TABLE 1—SERVICE BULLETINS

Service Bulletin	Revision	Date
328 Support Services Alert Service Bulletin ASB–328–57–037	2	May 20, 2008.
328 Support Services Alert Service Bulletin ASB–328J–57–015	2	May 20, 2008.
328 Support Services Service Bulletin SB–328–57–481	1	October 15, 2009.
328 Support Services GmbH Service Bulletin SB–328J–57–230	1	October 15, 2009.

Issued in Renton, Washington on November 22, 2010.

Ali Bahrami,

Manager, Transport Airplane Directorate, Aircraft Certification Service.

[FR Doc. 2010–30282 Filed 12–1–10; 8:45 am]

BILLING CODE 4910–13–P

COMMODITY FUTURES TRADING COMMISSION

17 CFR Part 190

RIN 3038–AD99

Protection of Cleared Swaps Customers Before and After Commodity Broker Bankruptcies

AGENCY: Commodity Futures Trading Commission.

ACTION: Advanced notice of proposed rulemaking; request for comments.

SUMMARY: The Commodity Futures Trading Commission (the "CFTC" or "Commission") seeks comment on possible models for implementing new statutory provisions enacted by Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank") concerning the protection of collateral posted by customers clearing swaps.

DATES: Submit comments on or before January 18, 2011.

ADDRESSES: You may submit comments, identified by RIN number 3038–AD99, by any of the following methods:

• *Agency Web site, via its Comments Online process: http://comments.cftc.gov.* Follow the instructions for submitting comments through the Web site.

• *Mail:* David A. Stawick, Secretary of the Commission, Commodity Futures Trading Commission, Three Lafayette Centre, 1155 21st Street, NW., Washington, DC 20581.

• *Hand Delivery/Courier:* same as mail above.

• *Federal eRulemaking Portal: http://www.regulations.gov.* Follow the instructions for submitting comments.

Please submit your comments by only one method.

All comments must be submitted in English, or if not, accompanied by an English translation. Comments will be posted as received to *http://www.cftc.gov.* You should submit only information that you wish to make available publicly. If you wish the Commission to consider information that you believe is exempt from disclosure under the Freedom of Information Act, a petition for confidential treatment of the exempt information may be submitted according to the procedures established in CFTC Regulation 145.9, 17 CFR 145.9.

The Commission reserves the right, but shall have no obligation, to review, pre-screen, filter, redact, refuse or remove any or all of your submission from *www.cftc.gov* that it may deem to be inappropriate for publication, such as obscene language. All submissions that have been redacted or removed that contain comments on the merits of the rulemaking will be retained in the public comment file and will be considered as required under the Administrative Procedure Act and other applicable laws, and may be accessible under the Freedom of Information Act.

FOR FURTHER INFORMATION CONTACT: Robert B. Wasserman, Associate Director, Division of Clearing and Intermediary Oversight (DCIO), at 202–418–5092 or *rwasserman@cftc.gov;* Martin White, Assistant General Counsel, at 202–418–5129 or *mwhite@cftc.gov;* or Nancy Liao Schnabel, Special Counsel, DCIO, at 202–418–5344 or *nschnabel@cftc.gov.* in each case, also at the Commodity Futures Trading Commission, Three Lafayette Centre, 1155 21st Street, NW., Washington, DC 20581.

SUPPLEMENTARY INFORMATION:

I. Introduction

This Advanced Notice of Proposed Rulemaking ("ANPR") is intended to obtain comment from interested parties concerning the appropriate model for protecting the margin collateral posted by customers clearing swaps transactions. As discussed in more detail below, the statutory language in Dodd-Frank concerning the protection of swaps customer margin is substantially similar, though not identical, to analogous provisions in Section 4d(a) of the Commodity Exchange Act ("CEA") [1] applicable to the protection of collateral posted by customers with respect to exchange-traded futures. The Commission therefore is seeking comment on whether to adopt a similar model to protect the margin collateral posted by customers clearing swaps transactions as it currently employs with respect to exchange-traded futures, or whether another model is appropriate.

