

Proposed Question and Answer regarding Foreign Exchange Prime Brokerage

Q. Many over the counter foreign exchange transactions are executed by dealers under give up arrangements with prime brokers. Each prime broker is an institution of the type specified in section 2(c)(2)(B)(ii) of the Commodity Exchange Act or an affiliate of such an institution that, in either case, is acting through an office in a jurisdiction that has anti-money laundering due diligence standards substantially similar to the United States. The prime broker, or an affiliate acting on its behalf, will perform due diligence on its clients in accordance with those standards.

Under these give up arrangements, the prime broker, the prime broker's client and the dealer all intend and agree that, upon execution of any transaction that the prime broker's client is authorized to execute with the dealer on behalf of the prime broker, no transaction will exist between the prime broker's client (in its individual capacity) and the executing dealer. Instead, that transaction will be between the dealer and the prime broker. Although the prime broker's client may have limited authority with respect to the execution of trades for the account of the prime broker, the client will have no involvement in the transfer of funds that occurs between the prime broker and the dealer in respect of the transaction given up to the prime broker. As a result, the dealer will treat its relationship with the prime broker as a "correspondent account" for purposes of the due diligence requirements set forth in section 312 of the USA Patriot Act and accompanying regulations. Does the dealer also have to treat the execution of trades by the prime broker's client as a "correspondent account" for purposes of the Act and the final rule implementing the Act?

A. No. The execution only relationship between the dealer and client will not constitute a correspondent account. The final rule adopted to implement section 312 defines "correspondent account" as an account established to "receive deposits from, or to make payments or other disbursements on behalf of, the foreign financial institution, or to handle other financial transactions related to the foreign financial institution" (31 CFR 103.175). The rule further defines "account" as meaning "any formal banking or business relationship established by a bank to provide regular services, dealings, and other financial transactions...".

In a give up relationship, the prime broker's client does not have an account with the dealer. In particular, no formal banking or business relationship between the dealer and the prime broker's client is created by the dealer's execution of these foreign exchange trades. The dealer does not commit to the client or the prime broker that it will provide these executions. The dealer's execution of trades remains in its sole discretion throughout the life of the relationship. Furthermore, it can stop executing trades at any time without liability to either the client or the prime broker. As a result, the dealer has no obligation to provide "regular" services, dealing or transactions as referenced in the rule. Similarly, the client has no ongoing obligations to the dealer. In addition, the dealer generally does not enter any transaction with the client on its books and records but rather books a transaction with the prime broker and performs all of its obligations

(including the transfer of funds) directly to the prime broker. For these reasons, this execution relationship will not be treated as an “account” or “correspondent account” for purposes of the Act and the final rule.