

SECURITIES AND EXCHANGE COMMISSION

17 CFR Part 240

Release No. 34-67405; File No. S7-30-11

RIN 3235-AL19

Extension of Interim Final Temporary Rule on Retail Foreign Exchange Transactions

AGENCY: Securities and Exchange Commission.

ACTION: Interim final temporary rule; extension.

SUMMARY: The Securities and Exchange Commission (“Commission”) is amending interim final temporary Rule 15b12-1T under the Securities Exchange Act of 1934 (“Exchange Act”) to extend the date on which the rule will expire from July 16, 2012 to July 16, 2013.

DATES: *Effective Date:* July 16, 2012. The expiration date of interim final temporary Rule 15b12-1T (17 CFR 240.15b12-1T) is extended to July 16, 2013.

FOR FURTHER INFORMATION CONTACT: Joanne Rutkowski, Branch Chief, Bonnie Gauch, Senior Special Counsel, and Leila Bham, Special Counsel, Division of Trading and Markets, at (202) 551-5550, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549.

SUPPLEMENTARY INFORMATION: The Commission is extending the expiration date for Rule 15b12-1T under the Exchange Act.

I. DISCUSSION

Section 742 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank Act”)¹ amended the Commodity Exchange Act (“CEA”) to provide that a person

¹ Public Law 111–203, 124 Stat. 1376 (2010).

for which there is a Federal regulatory agency,² including a broker or dealer (“broker-dealer”) registered under section 15(b) (except pursuant to paragraph (11) thereof) or 15C of the Exchange Act,³ shall not enter into, or offer to enter into, a foreign exchange (“forex”) transaction⁴ with a person who is not an “eligible contract participant”⁵ (“ECP”) except pursuant to a rule or regulation of a Federal regulatory agency allowing the transaction under such terms and conditions as the Federal regulatory agency shall prescribe (“retail forex rule”).⁶ A Federal

² 7 U.S.C. 2(c)(2)(E)(i), as amended by § 742(c) of the Dodd-Frank Act, defines a “Federal regulatory agency” to mean the Commodity Futures Trading Commission (“CFTC”), the Securities and Exchange Commission, an appropriate Federal banking agency, the National Credit Union Association, and the Farm Credit Administration.

³ 7 U.S.C. 2(c)(2)(B)(i)(II).

⁴ 7 U.S.C. 2(c)(2)(B)(i)(I). Transactions described in CEA section 2(c)(2)(B)(i)(I) include “an agreement, contract, or transaction in foreign currency that . . . is a contract of sale of a commodity for future delivery (or an option on such a contract) or an option (other than an option executed or traded on a national securities exchange registered pursuant to section 6(a) of the Securities Exchange Act of 1934 (15 U.S.C. 78f(a)).”

⁵ Section 1a(18) of the CEA defines “eligible contract participant” generally to mean certain regulated persons; entities that meet a specified total asset test (*e.g.*, a corporation, partnership, proprietorship, organization, trust, or other entity with total assets exceeding \$10 million) or an alternative monetary test coupled with a non-monetary component (*e.g.*, an entity with a net worth in excess of \$1 million and engaging in business-related hedging; or certain employee benefit plans, the investment decisions of which are made by one of four enumerated types of regulated entities); and certain governmental entities and individuals that meet defined thresholds. 7 U.S.C. 2(c)(2)(E)(i). The CFTC has adopted rules further clarifying the definition of “eligible contract participant” in the CEA. *See* 17 CFR 1.3(m). *See also Further Definition of “Swap Dealer,” “Security-Based Swap Dealer,” “Major Swap Participant,” “Major Security-Based Swap Participant” and “Eligible Contract Participant,”* Exchange Act Release No. 66868 (April 27, 2012), 77 FR 30596 (May 23, 2012). Because transactions that are the subject of this release are commonly referred to as “retail forex transactions,” this release uses the term “retail customer” to describe persons who are not ECPs.

⁶ *See* 7 U.S.C. 2(c)(2)(B)(i)(II) and 7 U.S.C. 2(c)(2)(E)(ii)(I). On September 10, 2010, the CFTC adopted a retail forex rule for persons subject to its jurisdiction. *See Regulation of Off-Exchange Retail Foreign Exchange Transactions and Intermediaries*, 75 FR 55410 (September 10, 2010). The CFTC had proposed its rules regarding retail forex transactions prior to the enactment of the Dodd-Frank Act. *See Regulation of Off-*

regulatory agency's retail forex rule must treat all forex agreements, contracts, and transactions and their functional or economic equivalents, similarly.⁷ Any retail forex rule also must prescribe appropriate requirements with respect to disclosure, recordkeeping, capital and margin, reporting, business conduct, and documentation, and may include such other standards or requirements as the Federal regulatory agency determines to be necessary.⁸

The prohibition in CEA section 2(c)(2)(B) took effect on July 16, 2011. Beginning on that date, broker-dealers, including broker-dealers also registered with the CFTC as futures commission merchants ("BD-FCMs"), for which the Commission is the "Federal regulatory agency," were no longer able to engage in off-exchange retail forex futures and options transactions with a customer except pursuant to a retail forex rule issued by the Commission.⁹ On July 13, 2011, the Commission adopted interim final temporary Rule 15b12-1T, which temporarily permits a broker-dealer to engage in a "retail forex business," as defined in the rule, in compliance with the Exchange Act, the rules and regulations thereunder, and the rules of the self-regulatory organizations of which the broker-dealer is a member, insofar as they are

Exchange Retail Foreign Exchange Transactions and Intermediaries, 75 FR 3282 (January 20, 2010). The Federal Deposit Insurance Corporation ("FDIC") and the Office of the Comptroller of the Currency ("OCC") have adopted similar rules. *See Retail Foreign Exchange Transactions*, 76 FR 40779 (July 12, 2011); *Retail Foreign Exchange Transactions*, 76 FR 41375 (July 14, 2011). The Board of Governors of the Federal Reserve System (the "Board") has proposed rules for bank holding companies. *See Retail Foreign Exchange Transactions*, 76 FR 46652 (August 3, 2011).

