

CLIENT ALERT

Do You Want to Run a Futures Commission Merchant?

CFTC Staff Issues a Primer

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I. INTRODUCTION

In response to increased interest and inquiries about futures commission merchants, Commodity Futures Trading Commission Staff recently published responses to frequently asked questions regarding FCMs.¹ The FCM FAQs serve as a primer on the regulatory landscape applicable to FCMs. They also highlight the importance of FCMs in CFTC-regulated markets and the extensive regulatory framework to which FCMs are subject.

FCMs serve as brokers to their customers. The Commodity Exchange Act (the “CEA”) defines an FCM, generally, as an entity that solicits or accepts orders to buy or sell futures contracts, options on futures, swaps or certain OTC

¹ CFTC Market Participants Division Responds to Frequently Asked Questions Regarding Futures Commission Merchant Registration and Ongoing Regulatory Obligations (June 30, 2025), <https://www.cftc.gov/PressRoom/PressReleases/9091-25> (the “FCM FAQs”).

foreign currency contracts, and accepts money or other assets from customers to support trades resulting from such orders.

As intermediaries, FCMs facilitate transactions between customers and exchanges, and the clearing organizations used by exchanges. CFTC rules impose significant financial and operational obligations on FCMs due to the critical role they play in holding customer funds and serving as a first line of defense for derivatives clearing organizations. Among other significant responsibilities, FCMs must step in to cover a customer default. The safety of customer funds is a paramount principle under the CEA. The CFTC, National Futures Association (“NFA”), and relevant exchanges and clearing organizations seek to ensure that each FCM has in place adequate capital and internal processes to meet these important regulatory requirements.

This memorandum provides an overview of FCMs and their roles, including topics covered by the FCM FAQs.

II. GETTING IN

Generally, any entity acting as an FCM that has a nexus to the U.S. must register with the CFTC and become a member of the NFA. NFA processes FCM registration applications on behalf of the CFTC. As part of its application process, an FCM must submit a number of forms disclosing general information regarding its business and those persons and entities with a financial or controlling interest in the FCM. Employees serving in certain roles at the FCM must be identified and submit biographical and other information. These “principals” and “associated persons” generally also must submit fingerprint cards.

The FCM FAQs explain that a primary goal of the registration process is to screen a potential registrant’s fitness to operate as an FCM. The operational soundness of an FCM depends on the qualifications of its employees and principals. FCM applicants (and registrants) should pay particular attention to the experience of employees and should seek to hire personnel who are familiar with FCM regulations and compliance.

A. Principal

CFTC rules generally define a principal as (i) any 10% owner; (ii) persons with certain titles (general partner, director, president, CEO, managing member, etc.); and (iii) any person with the power to exercise a controlling influence over the registrant’s activities that are subject to CFTC regulation. CFTC rules require each FCM to identify and list as principal a chief compliance officer (“CCO”) who is charged with specific responsibilities. As discussed further below, the CCO must report to the senior officer of the FCM or its board of directors. Only the board or the senior officer may terminate the CCO.

B. Associated Person

An associated person (“AP”) is anyone who solicits customers or supervises other APs, up the chain of command to the registrant’s CEO (or equivalent). The CFTC has defined solicitation broadly to include virtually any interaction

with customers other than mere provision of clerical services. Subject to limited exceptions, each AP must register as such with the CFTC and become an associate member of NFA. Generally, each AP must also pass the National Commodity Futures Examination (“Series 3”). APs that engage in swaps activities must complete NFA’s Swaps Proficiency Requirements. The Series 3 exam and the Swaps Proficiency Requirements are designed to test the AP’s subject matter knowledge of the futures and swaps markets.

An FCM must have at least one individual principal who is also an AP, in order to obtain and maintain registration with the CFTC and membership in NFA.

C. Background Checks and Statutory Disqualification

NFA performs background checks of each FCM applicant, its principals, and APs. This process helps NFA determine whether the FCM applicant or any relevant person is subject to a statutory disqualification under the CEA, which could prevent their registration or listing. Potentially disqualifying events include pleas and/or convictions of certain criminal offenses, bankruptcies, and regulatory infractions.

III. STAYING IN

Once an FCM is registered, CFTC and NFA rules require compliance with a number of stringent ongoing obligations, again underscoring the importance to the markets of well-functioning FCMs. Exchanges also impose rules on their member FCMs.

A. Capital Requirements

FCMs must comply, at all times, with specified capital and financial requirements to ensure their financial strength. Each applicant for registration and each registered FCM must maintain adjusted net capital² in excess of an amount that is determined by a variety of calculations. The absolute minimum is \$1 million, but an FCM’s capital requirement could be \$100 million or more. The amount required will depend on, among other factors, the value of customer and noncustomer accounts held by the FCM, whether the FCM engages in “retail forex,” whether the FCM is registered as a swap dealer with the CFTC or as a broker-dealer with the SEC, and whether the FCM uses models to compute market or credit risk capital charges.

