October 30, 2023

Via E-Mail to rule-comments@sec.gov
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090
Attn: Vanessa A. Countryman, Secretary

Re: FIA Supplemental Comment on SEC Proposal, "Safeguarding Advisory Client Assets"; File Number S7-04-23

Dear Ms. Countryman:

The Futures Industry Association ("FIA")[1] welcomes the opportunity to submit additional comments on the U.S. Securities and Exchange Commission's ("SEC" or the "Commission") proposed new safeguarding rule (the "Proposed Rule").[2] As stated in our letter submitted May 8, 2023,[3] we strongly believe that adoption of the Proposed Rule would undermine the CFTC's customer protection regime, subject futures commission merchants ("FCMs") acting as Qualified Custodians (QCs") to custodial requirements that are inapposite to the core functions FCMs perform for their customers and ultimately restrict investment advisers and their underlying customers' access to FCMs.

Moreover, the Proposed Rule marks a stark – and unsubstantiated – departure from the Commission's longstanding position that the segregation requirements of the Commodity Exchange Act ("CEA") and the Commodity Futures Trading Commission ("CFTC") regulations thereunder are sufficiently robust to permit FCMs (i) to custody futures, foreign futures and cleared swaps positions and margin assets for registered investment companies[4]; (ii) to hold security futures and margin in futures accounts[5]; (iii) to hold customer security-based swaps and margin in cleared swaps accounts pursuant

[1] FIA is the leading global trade organization for the futures, options, and centrally cleared derivatives markets, with offices in Brussels, London, Singapore and Washington, D.C. FIA's mission is to support open, transparent, and competitive markets; protect and enhance the integrity of the financial system; and promote high standards of professional conduct. FIA's membership includes clearing firms, exchanges, clearinghouses, trading firms and commodities specialists from more than 48 countries, as well as technology vendors, lawyers and other professionals serving the industry.
[2] *See* Safeguarding Advisory Client Assets, 88 Fed. Reg. 14672 (SEC, Proposing Release, Mar. 9, 2023) ("Safeguarding Proposed Rule" or "Proposed Rule").
[3] Letter from Allison Lurton, General Counsel and Chief Legal Officer, FIA, to Vanessa A. Countryman, Secretary, SEC (May 8, 2023), available at https://www.fia.org/fia/articles/fia-warns-proposed-sec-safeguarding-rule-may-harm-fcms-advisers-and-customers#:~:text=FIA%20has%20filed%20comments%20with,RIAs)%20and%20their%20underlying%20customers.
[4] *See* Exchange Act Rule 17f.6.
[5] *See* Customer Margin Rules Relating to Security Futures, 85 Fed. Reg. 75112, 75138 n. 264 (CFTC and SEC, Joint Final Rule, Nov. 20, 2020) ("The SEC acknowledges that any security futures held in futures accounts would benefit from the CFTC's customer protection rules found in part 1 of the CFTC's regulations.").

to eligible portfolio margin programs for cleared default swaps[6]; and (iv) to serve as qualified custodians under current Rule 206(4)-2.[7]

It is incumbent on the SEC to show that the Proposed Rule is necessary and appropriate as applied to FCMs, especially in this instance where it would interfere with the CEA, CFTC Regulations and FCM customer relationship documentation and disclosures, and effectively reverse years of Commission precedent.

I. None of the Commission's Policy Concerns Justifies Imposition of the Safeguarding Rule on FCMs.

We appreciate the time that Commission staff has taken to discuss with FIA the Proposed Rule and the related concerns of FCMs. We understand that the SEC is reluctant to grant broad exceptions to the new safeguarding requirements of the Proposed Rule. Nonetheless, we believe that none of the policy concerns the Commission advances as the basis for reconsidering "the important prophylactic protections of the custody rule"[8] can justify the extension of the requirements of the redesignated safeguarding rule to FCMs. Specifically:

- The Commission states that the "evolution of financial products and services" has led to "a general reduction in the level of protections offered by custodians," and notes that it is "decreasingly common for banks acting as custodians to do so in a fiduciary capacity."[9] FCMs hold customer property pursuant to the terms of a "statutory trust" created by the segregation requirements of the CEA and the CFTC's implementing regulations, under which the FCM assumes fiduciary duties that are determined by that statute and those regulations and cannot be overridden by contract.[10]

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[6] Order Granting Conditional Exemptions under the Securities Exchange Act of 1934 in Connection with the Portfolio Margining of Cleared Swaps and Security-based Swaps that are Credit Default Swaps, 86 Fed. Reg. 61357, 61360 (SEC, Nov. 5, 2021) (acknowledging the "success of the current CDS portfolio margin program" under which portfolios of cleared CDS that are security-based swaps and cleared swaps are cleared in a CFTC cleared swaps account); *see also* Further Definition of ''Swap,'' ''Security-Based Swap,'' and ''Security-Based Swap Agreement''; Mixed Swaps; Security-Based Swap Agreement Recordkeeping, 77 Fed. Reg. 48204, 48344 (CFTC/SEC, Joint Final Rule, Aug. 13, 2012) (acknowledging the benefits and efficiencies to be gained from "the adoption of a margin and segregation approach that would permit a customer to hold both swaps and security-based swaps in a single customer account").

[7] Custody of Funds or Securities of Clients by Investment Advisers, 68 Fed. Reg. 56,692 (SEC, Adopting Release, Oct. 1, 2003).

[8] *Id.* at 14674.

[9] *Id.* at 14675.

[10] *See, e.g.*, *Grede v. FCStone, LLC*, 867 F.3d 767, 780 (7th Cir. 2017) (An FCM's "customers were the beneficiaries of a statutory trust."); *In re Smith*, 72 B.R. 61, 62-63 (Bankr. N.D. Iowa 1987) ("The Court finds that [Section 4d(a)(2) of] the [CEA] and [CFTC] regulations created a technical trust…."); *see also* Memorandum to the Futures Industry Association and The International Swaps and Derivatives Association, Inc. Regarding Futures and Options Transactions, Cleared Swaps and Foreign Futures Transactions Executed and Carried by Futures Commission Merchants for Their Customers at n. 100 (Sullivan & Cromwell LLP November 17, 2021), available at https://www.fiadocumentation.org/fia/us-legal-opinions_8/united-states-4th-september-2020.

- The Commission states that the "core purpose" of the proposed rule is to protect client assets from loss, misuse, theft, or misappropriation by and the insolvency or financial reverses of registered investment advisers, and to maintain the Commission's ability to pursue advisers for failing to properly safeguard client assets under applicable antifraud provisions.[11] The "core foundation" of the "commodity futures and swaps markets" is "[s]egregation of customer funds," which "must be maintained at all times. . . every moment of the day."[12] As set forth in Section 4d(a) of the CEA as enacted in 1936 (and separately under Section 4d(f) of the CEA, for cleared swaps, as enacted with the passage of the Dodd-Frank Act), FCMs are required to treat all property received from a customer to margin trades or contracts "as belonging to such customer," to account for such property separately, to segregate customer property from their own property (while expressly permitting property of different customers to be commingled), and to not use any customer's property to secure the obligations of any other customer.[13] In 2013 the CFTC adopted extensive new rules and amended existing ones with the specific objective of reinforcing this "core foundation."[14]

- The Commission worries that certain client investments are not covered by the custody rule in its current form "because they were neither funds nor securities," or as a result of "the exception for privately offered securities," thus "putting them at greater risk" for fraud and misappropriation.[15] But the customer asset protections of the CEA and the CFTC regulations extends to *all* "customer funds," without exception – meaning, as defined under the CFTC regulations, "*all money, securities, and property* received by a futures commission merchant or by a derivatives clearing organization from, for, or on behalf of," futures, foreign futures,

[11] Safeguarding Proposed Rule at 14676.

[12] Statement of Chairman Gary Gensler in support of Enhancing Protections Afforded Customers and Customer Funds Held by Futures Commission Merchants and Derivatives Clearing Organizations (Final Rule), 78 Fed. Reg. 68506, 68656 (CFTC, Adopting Release, Nov. 14, 2013) (the "Enhanced Protections Rulemaking").

[13] *See* CEA § 4d(a)(2) (futures contracts listed on contract markets); *Id.* § 4d(f) (swaps cleared on derivatives clearing organizations).

[14] *See* Enhanced Protections Rulemaking at 68510. Those rules and amendments: (i) required FCMs to implement extensive risk management programs including written policies and procedures related to various aspects of their handling of customer funds; (ii) increased reporting requirements for FCMs related to segregated customer funds, including daily reports to the CFTC and the FCM's designated SRO (DSRO); (iii) required FCMs to establish target amounts of residual interest (consisting of proprietary funds of the FCM contributed to customer accounts) to be maintained in segregated accounts as well as created restrictions and increased oversight for FCM withdrawals of such residual interest out of customer segregated accounts, specifically including clear sign off and accountability from senior management for such withdrawals; (iv) strengthened requirements for the acknowledgment letters that FCMs and DCOs must obtain from custodians holding customer funds on their behalf; (v) eliminated a method used for calculating the amount of customer funds required to be segregated on behalf of customer trading in futures listed on foreign boards of trade and required FCMs to segregated such customer funds; (vi) strengthened the regulatory requirements applicable to SRO and DSRO oversight of FCMs, including regulating oversight provided under the function of a Joint Audit Committee that would establish standards for, and oversee the execution of, FCM audits; and (vii) required FCMs to provide additional disclosures to customers. *Id.* at 68579; *see also* Safeguarding Proposed Rule at n. 112.