⁷ 7 U.S.C. 2(c)(2)(E)(iii)(II).

⁸ 7 U.S.C. 2(c)(2)(E)(iii)(I).

⁹ *See* 7 U.S.C. 2(c)(2)(B)(i)(II)(cc) (giving the CFTC jurisdiction over retail forex transactions with FCMs that, among other things, are not registered broker-dealers) and 7 U.S.C. 2(c)(2)(C)(i)(I)(aa). In addition, a commenter noted that the CFTC "does not have jurisdiction over retail foreign exchange activities conducted by broker-dealers, including entities that are dually registered as broker-dealers with the SEC and as futures commission merchants ('FCMs') with the CFTC." SIFMA/ISDA Letter at 1.

applicable to retail forex transactions.¹⁰ We explained at the time that our action was intended to preserve potentially beneficial market practices that, for example, may serve to minimize a retail customer's exposure to the risk of changes in foreign currency rates in connection with the customer's purchase or sale of a security. We also discussed in the Interim Release that there may be potentially abusive practices such as lack of disclosure about fees and forex pricing, and insufficient capital or margin requirements occurring in the retail forex market, and sought comment on these practices and steps we should take to seek to prevent them.¹¹ Rule 15b12-1T, by its terms and without further Commission action, would have expired on July 16, 2012.

The Commission received comments on the Interim Release, which are summarized below.¹²

¹⁰ See *Retail Foreign Exchange Transactions*, Exchange Act Release No. 64874 (July 13, 2011), 76 FR 41676 (July 15, 2011) (adopting 17 CFR 240.15b12-1T) ("Interim Release").

¹¹ Our Office of Investor Education Advocacy has published an Investor Bulletin providing information about retail forex investing, including information about the risks involved in that trading. See *Investor Bulletin: Foreign Currency Exchange (Forex) Trading for Individual Investors* (July 2011), available at <http://www.sec.gov/investor/alerts/forextrading.pdf>. The CFTC and the North American Securities Administrators Association also have published an alert regarding risks of fraud in forex markets. See *Foreign Exchange Currency Fraud: CFTC/NASAA Investor Alert*, available at <http://www.cftc.gov/ConsumerProtection/FraudAwarenessPrevention/ForeignCurrencyTrading/cftcnasaeforexalert>. We recently brought an enforcement action against the CEO of a purported foreign currency trading firm alleging fraud by that person. See *SEC v. Jeffery A. Lowrance, et al.*, Case No. CV-11-3451, press release, complaint and litigation release, available at <http://www.sec.gov/news/press/2011/2011-147.htm>.

¹² The comments are available at <http://www.sec.gov/comments/s7-30-11/s73011.shtml>. In addition to other specific requests for comment, the Commission requested comment in the Interim Release as to whether Rule 15b12-1T should be extended, and if so for how long.

- Nine commenters asked the Commission to preserve their ability to engage in retail forex transactions.¹³
- One commenter stated that the Commission should rescind the rule and allow the ban to take effect or, in the alternative, to limit the scope of the rule to a narrowly defined class of forex transactions, specifically hedging and the facilitation of settlement of foreign securities.¹⁴ The commenter further stated that in adopting Rule 15b12-1T, the Commission did not provide notice of and opportunity for comment on the rule, and did not include a “concrete assessment or quantification of the need” for the relief granted by this rule.
- Another commenter provided data on the returns of retail forex accounts at futures commission merchants and retail foreign exchange dealers, and offered recommendations that the commenter believed would improve retail forex transactions and identified areas of retail forex that the commenter believed warrants further study.¹⁵ This commenter

¹³ See email comments from Raul Gonzalez, dated July 17, 2011, James Peck, dated July 17, 2011, Bob Flowers, dated July 17, 2011, James M. Beatty, dated July 17, 2011, Angela Li, dated July 17, 2011, Mark A. McDonnell, dated July 21, 2011, Mark Smith, dated July 23, 2011, John Baur, dated July 27, 2011, and Ronald Covington, dated October 23, 2011.

¹⁴ See Letter from Dennis M. Kelleher, President and CEO, and Stephen W. Hall, Securities Specialist, Better Markets, Inc. to Ms. Elizabeth Murphy, Secretary, Commission, dated September 12, 2011 (“Better Markets Letter”). We understand the commenter’s reference to transactions entered into to facilitate the settlement of foreign securities to mean the conversion trades discussed *infra*, in the text accompanying notes 19 and 20.