Section 4d(f)(2) of the CEA,[2] as added by Section 724 of Dodd-Frank, provides that "property of a swaps customer [received to margin a swap]* * * shall not be commingled with the funds of the futures commission merchant or be used to margin, secure or guarantee any trades or contracts of any swaps customer or person other than the person for whom the same are held.[3] Section 4d(f)(6) of the CEA makes it unlawful for a depository, including a derivatives clearing organization ("DCO"), that has received such swaps customer property "to hold, dispose of, or use any such * * * property as belonging to * * * any person other than the swaps customer of the futures commission merchant." [4]

The provisions applicable to the margin posted by exchange-traded futures customers are similar, but not identical. Section 4d(a)(2) provides that "property received [by a futures commission merchant] to margin, guarantee or secure the [exchange-traded] contracts of any customer of such [futures commission merchant] * * * shall not be commingled with the funds of such commission merchant or be used to guarantee the trades or contracts * * * of any person other than the one for whom the same are held." [5] Section 4d(b) makes it unlawful for a DCO that has received such customer property "to hold, dispose of, or use any such * * * property as belonging to * * * any person other

[1] 7 U.S.C. 6d(a).

[2] 7 U.S.C. 6d(f)(2).

[3] Section 4d(f)(3)(A) of the CEA provides an exception permitting commingling "for convenience."

[4] 7 U.S.C. 6d(f)(6) (emphasis added). This section was added by Section 724(a) of Dodd-Frank, Public Law 111–203, 124 Stat. 1376.

[5] Section 4d(a)(2) provides a similar exception permitting commingling "for convenience.".

than the customers of such futures commission merchant."

Commission Regulation ("Reg. § ") 1.22 [6] prohibits a futures commission merchant ("FCM") from using, or permitting the use, of one futures' customer's funds to margin, guarantee or secure another customer's futures trades or contracts. Thus, if a futures customer sustains losses sufficient to cause it to have a debit balance (i.e., the customer owes the FCM money), the FCM must deposit its own capital to "top up" the loss. Pursuant to existing industry custom and Reg § 1.20(b), however, futures commission merchants ("FCMs") segregate futures customer property posted as collateral with a DCO on an omnibus basis: Such property is treated separately from the property of the FCM, but futures customers are treated as a group, rather than individually.

Thus, if a futures customer suffers sufficient losses that the customer's debit balance exceeds the FCM's available capital, and such customer (the "defaulting customer") fails to promptly pay such loss, the FCM may, as a practical matter, be unable to "top up" the loss, and the FCM may be unable to make a required payment to a DCO with respect to that FCM's customer account. Such an FCM would then be a defaulter to the DCO (a "Defaulting FCM"). In case of such an FCM default in the futures customer account, the DCO is permitted to use the collateral of all customers of the Defaulting FCM to meet the net customer obligation of the Defaulting FCM to the DCO (including the use of any customer gains to meet customer losses), without regard to which customers gained or lost, or which customers defaulted or made full payment.

In such a case, customers of the Defaulting FCM other than the defaulting customer may lose collateral they have posted with the Defaulting FCM, and/or gains on their positions. The risk these other customers face shall be referred to as "fellow-customer risk."