[15] Safeguarding Proposed Rule at 14674-75.

and cleared swaps customers for the purpose of margining futures, foreign futures and cleared swaps, as applicable.[16]

- The Commission cites the expansion and development of advisory services and discretionary trading practices as having increased the risk of misappropriation of customer assets in transactions where no qualified custodian is involved.[17] But these concerns are misplaced as applied to FCMs, which are necessarily "involved" in any customer transaction in which funds are transferred for the purpose of securing a position in futures or cleared swaps.[18]

- Moreover, FCMs are required to prepare, retain, and make available for inspection to the CFTC and the U.S. Department of Justice: (i) written confirmation of *each* futures transaction executed and *each* cleared swap carried by the FCM for a customer; (ii) a monthly statement of *all* open contracts, net profit and loss, and customer funds carried by the FCM for *each* such customer; and (iii) the "point balance" of *all* open customer contracts carried by the FCM.[19] Monthly statements must include "[a] detailed accounting of all financial charges and credits to customers and foreign futures or foreign options customers, during the monthly reporting period, including all customer funds and any foreign futures or foreign options secured amount, received from or disbursed to customers or foreign futures or foreign options customers, as well as realized profits and losses."[20] Notably, CFTC Regulations expressly require, with respect to accounts controlled by "any person other than the customer" (that is, any account controlled by a registered investment adviser), that the FCM provide daily confirmations and monthly statements both to the "customer for whom such account is carried" as well as to "such other person."[21] It follows that the Commission's concerns about clients being "able to review the legitimacy of any movement within their account, whether it is a trade, a payment, or a fee withdrawal,"[22] simply do not apply to FCMs.

- The Commission states that the Proposed Rule's definition of "possession or control" "is designed to be consistent with the laws, rules, or regulations administered by the qualified custodian's functional or primary financial regulator for purposes of its custodial activities."[23]

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[16] *See* CFTC Regulation 1.3 (definitions of "customer funds" and "futures customer funds"); CFTC Regulation 30.1(h) (definition of "30.7 customer funds"); and CFTC Regulation 22.1 (definition of "Cleared Swap Customer Collateral") (emphasis supplied).

[17] Safeguarding Proposed Rule at 14674-75.

[18] *See* CEA §§ 1a(28) (definition of "futures commission merchant"), 4d(a), (f) (prohibiting any person not registered as an FCM from acting as an FCM in connection with futures and cleared swaps).

[19] A "point balance" is a statement "which accrues or brings to the official closing price, or settlement price fixed by the clearing organization, all open contracts of customers as of the last business day of each month or of any regular monthly date selected." CFTC Regulation 1.34(a); *see also* CFTC Regulation 1.31 and 1.33. The daily confirmation of futures transactions required under CFTC Regulation 1.33(b) must show the financial result of all offsetting transactions. *See* CFTC Regulation 1.46(a)(1).

[20] CFTC Regulation 1.33(a)(4).

[21] CFTC Regulation 1.33(d)

[22] Proposed Safeguarding Rule at 14675.

[23] *Id.* at 14687.

But the proposed definition reveals a blind spot about how FCMs handle customer funds. FCMs operate under a safekeeping regime that, in fact, prohibits them from being "involved in" changing the beneficial ownership of customer property. As noted, FCMs operate under a statutory trust over segregated customer funds designed to ensure that the FCM uses those funds only for the purposes for which they were provided to the FCM. In practice, this means that customer funds are deposited with FCMs under a pledge, which gives the FCM the right in turn to pledge those funds to downstream intermediaries and clearinghouses. The "beneficial ownership" of the funds does not change when FCMs pledge customer funds to clearinghouses or intermediaries to secure customer trades; those funds remain customer property (subject to liens, in favor of the FCM and the relevant clearinghouse or intermediary – priority to be determined by control – securing the customer's obligations to the FCM relating to its transactions in futures, foreign futures or cleared swaps).

- The Commission believes that because FCMs "already have systems to segregate customer assets from their own . . . their cost of meeting the segregation requirement of the proposed rule would also largely be mitigated."[24] This belief is erroneous. Subjecting FCMs to the additional requirements of the Proposed Rule is both inconsistent with the segregation regime of the CEA and CFTC regulations and will materially increase the cost to FCMs of providing clearing services to the clients of registered advisers. Specifically, the Proposed Rule requires that FCMs indemnify clients for loss of client assets in the event of their own negligence. Further, sub-custodial, depository and other similar arrangements "will not excuse" this duty of indemnification. Consistent with the agency relationship they have with their clients, FCMs have long operated under a standard of limited liability for loss of customer funds resulting from the failure of downstream custodians and depositories, under which they assume no liability for such losses, provided that they used due care in selecting the custodian or depository.[25] The proposed revision fundamentally alters the allocation of downstream sub-custodial risk as between FCMs and their customers.[26] Indeed, some FCMs, relying on this allocation of risk and the exclusion of liability for downstream sub-custodians (that were selected with due care, consistent with the requirements of CFTC Regulation 1.11), have

[24] *Id.* at 14747.

[25] *See* CFTC Regulation 1.11 (requiring FCMs to establish a process for the evaluation of depositories of segregated funds, including documented criteria that any such depository must meet such as criteria addressing the depository's capitalization, creditworthiness, operational reliability, and access to liability, as well as program to monitor any depository to assess continued satisfaction of such criteria); *see also* Enhanced Protections Rulemaking at 68556-57 (declining to withdraw while directing CFTC staff to further inquire into a 1971 Administrative Determination endorsing as an "appropriate standard of liability for an FCM in the event of a bank [depository] default" that FCMs should not be strictly liable for a depository's failure provided that it had used due care in selecting the depository and had not otherwise breached its fiduciary responsibilities to customers in respect of customer property under the CEA and CFTC regulations).

[26] That is, under the standard of proposed Rule 275.223-1(a)(1)(ii)(C), a qualified custodian (*e.g.*, the FCM) that establishes a sub-custodial or depository relationship consistent with the requirements of due care and diligence set forth under CFTC Regulation 1.11 might still be liable for losses arising from the negligence of that sub-custodian or depository in handling customer funds, notwithstanding the FCM's due care and diligence in having selected it.

implemented derecognition of customer cash from their balance sheets, in order to reduce the burdens imposed by the supplementary leverage ratio under the Basel capital requirements.[27] The Proposed Rule effectively mandates FCMs to reverse that implementation – a substantial burden, with material attendant costs that the Commission has not even considered, let alone attempted to calculate.

II. FCM Customer Disclosures

The Commission asks in the Proposed Rule whether there are "other disclosures that would appropriately distinguish how the qualified custodian maintains investments."[28] And in our meeting with Commission staff, staff members specifically asked about information that advisory clients receive from FCMs (as distinct from disclosures that are provided to the registered adviser from the FCM, or disclosures that the advisory client may receive from the registered adviser).

CFTC Regulation 1.55(a) prohibits an FCM from opening a customer trading or clearing account (other than for an "institutional customer"[29]) unless it has provided *the customer* (not the adviser or manager that controls the customer account) with a risk disclosure statement in the form specifically set forth in CFTC Regulation 1.55(b), or otherwise approved under the procedure set forth in CFTC Regulation 1.55(c).[30] The FCM must obtain from any such customer an acknowledgment signed and dated by the customer that the customer has received and understood that disclosure statement. In addition, we understand many FCMs provide a risk disclosure statement to institutional customers as a matter of standard practice.

Many registered advisers open FCM trading and clearing accounts pursuant to comprehensive authorizations or powers of attorney that entitle the adviser to receive and acknowledge such risk disclosure as agent for and on behalf of their advisory clients.[31] In 2013, in the wake of the "recent

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[27] *See* Regulatory Capital Rules: Regulatory Capital, Enhanced Supplementary Leverage Ratio Standards for Certain Bank Holding Companies and Their Subsidiary Insured Depository Institutions, 79 Fed. Reg. 24528, 24536 (May 1, 2014) (declining to exempt any category of balance sheet assets from the denominator of the supplementary leverage ratio). Some FCMs were able to exclude segregated customer cash from their balance sheets for purposes of the supplementary leverage ratio by relinquishing "control" of such cash – an undertaking that depends on demonstrating that the cash is neither an asset nor a liability of the FCM. The Proposed Rule effectively requires FCMs to recognize sub-custodial cash balances as a liability, thus making derecognition of such cash impossible.

[28] Safeguarding Proposed Rule at 14703.

[29] *See* CFTC Regulation 1.3. "Institutional customer" has the same meaning as "eligible contract participant" as defined under Section 1a(18) of the CEA.

[30] The CFTC has approved a disclosure form for futures and options on futures pursuant to CFTC Regulation 1.55(c). *See* FIA Combined Disclosure Statement, available at https://www.cftc.gov/sites/default/files/idc/groups/public/@newsroom/documents/file/fiastatement113016.pdf.

[31] The CFTC evinces awareness of the potential barrier that disclosure via an agent can create in a recently proposed rulemaking, which expressly requires disclosure to be "delivered separately to the customer via electronic means in writing or in such other manner as the [FCM] customarily delivers disclosures," and to "maintain documentation demonstrating that the disclosure statement . . . was delivered directly to the customer." *See* Derivatives Clearing Organization Risk Management Regulations To Account for the Treatment of Separate Accounts by Futures Commission Merchants, 88 Fed. Reg. 22934, 22954 (Apr. 14, 2023); *see also id.* at 22936 ("[I]n the customer relationship context, FCMs often deal directly with a commodity trading advisor acting as an agent of the customer rather than the customer itself.").

failures of two FCMs," the CFTC reviewed the adequacy of the risk disclosure required under 1.55(b) and determined that retail market participants "would benefit from several additional disclosures regarding the potential general risks of engaging in futures trading through an FCM, and the potential specific risks resulting from the bankruptcy of an FCM."[32] In addition, the CFTC required each FCM to "provide customers and potential customers with information about the FCM, including its business, operations, risk profile, and affiliates, as well financial information relating to the FCM's operations (including daily segregation schedules, summary capital schedules of the FCM and its most recent certified annual financial report). These disclosures are required to be disclosed both to the "general public" (via the FCM's public website) and to prospective customers at onboarding.[33] In response to these enhanced customer disclosure requirements, FIA's Law and Compliance Division published an FAQ on the Protection of Customer Funds under the CEA and the CFTC regulations thereunder, addressing the basics of (i) segregation, collateral management and investments, (ii) minimum financial and other requirements for futures commission merchants (FCMs) and joint FCM/broker-dealers, and (iii) derivatives clearing organization (DCO) guarantee funds.[34] We understand that most FCMs have incorporated the FAQ into their publicly available disclosure required under CFTC Regulation 1.55. We encourage Commission staff to review the FAQ (attached hereto as Appendix A and hyperlinked in footnote 34) as a source for answers to questions staff members may have about how customer asset protection works under the CEA and CFTC regulations. We are confident that staff will reach the same conclusion that the Commission has reached many times before, namely that the CFTC's customer protection regime is sufficient and adequate to the Commission's own investor and customer protection objectives and need not be supplemented with conflicting, overlapping, unduly costly and unnecessary additional requirements.