¹⁵ Letter from Justin Hughes, CFA and Managing Member, Philadelphia Financial Management of San Francisco to Ms. Elizabeth Murphy, Secretary, Commission, dated August 2, 2011 (“Philadelphia Financial Letter”). See also letter from P. Georgia Bullitt, Michael A. Piracci and F. Mindy Lo, Morgan Lewis to Joseph Furey, Bonnie L. Gauch and Adam Yonce, Commission, dated July 28, 2011 (“Morgan Lewis Letter”).

also suggested that currency exchange-traded funds (“currency ETFs”) would provide an alternative means for effectively hedging against currency risk.¹⁶

- One commenter provided data from five large broker-dealers showing that the notional amount of foreign exchange conversion trades at those broker-dealers accounts for approximately 90% of those firms’ foreign exchange transactions. The firms’ data further indicated that 99% of customer accounts have entered into a conversion trade, though not all trades within an account may be conversion trades.¹⁷
- One group of commenters urged the Commission to adopt a final rule based on the approach followed in the interim final temporary rule, with certain modifications.¹⁸

These commenters maintained that it is in the best interests of retail customers to have the opportunity to conduct forex activity as part of their broader investing activity, through their broker-dealers, with the assistance of personnel who have expertise in forex.

More recently, in April 2012, a group of commenters asked the CFTC, as well as other Federal regulatory agencies (including the Commission), to take the view that forex transactions that are solely incidental to, and that are initiated for the sole purpose of, permitting a customer to complete a transaction in a foreign security, so-called “conversion trades,” are not prohibited

¹⁶ See Philadelphia Financial Letter. See also Better Markets Letter. While certain forex transactions, in particular portfolio hedges or currency transactions that are part of a diversified investment strategy, may have close substitutes in currency ETFs, currency conversions that facilitate securities transactions (discussed in more detail below) may not have such close substitutes.

¹⁷ See Morgan Lewis Letter.

¹⁸ See Letter from Kenneth E. Bentsen, Jr., Executive Vice President Public Policy and Advocacy, SIFMA and Robert Pickel, Executive Vice Chairman, ISDA, to Ms. Elizabeth Murphy, Secretary, Commission, dated October 17, 2011 (“SIFMA/ISDA Letter”). See also Memorandum from SIFMA and ISDA to Marc Menchel, Gary Goldsholle, Matthew Vitek, Rudy Verra, Glen Garofalo, FINRA, dated February 23, 2012.

retail forex transactions for purposes of section 2 of the CEA.¹⁹ These commenters maintain that Congress did not intend to include within the scope of the CEA section 2 prohibition currency transactions effected in connection with securities transactions, stating that “[s]uch transactions do not involve speculation in the underlying currencies and, to the contrary, will result in an exchange of currencies to be used to settle the relevant securities transactions.”²⁰ We anticipate that the interpretation will be addressed in the context of the CFTC’s and SEC’s joint rulemaking to further define terms such as “swap” and “security-based swap” under Title VII of the Dodd-Frank Act (“Products Definition Release”).²¹ We further anticipate that the rulemaking will be finalized in the near future and the CFTC will provide at that time its views of whether conversion trades are excluded from the prohibition under CEA section 2.

The ABA/GFMA Letter and the CFTC response affect the scope, substance, and timing of our consideration of further rulemaking for retail forex transactions. If the CFTC were to adopt the interpretation put forth by the ABA/GFMA, conversion trades, which commenters have asserted comprise the overwhelming majority of retail forex transactions conducted through broker-dealers,²² would not fall within the scope of the prohibition. The potential for such

¹⁹ See Letter from Phoebe A. Papageorgiou, Senior Counsel, American Bankers Association, and James Kemp, Managing Director, Global Foreign Exchange Division, to Thomas J. Curry, Comptroller, OCC, Robert E. Feldman, Executive Secretary, FDIC, Jennifer J. Johnson, Secretary, the Board, David Stanwick, Secretary, CFTC, and Elizabeth Murphy, Secretary, Commission, dated April 18, 2012 (“ABA/GFMA Letter”).

²⁰ *Id.* at 2.

²¹ See also *Further Definition of “Swap,” “Security-Based Swap,” and “Security-Based Swap Agreement”*; *Mixed Swaps; Security-Based Swap Agreement Recordkeeping*, Securities Act Release No. 9204 (April 29, 2011), 76 FR 29818 (May 23, 2011) (proposing release).

²² See Morgan Lewis Letter.

interpretation means that further rulemaking could well confront a very different set of transactions than contemplated in April 2012, one focused not on conversion trades, but rather on apparently less common and more diverse retail forex transactions identified by commenters, such as hedging transactions and direct investments.²³ It also means that further rulemaking would need to consider whether there are classes of conversion trades not excluded under any final interpretation that may be adopted by the CFTC that must be addressed separately. We expect to consider these types of transactions and an appropriate regulatory approach to them in considering whether and what permanent rules we should adopt in this area.

Extending the expiration of Rule 15b12-1T to July 16, 2013 will provide the Commission additional time to consider carefully these issues. The extension will help to ensure that we have sufficient time to take such action as we may determine appropriate in this area, particularly in light of the diverse classes of transactions – beyond the conversion trades that have been the focus of comments to date – that any further rulemaking may need to consider.²⁴ We recognize that commenters' views differed as to whether and to what extent we should permit broker-dealers to continue to engage in some or all retail forex transactions. As discussed above, some commenters urged us to permit the statutory prohibition simply to take effect, thereby preventing potential abuses of retail customers by broker-dealers and BD-FCMs. A number of retail customers asked us to permit them to have continued access to retail forex transactions through broker-dealers. Some commenters stated that we should make certain revisions to Rule 15b12-

²³ See SIFMA/ISDA Letter (Annex A, Part I).

²⁴ If the Commission adopts permanent rules for retail forex transactions by broker-dealers before July 16, 2013, the Commission will consider whether it is appropriate to terminate the effectiveness of Rule 15b12-1T as part of that rulemaking.