II. Maximizing Customer Protection and Minimizing Cost

In considering how to implement Section 4d(f) of the Dodd-Frank Act, the Commission and its staff have heard countervailing concerns from various stakeholders. Some customers have noted that, in the context of uncleared swaps that they currently engage in—and may be obligated to clear under Dodd-Frank [7]—they are able to negotiate for individual segregation, with independent third parties, of collateral that they post for such uncleared swaps. These customers contend that it is inappropriate that they should be subject to an additional risk (fellow-customer risk) when clearing their positions.[8] Pension funds, in particular, are concerned about their obligations under the Employee Retirement Income Security Act, and about having their collateral used to subsidize others.[9]

FCMs and DCOs, on the other hand, point out that models of protecting swaps customer collateral that are different from the current model for protecting futures customer collateral would bring significant added costs, which they aver would ultimately be borne by the customers. Moreover, the use of fellow-customer collateral is included in existing DCO models for dealing with member defaults. The Commission has proposed to require DCOs to maintain default resources sufficient to

> [e]nable the derivatives clearing organization to meet its financial obligations to its clearing members notwithstanding a default by the clearing member creating the largest financial exposure for the derivatives clearing organization in extreme but plausible market conditions.[10]

Systemically-important DCOs would be required to maintain default resources sufficient to cover a default by the two clearing members creating the largest combined financial exposure in such conditions.[11]

Typically, DCOs use a variety of resources in addressing defaults arising from a member's customer account.[12] These resources, which are frequently referred to as a "waterfall," typically include, in order, the property of the Defaulting Member, the margin posted on behalf of all of that members' customers, a portion of the capital of the DCO, and the default fund contributions of other members of the DCO.[13]

If the collateral of non-defaulting swaps customers is not available as a default resource, DCOs will need to change their models for sizing their default waterfalls, and/or the size of the components of those default waterfalls. One means to do this would be to increase the collateral required to margin each customer's positions. One DCO estimated that it might need to increase collateral from a 99% confidence level to a 99.99% confidence level, which would cause an increase in required collateral of approximately 60%.[14] These increases in required margin levels would be passed on to customers, as an FCM is required to collect margin from a customer at a level no less than that imposed by the clearing house on the clearing member FCM. The Commission requests that DCOs provide data in support of their assertions.

An alternative approach to reacting to changes in the model for sizing default waterfalls would be to increase clearing members' default fund contributions. FCMs note that if they are required to commit added capital to clearing, they would pass such costs on to customers. Certain models for protecting collateral posted by customers clearing swaps could also cause significant added administrative costs, in requiring more transactions per customer every day, which costs would also be passed on to customers.[15] The Commission requests that FCMs provide data supporting these assertions.

The Commission is seeking to achieve two basic goals: Protection of customers and their collateral, and minimization of costs imposed on customers and on the industry as a whole. It is considering four models of achieving these goals with respect to cleared swaps. These are listed in order below, from most protective of customer collateral to least protective of customer collateral.

Each of these various models would potentially impose different levels of costs upon the various parties—*i.e.,* customers, FCMs, and DCOs—both pre- and post-default. Accordingly, the Commission seeks to obtain further information about the costs and benefits of such models.

III. Description of the Models

The Commission seeks comment on each of the following four potential models, as well as any additional models that may be proposed by commenters:

---

[6] 17 CFR 1.22.

[7] *See generally* CEA 2(h), added by Dodd-Frank 723(a).

[8] *See, e.g., Staff Roundtable on Individual Customer Collateral Protection* ("Roundtable") at 20–21 (Statement of Mr. Szycher), 12, 79 (Statements of Mr. Kaswell), 10 (Statement of Mr. Thum), *available at http://www.cftc.gov/LawRegulation/DoddFrankAct/OTC_6_SegBankruptcy.html.*

[9] Roundtable at 18 (Statement of Mr. Szycher).

[10] *See Financial Resources Requirements for Derivatives Clearing Organizations,* 75 FR 63113, 63118 (proposed regulation 39.11(a)(1)) (Oct. 14, 2010).

[11] *Id.* at 63119 (proposed regulation 39.29(a)).

[12] Customers would not be exposed to loss in the case of a default arising from their FCM's proprietary account.

[13] *See, e.g.,* CME Rule 802.

[14] *See, e.g.,* Roundtable at 137–138 (Colloquy between Ms. Taylor and Mr. Maguire).

[15] *See, e.g.,* Roundtable at 62–73 (Statements of Ms. Burke).

