

a location where the requirements of this AD can be accomplished.

**Note 4:** The subject of this AD is addressed in French airworthiness directive 2000-059-302(B), dated February 9, 2000.

Issued in Renton, Washington, on October 25, 2000.

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## COMMODITY FUTURES TRADING COMMISSION

### 17 CFR Part 1

RIN 3038-AB52

### Recordkeeping; Amendments to the Daily Computation of the Amount of Customer Funds Required To Be Segregated

**AGENCY:** Commodity Futures Trading Commission.

**ACTION:** Proposed rules.

**SUMMARY:** The Commodity Futures Trading Commission ("Commission") is proposing to amend Commission Rule 1.32 to permit a futures commission merchant ("FCM"), in computing the amount of customer funds required to be held in segregated accounts pursuant to section 4d(2) of the Commodity Exchange Act ("Act"), to offset a net liquidating deficit or debit ledger balance in a customer's account with securities that have a "ready market" as defined by Rule 15c3-1(c)(11) of the Securities and Exchange Commission ("SEC") and that are deposited as margin by such customer.<sup>1</sup> The proposal would limit the amount of the offset to the market value of the securities, less the applicable haircuts set forth in SEC Rule 15c3-1(c)(2)(vi). The FCM would also be required to maintain a security interest in the securities, including a written authorization to liquidate the securities at the FCM's discretion, and to segregate the securities in a safekeeping account with a bank, trust company, clearing organization of a contract market, or another FCM.

**DATES:** Comments must be received on or before November 30, 2000.

**ADDRESSES:** Comments should be mailed to Jean A. Webb, Secretary, Commodity Futures Trading Commission, Three Lafayette Centre,

1155 21st Street, NW., Washington, DC 20581. In addition, comments may be sent by facsimile to (202) 418-5521, or by electronic mail to *secretary@cftc.gov*. Reference should be made to "Recordkeeping—Futures Commission Merchants' Daily Computation of the Customer Segregated Amounts."

**FOR FURTHER INFORMATION CONTACT:** Thomas J. Smith, Special Counsel, Division of Trading and Markets, Commodity Futures Trading Commission, Three Lafayette Centre, 1155 21st Street, NW., Washington, DC 20581; telephone (202) 418-5495; electronic mail *tsmith@cftc.gov*; or Henry J. Matecki, Financial Audit and Review Branch, Commodity Futures Trading Commission, 300 S. Riverside Plaza, Room 1600-N, Chicago, IL 60606; telephone (312) 886-3217; electronic mail *hmatecki@cftc.gov*.

#### SUPPLEMENTARY INFORMATION:

#### I. Offsetting Customer Net Liquidating Deficits or Debit Ledger Balances With Securities That Have a "Ready Market"

##### A. Background

Section 4d(2) of the Act requires, among other things, that an FCM segregate from its own assets all money, securities, and other property held for customers as margin for their commodity futures and option contracts, as well as any gains accruing to such customers from open futures and option positions. The statute also prohibits an FCM from using the money, securities, or property of one customer to margin or secure futures or option positions of another customer. The segregation requirement is intended to: Protect customers who are dealing with an FCM by assuring the FCM has funds available to readily liquidate its obligations to its customers; assure an FCM has funds available to meet its daily variation margin obligations to the clearing organizations of contract markets; and prohibit an FCM from misappropriating customer funds for its own purposes.