The rigorous capital and financial reporting requirements applicable to each FCM are a result of the important role FCMs play in the markets as the holders of customer funds and essentially guarantors of customer obligations. The bankruptcies relatively close in time of two FCMs caused the CFTC to enhance capital-related requirements for FCMs. In 2011, MF Global, Inc. underwent one of the largest bankruptcies in U.S. history. Less than a year later,

² The term net capital means current assets less liabilities. Adjusted net capital means an FCM’s net capital less the value of certain enumerated items.

Peregrine Financial Group also declared bankruptcy. While Peregrine involved a fraud, both bankruptcies involved shortfalls in funds of customers that were supposed to be held in segregated accounts subject to safeguards.³

In response to MF Global and Peregrine, NFA implemented a series of rules aimed at bolstering its ability to detect fraud and accurately assess the financial health of an FCM and protect FCM customers. Chief among these rules is that NFA now confirms daily customer segregated fund balances as reported by each FCM with the depository that holds the FCM's customer funds.

B. Reporting

To customers

An FCM must prepare and distribute, by the next business day, a confirmation of each customer's transactions. Monthly account statements must also be distributed to each customer. The monthly statements detail the customer's account activities, including, as applicable, realized and unrealized gains and losses on transactions and positions, interest income earned, and any fees or expenses incurred by the customer.

To regulators

FCMs are required to file daily statements to demonstrate compliance with the CFTC's capital and customer segregation rules. FCMs also must file notices upon the occurrence of certain events, including if the FCM:

- i. is undercapitalized,
- ii. fails to comply with customer funds segregation requirements,
- iii. fails to maintain current books and records, or
- iv. experiences a reduction in net capital of 20% or more.

These daily reporting requirements are designed to identify signs of non-compliance or financial distress. In addition to daily filings, each FCM must submit a more detailed report of customer funds semi-monthly. Each FCM also must file periodic unaudited financial statements as well as annual financial statements. This "annual report" must be certified by an independent public accountant.

Each FCM must have a written cybersecurity program that establishes appropriate safety protocols and an incident response plan. An FCM must promptly report to NFA the occurrence of certain cyber-related incidents, including

³ At its most general level, the CFTC's customer protection regime requires FCMs to segregate customer funds from their own funds, deposit customer funds under an account name that clearly identifies them as customer funds, and obtain a written acknowledgment from each depository that holds customer funds.

any that result in the loss of customer, counterparty or proprietary funds or that require notice under state or federal law.

C. Recordkeeping

FCMs are subject to extensive recordkeeping requirements. These include maintaining customer and proprietary records relating to the FCM's business of dealing in, and the execution of, futures and swaps and related cash or forward transactions, as well as all "orders, trading cards, signature cards, journals, ledgers, canceled checks, copies of confirmations, copies of statements of purchase and sale, and all other records, which have been prepared in the course of the FCM's business." FCMs must also keep records of all communications that lead to an execution of futures or swaps and related cash or forward transactions.⁴

FCMs must maintain financial records relating to and affecting the FCM's asset, liability, income, expense, and capital accounts.⁵ FCMs also must maintain records of certain information provided to customers as well as the FCM's daily computations and reports related to funds on deposit in customer accounts.

FCMs should familiarize themselves with the various recordkeeping and reporting obligations and establish procedures to ensure internal compliance. A failure to maintain records in accordance with CFTC rules could result in an enforcement action by the CFTC and significant fines. For example, since 2021, the CFTC has imposed over \$1 billion in civil monetary penalties on a number of financial institutions registered as swap dealers and/or FCMs for, among other things, recordkeeping violations.⁶

IV. RISK MANAGEMENT AND GOVERNANCE

Rules designed to ensure operational soundness mandate that each FCM comply with a number of governance and risk management protocols. An FCM is required to develop and maintain policies and procedures applicable to its regulatory obligations and operational functions. Among others, these policies and procedures must address anti-money laundering, business continuity and disaster recovery, cybersecurity, electronic order routing systems, promotional material, supervision of APs, customer complaints, margin procedures, and ethics training.

Each FCM must implement a risk management program that meets a number of regulatory standards including:

⁴ See 17 C.F.R. § 1.35.

⁵ *Id.* at § 1.18.