(1) *Full Physical Segregation*—Each customer's cleared swaps account, and all property collateralizing that account, is kept separately for and on behalf of that cleared swaps customer, at the FCM, at the DCO, and at each depository.

a. *Impact on Customers' Risk:* Each customer is protected from losses on the positions or investments of any other customer.

b. *Impact on DCO Default Resources:* The collateral attributable to any non-defaulting customer is not available as a DCO default resource

(2) *Legal Segregation With Commingling*—The collateral of all cleared swaps customers of an FCM member of a DCO is *kept* on an omnibus basis, but is attributed to each customer based on the collateral requirements, as set by the clearinghouse, attributable to each customer's swaps.

a. *Process:* Payments and collections *of* both initial margin and variation margin between the DCO and its member FCMs customer accounts are made on an omnibus basis. Each FCM member reports to the DCO, on a daily basis, the portfolio of rights and obligations attributable to each cleared swaps customer. The performance bond collateral required at the DCO for each customer's swaps is a function, defined by the DCO, of that portfolio of rights and obligations. The collateral required for all of an FCM member's customers is the sum of the collateral requirements for each of such customers.

b. *Posting Collateral:*

i. The FCM may post the total required customer margin on an omnibus basis, without regard to the customer to whom any particular item of collateral (*e.g.,* a particular security) belongs.

ii. If the FCM loans to a customer any portion of the property necessary to margin that customer's positions, that collateral is treated at the DCO as belonging to the customer, and at the FCM as a debt from the customer to the FCM.

iii. The DCO may require an FCM to post its own capital as collateral for its guarantee of its customers.

c. *Use of Collateral in Case of Default*—If the FCM defaults, the DCO must treat each customer's swaps positions, and related margin (based on the positions reported as of the day previous to the default) individually, debiting each customer's account with losses attributable to that customer's positions, and crediting each customer's account *with* gains attributable to that customer's positions. However, if the value of the margin account is reduced below the required level as a result of market fluctuations in the value of the collateral, the margin attributed to each customer would be adjusted accordingly on a pro rata basis. The DCO has recourse to any collateral posted by the FCM as part of its own capital.

d. *Transfer or Return of Positions and Collateral*—The DCO may, at its election, transfer the swaps positions and *related* collateral of any or all of the defaulting FCM's customers to a willing transferee, or liquidate such swaps positions and return the remaining collateral to the FCM (or its trustee in bankruptcy).

e. *Impact on Customers' Risk*—Each customer of the defaulting FCM is protected from losses on the positions *of* other customers, but bears some risk of loss on the value of collateral (subject to the investment restrictions of Commission Regulation 1.25).[16]

f. *Impact on DCO Default Resources*—The remaining collateral attributable to each of the defaulting FCM's customers is not available as a DCO Default Resource.

(3) *Moving Customers to the Back of the Waterfall*—This model is similar to Model 2 above, Legal Segregation With Commingling, with two modifications:

a. The DCO may use the remaining *collateral* attributable to each of the defaulting FCM's customers as a DCO default resource.

b. Before using the remaining *collateral* attributable to any customer, however, the DCO must first apply (i) the DCO's contribution to its default resources from its own capital and (ii) the guarantee fund contributions of all members of the DCO.

c. *Impact on Customers' Risk*—Each customer of the defaulting FCM is protected from losses on the positions of other customers, except in the most extreme of circumstances (a default which consumes the DCO's guarantee fund), in which case the customers are at risk of losing their collateral. Customers also bear some risk of loss on the value of collateral (subject to the investment restrictions of Regulation 1.25).

d. *Impact on DCO Default Resources*—The remaining *collateral* attributable to each of the defaulting FCM's customers is available as a DCO Default Resource. Because the total required default resources (including the DCO's contribution and the guarantee fund) are substantial,[17] the remaining collateral of customers will only be used in the case of an extremely large default.

[16] 17 CFR 1.25.

