

Supporting Statement
Retail Foreign Exchange Transactions
OMB Control No. 3064-0182

Introduction

The FDIC is requesting OMB approval of a new information collection. The collection of information is comprised of reporting, recordkeeping and disclosure requirements included in a final rule on Retail Foreign Exchange Transactions issued by the FDIC as required by section 742(c)(2) of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank Act)¹. An information collection request (ICR) was submitted to OMB in conjunction with publication of the notice of proposed rulemaking (NPRM) on May 17, 2011 (76 FR 28358). In response to ICR, OMB asked that the FDIC examine public comment in response to the NPRM and include in the supporting statement of the next ICR, to be submitted to OMB at the final rule stage, a description of how the agency has responded to any public comments on the ICR, including comments on maximizing the practical utility of the collection and minimizing the burden. This Supporting Statement is submitted in compliance with OMB's request.

A. Justification.

1. Circumstances that make the collection necessary:

Section 742(c)(2) of the Dodd-Frank Act amended the Commodity Exchange Act (CEA) to provide that a U.S. financial institution for which there is a Federal regulatory agency shall not enter into, or offer to enter into, a transaction described in section 2(c)(2)(B)(i)(I) of the CEA with a retail customer 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 prescribe² (retail forex rule).

Section 2(c)(2)(B)(i)(I) of the CEA³ includes "an agreement, contract, or transaction in foreign currency that . . . is a contract of sale of a commodity for future delivery (or an option on such a contract) or an option (other than an option executed or traded on a national securities exchange registered pursuant to section 6(a) of the Securities Exchange Act of 1934."⁴

Under the CEA, the FDIC is the "Federal regulatory agency" for entities for which it is the "appropriate Federal banking agency" under section 3 of the Federal Deposit Insurance Act (12 U.S.C. 1813(q)).⁵ (such an entity is referred to here as an "FDIC-supervised IDI.") The

¹ Pub. L. 111-203, 124 Stat. 1376. (July 21, 2010) 7 U.S.C. 2(c)(2)(E).

² 7 U.S.C. 2(c)(2)(E)(ii)(I).

³ 7 U.S.C. 2(c)(2)(B)(i)(II).

⁴ 15 U.S.C. 78f(a)

⁵ The FDIC is currently the appropriate Federal banking agency for each State nonmember insured bank and each foreign bank having an insured branch. 12 U.S.C. § 1813(q)(3). When the powers of the Office of Thrift Supervision are transferred to the Office of Comptroller of the Currency, the FDIC, and the Board of Governors of the Federal Reserve System, pursuant to Title III of the Dodd-Frank Act, the FDIC will also become the appropriate

FDIC's retail forex rule must treat all such futures and options and all agreements, contracts, or transactions that are functionally or economically similar to such futures and options in a similar manner.⁶ The FDIC's retail forex rules must also prescribe appropriate requirements with respect to disclosure, recordkeeping, capital and margin, reporting, business conduct, and documentation requirements, and may include such other standards or requirements as it determines to be necessary.⁷

2. Use of the information

The reporting requirements in § 349.4 require that, prior to initiating a retail forex business, an FDIC-supervised IDI provide the FDIC with prior notice, obtain the FDIC's prior written consent, and submit the documents provided for in proposed § 349.4(c). The FDIC-supervised IDI must also provide other information required by the FDIC, such as documentation of customer due diligence. A FDIC-supervised IDI already engaging in a retail forex business may continue to do so, provided it request the FDIC's written consent.

The rule also contains a number of disclosure requirements. Section 349.5, regarding the application and closing out of offsetting long and short positions, requires an FDIC-supervised IDI to promptly provide the customer with a statement reflecting the financial result of the transactions and the name of the introducing broker to the account. The customer would provide specific instructions on how the offsetting transaction should be applied.

Section 349.6 requires that an FDIC-supervised IDI furnish a retail forex customer with a written disclosure before opening an account that will engage in retail forex transactions for a retail forex customer and receive an acknowledgment from the customer that it was received and understood. It also requires the disclosure by an FDIC-supervised IDI of its fees and other charges and its profitable accounts ratio.