III. Conclusion

In sum, the Commission has failed to articulate a satisfactory explanation for why the requirements of the Proposed Rule should be imposed on FCMs operating under the segregation regime established under the CEA and the CFTC regulations. The Commission does not adduce data or facts[35] relating to the insolvency of an FCM, or misappropriation of customer assets in the custody of an FCM; a fortiori, it advances no rational connection between any such data or facts and its decision to depart from its longstanding determinations that the FCM customer asset protection is sufficient for the purposes of Investment Company Act 17f-6, Investment Adviser Act Rule 206(4)-2, the rules governing security futures accounts and required margin, and the portfolio margining of cleared swaps with cleared security-based swaps in FCM accounts. In the absence of such analysis and any factual finding that, notwithstanding the protections already in place for investment advisory

[32] Safeguarding Proposed Rule at 68562.

[33] *See generally* CFTC Regulation 1.55(i), (j), (k) and (o).

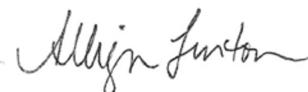
[34] The FIA FAQ is available at https://www.fia.org/sites/default/files/2023-04/Protection%20of%20Customer%20Funds%20FAQ%20%28Rev.%20November%202014%29.pdf and also attached hereto at Appendix A for staff's reference.

[35] Other than a footnote in passing to the Report the Trustee's Investigation and Recommendations in the SIPA proceeding of MF Global, noting that $1.6 billion in customer funds "were found to be missing" but not mentioning that, subsequently, the trustee achieved a full recovery of assets for former securities and commodities customers of MF Global. *See* Safeguarding Proposed Rule at 14695 n. 172. *See also* SIPC: Customers See Full Assets Restored as MF Global Liquidation Ends (Feb. 9, 2016), available at https://www.sipc.org/news-and-media/news-releases/20160209.

customers of FCMs, the Proposed Rule is still necessary and appropriate, we do not think the Commission can, consistent with applicable administrative law, finalize the Proposed Rule as applied to FCMs. Accordingly, we urge the Commission to preserve its longstanding exception to FCMs serving advisory clients as qualified custodians by ensuring that the Proposed Rule not apply to FCMs.

FIA appreciates the opportunity to provide additional comments to the Commission on the Proposed Rule. If you have any questions about FIA's comments, please do not hesitate to contact me at (202) 772-3057 or alurton@fia.org.

Respectfully submitted,



Allison Lurton
General Counsel and Chief Legal Officer

cc: The Hon. Gary Gensler, SEC Chairman
The Hon. Hester Peirce, SEC Commissioner
The Hon. Caroline Crenshaw, SEC Commissioner
The Hon. Mark Uyeda, SEC Commissioner
The Hon. Jaime Lizarraga, SEC Commissioner
Mr. William Birdthistle, Director, Division of Investment Management

APPENDIX A
PROTECTION OF CUSTOMER FUNDS: FREQUENTLY ASKED QUESTIONS, VERSION 4.0

PROTECTION OF CUSTOMER FUNDS

FREQUENTLY ASKED QUESTIONS

Version 4.0

REVISED NOVEMBER 2014

This document, first issued in February 2012, has been prepared by members of the FIA Law and Compliance Division and contains questions and answers addressing the basics of (i) segregation, collateral management and investments, (ii) minimum financial and other requirements for futures commission merchants (FCMs) and joint FCM/broker-dealers, and (iii) derivatives clearing organization (DCO) guarantee funds.

By Federal Register Release dated November 14, 2013, the Commodity Futures Trading Commission (Commission) promulgated a package of rules and rule amendments designed to enhance the protections afforded customers and customer funds held by FCMs and DCOs. (78 Fed.Reg. 68506). The Frequently Asked Questions set out herein have been revised, as necessary, to reflect these enhanced customer protection rules.

GLOSSARY

As used herein, the following terms have the meaning set forth below:

30.7 Account means any account maintained by an FCM for or on behalf of 30.7 Customers to hold money, securities, or other property to margin, guarantee, or secure foreign futures or foreign option positions, and all money, securities, or other property accruing to 30.7 Customers as a result of foreign futures and foreign option positions.

30.7 Customer means any person that trades foreign futures or foreign options through an FCM, other than an owner or holder of a proprietary account of such FCM.

30.7 Customer Funds means any money, securities, or other property received by a futures commission merchant from, for, or on behalf of 30.7 Customers to margin, guarantee, or secure foreign futures or foreign option positions, or money, securities, or other property accruing to 30.7 Customers as a result of foreign futures and foreign option positions. 30.7 Customer Funds are also sometimes referred to as the ***Foreign Futures and Foreign Options Secured Amount.***

Cleared Swap means any swap that is, directly or indirectly, submitted to and cleared by a derivatives clearing organization registered with the Commission.

Cleared Swaps Customer means any person that trades Cleared Swaps through an FCM, other than an owner or holder of a proprietary account of such FCM.

Cleared Swaps Customer Account means any account for the Cleared Swaps of Cleared Swaps Customers and associated Cleared Swaps Customer Collateral that an FCM maintains on behalf of Cleared Swaps Customers, or a DCO maintains for FCMs on behalf of such FCMs' Cleared Swaps Customers.

[1] **DISCLAIMER.** FIA has prepared this document for the benefit of its members and their customers. Although care has been taken to assure that the responses to the questions herein are accurate, this document is not intended to constitute legal advice. FIA specifically disclaims any legal responsibility for any errors or omissions and disclaims any liability for losses or damages incurred through the use of the information herein.

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GLOSSARY (CONTINUED)

Cleared Swaps Customer Collateral means all money, securities, or other property received by an FCM or by a DCO from, for, or on behalf of a Cleared Swaps Customer to margin, guarantee, or secure a Cleared Swap, and money, securities, or other property accruing to Cleared Swaps Customers as a result of Cleared Swaps.

Customer Funds means, collectively, Customer Segregated Funds, Cleared Swaps Customer Collateral and 30.7 Customer Funds.

Customer Account means, collectively, a Customer Segregated Account, a Cleared Swaps Customer Account and a 30.7 Account.

Customer Segregated Account means any account maintained by an FCM for or on behalf of Segregated Customers to hold money, securities, or other property to margin, guarantee, or positions entered into on or subject to the rules of a designated contract market, *i.e.*, a US futures exchange, and money, securities, or other property accruing to Segregated Customers as a result of such positions.

Customer Segregated Funds means all money, securities, or other property received by an FCM or by a DCO from, for, or on behalf of a Segregated Customer to margin, guarantee, or secure a positions entered into on a designated contract market, and money, securities, or other property accruing to Segregated Customers as a result of such positions.

Designated Self-Regulatory Organization (DSRO) means a self-regulatory organization that has been delegated the responsibility for monitoring and examining an FCM for compliance with the minimum financial and related reporting requirements of the self-regulatory organizations of which the FCM is a member, and for receiving the financial reports required by such minimum financial and related reporting requirements from such FCM.

Proprietary Account means, generally, an account carried on the books and records of an FCM for (i) the FCM, or (ii) an affiliate that, directly or indirectly, is controlled by or is under common control with, such FCM. For the avoidance of doubt, a Customer Account of an affiliate of the FCM which is carried by the FCM (either on an omnibus or fully disclosed basis) is a Customer Account and not a Proprietary Account.

Residual Interest means the amount of an FCM's own funds that the FCM holds in a Customer Account.

Segregated Customer means any person that trades futures or options on futures entered into on or subject to the rules of a designated contract market through an FCM, other than an owner or holder of a proprietary account of such FCM.

Targeted Residual Interest means an amount of the FCM's own funds that the FCM holds in a Customer Account that an FCM determines will reasonably ensure that the FCM will remain in compliance with the requirements of the Commodity Exchange Act ***(Act)*** and the Commission's rules relating to the protection of Customer Funds at all times.

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I. Basics of Segregation

1. What accounts do FCMs maintain for customers that trade futures, options on futures contracts and Cleared Swaps? What is the difference among the accounts?

FCMs may maintain up to three different types of accounts for customers, depending on the products a customer trades:

(i) a **Customer Segregated Account** for customers that trade futures and options on futures listed on US futures exchanges;

(ii) a **30.7 Account** for customers that trade futures and options on futures listed on foreign boards of trade; and

(iii) **a Cleared Swaps Customer Account** for customers trading swaps that are cleared on a DCO registered with the Commission.

The requirement to maintain these separate accounts reflects the different risks posed by the different products. Cash, securities and other collateral (collectively, **funds**) required to be held in one type of account, *e.g.*, the Customer Segregated Account, may not be commingled with funds required to be held in another type of account, *e.g.*, the 30.7 Account, except as the Commission may permit by order.[2]

Customer Segregated Account. Funds that Segregated Customers deposit with an FCM, or that are otherwise required to be held for the benefit of customers, to margin futures and options on futures contracts traded on futures exchanges located in the US, *i.e.*, designated contract markets, are held in a **Customer Segregated Account** in accordance with section 4d(a)(2) of the Act and Commission Rule 1.20. **Customer Segregated Funds** held in the Customer Segregated Account may not be used to meet the obligations of the FCM or any other person, including another customer.