Commission Regulations 1.20 through 1.30 implement the segregation of funds provisions of Section 4d(2) of the Act. Rule 1.32, a related recordkeeping regulation, requires each FCM to prepare a daily computation which shows: (1) The amount of funds that an FCM is required to segregate for customers who are trading on U.S. commodity exchanges pursuant to the Act and the Commission's regulations; (2) the amount of funds the FCM actually has in segregated accounts; and (3) the amount, if any, of the FCM's residual interest in the customer funds segregated. The computations required

by Rule 1.32 are hereinafter collectively referred to as the "segregation computation".<sup>2</sup>

In 1959, the Commodity Exchange Authority ("CEA"), the predecessor agency of the Commission, issued Administrative Determination No. 171 ("AD No. 171") in which it expressed the opinion that if an FCM elects to accept securities from a customer as margin, the securities, for purposes of computing the segregation computation, must be handled separately from the money deposited by, or due to, other customers.<sup>3</sup> The AD further provided that any net liquidating deficit in the account of a customer who deposited securities as margin was required to be covered by a deposit in segregation of an equivalent amount of the FCM's own money. This effectively required an FCM who held securities for a particular customer to segregate for the full value of those securities even though the customer's account liquidated to a deficit. For example, if a customer had a credit ledger balance of \$3,000 and a mark-to-market loss on open positions of \$4,200, that customer's account would liquidate to a deficit of \$1,200.<sup>4</sup> If that customer also had securities with a market value of \$50,000 on deposit with the FCM as margin for his commodity account, the FCM would be required to include in its daily segregation computation, a \$50,000 segregation requirement for that customer. The FCM would not have been able to reduce the value of the security by the \$1,200 net liquidating deficit.

The rationale for this treatment was that securities, unlike cash, are not fungible. Therefore, if an FCM became insolvent, a customer whose securities could be identified to that customer might be in a position to reclaim those securities free of any pro rata distribution. If the customer who deposited these "specifically identifiable" securities had been

<sup>2</sup> Regulation 1.32 further requires that the FCM complete the segregation computation for each trading day prior to 12:00 noon on the next business day and that the computation, and all supporting data, be maintained for a five-year period in accordance with Commission Rule 1.31.

<sup>3</sup> Commodity Exchange Authority Administrative Determination No. 171 (Aug. 13, 1959).

<sup>4</sup> A distinction is sometimes drawn between a net liquidating deficit and a debit balance. A net liquidating deficit is an amount owed to the FCM resulting from the combination of the customer's debit or credit ledger balance and the mark-to-market gain or loss on any open positions in the customer's account. A debit balance is the amount owed to the FCM by the customer represented by the debit ledger balance, and implies that there are no open positions in the account. For purposes of this proposal, a net liquidating deficit also includes customers' accounts with debit ledger balances and no open positions.

<sup>1</sup> Commission regulations cited herein may be found at 17 CFR Ch. I (2000). SEC regulations cited herein may be found at 17 CFR Ch. II (2000). Section 4d(2) of the Act may be found at 7 U.S.C. § 6d(2) (1994).

allowed to build up a deficit in his account and the FCM had not deposited enough of its own money into segregation to cover the deficit, the amount of money available in the segregated accounts to pay other customers would be insufficient.

The concerns raised by the CEA were subsequently addressed by the passage of the Bankruptcy Reform Act of 1978 which provided that a commodity futures customer could not reclaim specifically identifiable property that would exceed such customer's pro rata share of the FCM's bankruptcy estate.<sup>5</sup> In recognition of this change, the Commission's Division of Trading and Markets ("Division of T&M") issued an advisory wherein it set forth a no-action position applicable to FCMs with respect to the segregation computation when customers' accounts incur net liquidating deficits.<sup>6</sup> In the advisory, the Division of T&M stated that it would not recommend that the Commission commence an enforcement action against an FCM based solely upon the FCM's use of customer-owned U.S. Treasury Bills, U.S. Treasury Notes, or U.S. Treasury Bonds (collectively "Treasuries") in connection with the segregation computation provided that certain conditions were met, including that: (1) The FCM maintained a security interest in the Treasuries, which included written authorization to liquidate the Treasuries at the FCM's discretion in order to protect the FCM and to cover any deficit in the customer's account; and (2) the Treasuries were segregated in safekeeping accounts with a bank, trust company, clearing organization of a contract market, or another FCM as provided by the Act and Commission regulations.

