves, establish programs to provide access to any necessary financial or related information.

(g) After appropriate notice and opportunity for comment, the Commission may, by written notice, approve such a plan, or any part of the plan, if it finds that the plan, or any part of it: (1) Is necessary or appropriate to serve the public interest; (2) is for the protection and in the interest of customers; (3) reduces multiple monitoring and auditing for compliance with the minimum financial rules of the self-regulatory organizations submitting the plan for any futures commission merchant which is a member of more than one self-regulatory organization; (4) reduces multiple reporting of the financial information necessitated by such minimum financial and related reporting requirements by any futures commission merchant which is a member of more than one self-regulatory organization; (5) fosters cooperation and coordination among the contract markets; and (6) does not hinder the development of a registered futures association under section 17 of the Act.

(h)(1) Upon the approval of a plan or part of one under § 1.52(g), a self-regulatory organization which is included in such a plan shall be considered to have met its affirmative action responsibilities under § 1.51 to the extent that such responsibilities have been delegated to a designated self-regulatory organization.

(2) After the Commission has approved a plan or part of one under § 1.52(g), a self-regulatory organization relieved of responsibility must notify each of its members which is subject to such a plan: (i) Of the limited nature of its responsibility for such a member's compliance with its minimum financial and related reporting requirements; and (ii) of the identity of the designated self-regulatory organization which has been delegated responsibility for such a member.

(i) The Commission may at any time, after appropriate notice and opportunity for hearing, withdraw its approval of any plan or part of one established under § 1.52, if such plan or part of one ceases to effectuate adequately the purposes of section 4f(2) of the Act or of this § 1.52.

(j) Whenever a registered futures commission merchant holding membership in a self-regulatory organization ceases to be a member in good standing of that self-regulatory organization, such self-regulatory organization must, on the same day that event takes place, give telegraphic notice of that event to the principal office of the Commission in Washington, D.C., send a copy of that notification to such futures commission merchant.

(k) Nothing in this § 1.52 shall preclude the Commission from examining any futures commission merchant for compliance with the minimum financial and related reporting requirements to which such futures commission merchant is subject.

(l) In the event a plan is not filed and/or approved for each registered futures commission merchant which is a member of more than one self-regulatory organization, the Commission may design and, after notice and opportunity for comment, approve a plan for those futures commission merchants which are not the subject of an approved plan (under paragraph (g) of this section), delegating to a designated self-regulatory organization the responsibilities described in paragraph (c) of this section.

(7 U.S.C. 6c, 6d, 6f, 6g, 7a, 12a, 19, and 21.)

The foregoing adoption by the Commission of the amendments to §§ 1.3, 1.10, 1.17, and 1.18 and of new §§ 1.12 and 1.16 shall become effective December 20, 1078; the foregoing adoption by the Commission of § 1.52 (other than paragraph (b) thereof) shall become effective January 31, 1979; the foregoing adoption by the Commission of § 1.52(b) shall become effective June 30, 1979.

Issued in Washington, D.C., on September 1, 1978, by the Commission.

WILLIAM T. BAGLEY, *Chairman, Commodity Futures Trading Commission.*

[FR Doc. 78-25180 Filed 9-7-78; 8:45 am]

[6740-02]

Title 18—Conservation of Power and Water Resources

CHAPTER I—FEDERAL ENERGY REGULATORY COMMISSION

SUBCHAPTER A—GENERAL RULES

[Docket No. RM78-20]

PART 1—RULES OF PRACTICE AND PROCEDURE

References to the Record in Briefs Filed With the Commission

AGENCY: Federal Energy Regulatory Commission.

ACTION: Final rule.

SUMMARY: The Federal Energy Regulatory Commission is amending its procedural regulations relating to briefs on exceptions. In addition to existing requirements, briefs on exceptions shall contain specific references to the pages of the record or exhibits which support arguments or allegations of error.

EFFECTIVE DATE: August 29, 1978.

FOR FURTHER INFORMATION CONTACT:

Robert L. Baum, Deputy General Counsel, 825 North Capitol Street NE., Washington, D.C. 20426, 202-275-4333.

SUPPLEMENTAL INFORMATION: Commission rules currently require that briefs on exceptions contain "* * * appropriate references to the record and legal authorities." (18 CFR 1.31(b)). Despite this requirement many briefs on exceptions do not contain such references. This failure causes significant delays in Commission review of the briefs and in the writing of proposed orders for Commission action.

Accordingly, the Commission now amends its rules to include an express requirement that briefs on exceptions cite the pages of the record or exhibit that support the contentions made. Briefs that fail to comply with this requirement may be rejected or disregarded. The Director, Office of Opinions and Reviews, is authorized to require supplemental briefs in cases where briefs filed with the Commission do not conform to this requirement.

Since this rule deals with a matter of agency procedure and practice, notice and public procedure thereon is unnecessary pursuant to 5 U.S.C. 553(b). Moreover, because of the need to expedite Commission proceedings and because all parties to proceedings before the Commission will be given adequate time to file supplemental briefs in conformance with the requirement, the Commission finds that good cause exists for making the rule effective upon publication.