Section 349.10 requires an FDIC-supervised IDI to issue monthly statements to each retail forex customer and to send confirmation statements following transactions.

Section 349.13(b) allows disclosure by an FDIC-supervised IDI that an order of another person is being held by them only when necessary to the effective execution of the order or when the disclosure is requested by the FDIC. Section 349.13(c) prohibits an FDIC-supervised IDI engaging in retail forex transactions from knowingly handling the account of any related person of another retail forex counterparty unless it receives proper written authorization, promptly prepares a written record of the order, and transmits to the counterparty copies all statements and written records. Section 349.13(d) prohibits a related person of an FDIC-supervised IDI engaging in forex transactions from having an account with another retail forex counterparty unless it receives proper written authorization and copies of all statements and written records for such accounts are transmitted to the counterparty.

Federal banking agency for each State savings association. See Dodd-Frank Act § 312(c) (amending 12 U.S.C. § 1813(q) to redefine "appropriate Federal banking agency").

⁶ 7 U.S.C. 2(c)(2)(E)(iii)(II).

⁷ 7 U.S.C. 2(c)(2)(E)(iii)(I).

Section 349.15 requires an FDIC-supervised IDI to provide a retail forex customer with 30 days' prior notice of any assignment of any position or transfer of any account of the retail forex customer. It also requires an FDIC-supervised IDI to which retail forex accounts or positions are assigned or transferred to provide the affected customers with risk disclosure statements and forms of acknowledgment and receive the signed acknowledgments within 60 days.

The customer dispute resolution provisions in § 349.16 require that within 10 business days after receipt of notice from the retail forex customer that they intend to submit a claim to arbitration, the FDIC-supervised IDI provides them with a list of persons qualified in the dispute resolution, and that the customer must notify the FDIC-supervised IDI of the person selected within 45 days of receipt of such list.

Regarding recordkeeping, sections 349.7 and 349.13 requires that an FDIC-supervised IDI engaging in retail forex transactions keep full, complete, and systematic records and establish and implement internal rules, procedures, and controls. Section 349.7 also requires that an FDIC-supervised IDI keep account, financial ledger, transaction and daily records, as well as memorandum orders, post-execution allocation of bunched orders, records regarding its ratio of profitable accounts, possible violations of law, records for noncash margin, and monthly statements and confirmations. Section 349.9 requires policies and procedures for haircuts for noncash margin collected under the rule's margin requirements, and annual evaluations and modifications of the haircuts.

The information required to be reported, maintained and disclosed requirements is deemed necessary to ensure the safety and soundness of institutions engaging in retail foreign exchange transactions and to protect customers on whose behalf the activities are conducted.

3. Consideration of the use of improved information technology:

An FDIC-supervised IDI may use any information technology that permits review by FDIC examiners.

4. Efforts to identify duplication:

The information required is unique. It is not duplicated elsewhere.

5. Methods used to minimize burden if the collection has an impact on a substantial number of small entities:

Not applicable.

6. Consequences to the Federal program if the collection were conducted less frequently:

Conducting the collection less frequently would present safety and soundness risks and

weaken protection of consumers engaging in retail foreign exchange transactions.

7. Special circumstances necessitating collection inconsistent with 5 CFR Part 1320:

None.

8. Efforts to consult with persons outside the agency:

The FDIC published a notice of proposed rulemaking in the *Federal Register* seeking comment for a 30-day period. Six comments were received and considered in development of the final rule. Two comments were from banks, one comment was from a banking trade association, and three comments were from individuals. Several of the comments addressed the substance and/or method of disclosure and reporting requirements contained in the rule as more fully explained below.

Section 349.5 – Application and Closing Out of Offsetting Long and Short Positions

This section requires an FDIC-supervised IDI to close out offsetting long and short positions in a retail forex account. The FDIC-supervised IDI would have to offset such positions regardless of whether the customer has instructed otherwise. The CFTC concluded that “keeping open long and short positions in a retail forex customer’s account removes the opportunity for the customer to profit on the transactions, increases the fees paid by the customer and invites abuse.”⁸ The FDIC agreed with this concern in the notice of proposed rulemaking.