All Customer Segregated Funds may be commingled in a single account, *i.e.*, an omnibus Customer Account, and held with: (i) a bank or trust company located in the US; (ii) a bank or trust company located outside of the US that has in excess of $1 billion of regulatory capital; (iii) an FCM; or (iv) a DCO. Such commingled account must be properly titled to make clear that the funds belong to, and are being held for the benefit of, the FCM's Segregated Customers. Unless a customer provides instructions to the contrary, an FCM may hold Customer Segregated Funds only: (i) in the US; (ii) in a money center country;[3] or (iii) in the country of origin of the currency.

An FCM must hold sufficient US dollars in the US to meet all US dollar obligations and sufficient funds in each other currency to meet obligations in such currency. Notwithstanding the foregoing, assets denominated in a currency may be held to meet obligations denominated in another currency (other than the US dollar) as follows: (i) US dollars may be held in the US or in money center countries to meet obligations denominated in any other currency; and (ii) funds in money center currencies[4] may be held in the US or in money center countries to meet obligations denominated in currencies other than the US dollar.

30.7 Account. Funds that **30.7 Customers** deposit with an FCM, or that are otherwise required to be held for the benefit of 30.7 Customers, to margin futures and options on futures contracts traded on foreign

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[2] For example, in August 2012, the Commission issued an order authorizing ICE Clear Europe Limited, which is registered with the Commission as a DCO, and its FCM clearing members to hold in Cleared Swaps Customer Accounts Customer Funds used to margin both (i) Cleared Swaps and (ii) foreign futures and foreign options traded on ICE Futures Europe, and to provide for portfolio margining of such Cleared Swaps and foreign futures and foreign options. In separate orders issued in October 2012 and May 2014, the Commission authorized ICE Clear Europe and its FCM clearing members to hold in Customer Segregated Accounts Customer Funds used to margin both (i) futures and options on futures traded on ICE Futures US and (ii) foreign futures and foreign options traded on ICE Futures Europe, and to provide for portfolio margining of such transactions.

[3] Money center countries means Canada, France, Italy, Germany, Japan, and the United Kingdom.

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boards of trade, *i.e.*, **30.7 Customer Funds,** and sometimes referred to as the **foreign futures and foreign options secured amount,** are held in a **30.7 Account** in accordance with Commission Rule 30.7.

Funds required to be held in the 30.7 Account for or on behalf of 30.7 Customers may be commingled in an omnibus 30.7 Account and held with: (i) a bank or trust company located in the US; (ii) a bank or trust company located outside the US that has in excess of $1 billion in regulatory capital; (iii) an FCM; (iv) a DCO; (v) the clearing organization of any foreign board of trade; (vi) a foreign broker; or (vii) such clearing organization's or foreign broker's designated depositories. Such commingled account must be properly titled to make clear that the funds belong to, and are being held for the benefit of, the FCM's 30.7 Customers. As explained below, Commission Rule 30.7 restricts the amount of such funds that may be held outside of the US.

Cleared Swaps Customer Account.[5] Funds deposited with an FCM, or otherwise required to be held for the benefit of customers, to margin swaps cleared through a registered DCO, *i.e.*, **Cleared Swaps Customer Collateral,** are held in a **Cleared Swaps Customer Account** in accordance with the provisions of section 4d(f) of the Act and Part 22 of the Commission's rules. Funds required to be held in a Cleared Swaps Customer Account may be commingled in an omnibus account and held with: (i) a bank or trust company located in the US; (ii) a bank or trust company located outside of the US that has in excess of $1 billion of regulatory capital; (iii) a DCO; or (iv) another FCM. Such commingled account must be properly titled to make clear that the funds belong to, and are being held for the benefit of, the FCM's Cleared Swaps Customers.

2. What is the FCM's Residual Interest? What is the purpose of the FCM depositing its own money in a Customer Account and how does the FCM determine how much that deposit should be?

An FCM deposits a portion of its own funds in Customer Accounts as a buffer to assure that the FCM is always in compliance with the relevant provisions of the Act and Commission rules governing the segregation of Customer Funds. Such excess funds represent the FCM's Residual Interest in the Customer Account. All FCM excess funds are held for the exclusive benefit of the FCM's customers while held in a Customer Account.

Each FCM is required to have written policies and procedures regarding the establishment and maintenance of the FCM's Targeted Residual Interest in each Customer Account. In establishing its Targeted Residual Interest, the FCM's board of directors or senior management must take into consideration a number factors, including: (i) the nature of the FCM's customers, their general creditworthiness, and their trading activity; (ii) the type of markets and products traded by the FCM's customers and the FCM itself; (iii) the general volatility and liquidity of those markets and products; (iv) the FCM's own liquidity and capital needs; and (v) historical trends in Customer Funds balances and customer debits.[6]

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[4] Money center currencies mean the currency of any money center country and the Euro.

[5] Cleared Swaps Customer Accounts are sometimes referred to as **LSOC Accounts**. LSOC is an acronym for "legally separated, operationally commingled."

[6] Commission rules require that the analysis and calculation of the FCM's Targeted Residual Interest be described in writing with the specificity necessary to allow the Commission and the FCM's DSRO to duplicate the analysis and calculation and test the assumptions made by the FCM. The adequacy of the Targeted Residual Interest and the process for establishing the Targeted Residual Interest must be reassessed periodically by the FCM's senior management and revised as necessary.

As described in greater detail in the response to Question 11, below, the Commission posts on its website a monthly report providing certain non-confidential financial information concerning each registered FCM, including each FCM's Targeted Residual Interest in each type of Customer Account that the FCM maintains.

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Commission rules require an FCM to notify the Commission immediately whenever the amount of Residual Interest in any Customer Account falls below the FCM's Targeted Residual Interest for such Customer Account. The FCM is required to file a copy of each notice concurrently with its DSRO.

3. Are there any restrictions on an FCM's ability to withdraw its Residual Interest from a Customer Account?

Commission rules provide that, on any day, an FCM may not withdraw funds comprising its Residual Interest from any Customer Account, in a single transaction or a series of transactions, that are not made to or for the benefit of customers, if such withdrawal would exceed 25 percent of the FCM's Residual Interest in such account, as reported on the daily segregation report as of the previous business day, unless: (i) the FCM's chief executive officer, chief finance officer or other senior official knowledgeable about the FCM's financial requirements and financial position pre-approves in writing the withdrawal, or series of withdrawals; and (ii) the FCM files written notice of the withdrawal, or series of withdrawals, with the Commission and with its DSRO immediately thereafter.

The written notice must: (i) be signed by the chief executive officer, chief finance officer or other senior official; (ii) include a description of the reasons for the withdrawal or series of withdrawals; (iii) list the amount of funds provided to each recipient and each recipient's name; (iv) include the current estimate of the amount of the FCM's Residual Interest in the Customer Account after the withdrawal; and (v) contain a representation by the chief executive officer, chief finance officer or other senior official that, after due diligence, to such person's knowledge and reasonable belief, the FCM remains in compliance with the applicable segregation requirements after the withdrawal.

4. Is a customer at risk if another customer defaults on its obligations to the FCM?

Commission rules prohibit an FCM from using the funds of one customer to meet the obligations of another customer; an FCM must use its own funds to meet a defaulting customer's obligations to a DCO or clearing FCM. To this end, as discussed earlier, each FCM is required to have written policies and procedures regarding the establishment and maintenance of the FCM's Targeted Residual Interest, which acts as a buffer to assure that the FCM is always in compliance with the relevant provisions of the Act and Commission rules governing the segregation of Customer Funds.[7]

Nonetheless, if one or more customers of an FCM defaults on their obligations to the FCM and the loss is so great that, notwithstanding the application of the FCM's available own funds, there is a shortfall in the amount of Customer Funds required to be held in one or more Customer Accounts, the FCM will likely default and be placed into bankruptcy. In these circumstances, the Bankruptcy Code and Commission rules provide that, in the event of an FCM's bankruptcy, funds allocated to each account class — the Customer Segregated Account, the 30.7 Account, and the Cleared Swaps Customer Account — or readily traceable to an account class must be allocated solely to that customer account class. The Bankruptcy Code also provides that non-defaulting customers in an account class that has incurred a loss, *e.g.*, the Customer Segregated Account, will share in any shortfall, *pro rata*. However, customers whose funds are held in another account class that has not incurred a loss, *e.g.*, the 30.7 Account, will not be required to share in such shortfall. A shortfall in a customer account class may also make the

[7] As discussed below, in order to monitor an FCM's compliance with the Customer Funds requirements, Commission rules require each FCM to calculate as of the close of business each business day, and submit to the Commission and the FCM's DSRO no later than Noon the following business day, a report that sets out: (i) the amount of Customer Funds required to be held in the Customer Account; (ii) the amount of Customer Funds actually held in the Customer Account; and (iii) the FCM's Residual Interest in the Customer Account. Separate calculations are required for the Customer Segregated Accounts, the 30.7 Accounts and the Cleared Swaps Customer Accounts. Commission rules further require an FCM to notify the Commission and the FCM's DSRO immediately whenever: (i) the amount of Residual Interest in any Customer Account falls below the FCM's Targeted Residual Interest for such account; or (ii) the FCM knows or should know that the total amount of funds on deposit in Customer Accounts is less than the amount required to be held in such accounts.

transfer of the accounts of non-defaulting customers to another FCM more difficult.[8]

For this reason, an FCM's excess adjusted net capital, which is available to satisfy a defaulting customer's obligations to a DCO or clearing FCM, is one of the factors that a customer should consider carefully in selecting an FCM to carry the customer's account.

5. How does the treatment of the Cleared Swaps Customer Account differ from the Customer Segregated Account in the event of an FCM's bankruptcy?

The Part 22 Rules governing the treatment of Cleared Swaps Customer Collateral incorporate by reference many of the rules governing the treatment of Customer Segregated Funds. Nonetheless, the regulatory requirements for Cleared Swaps Customer Collateral differ in several important respects from the requirements applicable to Customer Segregated Funds. In particular, the Part 22 Rules are designed to provide Cleared Swaps Customers enhanced protection from fellow customer risk in the event of an FCM's bankruptcy.