## B. Proposed Rule Amendments

The Joint Audit Committee ("JAC") has asked the Commission to amend Rule 1.32 to permit an FCM to offset a customer's net liquidating deficit with securities deposited by such customer that have a "ready market" as defined in SEC Rule 15c3-1(c)(11).<sup>7</sup> The amount

of the offset would be limited to the market value of the securities, less applicable haircuts set forth in SEC Rule 15c3-1(c)(2)(vi).<sup>8</sup> Furthermore, an FCM would be required to maintain a security interest in the securities, including the written authorization to liquidate the securities at the FCM's discretion, and to segregate the securities in a safekeeping account with a bank, trust company, clearing organization of a contract market, or another FCM.

SEC Rule 15c3-1(c)(11) defines "ready market" to include a recognized established securities market in which there exists independent bona fide offers to buy and sell so that a price reasonably related to the last sales price or current bona fide competitive bid and offer quotations can be determined for a particular security almost instantaneously and where payment will be received in settlement of a sale at such price within a relatively short time conforming to trade custom.<sup>9</sup> Therefore, if adopted, the proposal would expand the securities against which an FCM could offset a customer's liquidating deficit from just Treasuries to any security which has a ready market as defined in the SEC's rule. In the example set forth above, the FCM would be required to segregate \$48,800 for the customer (\$50,000 in securities less the \$1,200 liquidating deficit), rather than \$50,000 as is currently required.

The Commission believes that the proposal recognizes both the economic and legal realities that exist in such a situation. Economically, the FCM is liable to its customer for only \$48,800, not the amount represented by the current value of the securities it is holding for the customer, and should be required to segregate only the amount it owes its customer. Likewise, current bankruptcy rules recognize this economic reality by permitting the FCM to liquidate the securities, apply the proceeds against the liquidating deficit,

surveillance activities to promote a uniform framework of self-regulation.

<sup>8</sup> SEC Rule 15c3-1(c)(2)(vi) sets forth haircuts that a broker or dealer is required to apply to investment securities in computing its adjusted net capital. This Rule and the haircuts are incorporated by reference in the Commission's net capital rule. See Commission Rule 1.17(c)(2)(vi)(B).

<sup>9</sup> The definition goes on to say that a "ready market" will also be deemed to exist where securities have been accepted as collateral for a loan by a bank as defined in section 3(a)(6) of the Securities and Exchange Act of 1934 and where the broker or dealer demonstrates to its Examining Authority that such securities adequately secure such loans as that term is defined in Rule 15c3-1(c)(5). This portion of the definition of a "ready market" is not applicable to this proposal.

and return the net balance owed to the customer.<sup>10</sup>

The Commission invites interested parties to comment on the proposed amendments. In particular, the Commission is interested in obtaining views regarding whether the types of securities that would be permitted to offset customer net liquidating deficits should be further restricted in any way, for example, to securities which are deemed acceptable for margin, or performance bond, under exchange rules.<sup>11</sup>

## II. Related Matters

### A. Regulatory Flexibility Act

The Regulatory Flexibility Act ("RFA"), 5 U.S.C. 601-611, requires that agencies, in proposing rules, consider the impact of those rules on small businesses. The proposed rule amendments discussed herein would affect FCMs. The Commission has previously determined that, based upon the fiduciary nature of FCM/customer relationships, as well as the requirement that FCMs meet minimum financial requirements, FCMs should be excluded from the definition of small entity.<sup>12</sup>

### B. Paperwork Reduction Act

The Paperwork Reduction Act of 1995, 44 U.S.C. 3501 *et seq.* (Supp. I 1995), imposes certain requirements on federal agencies (including the Commission) to review rules and rule amendments to evaluate the information collection burden that they impose on the public. The Commission believes that the proposed amendments to Rule

<sup>10</sup> Of course should there be a shortfall in the funds available to pay all customers, the net amount owed would be included among the claims of all customers and be subject to pro rata distribution of available assets.