[17] *See supra* footnotes 10–11.

(4) *Baseline Model*—The current approach to futures. The rights and obligations arising out of the cleared swaps positions of all cleared swaps customers of an FCM member of a DCO, as well as the money, securities and other property collateralizing such rights and obligations, are held at the DCO on an omnibus basis. The DCO has recourse to all such collateral in the event of any failure of the FCM member to meet a margin call (initial or variation) with respect to the FCM's cleared swaps customer account at that DCO.

a. *Impact on Customers' Risk*—Each *customer* of the defaulting FCM is exposed to loss of their collateral due to losses on the positions of other customers. Customers also bear some risk of loss on the value of collateral (subject to the investment restrictions of Regulation 1.25).

b. *Impact on DCO Default Resources*—The *remaining* collateral attributable to each of the defaulting FCM's customers is fully available as a DCO default resource, and may be used before the DCO's contribution or the default fund contributions of other clearing members.

IV. Cost and Benefit Questions

The Commission seeks comment on all of the following questions from all members of the public, but will direct specific questions to three particular groups of stakeholders:

(1) Cleared Swaps Customers, including asset management firms and others who may act on their behalf.

(2) FCMs who currently intermediate swaps on behalf of customers, or who intend to do so in the future, or trade organizations with FCM members.

(3) DCOs.

1. For Cleared Swaps Customers

a. What are the benefits of *each* of the models relative to the baseline model and relative to other models?

b. What costs would you expect to incur for each of the models relative to the baseline model? Please provide a detailed basis for that estimate.

c. How should the Commission balance such costs and benefits?

2. For FCMs

For Each Model (Other Than the Baseline Model)

a. Compliance:

i. What compliance activities (including gathering of information) would you need to perform as a result of that model that you do not perform now (*i.e.,* as part of the baseline model).

ii. What is a reasonable estimate of the initial and annualized ongoing cost of such incremental activities (relative to the baseline model) for your institution? Please provide a detailed basis for that estimate.

iii. How can such costs be estimated industry-wide? Please provide a detailed basis for that estimate?

b. Risk environment:

i. How do you see the industry adapting to the risk changes attendant to the model?

ii. What types of costs would you expect your institution to incur if the industry adapts to that model in the most efficient manner feasible? How are these costs different from the costs you would incur under the baseline model?

iii. What is a reasonable estimate of the initial and annualized ongoing incremental cost incurred by your institution? Are these costs the same for each FCM clearing member, or a function of activity level? Please provide a detailed basis for that estimate.

iv. How can such costs be estimated industry-wide? Please provide a detailed basis for that estimate?

c. What benefits does the model present relative to the baseline model, and relative to other models?

3. For DCOs

For Each Model (Other Than the Baseline Model)

a. Compliance (internal):

i. What compliance activities (including gathering of information) would you need to perform as a result of that model that you do not perform now (*i.e.,* as part of the baseline model)?

ii. What is a reasonable estimate of the initial and annualized ongoing cost of such incremental activities (relative to the baseline model) for your DCO? Please provide a detailed basis for that estimate.

b. Compliance (members):

i. What compliance activities (including gathering of information) would you expect each of your members to perform as a result of that model that they do not perform now (*i.e.,* as part of the baseline model).

ii. What is a reasonable estimate of the initial and annualized ongoing cost of such incremental activities (relative to the baseline model) for each such member? Do these costs vary with the member's level of activity? How? Please provide a detailed basis for your estimates.

iii. What is a reasonable estimate of the initial and ongoing costs of such activities across your membership? May there be some members who do not incur these costs? Please provide a detailed basis for these estimates.

c. Changes to default management structure:

i. What changes to your default management structure (relative to the baseline model) would the model require?

ii. Costs to the DCO

1. What types of costs would these changes impose on the DCO if the industry adapts to that model in the most efficient manner feasible? How are these costs different from the costs the DCO would incur under the baseline model?