1T, while others favored the rule as written, stating that existing broker-dealer regulations adequately address retail forex activities.

In considering commenters' views, we believe, on balance, that we should extend the expiration date of the rule to permit further assessment by the Commission in this area, which would be informed by any potential CFTC interpretation regarding conversion trades. Our view is influenced by investors' views that we should permit them to conduct retail forex transactions with broker-dealers. We also are mindful that while futures commission merchants that are not also broker-dealers could continue to engage in retail forex transactions in compliance with CFTC rules, a futures commission merchant that is also a broker-dealer would be prohibited from engaging in retail forex transactions if we do not extend Rule 15b12-1T. For these reasons, we are extending the expiration date of Rule 15b12-1T to July 16, 2013 to prevent retail customers who transact retail forex transactions through a broker-dealer from being potentially disadvantaged by the prohibition for retail forex transactions taking effect.²⁵ Given the limited nature of this extension, the pending request for a CFTC interpretation regarding conversion trades, the need to further understand the implications of the CFTC's interpretation, and the scope of comments we are seeking before any further action is taken, we are not modifying the interim final temporary rule other than to extend the expiration date of Rule 15b12-1T to July 16, 2013. Absent further action by the Commission, Rule 15b12-1T as amended will expire on July 16, 2013 at 11:59 p.m. Eastern Time.

²⁵ While retail customers could of course open an account with a futures commission merchant (that is not also registered as a broker-dealer) to engage in retail forex transactions, as explained below, this could create certain inefficiencies and additional costs. *See* discussion in the Economic Analysis section below.

II. REQUEST FOR COMMENT

The Commission requests comment regarding all aspects of the interim final temporary rule and the current market practices involving retail forex transactions, as well as any investor protection or other concerns that commenters believe should be addressed by Commission rulemaking. The Commission particularly requests comment from broker-dealers, including BD-FCMs, that are currently engaged or plan to engage in a retail forex business, retail customers that engage in forex transactions, and ECPs. The Commission welcomes information from all affected parties about the current scope and nature of retail forex transactions. This information, together with input from market participants and other regulators, as well as comments received on the Interim Release, will help inform the Commission's consideration of the appropriate regulatory framework, if any, for retail forex transactions before or beyond the expiration of the interim final temporary rule.

The Commission seeks comment on the need for further Commission rulemaking, should the CFTC determine that certain conversion trades are not subject to the CEA prohibition with respect to retail forex transactions.²⁶ We specifically seek to better understand the other types of retail forex transactions in which broker-dealers may engage, such as forex transactions to hedge portfolio currency risk or to diversify a portfolio, that would not be excluded from the prohibition under section 2 of the CEA by the requested interpretation. We also request information about what mechanisms broker-dealers use currently to comply with existing disclosure, recordkeeping, capital and margin, reporting, business conduct and documentation rules with respect to each type of retail forex transaction in which they engage. What policies and procedures and supervisory controls, for example, have broker-dealers implemented to

²⁶ See 7 U.S.C. 2(c)(2)(E)(ii)(I).

address those transactions? We also seek comment on what mechanisms broker-dealers use currently to comply with other existing regulatory requirements with respect to retail forex transactions.

If commenters believe further rulemaking is needed, please explain why, and provide us with a discussion of the types of transactions for which rules are needed and the circumstances under which such transactions are entered into. If commenters believe further rulemaking is not needed, please explain why not. The Commission seeks comment on the extent to which broker-dealers' retail forex activities may be affected, and any impact on retail customers of broker-dealers, in the event the Commission does not adopt any further rules in this area.

The Commission also seeks comment on the retail forex activities of BD-FCMs, and whether the Commission should adopt tailored rules for these intermediaries. We seek comment on the nature of BD-FCM retail forex activities, including the type of transactions in which they engage, and which part of the dually registered entity may engage in these activities or transactions. We also request comment on the mechanisms BD-FCMs use currently to comply with existing disclosure, recordkeeping, capital and margin, reporting, business conduct and documentation rules with respect to each type of retail forex transaction in which they engage. In connection with this specific request for comment, please identify whether the relevant requirements are Exchange Act Rules, CEA Rules, or rules of a particular self-regulatory organization ("SRO") of which the BD-FCM is a member. The Commission also seeks comment on the extent to which the retail forex activities of BD-FCMs may be affected, and any impact on retail customers of BD-FCMs, in the event the Commission does not adopt any further rules in this area.

Some commenters have suggested that if broker-dealers were prohibited from engaging in retail forex activities, currency ETFs would be a reasonable substitute for broker-dealer customers seeking to hedge their currency exposures.²⁷ The Commission requests comment on whether and how currency ETFs could meet the needs of retail customers in this regard. The Commission also requests information about how currency ETFs (and any other financial product or service that commenters believe could serve as a substitute for forex) could be used more generally to meet the risk mitigation and any other needs of retail customers that currently are addressed using retail forex transactions. Would currency ETFs (or other financial products) hedge currency risks in connection with foreign securities transactions in the same manner or differently than retail forex transactions? How would the transaction and other costs associated with currency ETFs and retail forex transactions compare? We further seek comment on what the associated benefits and costs would be of retail customers using currency ETFs or some other product or service, as a substitute for retail forex. We also seek comment on the liquidity of such alternative products or services, the ease or difficulty of accessing and using those products or services, and any additional risks involved in using those products or services.

The Commission also seeks comment on whether Rule 15b12-1T should be extended beyond July 16, 2013, and if so, why and for how long, or whether it should be adopted as a final rule.