One commenter indicated that a customer should be given the opportunity to provide instructions with respect to the manner in which the customer’s retail forex transactions are offset when: (i) the customer maintains separate accounts managed by different advisors; (ii) the customer maintains separate accounts using different trading strategies; or (iii) the customer employs different trading strategies in one account and uses certain orders to risk-manage that exposure. Two commenters also sought clarification that a customer could provide specific offset instructions in writing or orally, and that such instructions could be on a blanket basis.

The FDIC agrees that a customer should be able to offset retail forex transactions in a particular manner, if he or she so chooses. Paragraph (c) has been modified to provide that, notwithstanding the default offset rules in paragraphs (a) and (b), the FDIC-supervised IDI must offset retail forex transactions pursuant to a customer’s specific instructions. Blanket instructions are not sufficient for this purpose, as they could obviate the default rule. However, offset instructions need not be given separately for each pair of orders in order to be “specific.” Instructions that apply to sufficiently defined sets of transactions could be specific enough. Finally, consistent with the changes to section 349.12, offset instructions may be provided in writing or orally provided that any oral instruction be captured by a recording mechanism.

Section 349.6—Disclosure

⁸ Proposed CFTC Retail Forex Rule, 75 FR at 3287 n.54.

This section requires an FDIC-supervised IDI to provide retail forex customers with a risk disclosure statement similar to the one required by the CFTC’s retail forex rule, but tailored to address certain unique characteristics of retail forex in FDIC-supervised IDIs. The prescribed risk disclosure statement would describe the risks associated with retail forex transactions.

Two commenters agreed with the need for a robust risk disclosure statement, but suggested that a shorter, clearer, more direct and less redundant statement would be more effective. One commenter recommended that the proposed disclosure statement be a sample or safe harbor language for banks to use as they find appropriate.

After careful consideration, the final rule incorporates several changes to the disclosures to eliminate redundancies, address ambiguities, and convey the information more clearly.

The proposal requested comment on whether the risk disclosure statement should disclose the percentage of profitable retail forex accounts.

One commenter said that disclosing the ratio of profitable to nonprofitable retail forex accounts is not useful because those ratios depend on many factors (including the trading expertise of customers) and could suggest that a bank is a more attractive retail forex counterparty than another.

In its retail forex rule, the CFTC requires its registrants to disclose to retail customers the percentage of retail forex accounts that earned a profit, and the percentage of such accounts that experienced a loss, during each of the most recent four calendar quarters.⁹ The CFTC explained that “the vast majority of retail customers who enter these transactions do so solely for speculative purposes, and that relatively few of these participants trade profitably.”¹⁰ In its final rule, the CFTC found this requirement appropriate to protect retail customers from “inherent conflicts embedded in the operations of the retail over-the-counter forex industry.”¹¹ The FDIC agrees with the CFTC and thus the final rule requires this disclosure.

The proposal requested comment on whether the risk disclosure statement should include a disclosure that when a retail customer loses money trading, the dealer makes money.

One of the commenters said that this disclosure is inaccurate because in most cases a bank may immediately hedge retail forex transactions or nets them with similar transactions and therefore does not profit from exchange rate fluctuations. The commenter argued it is more accurate to inform customers that the bank may or does mark-up (or down) transactions or apply commission rates to transactions that will result in income to the bank.

The FDIC understands that the economic model of a retail forex business may be to profit from spreads, fees, and commissions. Nonetheless, because any FDIC-supervised IDI engaging in retail forex transactions is trading as principal, by definition, when the retail forex customer

⁹ 17 CFR 5.5(e)(1).

¹⁰ Proposed CFTC Retail Forex Rule, 75 FR at 3289.

¹¹ Final CFTC Retail Forex Rule, 75 FR at 55412.

loses money, the FDIC-supervised IDI makes money on that transaction. The FDIC therefore believes that this disclosure is accurate and helps potential retail forex customers understand the nature of retail forex transactions. Similarly, the CFTC's retail forex rule requires a disclosure that when a retail customer loses money trading, the dealer makes money on such trades, in addition to any fees, commissions, or spreads.¹² The final rule includes this disclosure requirement.

The proposal asked whether it would be convenient to banks and retail forex customers to allow the retail forex risk disclosure to be combined with other disclosures that FDIC-supervised IDIs make to their customers.