As with Customer Segregated Funds and 30.7 Customer Funds, the Part 22 Rules permit an FCM to maintain Cleared Swaps Customer Collateral in an omnibus account, on its own books and at the relevant DCO. However, the FCM carrying the Cleared Swaps Customer Account must provide the FCM through which the FCM clears Cleared Swaps Customer transactions (if different) with sufficient information to identify each Cleared Swaps Customer within the omnibus account, the portfolio of positions held by each Cleared Swaps Customer and the margin required to support such positions. The clearing FCM must provide the same information to the DCO that clears the positions. The DCO is required to treat the value of the Cleared Swaps Customer Collateral required to margin each Cleared Swaps Customer's positions as belonging to such Cleared Swaps Customer.

In the event the default of one or more Cleared Swaps Customers leads to the failure of an FCM, the Part 22 Rules require the FCM to advise the FCM through which the FCM clears Cleared Swaps Customer transactions (if different) or the DCO of the identity of the defaulting Cleared Swaps Customer(s). The clearing FCM (if different) and the DCO are prohibited from applying funds in an omnibus Cleared Swaps Customer Account attributable to non-defaulting Cleared Swaps Customers to meet the shortfall owing to the clearing FCM (if different) or the DCO.[9] In contrast to this provision of the Part 22 Rules, the Commission's rules governing Customer Segregated Accounts do not prohibit a clearing FCM (if different) or a DCO, following application of all assets of the defaulting FCM available to the clearing FCM (if different) or DCO, from using the funds of non-defaulting Segregated Customers held by the DCO to meet the shortfall owing to the DCO.

It is important to understand that the Part 22 Rules do not fully protect Cleared Swaps Customers from all loss in the event of a shortfall in the Cleared Swaps Customer Account following the bankruptcy of an FCM. For example, the rules would not protect such Cleared Swaps Customers: (i) if the bankrupt FCM's books and records are inaccurate; (ii) in the event of a shortfall in the Cleared Swaps Customer Account arising from FCM fraud or mismanagement; or (iii) in the event a bankruptcy trustee incurs losses in liquidating collateral held in the Cleared Swaps Customer Account in which the FCM had invested in accordance with Commission Rule 1.25.

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[8] As discussed in detail immediately below in response to Question 5, the treatment of the Cleared Swaps Customer Account differs from the treatment of the Customer Segregated Account in the event of the default of the FCM carrying the Customer Account.

[9] The Part 22 Rules also provide that an FCM may transmit to a DCO any collateral posted by a Cleared Swaps Customer in excess of the amount required by DCO if: (i) the rules of the DCO expressly permit the FCM to transmit collateral in excess of the amount required by the DCO; and (2) the DCO provides a mechanism by which the FCM is able to, and maintains rules pursuant to which the FCM is required to, identify each business day, for each Cleared Swaps Customer, the amount of collateral posted in excess of the amount required by the DCO. A DCO would be prohibited from applying such excess funds attributable to non-defaulting Cleared Swaps Customers to meet the shortfall owing to the DCO.

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6. Why is an FCM prohibited from commingling Customer Funds held in the Customer Segregated Accounts, the 30.7 Accounts and Cleared Swaps Customer Accounts?

30.7 Accounts. Because customers trading on foreign markets assume additional risks, the Commission generally does not permit funds held to margin foreign futures and foreign options transactions to be held in the same account as Customer Segregated Funds or Cleared Swaps Customer Collateral. Laws or regulations will vary depending on the foreign jurisdiction in which the transaction occurs, and funds held in a 30.7 Account outside of the US may not receive the same level of protection as Customer Segregated Funds. If the foreign broker carrying 30.7 Customer positions fails, the broker will be liquidated in accordance with the laws of the jurisdiction in which it is organized, which laws may differ significantly from the US Bankruptcy Code. Return of 30.7 Customer Funds to the US will be delayed and likely will be subject to the costs of administration of the failed foreign broker in accordance with the law of the applicable jurisdiction, as well as possible other intervening foreign brokers, if multiple foreign brokers were used to process the US customers' transactions on foreign markets.

If the foreign broker does not fail but the 30.7 Customers' US FCM fails, the foreign broker may want to assure that appropriate authorization has been obtained before returning the 30.7 Customer Funds to the FCM's trustee, which may delay their return. If both the foreign broker and the US FCM were to fail, potential differences between the trustee for the US FCM and the administrator for the foreign broker, each with independent fiduciary obligations under applicable law, may result in significant delays and additional administrative expenses. Use of other intervening foreign brokers by the US FCM to process the trades of 30.7 Customers on foreign markets may cause additional delays and administrative expenses.

To reduce the potential risk to 30.7 Customer Funds held outside of the US, Commission Rule 30.7 generally provides that an FCM may not deposit or hold 30.7 Customer Funds in permitted accounts outside of the US except as necessary to meet margin requirements, including prefunding margin requirements, established by rule, regulation, or order of the relevant foreign boards of trade or foreign clearing organizations, or to meet margin calls issued by foreign brokers carrying the 30.7 Customers' positions. The rule further provides, however, that, in order to avoid the daily transfer of funds from accounts in the US, an FCM may maintain in accounts located outside of the US an additional amount of up to 20 percent of the total amount of funds necessary to meet margin and prefunding margin requirements to avoid daily transfers of funds.

An FCM may exclude from the calculation of 30.7 Customer Funds permitted to be held outside of the US, those 30.7 Customer Funds held in a properly-titled account established by the FCM in a bank or trust company located outside of the US, provided the bank or trust company: (i) maintains regulatory capital of at least $1 billion; and (ii) provides the FCM a written acknowledgment letter that the depository was informed that such funds held in the 30.7 Account belong to customers and are being held in accordance with the Act and the Commission's rules.[10]

Cleared Swaps Customer Accounts. Similarly, because the rules regarding Cleared Swaps Customer Collateral provide Cleared Swaps Customers enhanced protection from fellow customer risk in the event of an FCM's bankruptcy, Commission rules generally do not permit Cleared Swaps Customer Collateral from being held in the same account with Customer Segregated Funds (or 30.7 Customer Funds).[11]

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[10] *See* Commission Letter No. 14-138 (November 13, 2014).

[11] Although FCMs are generally prohibited from commingling Customer Funds held in the Customer Segregated Accounts, the 30.7 Accounts and Cleared Swaps Customer Accounts, it should be noted that an FCM's agreement with its customers typically includes a provision that, at a minimum, authorizes the FCM to transfer from one account of the customer, *e.g.*, the Customer Segregated Account, to any other account of the customer, *e.g.*, the 30.7 Account, such excess funds as may be required to avoid a margin call in such other account.

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7. How does an FCM segregate Customer Funds? Who oversees this process?

Customer Funds are required to be held in Customer Accounts at a bank or trust company, a DCO or another FCM (each, a **depository**).[12] In accordance with Commission rules, each account holding Customer Funds must be properly titled to identify it as holding Customer Funds and segregated as required by the relevant provisions of the Act and the Commission's rules.[13] Except as noted below, Customer Funds may not be commingled with the funds of any other person, including (and in particular) the carrying FCM. Each depository is required to provide the depositing FCM with a written acknowledgment that the depository was informed that such funds held in the Customer Account belong to customers and are being held in accordance with the Act and the Commission's rules.[14] Among other representations, the depository must acknowledge that it cannot use any portion of Customer Funds to satisfy any obligations that the FCM may owe the depository.[15]

In order to monitor an FCM's compliance with the Customer Funds requirements, Commission rules require each FCM to calculate as of the close of business each business day, and submit to the Commission and the FCM's DSRO no later than Noon the following business day, a report that sets out (i) the amount of Customer Funds required to be held in the Customer Account, (ii) the amount of Customer Funds actually held in the Customer Account, and (iii) the FCM's Residual Interest in the Customer Account. Separate calculations are required for the Customer Segregated Accounts, the 30.7 Accounts and the Cleared Swaps Customer Accounts.

Commission rules require an FCM to notify the Commission immediately whenever (i) the amount of Residual Interest in any Customer Account falls below the FCM's Targeted Residual Interest for such account, or (ii) the FCM knows or should know that the total amount of funds on deposit in Customer Accounts is less than the amount required to be held in such accounts. The FCM is required to file a copy of each notice concurrently with its DSRO.

In addition, each FCM must submit a Segregated Investment Detail Report (**SIDR**) to the Commission and the FCM's DSRO on the fifteenth and last business day of each month listing the names of all banks, trust companies, FCMs, DCOs, or any other depository or custodian holding Customer Funds. This report must include: (1) the name and location of each entity holding Customer Funds; (2) the total amount of Customer Funds held by each entity; and (3) the total amount of Customer Funds, cash and investments that each entity holds.[16] The FCM must also indicate whether any such depository is affiliated with the FCM.[17]

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[12] Certain assets that may be permitted to be maintained in Customer Accounts, *e.g.*, warehouse receipts, may be held by the FCM.

[13] Consequently, as explained earlier, an FCM must maintain separate Customer Segregated Accounts, 30.7 Accounts and Cleared Swaps Customer Accounts at a depository.

[14] An FCM is not required to obtain a written acknowledgment from a DCO that has adopted rules providing for the segregation of Customer Funds in accordance with the provisions of the Act and the Commission rules and orders promulgated thereunder.

[15] Except as explained in footnote 14 immediately above, a depository that holds Customer Funds must execute an acknowledgment letter in the form prescribed by the Commission in the enhanced customer protection rules. A copy of the letter must be filed with the Commission and the FCM's DSRO. Among other provisions, the depository must agree that that it will reply promptly and directly to any request for confirmation of account balances or any other information regarding or related to the Customer Account from authorized members of the Commission staff, or an appropriate representative of the FCM's DSRO. In addition, the depository will provide the Commission with the technological capability to obtain direct, read-only access to account and transaction information.

[16] Separate reports are required for the Customer Segregated Accounts, the 30.7 Accounts and the Cleared Swaps Customer Accounts.

[17] As discussed below, each FCM is required to provide certain non-confidential financial information on its website. In addition, certain financial information, including a substantial portion of the information described herein, is available on either the Commission's website or NFA's website.