III. ECONOMIC ANALYSIS

A. Introduction

Section 3(f) of the Exchange Act requires the Commission, whenever it engages in rulemaking under the Exchange Act and is required to consider or determine whether an action is

²⁷ See Philadelphia Financial Letter at 8, and Better Markets Letter at 3.

necessary or appropriate in the public interest, to consider, in addition to the protection of investors, whether the action would promote efficiency, competition and capital formation.²⁸ In addition, Section 23(a)(2) of the Exchange Act requires the Commission, when making rules under the Exchange Act, to consider the impact such rules would have on competition.²⁹ Section 23(a)(2) of the Exchange Act prohibits the Commission from adopting any rule that would impose a burden on competition not necessary or appropriate in furtherance of the purposes of the Exchange Act.³⁰

We understand that under the current regulatory regime, retail customers typically enter into foreign exchange transactions with broker-dealers for a number of reasons. Industry participants have told us that the most common transaction is a foreign exchange conversion trade, in which a currency trade is made in connection with a foreign securities transaction.³¹ Commenters have also told us that retail customers enter into forex transactions with broker-dealers as part of a hedging strategy. For instance, retail customers may engage in forex transactions through broker-dealers in order to hedge currency risk in securities or in a portfolio generally held in the customer's brokerage account; they may also engage in these transactions in order to obtain exposure to foreign markets as part of their investment strategy.³²

²⁸ See 15 U.S.C. 78c(f).

²⁹ See 15 U.S.C. 78w(a)(2).

³⁰ See *id.*

³¹ Morgan Lewis Letter. As explained above, the ABA/GFMA Letter requests an interpretation that would exclude conversion trades from the prohibition under CEA section 2.

³² SIFMA/ISDA Letter at 4, Annex A at 1 – 2.

Congress prohibited the retail forex transactions described in CEA section 2 except pursuant to rules adopted by the relevant Federal regulatory agencies allowing the transactions. As we noted in the Interim Release, some of these transactions, in particular hedging transactions and securities conversion trades, may be beneficial to investors.³³ At the same time, as discussed in the Interim Release, the Commission is aware of potentially abusive practices that may be occurring in the retail forex market. Such practices may include, for example, lack of disclosure about fees and forex pricing, and insufficient capital or margin requirements.³⁴

As discussed above, on April 18, 2012, a group of commenters asked the CFTC, as well as other Federal regulatory agencies (including the Commission), to take the view that forex transactions that are solely incidental to, and are initiated for the sole purpose of, permitting a client to complete a transaction in a foreign security, through “conversion trades,” would not be subject to the retail forex prohibition under section 2 of the CEA.³⁵ An interpretation by the CFTC that conversion trades are not subject to the statutory prohibition could significantly affect the costs and benefits of any action by the Commission with regard to retail forex transactions going forward. Commenters have stated that conversion trades comprise the vast majority of retail forex transactions engaged in by broker-dealers,³⁶ but also note that there are other types of forex transactions in which broker-dealers engage with retail customers.³⁷ Because the request for the interpretation is still pending, however, the Commission will continue to consider

³³ See Interim Release at 41684.

³⁴ See *id.*

³⁵ See ABA/GFMA Letter.

³⁶ See Morgan Lewis Letter.

³⁷ See SIFMA/ISDA Letter, Annex A.

conversion trades as retail forex transactions that would be prohibited but for Rule 15b12-1T, for purposes of our economic analysis.

Extending Rule 15b12-1T maintains the regulatory framework that currently exists for broker-dealers, and does not create any new regulatory obligations. Furthermore, the rule preserves the ability of broker-dealers to provide, among other services, hedging and conversion trades to retail customers while the Commission considers what further appropriate steps to take, if any.³⁸

The Commission has previously considered and discussed in the Interim Release its economic analysis of Rule 15b12-1T.³⁹ The Commission solicited comment on its economic analysis in the Interim Release, and received one comment that addressed but did not support its economic analysis.⁴⁰ As stated in the Interim Release, we adopted Rule 15b12-1T as an interim final temporary rule to allow the existing regulatory framework for retail forex transactions to continue for a defined period, to avoid potentially unintended consequences from broker-dealers immediately discontinuing their retail forex business, and to provide the Commission sufficient time to determine the appropriate regulatory framework regarding retail forex transactions.⁴¹ Furthermore, investors who commented on the rule asked the Commission to preserve their

³⁸ To the extent that conversion trades are not excluded from the prohibition in CEA section 2, extension of the Rule 15b12-1T would also have the benefit of allowing customers to continue to engage in those transactions as part of their brokerage activities while the Commission considers any further action.

³⁹ For a detailed description of the costs and benefits of Rule 15b12-1T, *see also* Interim Release at 41684.

⁴⁰ Better Markets Letter. *But see* SIFMA/ISDA Letter.

⁴¹ *See* Interim Release at 48683.

ability to engage in retail forex transaction through their broker-dealers. In addition, we included an economic analysis of the rule in the Interim Release.⁴²

As mentioned above, based on data a commenter provided of five broker-dealers, in terms of notional amount, foreign exchange conversion trades would account for approximately 90% of foreign exchange transactions done through broker-dealers, and 99% of all broker-dealer customer accounts are involved in conversion trades, though not all trades within an account may be conversions.⁴³ Commenters have told us that certain forex transactions, particularly certain portfolio hedges, may have close substitutes in currency ETFs.⁴⁴ It does not appear that currency ETFs would necessarily function as effectively in mitigating the currency risk of particular securities transactions, because the precise timing and amount of a securities transaction may not be readily matched to a currency ETF, as conversion trades are customer-specific and typically designed to facilitate particular securities transactions, whereas currency ETFs generally are designed to provide broad exposure to exchange rate movements. The contracts used to complete forex conversions do have close substitutes in exchange-traded currency futures, as both involve the exchange of currency at a future date. However, as with currency ETFs, the precise timing and amount of a securities transaction may not be easily matched to exchange-traded futures contracts, which have standardized maturity dates and notional amounts. Off-exchange forwards, on the other hand, can be easily customized to match a particular transaction. Additionally, exchange-traded futures are not as effective at mitigating risks between the trade

⁴² See *id.* at 41684.