<sup>11</sup> It should also be noted that the Commission requires an FCM to set aside in special accounts a certain amount of funds for those of its U.S.-domiciled customers who trade on non-U.S. commodity markets. (See Commission Regulation 30.7, which identifies this as the "secured amount.") Unlike section 4d(2) of the Act and Commission Regulation 1.20, which require an FCM to segregate for the total net liquidating equities in accounts of customers who are trading on U.S. markets, Regulation 30.7 requires the FCM to set-aside only an amount that equals the margin required on foreign market open positions, plus or minus the mark-to-market gain or loss on such positions. This is normally less than the net liquidating equity in such accounts. However, an FCM is permitted to set-aside funds for customers trading on foreign markets in an amount which is calculated in the same manner as that done in determining section 4d(2) segregation requirements. If the FCM chooses to calculate its foreign secured amount requirement using the same method as it uses to calculate the segregation requirements under section 4d(2) of the Act, then the FCM would be able to use the same type of offset as permitted under the proposed change to Rule 1.32.

<sup>12</sup> 47 FR 18618, 18619-18620 (April 30, 1982).

<sup>5</sup> The provisions of that statute relevant to the futures industry have been amended since that time and current law is codified in 11 U.S.C. 362, 546, 548, 556 and 761-766 (1994). The Commission's bankruptcy Rules are contained in 17 CFR part 190 (1999).

<sup>6</sup> Division of Trading and Markets Advisory on Treatment of Government Securities Deposited as Customer Funds, reprinted in [1980-1982 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 21,101 (Nov. 3, 1980) (the "November 1980 Advisory").

<sup>7</sup> The JAC is comprised of representatives of the audit and compliance departments of the domestic SROs and the National Futures Association. The JAC coordinates the industry's audit and ongoing

1.32 do not impose an information collection burden on the public.

#### List of Subjects in 17 CFR Part 1

Brokers, Commodity Futures.

In consideration of the foregoing and pursuant to the authority contained in the Commodity Exchange Act and, in particular, sections 4d, 4f, 4g and 8a(5) thereof, 7 U.S.C. 6d, 6f, 6g and 12a(5), the Commission hereby proposes to amend Chapter I of Title 17 of the Code of Federal Regulations as follows:

### PART 1—GENERAL REGULATIONS UNDER THE COMMODITY EXCHANGE ACT

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

**Authority:** 7 U.S.C. 1a, 2, 2a, 4, 4a, 6, 6a, 6b, 6c, 6d, 6e, 6f, 6g, 6h, 6i, 6j, 6k, 6l, 6m, 6n, 6o, 6p, 7, 7a, 7b, 8, 9, 12, 12a, 12c, 13a, 13a-1, 16, 16a, 19, 21, 23, and 24.

2. Section 1.32 is proposed to be revised to read as follows:

#### § 1.32 Segregated account; daily computation and record.

(a) Each futures commission merchant must compute as of the close of each business day:

(1) The total amount of customer funds on deposit in segregated accounts on behalf of commodity and option customers;

(2) The amount of such customer funds required by the Act and these regulations to be on deposit in segregated accounts on behalf of such commodity and option customers; and

(3) The amount of the futures commission merchant's residual interest in such customer funds.

(b) In computing the amount of funds required to be in segregated accounts, a futures commission merchant may offset any net deficit in a particular customer's account against the current market value of readily marketable securities, less applicable percentage deductions (*i.e.*, "securities haircuts") as set forth in Rule 15c3-1(c)(2)(vi) of the Securities and Exchange Commission (17 CFR 241.15c3-1(c)(2)(vi)), held for the same customer's account. The futures commission merchant must maintain a security interest in the securities, including the written authorization to liquidate the securities at the futures commission merchant's discretion, and must segregate the securities in a safekeeping account with a bank, trust company, clearing organization of a contract market, or another futures commission merchant. For purposes of this section, a security will be considered readily marketable if it is traded on a "ready market" as defined

in Rule 15c3-1(c)(11)(i) of the Securities and Exchange Commission (17 CFR 240.15c3-1(c)(11)(i)).