2. What is a reasonable estimate of the initial and annualized ongoing incremental cost to the DCO? Please provide a detailed basis for that estimate.

iii. Costs to members

1. What types of costs would these changes to the DCO's default management impose on members if the industry adapts to that model in the most efficient manner feasible? How are these costs different from the costs the members would incur under the baseline model?

2. What is a reasonable estimate of the initial and annualized ongoing incremental cost to each member? Are these costs the same for each member, or are they a function of activity level? Please provide a detailed basis for that estimate.

3. What is a reasonable estimate of the initial and ongoing costs of such activities across your membership? May there be some members who do not incur these costs? Please provide a detailed basis for these estimates.

iv. To what extent do the costs identified above represent increased costs to the system as a whole (*i.e.,* customers, FCMs, and DCOs considered together) and to what extent do they represent a shift of risk and/or cost between those groups?

b. What benefits does the model present relative to the baseline model, and relative to other models?

For all commenters:

2. *Optional Models*

A point frequently raised is that individual customer protection should be made available on an optional basis. There are questions as to how such a model could be implemented, and how the costs imposed by a customer obtaining individual protection could be attributed to—and charged to—that customer. For example, in the "Full Physical Segregation" and "Legal Segregation with Commingling" models discussed above, a significant portion of the marginal costs may arise from the fact that the collateral posted by the opting-out customer would not be available in the event of a default caused by other customers of the same FCM. How could a payment by the opting-out customer be used to address the changes to the DCO's default management structure that would be attributable to that opting out? Considered from another perspective, how much cost would be avoided from an optional as contrasted to a mandatory implementation of each of the models above? Also, what would be the effect on customers of an FCM in bankruptcy if different DCOs of which the FCM was a member adopted different voluntary models? If a marketplace in which varying models were in use was otherwise desirable, what changes to the Regulation Part 190 rules regarding bankruptcy account classes could or should be made to accommodate such variety?

3. *Moral Hazard: Customers risk-managing their FCMs:*

Another point frequently raised is that customers should risk-manage their FCMs, and provide market discipline by doing business with FCMs that pose less risk. DCOs already monitor the eligibility of their members, supervising the member's risk relative to collateral and capital, and considering members' risk management.[18] The Commission is aware of concerns that, if the risk that customers will lose swaps collateral posted at an FCM is minimized, there will be less incentive for FCMs to maintain capital in excess of the minimum levels required by the Commission and the DCOs of which such FCMs are members. These concerns lead to a number of questions:

a. To what extent would each model lead to moral hazard concerns? How, if at all, could such concerns be addressed?

b. Are the capital requirements currently imposed by the Commission on FCMs and by DCOs on their clearing members sufficient? If not, what steps should DCOs or the Commission take to address this insufficiency?

c. Do the rules and procedures of DCOs currently provide adequate tools and incentives for DCOs to supervise their clearing members so as to mitigate the risk of default? If not, what steps should DCOs or the Commission take to address this inadequacy?

In analyzing costs, the Commission needs to consider the additional cost incurred by customers risk-managing their FCMs on an initial and ongoing

[18] *See* Sections 5b(c)(2)(C)(i)(I), (c)(2)(C)(ii), (c)(2)(D) of the CEA (participant eligibility and risk management).

basis.[19] This leads to a number of questions:

d. What information would each customer need, on an initial and an ongoing basis, to effectively manage the risk posed by fellow-customers at an FCM?

e. What information should be provided to each customer regarding the FCM's risk management policies, and how those policies are, in fact, implemented with respect to other customers, on both an initial and ongoing basis?

f. What information should be provided to each customer regarding fellow-customer risk, on both an initial and ongoing basis?

g. What is or would be the cost, per customer, on an annualized basis, of conducting this risk management?

h. What is or would be the cost to the industry as a whole, on an annualized basis, of customer-conducted FCM risk management?