⁶ See *CFTC Orders JPMorgan to Pay \$75 Million for Widespread Use by Employees of Unapproved Communication Methods and Related Recordkeeping and Supervision Failures*, Release Number 8470-21 (Dec. 17, 2021); *CFTC Orders 11 Financial Institutions to Pay Over \$710 Million for Recordkeeping and Supervision Failures for Widespread Use of Unapproved Communication Methods*, Release Number 8599-22 (Sept. 27, 2022); *CFTC Orders The Bank of Nova Scotia to Pay a \$15 Million Penalty for Recordkeeping and Supervision Failures for Widespread Use of Unapproved Communication Methods*, Release Number 8699-23 (May 11, 2023); *CFTC Orders HSBC to Pay a \$30 Million Penalty for Recordkeeping and Supervision Failures for Widespread Use of Unapproved Communication Methods*, Release Number 8701-23 (May 12, 2023).

- i. ensure the appropriate segregation of customer funds,
- ii. have processes in place to prevent erroneous or disruptive orders,
- iii. detect discrepancies in the risk tolerance limits set by the FCM, and
- iv. monitor the capital and liquidity requirements to meet the FCM's foreseeable needs.

As part of its risk management program, each FCM also must comply with a number of CFTC and NFA rules related to residual interest, withdrawal of customer funds, risk exposure reports, and other relevant requirements aimed at mitigating or reducing operational risk. The risk management program must be carried out by qualified personnel and reviewed at least annually.

CFTC rules require an FCM's governing body to actively participate in its risk management program. The governing body is tasked with overseeing, approving, and supervising the operations of the FCM. Importantly, directors, officers, and other principals, as "controlling persons," may be held personally liable for violations committed by FCM employees. Establishing, maintaining and enforcing a robust system of internal supervision and control can be a defense for a controlling person. This includes exercising reasonable diligence, understanding the systemically important role of FCMs, ensuring that employees have appropriate experience and training, and allocating sufficient resources to the compliance function.

In addition, controlling persons and FCM employees may be subject to criminal liability under the CEA for a variety of infractions. These include, but are not limited to, manipulating the price of a commodity or swap; making false or misleading statements in an application, report, or document required under the CEA; falsifying or concealing a material fact in a communication with an exchange or regulator; and misappropriation of information or property.

The FCM FAQs note that directors, officers, principals, and other FCM employees can be held liable for "insider trading." Under the CEA, with respect to such persons, that generally means misappropriation of information in violation of a duty. This differs from the concept of insider trading under the federal securities laws where a person could be liable for trading a stock when in possession of material non-public information (aka "MNPI") about that stock.⁷

A. The Chief Compliance Officer

Key to the governance and risk management program of an FCM is the CCO. The Dodd-Frank Act, passed in response to the 2008 financial crisis, required FCMs and certain other CFTC registrants to appoint a CCO. The CCO must perform a number of duties and has specified responsibilities prescribed in the CEA and CFTC

⁷ The CEA permits parties to trade on the basis of information that only they possess, subject to exceptions applicable to employees of the CFTC and exchanges. Such trading often supports sound risk management and promotes price discovery. "Insider trading" in the derivatives market is different than in the securities market. It is important to distinguish these concepts.

regulations. Duties include the preparation of a written report for each fiscal year, which must be submitted to the CFTC. The CCO's annual report, at a minimum, must include a description of the FCM's:

- i. written policies and procedures, including its code of ethics and conflict of interest policies;
- ii. assessment of the effectiveness of such policies and procedures;
- iii. identified areas for improvement, and recommended potential or prospective changes or improvements to the FCM's compliance programs and resources devoted to compliance;
- iv. financial, operational, managerial and staffing resources dedicated to compliance;
- v. identified material noncompliance issues and the corresponding action taken; and
- vi. material changes to compliance policies and procedures during the reporting period.

The annual report also must include a certification by the FCM's CCO or CEO that the report is accurate and complete in all material respects. The CCO is required to provide the annual report to the FCM's board of directors or senior officer, as well as the audit committee (if the FCM has an audit committee).

* * *

The oversight exercised by the CFTC, NFA and exchanges, together with the extensive risk management and governance requirements to which FCMs are subject, underscores the importance of the FCM's role in the derivatives industry. An insolvent FCM could have rippling consequences throughout futures and swaps markets. Financially and operationally sound FCMs play a critical role in protecting the U.S. financial industry and reducing systemic risk.⁸

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If you have any questions regarding this client alert, please contact one of the authors, any member of our CFTC team listed below, or the Willkie attorney with whom you regularly work.

⁸ See Editorial, *Pudd'nhead Wilson in Washington*, Wall St. J. (Apr. 23, 2011), <https://www.wsj.com/articles/SB10001424052748704658704576274870104134358>.

Willkie has a dedicated team of attorneys with extensive knowledge and experience in all aspects of the Commodity Exchange Act and the CFTC regulatory regime. We would be pleased to assist on your matters.

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