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Separately, DSRO rules require each FCM to instruct each depository, whether located in the US or outside the US, that holds Customer Funds to confirm to the DSRO all account balances daily. DSRO programs compare the daily balances reported by the depositories with the balances reported by the FCMs in their daily segregation reports. Any material discrepancies would generate an immediate alert.

Finally, an FCM's DSRO conducts periodic examinations of the FCM and, in connection with such examinations, confirms that Customer Funds are being held in properly designated accounts. The Commission may also conduct an examination of the FCM for this purpose.

8. Would a separate Customer Account maintained solely for the benefit of one customer allow such customer, in the event an FCM were to become insolvent, to avoid sharing *pro rata* in any shortfalls as required under the Bankruptcy Code?

No. In adopting rules for the protection of Cleared Swaps Customer Collateral, the Commission determined that any increased protection that might be provided by requiring an FCM to maintain separate accounts for each customer would be minimal. In particular, the Bankruptcy Code provides that non-defaulting public customers of an FCM will share in any shortfall in customer segregated funds *pro rata*. Under the existing segregation models, therefore, separate accounts would not allow a customer to avoid sharing *pro rata* in any shortfalls, as required under the Bankruptcy Code.[18]

Although the Commission has stated that an FCM may agree to maintain a third-party custodial account on behalf of a Cleared Swaps Customer, third-party custodial accounts would require an FCM to use its own capital to post initial margin with a DCO on behalf of a customer.[19] Consequently, such accounts may adversely affect an FCM's liquidity and would impose additional costs on customers. Importantly, as noted above, the Commission has emphasized that third-party custodial accounts do not provide any greater protection to customers in the event that an FCM fails when there is a shortfall in one or more Customer Accounts.

9. Are funds that comprise customer excess margin or the FCM's Residual Interest protected if the FCM becomes insolvent?

The Bankruptcy Code broadly defines customer property to mean cash, a security, or other property, or the proceeds of such cash, security or property received, acquired, or held by or for the account of the FCM from or for the account of a customer. Customer property is not limited only to the funds required by the relevant exchange or DCO to margin open contracts. Consequently, in the event of an FCM's insolvency, customer excess margin deposited with the FCM and the FCM's Residual Interest held in a Customer Segregated Account, a 30.7 Account or a Cleared Swaps Customer Account, as applicable, would be entitled to the same protections as margin that is required by a DCO.

The Commission's Part 22 Rules relating to the protection of Cleared Swaps Customer Collateral permit a DCO to establish a procedure pursuant to which a Cleared Swaps Customer's excess Cleared Swaps

[18] As discussed above, the Bankruptcy Code and Commission rules provide that funds allocated to each account class — the Customer Segregated Account, the 30.7 Account, and the Cleared Swaps Customer Account — or readily traceable to an account class must be allocated to that customer account class. Therefore, a loss arising from one account class, *e.g.*, the Customer Segregated Account, should not endanger Customer Funds held in the other account classes, *e.g.*, the 30.7 Account.

[19] It should be noted that, in May 2005, Commission staff prohibited the use of third-party custodial accounts on behalf of Segregated Customers and 30.7 Customers, except in limited circumstances. The staff expressed concern that such accounts "may create unnecessary confusion on the part of the customer and create the potential risk that third party custodial accounts might receive priority or preference over other customers in an FCM's bankruptcy proceeding, or at least cause additional administrative expenses to be incurred, in a manner inconsistent with the Commission regulations and regulatory objectives." 70 Fed.Reg. 24768, 24770 (May 11, 2005).

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Customer Collateral, *i.e.*, Cleared Swaps Customer Collateral not required by the DCO to margin open positions, may be held by the DCO. The DCO must provide a mechanism by which the FCM is able to, and maintains rules pursuant to which the FCM is required to, identify each business day, for each Cleared Swaps Customer, the amount of collateral posted in excess of the amount required by the DCO. This process assures that, in the event of an FCM default, the DCO will not use the excess value attributed to one customer to meet the losses of another customer.

It should be noted that excess funds, wherever held, are subject to the *pro rata* distribution provisions of the Bankruptcy Code in the event of a shortfall in a defaulting FCM's Cleared Swaps Customer Account.

10. Is there insurance for any shortfall in Customer Funds?

There is no industry-wide insurance fund to compensate customers in the event of a shortfall in Customer Funds upon the insolvency of an FCM. However, the CME Group has established a $100 million fund to further protect US family farmers and ranchers who hedge their business in CME Group futures markets. The Family Farmer and Rancher Protection Fund will provide up to $25,000 to individual farmers and ranchers and $100,000 to co-ops that hedge their risk in CME Group futures markets as a means to help offset losses arising from the failure of a CME Group clearing member or other market participant.

11. What type of financial information concerning an FCM is publicly available?

Each FCM must make the following financial information available on its website:

(i) the daily Statement of Segregation Requirements and Funds in Segregation for the most current 12-month period;

(ii) the daily Statement of Secured Amounts and Funds Held in Separate Accounts for 30.7 Customers for the most current 12-month period;

(iii) the daily Statement of Cleared Swaps Customer Segregation Requirements and Funds in Cleared Swaps Customer Accounts for the most current 12-month period;

(iv) a summary schedule of the FCM's adjusted net capital, net capital and excess net capital, reflecting balances as of the month-end for the 12 most recent months;

(v) the Statement of Financial Condition, the Statement of Segregation Requirements and Funds in Segregation, the Statement of Secured Amounts and Funds Held in Separate Accounts for 30.7 Customers, the Statement of Cleared Swaps Customer Segregation Requirements and Funds in Cleared Swaps Customer Accounts, and all related footnotes to the above schedules that are part of FCM's most current certified annual report; and

(vi) the Statement of Segregation Requirements and Funds in Segregation, the Statement of Secured Amounts and Funds Held in Separate Accounts for 30.7 Customers, and the Statement of Cleared Swaps Customer Accounts that are part of the FCM's unaudited Form 1-FR-FCM or FOCUS Report for the most current 12-month period.

The Commission posts on its website a monthly report providing certain non-confidential financial information concerning each registered FCM. Beginning with the month ending January 31, 2014, the report includes the following information:

(i) the FCM's adjusted net capital;

(ii) the FCM's required net capital;

(iii) the FCM's excess net capital;

(iv) the total amount of funds held in the Customer Segregated Account;

(v) the amount of Customer Segregated Funds required to be segregated in accordance with section 4d(a) of the Act;

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(vi) the amount of excess held by the FCM in the Customer Segregated Account;
(vii) the FCM's targeted Residual Interest for the Customer Segregated Account;
(viii) the total amount of funds held in the 30.7 Account;
(ix) the amount of 30.7 Customer Funds required to be held in the 30.7 Account;
(x) the amount of excess funds held by the FCM in the 30.7 Account;
(xi) the FCM's targeted Residual Interest for the 30.7 Account;
(xii) the total amount of funds held in the Cleared Swaps Customer Account;
(xiii) the amount of Cleared Swaps Customer Collateral required to be segregated in accordance with section 4d(f) of the Act;
(xiv) the amount of excess held by the FCM in the Cleared Swaps Customer Account;
(xv) the FCM's targeted Residual Interest for the Cleared Swaps Customer Account; and (xvi) the total amount of the FCM's retail foreign exchange obligation.

The report is created from financial reports that each FCM must file with the Commission within 17 business days following each month end and is generally posted on the Commission's website within six weeks following each month end.

The reports may be found on the Commission's website at:
www.cftc.gov/MarketReports/FinancialDataforFCMs/index.htm

NFA publishes similar financial information on its website with respect to each FCM. The FCM Capital Report provides each FCM's most recent month-end adjusted net capital, required net capital, and excess net capital. (Information for a twelve-month period is available.) In addition, NFA publishes twice-monthly a Customer Segregated Funds report. This report shows for each FCM:

(i)(a) total funds (cash and securities) held in Customer Segregated Accounts; (b) total funds required to be held in Customer Segregated Accounts; and (c) excess segregated funds, i.e., the FCM's Residual Interest;
(ii) percentage of Customer Segregated Funds held in cash in Customer Segregated Accounts at: (a) banks; and (b) clearing organizations and other FCMs;
(iii) percentage of customer-owned securities held in Customer Segregated Accounts;
(iv)(a) percentage of Customer Segregated Funds held in each of the permitted investments under Commission Rule 1.25, including (b) percentage of Customer Segregated Funds subject to reverse repurchase agreements;[20] and
(v) whether during that month the FCM held any Customer Segregated Funds at a depository that is an affiliate of the FCM.

The report shows the most recent semi-monthly information, but the public will also have the ability to see information for the most recent twelve-month period.[21] A 30.7 Customer Funds report and a Customer Cleared Swaps Collateral report provides the same information with respect to the 30.7 Account and the Cleared Swaps Customer Account.

[20] The permitted investments under Commission Rule 1.25 are described in the response to Question 17, below.

[21] Information regarding: (i) the percentage of Customer Segregated Funds held in cash in Customer Segregated Accounts at banks, and clearing organizations and other FCMs; (ii) the percentage of customer-owned securities held in Customer Segregated Accounts; and (iii) the percentage of Customer Segregated Funds that are subject to reverse repurchase agreements is available only for the period beginning November 17, 2014.

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The above financial information reports can be found by conducting a search for a specific FCM in NFA's BASIC system (**www.nfa.futures.org/basicnet**) and then clicking on "View Financial Information" on the FCM's BASIC Details page.

II. Collateral Management and Investments

12. Can a customer select the depository at which its funds are held? Can a customer find out which depositories an FCM uses to hold Customer Funds?

An FCM may agree to hold a portion of its Customer Funds at a depository selected by the customer, provided the FCM determines that the depository is otherwise an acceptable depository.[22] However, the customer must recognize that Commission rules provide that such funds must held in the name of the FCM for the benefit of its customers generally and not for the benefit of the requesting customer. Further, for operational efficiency, an FCM may limit the number of banks at which it maintains Customer Accounts. In the event of the FCM's bankruptcy and a shortfall in Customer Funds available for distribution, the requesting customer would receive no greater protection than all other customers of the FCM in the same account class.