⁴³ Morgan Lewis Letter.

⁴⁴ See Philadelphia Financial Letter. See also Better Markets Letter.

and settlement dates, since mark-to-market margin requirements expose the investor to additional cash flow risk.

The Commission understands that conversion trades can be replicated at futures commission merchants. However, as a practical matter, this would require the customer to maintain multiple accounts, which could increase transaction costs and reduce efficiency relative to conversion trades performed within a broker-dealer.

B. Alternatives Considered

The Commission considered certain alternatives to extending Rule 15b12-1T. One alternative would be to let Rule 15b12-1T expire on its original expiration date, and so preclude broker-dealers from engaging in certain types of retail forex business other than, potentially, conversion trades, at least until such time as the Commission were to adopt final rules in this area. The benefit of this alternative would be that the abuses Congress sought to address through Dodd-Frank Act Section 724 would be addressed through this complete prohibition. The cost of this alternative would be that an outright prohibition on retail forex activity would interfere with certain business activities engaged in by broker-dealers that are potentially beneficial for their customers, in particular the potential benefit to customers relating to conversion trades. We note in this alternative approach, retail customers of broker-dealers would be required to open an account with a futures commission merchant or other financial service provider merely to engage in currency transactions intended to mitigate risks in connection with brokerage transactions in foreign securities. While this shifting to services to another intermediary would impose additional costs, retail customers may, however, benefit from the protection of rules to which those intermediaries are subject.⁴⁵

⁴⁵ See *supra* note 6.

The Commission has not adopted this alternative at this time for the reasons discussed above, and in particular because of concerns that we not disrupt potentially beneficial market practices, such as conversion trades that may serve to minimize a retail customer's exposure to the risk of changes in foreign currency rates in connection with the customer's purchase or sale of a security. In addition, we have not adopted this alternative because the CFTC's interpretation regarding conversion trades is not yet settled.

The Commission also considered adopting Rule 15b12-1T as a final, permanent rule. While the direct costs and benefits of this alternative would be minimal (as it would simply continue the existing regulatory requirements for broker-dealers engaging in retail forex transactions), it nevertheless could have broader impacts on the markets given that other regulators have now adopted or proposed final rules with various specific requirements relating to retail forex that impose different requirements on market intermediaries than those the Commission imposes on broker-dealers under Rule 15b12-1T.⁴⁶ The lack of comparable rules across the various intermediaries engaging in a retail forex business could lead to regulatory arbitrage or regulatory gaps. The Commission is considering alternatives, including proposing rules pertaining to retail forex that are more tailored than Rule 15b12-1T and that would be more closely aligned with those of the other regulators but has deferred a determination pending the resolution by the CFTC of the pending request in the ABA/GFMA Letter concerning the treatment of conversion trades.

C. Benefits

⁴⁶ *Id.*

Rule 15b12-1T was designed to preserve retail customers' access to the forex markets through broker-dealers and so promote efficiency by, for example, permitting retail customers to continue to enter into forex transactions in connection with trades in foreign securities, as part of their brokerage activities until such time as the Commission allows Rule 15b12-1T to expire or adopts final, permanent rules in this area. Without the Commission acting to extend Rule 15b12-1T, broker-dealers would be required to exit certain types of retail forex business, which could require retail customers to engage in forex transactions through a futures commission merchant or other service provider. This could be economically inefficient. In particular, to the extent that access to the foreign exchange markets through broker-dealers provides hedging and conversion opportunities for foreign investments, economic benefits may accrue to retail customers.⁴⁷ To the extent that the CFTC takes the view that some or all conversion trades remain subject to the retail forex prohibition, and as noted in the Interim Release, the benefits of these trades may not be as easily or efficiently replicated outside of the broker-dealer.⁴⁸ Furthermore, by continuing to preserve a channel for broker-dealers' retail customers to access forex transactions through broker-dealers, the extension of the interim final temporary rule will continue to prevent any loss of competition in the retail forex market that could result if broker-dealers were required to exit the business. Moreover, extending the term of the rule will likely, for the period of the extended term, maintain the status quo for broker-dealers with respect to other regulated intermediaries offering retail forex services, whose regulators have adopted (or have proposed to adopt) rules targeted to retail forex with which those intermediaries must comply.⁴⁹ Extending the term of

⁴⁷ See Interim Release at 41684.

⁴⁸ See *id.*

⁴⁹ See *supra* note 6.

the rule would not necessarily promote competition between broker-dealers and the other regulated intermediaries, as broker-dealers would continue to offer retail forex services under Rule 15b12-1T which, in general, imposes requirements that arguably could be viewed as less burdensome than those that have become (or are proposed to become) applicable to other regulated intermediaries. Competition among broker-dealers would most likely not be affected by extending the term of the rule.