(Federal Power Act, as amended (16 U.S.C. 792 et seq.); Natural Gas Act, as amended (15 U.S.C. 717 et seq.); Interstate Commerce Act, as amended (49 U.S.C. 1 et seq.); Department of Energy Organization Act, Pub. L. 95-91, E.O. 12009, 42 FR 46267.)

In consideration of the foregoing, part 1 of title 18, Code of Federal Regulations, is amended as set forth below.

By the Commission.

KENNETH F. PLUMB,
Secretary.

1. Section 1.31 is amended by revising clause (iv) of subparagraph (1) of paragraph (b) to read as follows:

§ 1.31 Exceptions to intermediate decisions, briefs; briefs and oral arguments before the Commission.

* * * * *

(b) *Nature and service of briefs on exceptions and of briefs opposing exceptions.* * * *

(1) * * *

(iv) the argument in support with references to the pages of the record or exhibits where the evidence appears. Briefs not in compliance with this requirement may be rejected or disregarded. The Director, Office of Opinions and Reviews is authorized to require supplemental briefs in cases where briefs filed with the Commission on and after the effective date of this amendment, do not conform to this requirement.

* * * * *

[FR Doc. 78-25178 Filed 9-7-78; 8:45 am]

[4210-01]

Title 24—Housing and Urban Development

CHAPTER X—FEDERAL INSURANCE ADMINISTRATION, DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

SUBCHAPTER B—NATIONAL FLOOD INSURANCE PROGRAM

[Docket No. FI-3745]

PART 1917—APPEALS FROM FLOOD ELEVATION DETERMINATION AND JUDICIAL REVIEW

Final Flood Elevation Determination for the City of McAlester, Pittsburg County, Okla.

AGENCY: Federal Insurance Administration, HUD.

ACTION: Final rule.

SUMMARY: Final base (100-year) flood elevations are listed below for selected locations in the city of McAlester, Pittsburg, County, Okla. These base (100-year) flood elevations are the basis for the flood plain management measures that the community is required to either adopt or show evidence of being already in effect in order to qualify or remain qualified for participation in the national flood insurance program (NFIP).

EFFECTIVE DATE: The date of issuance of the flood insurance rate map (FIRM), showing base (100-year) flood elevations, for the city of McAlester, Pittsburg County, Okla.

ADDRESS: Maps and other information showing the detailed outlines of the flood-prone areas and the final elevations for the city of McAlester, Pittsburg County, Okla. are available for review at the City Engineer's Office, Municipal Building, Box 578, McAlester, Okla. 74501.

FOR FURTHER INFORMATION CONTACT:

Mr. Richard Krimm, Assistant Administrator, Office of Flood Insurance, Room 5270, 451 Seventh Street SW., Washington, D.C. 20410, 202-755-5581 or toll-free line 800-424-8872.

SUPPLEMENTARY INFORMATION: The Federal Insurance Administrator gives notice of the final determinations of flood elevations for the city of McAlester, Pittsburg County, Okla.

This final rule is issued in accordance with section 110 of the Flood Disaster Protection Act of 1973 (Pub. L. 93-234), 87 Stat. 980, which added section 1363 to the National Flood Insurance Act of 1968 (Title XIII of the Housing and Urban Development Act of 1968 (Pub. L. 90-448), 42 U.S.C. 4001-4128, and 24 CFR 1917.4(a)). An opportunity for the community or individuals to appeal this determination to or through the community for a period of ninety (90) days has been provided, and the Administrator has resolved the appeals presented by the community.

The Administrator has developed criteria for flood plain management in flood-prone areas in accordance with 24 CFR Part 1910.

The final base (100-year) flood elevations for selected locations are:

Source of flooding	Location	Elevation in feet, national geodetic vertical datum
Tributary A of Mud Creek.	Just downstream of County Road near Fish Hatchery.	710
Tributary AA of Mud Creek.	Just downstream of the east lane of U.S. Highway 69 Bypass.	705
Tributary B of Sandy Creek.	Approximately 150 feet upstream of C Street.	694
	Just upstream of South Main Street.	709
Tributary C of Mud Creek.	Just downstream of Electric Avenue.	657
	Just upstream of Polk Avenue.	674
Tributary D of Sandy Creek.	Just downstream of West Street.	680
	Just upstream of C Street.	688
	Just upstream of South Main Street.	699
	Just downstream of 6th Street.	701
	Approximately 100 feet downstream of Miami Avenue.	715
Tributary DD of Sandy Creek.	Just downstream of 10th Street.	710
Tributary E of Sandy Creek.	Just upstream of the downstream coporate limit.	658

(National Flood Insurance Act of 1968 (Title XIII of Housing and Urban Development Act of 1968), effective January 28, 1969 (33 FR 17804, November 28, 1968), as amended (42 U.S.C. 4001-4128); and Secretary's delegation of authority to Federal Insurance Administrator, 43 FR 7719.)

Issued: July 20, 1978.

GLORIA M. JIMENEZ,
Federal Insurance Administrator.

[FR Doc. 78-24984 Filed 9-7-78; 8:45 am]

[4210-01]

[Docket No. FI-4127]

PART 1917—APPEALS FROM FLOOD ELEVATION DETERMINATION AND JUDICIAL REVIEW

Final Flood Elevation Determination for Grant County, Oreg.

AGENCY: Federal Insurance Administration, HUD.

ACTION: Final rule.