Customer statements generally do not indicate where a customer's funds are held. However, upon request of a customer, an FCM should identify for the customer the depositories at which the FCM holds Customer Funds.[23]

13. Can a customer maintain its own custody account at the bank as long as it is in the name of the FCM?

Such an account would be similar in effect to a third-party custodial account. As discussed above, although third-party custodial accounts are permitted for Cleared Swaps Customer Accounts, they are not permitted for Customer Segregated and 30.7 Accounts.

14. If a customer does not trade foreign futures, can the customer require that the FCM hold all Customer Funds and collateral in the United States?

Assuming that the customer is located in the US and has deposited US dollars or securities denominated in US dollars to margin futures and options on futures contracts traded on US futures exchanges or Cleared Swaps, the FCM is required under Commission Rule 1.49 to hold such funds or securities in depositories located in the US and may not transfer funds outside of the US, except as a customer may otherwise instruct the FCM.

15. When an FCM opens a 30.7 Account with a foreign broker, what steps does the FCM take to protect those funds?

When an FCM opens a 30.7 Account with a foreign broker, the FCM obtains from the broker a written acknowledgment, as required by Commission Rule 30.7, pursuant to which the foreign broker confirms that it has been advised that the 30.7 Customer Funds are held for and on behalf of the FCM's 30.7 Customers and agrees that the funds will be held in accordance with the Act and applicable Commission

[22] Each FCM must have written policies and procedures setting out a process by which the FCM will evaluate the depositories at which the FCM holds Customer Funds, including, at a minimum, documented criteria that any depository that will hold Customer Funds, including an entity affiliated with the FCM, must meet, including criteria addressing the depository's capitalization, creditworthiness, operational reliability, and access to liquidity.

[23] Each FCM must prepare and make available on the FCM's website a disclosure document that provides customers with such information regarding the FCM's business, operations, risk profile and affiliates that would be material to the customer's decision to entrust funds and otherwise do business with the FCM. Among other information required to be provided, the FCM must describe its policies and procedures concerning the choice of bank depositories, custodians and counterparties to permitted transactions under Commission Rule 1.25.

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rules. In particular, the foreign broker confirms that such 30.7 Customer Funds will not be used to secure or guarantee the obligations of, or extend credit to, the FCM or any proprietary account of the FCM.[24]

In addition, Commission Rule 30.7 provides that an FCM must deposit 30.7 Customer Funds under the laws and regulations of the foreign jurisdiction that provide the greatest degree of protection to such funds. An FCM may not by contract or otherwise waive any of the protections afforded customer funds under the laws of the foreign jurisdiction.

16. Are there any special factors or risks that a customer should take into consideration before choosing to trade futures and options on futures contracts listed for trading on foreign boards of trade?

As with trading on US futures exchanges, the risk of loss in trading foreign futures and foreign options can be substantial. Consequently, a customer should carefully consider whether such trading is appropriate in light of the customer's financial condition and investment goals. Customers trading on foreign markets also assume additional risks and, therefore, should understand those risks before trading.

Customer Funds protections may be different. 30.7 Customer Funds used to margin transactions on foreign markets are deposited with a foreign broker or other permitted depository located outside of the US. Although an FCM is required to deposit Customer Funds under the laws and regulations of the foreign jurisdiction that provide the greatest degree of protection to such funds, it is important to understand that 30.7 Customer Funds held outside of the US to margin transactions on foreign boards of trade will not receive the same protections under the Act and the US Bankruptcy Code as Customer Segregated Funds or Cleared Swaps Customer Collateral. If the foreign broker carrying the US customers' positions fails, the broker will be liquidated in accordance with the laws of the jurisdiction in which it is located. If the foreign broker does not fail but the customer's US FCM fails, the return of the funds held outside of the US may nonetheless be delayed.

It is also important to understand that, in the event of an FCM's bankruptcy, 30.7 Customers comprise a single account class under the Bankruptcy Code and the Commission's Bankruptcy Rules. Therefore, if a US FCM were to fail and there was a shortfall in 30.7 Customer Funds arising from losses in one foreign jurisdiction, those losses would be shared *pro rata* by all 30.7 Customers, including customers that did not engage in trading in that jurisdiction.

A 30.7 Customer that chooses to effect transactions on foreign boards of trade, therefore, is encouraged to consider carefully the client assets protection regimes in the jurisdictions in which the customer's 30.7 Customer Funds will be held.

NOTE: Transactions on certain foreign boards of trade are cleared through a clearing organization that is registered with the Commission as a DCO. In these circumstances, funds held for or on behalf of customers to margin contracts executed on the foreign board of trade may not always be held in the 30.7 Account maintained by the FCM and clearing organization. Rather, at the request of the DCO and pursuant to Commission order, the funds deposited by customers to margin such transactions executed on the foreign board of trade and cleared by a registered FCM may be permitted to be held in a Customer Segregated Account under section 4d(a)(2) of the Act. In the event of the default of a US

[24] A foreign broker that holds Customer Funds must execute an acknowledgment letter in the form prescribed by the Commission in the enhanced customer protection rules. A copy of the letter must be filed with the Commission and the FCM's DSRO. Among other provisions, the foreign broker must agree that that it will reply promptly and directly to any request for confirmation of account balances or any other information regarding or related to the 30.7 Account from authorized members of the Commission staff, or an appropriate representative of the FCM's DSRO. In addition, the foreign broker will provide the Commission with the technological capability to obtain direct, read-only access to account and transaction information. If an FCM opens a 30.7 Account directly with a foreign depository, the FCM must obtain a similar acknowledgment letter from the foreign depository.

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FCM, such funds will receive the same protections under the Act and the US Bankruptcy Code as funds held by a US FCM to margin transactions on US futures exchanges.

For example, pursuant to Commission order, certain futures contracts listed for trading on the ICE Futures Europe and cleared through ICE Clear Europe are treated as Customer Segregated Funds and held in a Customer Segregated Account.

Transactions on foreign boards of trade are not governed by US law. Transactions entered into on a foreign board of trade are governed by applicable foreign laws and regulations. Moreover, such laws or regulations will vary depending on the country in which the foreign futures or foreign options transaction occurs. Neither the Commission nor the National Futures Association regulates activities of any foreign board of trade, including the execution, delivery and clearing of transactions. Similarly, they have no the power to compel enforcement of the rules of a foreign board of trade or any applicable foreign laws.

Foreign brokers are not subject to US law. Generally, foreign brokers are not subject to the jurisdiction of the Commission or any other US regulatory body; nor is the Commission able to compel a foreign jurisdiction or foreign board of trade to enforce applicable foreign laws or regulations. It is especially important, therefore, that an FCM carefully choose the foreign broker that will carry and clear transactions executed on behalf of the FCM's customers. A customer may request an FCM to (i) identify the foreign brokers that will carry and clear its customers' transactions in the applicable foreign jurisdiction, and (ii) explain the criteria the FCM follows in selecting such foreign brokers, including any affiliates of the FCM.

NOTE: Pursuant to an exemption issued under Commission Rule 30.10, certain foreign brokers are authorized to solicit or accept orders directly from 30.7 Customers for execution on foreign boards of trade without being registered with the Commission as an FCM. Such foreign brokers consent to the jurisdiction of the US with respect to any activities of such foreign brokers otherwise subject to regulation under Part 30. Foreign brokers that have received an exemption from registration under Rule 30.10 are identified as such on NFA's Background Affiliation Status Information Center System (BASIC), which may be accessed at **www.nfa.futures.org/basicnet**.

Foreign brokers that have received an exemption from registration under Commission Rule 30.10 are not authorized to solicit from customers located in the US orders for execution on a US futures exchange or transactions in Cleared Swaps.

The use of affiliates to carry and clear foreign transactions provides benefits but also presents risks. Provided the affiliate meets the criteria the FCM has established for depositories holding Customer Funds,[25] an FCM may use one or more affiliates to carry and clear transactions on foreign boards of trade, including in major markets such as the United Kingdom, Hong Kong and Singapore. A customer is encouraged to consider the risks as well as the benefits of effecting transactions on foreign boards of trade through the FCMs' affiliates.

Many FCMs believe customers receive significant benefits if trades are executed through affiliated foreign brokers. FCMs will necessarily have far more information about an affiliated foreign broker, *e.g.*, its internal controls, investment policies, customer protection regime, finances and systems, and are better able to exert influence over an affiliated foreign broker. Customers, for their part, often prefer to deal with one integrated company, whose unified balance sheet and financial statement permit the customers to assess more easily the potential risk of trading through that FCM.

[25] *See* footnote 15, above.

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In addition, an FCM generally is able to provide services to its customers more efficiently and more effectively if trades are executed and cleared through one or more affiliates. An FCM and its affiliates customarily use the same systems, which permit straight-through processing of trades, thereby enhancing certainty of execution (including give-up transactions), facilitating reconciliations and reducing errors (or the time necessary to resolve errors). Straight-through processing also facilitates an FCM's ability to (i) manage the risks of carrying its customers' positions, and (ii) comply with position limit and large trader reporting requirements, both in the US and in foreign jurisdictions. Moreover, an FCM that executes transactions on foreign boards of trade through an affiliate may be able to offer certain value-added services, including a platform for direct access to certain markets and single currency margining.