Because the regulatory requirements for broker-dealers operating in the retail forex market will remain unchanged, extending the expiration date of Rule 15b12-1T will impose no new burden on competition. Similarly, since the rule preserves an existing regulatory structure, the Commission does not expect that extending the term of the rule would result in any potential impairment of the capital formation process.

D. Costs

Because Rule 15b12-1T preserves the regulatory regime that had been in place prior to the effective date of Section 742(c) of the Dodd-Frank Act, the extension of the rule imposes no new regulatory burdens beyond those that already existed for broker-dealers engaged in a retail forex business. The Commission recognizes that broker-dealers will face regulatory costs and requirements associated with operating in the retail forex market, but these costs and requirements are those they already shouldered from engaging in the business.⁵⁰ As discussed

⁵⁰ As described in the Interim Release, these costs include costs related to disclosure, recordkeeping and documentation, capital and margin, reporting, and business conduct. A broker-dealer that currently engages in forex transactions with retail customers, for example, incurs costs associated with establishing, maintaining, and implementing policies and procedures to comply with regulatory requirements; preparing disclosure documents; establishing and maintaining forex-related business records; and preparing filings with the Commission, which may include legal and accounting fees. Interim Release at 41684.

above and in the Interim Release, the Commission is aware of potentially abusive practices that may be occurring in the retail forex market.⁵¹ To the extent that such practices continue, customers may bear the costs associated with these abuses. We are monitoring potential fraud involved in forex within our jurisdiction,⁵² and our staff has also alerted investors to the risks of retail forex trading.⁵³ The Commission believes, on balance, that the cost of market disruption that may occur if the Commission does not extend Rule 15b12-1T, particularly with respect to conversion transactions that may not be easily replicated outside of the broker-dealer,⁵⁴ justifies the cost of maintaining the current regulatory regime while the Commission considers proposing rules in light of additional developments, including the recent request for the CFTC's interpretation regarding conversion trades.⁵⁵

E. Conclusion

Because the extension of Rule 15b12-1T will not affect the regulatory requirements for broker-dealers operating in the retail forex market, this extension will impose no new burden on competition. Similarly, because the rule's extension does not alter the existing regulatory structure, the Commission does not expect any potential impairment of the capital formation process. To the extent that potentially abusive practices continue in the retail forex market, the

⁵² For instance, we recently brought an enforcement action against the CEO of a purported foreign currency trading firm, alleging fraud by that person. *See SEC v. Jeffery A. Lowrance, et al.*, Case No. CV-11-3451, press release, complaint and litigation release, available at <http://www.sec.gov/news/press/2011/2011-147.htm>.

⁵³ *See Investor Bulletin: Foreign Currency Exchange (Forex) Trading for Individual Investors* (July 2011), available at <http://www.sec.gov/investor/alerts/forextrading.pdf>.

⁵⁴ *See* Interim Release at 41684.

⁵⁵ *Id.*

market will continue to bear the costs associated with any such abuses and the resultant inefficient provision of services across the market. Because extending Rule 15b12-1T does not alter the existing regulatory structure or regime, the Commission does not expect any potential impairment of the capital formation process, especially as the rule's extension allows retail customers to continue to have access through broker-dealers to hedging transactions, conversion trades, and other forex transactions, without the need to shift business and open new accounts at other market intermediaries.

IV. Paperwork Reduction Act

Rule 15b12-1T does not impose any new “collection of information” requirements within the meaning of the Paperwork Reduction Act of 1995 (“PRA”),⁵⁶ or create any new filing, reporting, recordkeeping, or disclosure reporting requirements for broker-dealers that are or plan to be engaged in a retail forex business. In the Interim Release, the Commission requested comment on its conclusion that there are no collections of information.⁵⁷ The Commission received no comments relating to the PRA analysis. Accordingly, the Commission maintains its PRA analysis set forth in the Interim Release for purposes of this extension.

V. OTHER MATTERS

A. Administrative Procedure Act

The Administrative Procedure Act generally requires an agency to publish notice of a proposed rulemaking in the Federal Register.⁵⁸ This requirement does not apply, however, if the agency “for good cause finds . . . that notice and public procedure are impracticable,

⁵⁶ 44 U.S.C. 3501 *et seq.*

⁵⁷ *See* Interim Release at 41683-84.

⁵⁸ *See* 5 U.S.C. 553(b).

unnecessary, or contrary to the public interest.”⁵⁹ The Administrative Procedure Act also generally requires that an agency publish an adopted rule in the Federal Register 30 days before it becomes effective.⁶⁰ This requirement, however, does not apply if the agency finds good cause for making the rule effective sooner.⁶¹ The Commission finds that there is good cause to extend the expiration date of Rule 15b12-1T to July 16, 2013, without notice and comment and not to delay the effective date of the extension. The Commission further finds that notice and solicitation of comment on the extension is impracticable, unnecessary, or contrary to the public interest.⁶²

As discussed above, on April 18, 2012, a group of commenters asked the CFTC, as well as other Federal regulatory agencies (including the Commission), to find that forex transactions that are solely incidental to, and are initiated for the sole purpose of, permitting a client to complete a transaction in a foreign security, so-called “conversion trades,” would not be subject to the retail forex prohibition under section 2 of the CEA.⁶³ We anticipate that the CFTC will address this request in the context of the Products Definition Release. An interpretation by the CFTC that conversion trades are not subject to the statutory prohibition could affect the need for, or the extent and reach of, any Commission rulemaking for retail forex transactions generally. Commenters have stated that conversion trades comprise the vast majority of retail

⁵⁹

Id.

⁶⁰

See 5 U.S.C. 553(d).

⁶¹

Id.