One commenter asked the FDIC to confirm that banks may add topics to the risk disclosure statement.

The FDIC is concerned that the effectiveness of the disclosure could be diminished if surrounded by other topics. Therefore, the final rule requires the risk disclosure statement to be given to potential retail forex customers as set forth in the rule. FDIC-supervised IDIs may describe and provide additional information on retail forex transactions in a separate document.

One commenter further asked the FDIC to confirm that the risk disclosure statement may be appended to account opening agreements or forms, and that a single signature by the customer on a combined account agreement and disclosure form can be used as long as the customer is directed to and acknowledges the risk disclosure statement immediately prior to the signature line.

The FDIC believes that a separate risk disclosure document appropriately highlights the risks in retail forex transactions, and that requiring a separate signature for the separate risk disclosure appropriately calls a potential retail forex customer's attention to the risk disclosure statement. However, a bank may attach the risk disclosure to a related document, such as the account agreement.

The proposal requested comment on whether the risk disclosure statement should include a disclosure of fees the bank charges retail forex customers.

One of the commenters agreed that the disclosure of fees is appropriate, but should not include income from hedging retail forex customers' positions or income streams not charged to the customer. Moreover, the same commenter stated it is impractical to numerically state the bid/ask spread given that it may vary.

The final rule, like the proposed rule, does not require FDIC-supervised IDIs to disclose income streams not charged to the retail forex customer. However, an FDIC-supervised IDI must do more than simply describe the means by which they earn revenue. To the extent practical, it must quantify the fees, commissions, spreads, and charges it charges the retail forex customer. The FDIC further believes that disclosure of the bid/ask spread is possible in a variety

¹² 17 CFR 5.5(b).

of ways. If an FDIC-supervised IDI bases its prices off of the prices provided by a third party, then the FDIC-supervised IDI may disclose the use of the third party's pricing and the markup charged to retail forex customers. Alternatively, the FDIC-supervised IDI may disclose the bid/ask spread by quoting both the bid and ask prices to retail forex customers prior to entering into a retail forex transaction. These quotes may be provided as part of an electronic trading platform or, after a retail forex customer calls the FDIC-supervised IDI for a retail forex transaction, by providing both a bid and ask price for the transaction.

One of the bank commenters read the proposed disclosure to suggest that a bank cannot seek to recover losses not covered by a customer's margin account via an appropriate dispute resolution forum, and asked the FDIC confirm that this was not the case.

It is not clear how common it will be for a retail forex customer to incur retail forex obligations, including losses, in excess of margin funds. Section 48.9(d)(4) requires an FDIC-supervised IDI, in the event that a retail forex customer's margin falls below the amount needed to satisfy the margin requirement to either: (1) collect sufficient margin from the retail forex customer; or (2) liquidate the retail forex customer's retail forex transactions. This requirement precludes an FDIC-supervised IDI from allowing customer's retail forex transactions to remain open and continuing to accrue losses after it has determined that additional margin funds are required. The final rule does not forbid an FDIC-supervised IDI, from seeking to recover a deficiency from a retail forex customer by obtaining a money judgment or other enforceable order in an appropriate venue and then exercising its collection rights as a judgment creditor. The disclosure has been revised to make this fact clear.

Finally, the commenter said that the disclosure regarding the availability of FDIC-insurance for retail forex transactions should be clarified.

In the final rule, the disclosure requires an FDIC-supervised IDI to state that retail forex transactions are not FDIC-insured. The commenter agreed with that statement. It noted, however, that margin funds may be insured deposits. The FDIC is charged with interpreting the deposit insurance provisions of the FDI Act, and the insured status of margin funds will turn on whether the funds are held in a way consistent with those provisions, as interpreted by the FDIC. Nevertheless, an FDIC-supervised IDI may disclose the availability of FDIC insurance for retail forex margin accounts in a separate document if permitted by law, including FDIC requirements related to such disclosure and applicable provisions of the NDIP Policy Statement.