(c) The daily computations required by this section must be completed by the futures commission merchant prior to noon on the next business day and must be kept, together with all supporting data, in accordance with the requirements of § 1.31.

Issued in Washington D.C. on October 25, 2000 by the Commission.

Jean A. Webb,

Secretary of the Commission.

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## DEPARTMENT OF THE INTERIOR

### Office of Surface Mining Reclamation and Enforcement

#### 30 CFR Part 925

[SPATS No. MO-033-FOR]

#### Missouri Regulatory Program and Abandoned Mine Land Reclamation Plan

**AGENCY:** Office of Surface Mining Reclamation and Enforcement, Interior.

**ACTION:** Proposed rule; public comment period and opportunity for public hearing.

**SUMMARY:** The Office of Surface Mining Reclamation and Enforcement (OSM) is announcing receipt of a proposed amendment to the Missouri regulatory program (Missouri program) and the Missouri Abandoned Mine Land Reclamation Plan (Missouri plan) under the Surface Mining Control and Reclamation Act of 1977 (SMCRA). Missouri proposes revisions to its rules pertaining to surface mining performance requirements, special mining activities, prohibitions and limitations on mining in certain areas and areas unsuitable for mining, permitting requirements, bond and insurance requirements, definitions and general requirements, and abandoned mine land reclamation requirements. Missouri intends to revise its program to be consistent with the corresponding Federal regulations, to provide additional safeguards, to clarify ambiguities, and to improve operational efficiency.

This document gives the times and locations that the Missouri program and the proposed amendment to that program are available for your inspection, the comment period during which you may submit written comments on the amendment, and the

procedures that we will follow for the public hearing, if one is requested.

**DATES:** We will accept written comments until 4:00 p.m., c.s.t., November 30, 2000. If requested, we will hold a public hearing on the amendment on November 27, 2000. We will accept requests to speak at the hearing until 4:00 p.m., c.s.t. on November 15, 2000.

**ADDRESSES:** You should mail or hand deliver written comments and requests to speak at the hearing to John W. Coleman, Mid-Continent Regional Coordinating Center, at the address listed below.

You may review copies of the Missouri program, the amendment, a listing of any scheduled public hearings, and all written comments received in response to this document at the addresses listed below during normal business hours, Monday through Friday, excluding holidays. You may receive one free copy of the amendment by contacting OSM's Mid-Continent Regional Coordinating Center.

John W. Coleman, Mid-Continent Regional Coordinating Center, Office of Surface Mining, Alton Federal Building, 501 Belle Street, Alton, Illinois 62002, Telephone: (618) 463-6460.

Missouri Department of Natural Resources, Land Reclamation Program, 205 Jefferson Street, P.O. Box 176, Jefferson City, Missouri 65102, Telephone: (573) 751-4041.

**FOR FURTHER INFORMATION CONTACT:** John W. Coleman, Mid-Continent Regional Coordinating Center. Telephone: (618) 463-6460. Internet: jcoleman@mcrwg.osmre.gov.

#### SUPPLEMENTARY INFORMATION:

#### I. Background on the Missouri Program and the Missouri Plan

On November 21, 1980, the Secretary of Interior conditionally approved the Missouri program. You can find general background information on the Missouri program, including the Secretary's findings, the disposition of comments, and the conditions of approval in the November 21, 1980, **Federal Register** (45 FR 77017). You can find later actions on the Missouri program at 30 CFR 925.12, 925.15, and 925.16.

On January 29, 1982, the Secretary of the Interior approved the Missouri plan. Background information on the Missouri plan, including the Secretary's findings, the disposition of comments, and the approval of the plan can be found in the January 29, 1982, **Federal Register** (47 FR 4253). Subsequent actions concerning the Missouri plan and amendments to the plan can be found at 30 CFR 925.25.