⁶²

See 5 U.S.C. 553(b) and (d).

⁶³

See ABA/GFMA Letter.

forex transactions engaged in by broker-dealers,⁶⁴ and permitting conversion trades by broker-dealers was one of the reasons we adopted Rule 15b12-1T.⁶⁵ As we previously have noted, there are other types of forex transactions broker-dealers engage in which may be potentially beneficial for retail customers, such as using forex to hedge portfolio currency risk or to provide portfolio diversification.⁶⁶ The potential CFTC interpretation means that further rulemaking could well confront a very different set of transactions than contemplated in April 2012, one focused not on conversion trades, but rather on these other types of forex transactions. It also means that further rulemaking would need to consider whether there are classes of conversion trades not excluded under any final interpretation that may be adopted by the CFTC that must be addressed separately. Accordingly, if the CEA is interpreted so that certain conversion trades would not be prohibited, we would want to consider what, if anything, we believe is appropriate with respect to proposing and adopting a permanent rule in this area in light of the diverse classes of transactions – beyond the conversion trades that have been the focus of comments to date – that any such rule may need to consider. Accordingly, in view of these very recent developments, the Commission has determined that it would be impracticable to publish notice of the proposed extension.

In making this finding of good cause,⁶⁷ the Commission has decided to maintain the current regulatory regime in order to avoid disruption for investors engaging in retail forex

⁶⁴ See Morgan Lewis Letter.

⁶⁵ See Interim Release at 41684.

⁶⁶ See *id.* See also SIFMA/ISDA Letter (Annex A, Part I).

⁶⁷ This finding also satisfies the requirements of 5 U.S.C. 808(2), allowing the rules to become effective notwithstanding the requirement of 5 U.S.C. 801 (if a federal agency finds that notice and public comment are “impractical, unnecessary or contrary to the

transactions through broker-dealers, until such time as the Commission makes any final decision with regard to permanent rulemaking in this area, in light of any potential interpretation by the CFTC. In particular, the Commission considered that not extending the expiration date, or allowing the extension to be delayed, would cause disruption to the markets and potentially harm investors, as retail forex transactions, including conversion trades, would, as of July 16, 2012, the original expiration date of Rule 15b12-1T, be prohibited. For the same reasons, the Commission finds good cause not to delay the effective date of this extension for 30 days.

In the event that the Commission determines to propose a permanent rule to replace Rule 15b12-1T, the Commission will provide notice and solicit comment on that proposal.

B. Regulatory Flexibility Act Certification

In the Interim Release, the Commission certified that pursuant to 5 U.S.C. 605(b), Rule 15b12-1T would not have a significant economic impact on a substantial number of small entities. As explained in the Interim Release, although Rule 15b12-1T applies to broker-dealers that may engage in retail forex transactions, which may include small businesses, any costs or regulatory burdens incurred as a result of the rule are the same as those incurred by small broker-dealers prior to the effective date of Section 742 of the Dodd-Frank Act.⁶⁸ We also noted that the rule would impose no new regulatory obligations, costs, or burdens on such broker-dealers. Thus, there would not be a significant economic impact on a substantial number of small entities. In the Interim Release, we requested comment on our conclusion that Rule 15b12-1T should not have a significant economic impact on a substantial number of small entities. The Commission received no comments addressing this issue. In light of this, as well as the fact that we are

public interest,” a rule “shall take effect at such time as the federal agency promulgating the rule determines”).

⁶⁸ See *id.* at 41684-85.

making no change to Rule 15b12-1T apart from extending its expiration date, we hereby certify pursuant to 5 U.S.C. 605(b) that extending Rule 15b12-1T will not have a significant economic impact on a substantial number of small entities.

VI. STATUTORY AUTHORITY AND TEXT OF RULE AND AMENDMENT

Pursuant to section 2(c)(2) of the Commodity Exchange Act, as well as the Exchange Act as amended, the Commission is amending Exchange Act Rule 15b12-1T.

List of Subjects in 17 CFR Part 240

Brokers, Consumer protection, Currency, Reporting and recordkeeping requirements. In accordance with the foregoing, the Securities and Exchange Commission is amending Title 17, chapter II, of the Code of Federal Regulations as follows:

TEXT OF THE RULE AND AMENDMENT

PART 240 - GENERAL RULES AND REGULATIONS, SECURITIES EXCHANGE ACT OF 1934

1. The general authority citation for Part 240 continues to read as follows:

Authority: 15 U.S.C. 77c, 77d, 77g, 77j, 77s, 77z-2, 77z-3, 77eee, 77ggg, 77nnn, 77sss, 77ttt, 78c, 78d, 78e, 78f, 78g, 78i, 78j, 78j-1, 78k, 78k-1, 78l, 78m, 78n, 78n-1, 78o, 78o-4, 78p, 78q, 78s, 78u-5, 78w, 78x, 78ll, 78mm, 80a-20, 80a-23, 80a-29, 80a-37, 80b-3, 80b-4, 80b-11, and 7201 et. seq.; 18 U.S.C. 1350; 12 U.S.C. 5221(e)(3); and 7 U.S.C. 2(c)(2)(E), unless otherwise noted.

* * * * *

§ 240.15b12-1T [Amended]

2. Revise paragraph (d) of § 240.15b12-1T to read as follows:

§ 240.15b12-1T Brokers or dealers engaged in a retail forex business.

* * * * *

(d) This section will expire and no longer be effective on July 16, 2013.

By the Commission.

Elizabeth M. Murphy
Secretary

July 11, 2012