Nonetheless, the use of affiliates also poses certain risks. Because the activities of a US FCM and its affiliates are integrated, the failure of one such entity may cause all of the affiliated companies to fail or be placed in administration within a relatively brief period of time. As is the case if an unaffiliated foreign broker were to fail, each of these companies would be liquidated in accordance with the bankruptcy laws of the local jurisdiction. 30.7 Customer Funds held with such entities would not receive the same protections afforded Customer Funds under the Act and the US Bankruptcy Code. If, on the other hand, a defaulting US FCM had cleared its 30.7 Customers' foreign futures and foreign options transactions through unaffiliated foreign brokers, the foreign broker likely would not have failed as a result of the FCM's failure, and the defaulting FCM's trustee in bankruptcy could have directed the foreign broker to liquidate all customer positions and return the balance to the trustee for distribution to customers. In either case, however, in the event of the failure of a foreign broker, return of 30.7 Customer Funds to the US will be delayed and likely will be subject to the costs of administration of the failed foreign broker in accordance with the law of the applicable jurisdiction, as well as possible other intervening foreign brokers, if multiple foreign brokers were used to process the US customers' transactions on foreign markets.

17. What types of investments may an FCM make with Customer Segregated Funds? With 30.7 Customer Funds? With Cleared Swaps Customer Collateral?

Section 4d(a)(2) of the Act authorizes FCMs to invest Customer Segregated Funds in obligations of the United States, in general obligations of any State or of any political subdivision thereof, and in obligations fully guaranteed as to principal and interest by the United States. Section 4d(f) authorizes FCMs to invest Cleared Swaps Customer Collateral in similar instruments.

Commission Rule 1.25 authorizes FCMs to invest Customer Segregated Funds, Cleared Swaps Customer Collateral and 30.7 Customer Funds in instruments of a similar nature. Commission rules further provide that the FCM may retain all gains earned and is responsible for investment losses incurred in connection with the investment of Customer Funds. However, the FCM and customer may agree that the FCM will pay the customer interest on the funds deposited.

Permitted investments include:

(i) Obligations of the United States and obligations fully guaranteed as to principal and interest by the United States (U.S. government securities);

(ii) General obligations of any State or of any political subdivision thereof (municipal securities);

(iii) Obligations of any United States government corporation or enterprise sponsored by the United States government (U.S. agency obligations);[26]

[26] Obligations issued by the Federal National Mortgage Association or the Federal Home Loan Mortgage Association are permitted only while these entities operate under the conservatorship or receivership of the Federal Housing Finance Authority with capital support from the United States.

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(iv) Certificates of deposit issued by a bank (certificates of deposit) as defined in section 3(a)(6) of the Securities Exchange Act of 1934, or a domestic branch of a foreign bank that carries deposits insured by the Federal Deposit Insurance Corporation;
(v) Commercial paper fully guaranteed as to principal and interest by the United States under the Temporary Liquidity Guarantee Program as administered by the Federal Deposit Insurance Corporation (commercial paper);
(vi) Corporate notes or bonds fully guaranteed as to principal and interest by the United States under the Temporary Liquidity Guarantee Program as administered by the Federal Deposit Insurance Corporation (corporate notes or bonds); and
(vii) Interests in money market mutual funds.

The duration of the securities in which an FCM invests Customer Funds cannot exceed, on average, two years.

An FCM may also engage in repurchase and reverse repurchase transactions with non-affiliated registered broker-dealers, provided such transactions are made on a delivery versus payment basis and involve only permitted investments. All funds or securities received in repurchase and reverse repurchase transactions with Customer Funds must be held in the appropriate Customer Account, *i.e.*, Customer Segregated Account, 30.7 Account or Cleared Swaps Customer Account. Further, in accordance with the provisions of Commission Rule 1.25, all such funds or collateral must be received in the appropriate Customer Account on a delivery versus payment basis in immediately available funds.[27]

18. Can a customer direct the investment of its funds or impose restrictions on their use?

A customer is not able to direct the investment of the Customer Funds it deposits with an FCM. Investments of Customer Funds are made on an omnibus basis and FCMs cannot identify specific investments for the benefit of specific customers.

19. Why does the FCM need the ability to pledge, hypothecate and re-hypothecate customer securities? What limitations are there on the FCM's ability to do so?

An FCM must have the ability to pledge, hypothecate and re-hypothecate customer securities in order to post such securities with a DCO to margin the customer's futures or Cleared Swaps transactions. Moreover, to the extent a customer posts securities as margin that are not permitted to be deposited with a DCO to margin the customer's positions, an FCM must have the ability to pledge, hypothecate and re-hypothecate such securities in order to convert customer-owned securities to securities that are accepted by the DCO. This process is commonly referred to as collateral transformation. Such transactions must be completed on a delivery versus payment **("DVP")** basis and will not be recognized as completed until the funds and/or securities are received by the custodian of the FCM's Customer Account. Therefore, the Customer Account will be fully collateralized at all times.

Finally, an FCM must have the authority to hypothecate and re-hypothecate securities in order to enter into repurchase and reverse repurchase transactions with permitted third-parties, *i.e.*, a bank or a broker-dealer, in accordance with the provisions of Commission Rule 1.25. In this latter regard, it is important to note that, as with collateral transformation transaction described above, all such repurchase and reverse repurchase transactions must be completed on a DVP basis; a transaction will

[27] As described in response to Question 11, above, NFA publishes twice-monthly a report, which shows for each FCM, *inter alia*, the percentage of Customer Funds that are held in cash and each of the permitted investments under Commission Rule 1.25. The report also indicates whether the FCM held any Customer Funds during that month at a depository that is an affiliate of the FCM.

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not be recognized as completed until the funds and/or securities are received by the custodian of the FCM's Customer Account.

Because Customer Funds are held in an omnibus account, an FCM must have the authority to hypothecate and re-hypothecate the funds and securities of all customers whose funds are held in that account.

III. Basics of FCMs

20. What is the purpose of the FCM's capital requirement? Can it be used to cover a shortfall in Customer Funds?

The Commission's minimum financial requirements are designed to assure that FCMs are able meet their financial obligations in a regulated marketplace, including their financial obligations to customers in the event of an inadequacy in Customer Funds arising from the default of one or more customers, adverse market conditions, or for any other reason. As discussed above, Commission rules provide that an FCM is required to use its own capital to make up any deficiency, if the customer fails to have sufficient funds on deposit with the FCM to meet the customer's obligations. In the event an FCM's capital is insufficient to make up for the shortfall caused by one or more defaulting customers or for any other reason, non-defaulting customers (or all customers) should share in any loss *pro rata*.

The FCM's capital is also designed to assure that the FCM has the resources to maintain the infrastructure, *e.g.*, personnel, recordkeeping systems, risk management systems, and supervisory and compliance procedures, necessary to operate its business in accordance with applicable laws and rules for the protection of customers.

21. When are customers expected to meet margin calls? What are consequences if a customer fails to meet a margin call within the time prescribed?

As discussed above, if a customer does not have sufficient funds on deposit with the FCM to meet the DCO's margin requirements with respect to the customer's open positions, the FCM must use its own funds until the customer has met the FCM's margin call. In order to reduce the potential risk to the FCM and its other customers, therefore, institutional customers are generally expected meet margin calls by wire transfer within one business day following the trade date. An FCM may also require a customer to meet a margin call intraday.[28]

An FCM generally is required to take a capital charge with respect to a Customer Account for which a margin call has been outstanding more than one business day following the date on which the margin call was made.[29] In addition, if a margin call with respect to a Customer's Account has been outstanding more than three business days following the date on which the margin call was made, an FCM may only accept orders from the customer that reduce the risk of existing positions in the Customer's Account.[30]

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[28] CME Group exchange rules provide that an FCM clearing member may require a customer to meet a margin call within one hour.

[29] The FCM is presumed to have issued the margin call the day after an account becomes undermargined. 78 Fed.Reg. 68506, 68529, fn. 145 (November 14, 2013).

Further, the FCM is required to maintain Residual Interest at least equal to any margin deficits that have not been met by 6:00 pm (eastern) on the business day following trade date.

[30] The Joint Audit Committee has expressed the view that an FCM should take appropriate action to restrict the trading activity of an account prior to the third business day if (i) the FCM learns that the customer has not initiated payment to the FCM to timely meet its margin calls or (ii) the FCM has a credit concern with regard to the account. Joint Audit Committee Regulatory Alert #14-07 (November 4, 2014).

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IV. Joint FCM/Broker-Dealers

22. If an FCM is also a BD, is there a single capital pool or is there a separate capital requirement for each function?

If an FCM is also a broker-dealer, the FCM is required to maintain capital equal to or greater than the higher of its capital requirement as an FCM and its capital requirement as a broker-dealer. An FCM-broker-dealer, therefore, maintains a single pool of capital.

23. If a customer has a securities account and a futures account at a joint BD/FCM, is a customer permitted to leave the funds in the securities account but allow the FCM to count the funds as covering a futures margin call so that the funds will be covered by SIPC?

No. The Act and Commission rules require an FCM to hold funds deposited to margin futures and options on futures contracts traded on US designated contract markets in Customer Segregated Accounts. Similarly, FCMs must hold funds deposited to margin Cleared Swaps and futures and options on futures contracts traded on foreign boards of trade in a Cleared Swaps Customer Account or a 30.7 Account, respectively. In computing its Customer Funds requirements under the Act and relevant Commission rules, an FCM may only consider those Customer Funds actually held in the applicable Customer Accounts. In this regard, the Joint Audit Committee's Margins Handbook confirms that an FCM may not apply free funds in an account under identical ownership but of a different classification or account type (*e.g.*, securities, Customer Segregated, 30.7) to an account's margin deficiency. In order to be used for margin purposes, the funds must actually transfer to the identically-owned undermargined account.

V. DCO Guarantee Fund

24. Will a DCO's guarantee fund compensate a customer in the event the customer's FCM becomes insolvent and there is a shortfall in the Customer Account maintained by the insolvent FCM?

A DCO's guarantee fund does not compensate customers of a defaulting FCM for shortfalls that result in the *pro rata* sharing of losses among non-defaulting customers. The primary purpose of the guarantee fund is to meet the DCO's obligations to other clearing members arising from the default of the clearing member FCM.[31]

[31] LCH.Clearnet Limited and LCH.Clearnet LLC, in connection with their SwapClear services, provide for "VM segregation" in which the DCO's guarantee fund will be used to cover variation margin losses of Cleared Swaps Customers within a defaulting FCM's Cleared Swaps Customer Account.

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