Section 349.7—Recordkeeping

This section specifies which documents and records an FDIC-supervised IDI engaged in retail forex transactions must retain for examination by the FDIC. This section also prescribes document maintenance standards. The FDIC notes that records may be kept electronically as permitted under the Electronic Signatures in Global and National Commerce Act.¹³

One of the commenters, had a concern with proposed section 349.7(a)(5), which states

¹³ 15 U.S.C. 7001(d).

that immediately upon the written or verbal receipt of a retail forex transactions order, an FDIC-supervised IDI shall prepare a written order memorandum, sometimes referred to as a trade confirmation, for the order. The commenter requested clarification about whether the use of a telephone recording system and the retention of telephone recordings would satisfy such recordkeeping requirements if details of the transaction are affirmed or confirmed with the customer over a recorded telephone line.

After considering this comment, the FDIC has amended section 349.7 to permit the use of oral phone orders provided they are recorded and customers are advised that they are speaking on a recorded line.

Recordkeeping requirements found in section 349.13(a)(4) of the proposed rule were moved into this section to centralize recordkeeping requirements in one section. Furthermore, the recordkeeping requirements for order tickets are now medium-neutral: an FDIC-supervised IDI may prepare an order ticket by recording an oral conversation, for example via a telephone recording system. This change reflects a change to section 349.12 that allows a retail customer to authorize a retail forex transaction orally.

Section 349.10—Required reporting to customers

This section requires an FDIC-supervised IDI engaging in retail forex transactions to provide each retail forex customer a monthly statement and confirmation statements.

The proposal sought comment on whether this section provides for statements that would be useful and meaningful for retail forex customers, or whether other information would be more appropriate.

One commenter sought clarification that the statements may be provided electronically, and also suggested that retail forex customers would be better served with continuous online access to account information rather than monthly statements. One commenter recommended that the customer should have the opportunity to opt out of receiving monthly statements (whether paper or electronic) and confirmation statements for each retail forex transaction.

The FDIC encourages FDIC-supervised IDIs to provide real-time, continuous access to account information, and this rule does not prevent FDIC-supervised IDIs from doing so. However, the FDIC believes it is valuable to require FDIC-supervised IDIs to provide retail forex account information to retail forex customers at least once per month. Monthly statements may be provided electronically as permitted under the Electronic Signatures in Global and National Commerce Act.¹⁴

Section 349.12—Authorization to Trade

The proposed rule required FDIC-supervised IDIs to have specific written authorization from a retail forex customer before effecting a retail forex transaction. Three commenters said

¹⁴ 15 U.S.C. 7001(c).

that requiring specific written authorization from a retail forex customer before effecting a retail forex transaction for that customer would be impractical. One of the commenters indicated that such a requirement could be burdensome and detrimental to the customer's interests, for example if the customer cannot, due to technical difficulties, convey written instructions.

The FDIC agrees with this concern, and further notes that the CFTC's retail forex rule does not require written authorization for each retail forex transaction. The final rule requires an FDIC-supervised IDI to obtain a retail forex customer's specific authorization to effect a particular trade. FDIC-supervised IDIs must keep records of authorizations to trade pursuant to this rule and, if the customer conveys his or her authorization orally by telephone, the authorization must be preserved by recording.

9. Payment to respondents:

None.

10. Any assurance of confidentiality:

There is no assurance of confidentiality.

11. Justification for questions of a sensitive nature:

There are no questions of a sensitive nature.

12. Burden estimate:

Estimated Number of Respondents: 3 state nonmember banks; 1 service provider.

Total Reporting Burden: 48 hours.

Total Disclosure Burden: 5,326 hours.

Total Recordkeeping Burden: 664 hours.

Total Annual Burden: 6,038 hours.

13. Estimate of annualized costs to respondents (excluding cost of hour burden in Item #12):

None.

14. Estimate of annualized costs to the government:

None.

15. Changes in burden:

This is a new information collection. The addition of 6,038 hours to the FDIC's

inventory is the result of new reporting, recordkeeping, and disclosure requirements contained in a notice of proposed rulemaking.

16. Information regarding collections whose results are planned to be published for statistical use:

No publication for statistical use is contemplated.

17. Display of expiration date:

Not applicable.

18. Exceptions to certification statement:

Not applicable.

B. Collections of Information Employing Statistical Methods.

Not applicable.