V. Other Questions

1. Did Congress evince an intent as to whether the Commission should adopt any one or more of these models?

How do commenters view Interpretation 85–3, and how should it inform the rulemaking on segregation of collateral for cleared swaps customers? (A copy of this interpretation is attached as an appendix to this Request for Comment.)

Issued in Washington, DC, on November 19, 2010, by the Commission.

David A. Stawick,

Secretary of the Commission.

APPENDIX

Interpretative Statement, No. 85–3, Regarding the Use of Segregated Funds by Clearing Organizations Upon Default by Member Firms. (OGC Aug. 12, 1985)

Use of Segregated Funds by Clearing Organizations Upon Defaults By Member Firms

The rights of a clearing organization to make use of margin funds deposited by a clearing member firm that has defaulted on an obligation to the clearing organization are defined by the rules and by-laws of the clearing organization subject to limitations imposed by the Commodity Exchange Act ("Act") and the rules and regulations promulgated thereunder, 17 CFR 1, *et seq.* (1984). Clearing organization rules and by-laws commonly provide that upon the failure of a member firm to satisfy an obligation owed the clearing organization, the clearing organization may use all margin funds and property of the member firm within the clearing organization's custody to satisfy the firm's obligations to the clearing organization. In our view, Section 4d(2) of the Act does not preclude the clearing organization from applying all margin deposits of a defaulting firm to discharge such firm's obligations on behalf of the customer account for which they were deposited with the clearing organization. The clearing organization may be precluded from exercising such rights in limited circumstances, however, by reason of its knowledge of or participation in a violation of the Act or other provision of law by the defaulting firm or other parties that renders its rights to such funds inferior to those of the clearing firm's customers.

Section 4d(2) of the Act, 7 U.S.C. 6d, defines the manner in which futures commission merchants ("FCMs"), clearing organizations, and other depositories of funds deposited by commodity customers to margin or settle futures transactions, or accruing to customers as the result of such trades, must deal with such funds. Section 4d(2) requires that FCMs "treat and deal with" funds deposited by a customer to margin or settle trades or contracts or accruing as the result of such trades or contracts "as belonging to such customer," separately account for such funds, and refrain from using such funds "to margin or guarantee the trades or contracts, or to secure or extend the credit, of any customer or person other than the one for whom the same are held." Section 4d(2) specifically authorizes FCMs to commingle such funds, for purposes of convenience, in the same account or accounts with any bank, trust company or clearing organization of a contract market. This provision also authorizes withdrawals from such funds of "such share thereof as in the normal course of business shall be necessary" to margin, guarantee, secure, transfer, adjust, or settle trades or contracts, "including the payment of commissions, brokerage, interest, taxes, storage and other charges, lawfully accruing in connection with such contracts and trades."

The final sentence of Section 4d(2) defines the obligations of clearing organizations, depositories and all other recipients of customer margin funds and property in the following terms:

It shall be unlawful for any person, including but not limited to any clearing agency of a contract market and any depository, that has received any money, securities, or property for deposit in a separate account as provided in paragraph (2) of this section, to hold, dispose of or use any such money, securities, or property as belonging to the depositing futures commission merchant or any person other than the customers of such futures commission merchant.

This provision prohibits clearing organizations and all other depositories of customer funds from using such funds to discharge proprietary obligations of the depositing FCM or for any purpose other than to margin, guarantee, secure, transfer, adjust, or settle trades or contracts of the depositing firm's customers, including the payment of commissions and other charges "lawfully accruing in connection with" such contracts and trades.

In our view, Section 4d(2)'s provisions with respect to clearing organizations' treatment of customer funds must be construed in light of the fact that clearing organizations' direct customers are, generally, clearing firms, not the ultimate "customers" who entered into the futures contracts and options positions accepted for clearance by the clearing organization. Margin deposits posted with clearing organizations by their member firms normally consist, at least in part, of funds belonging to clearing firm customers, whose margin deposits were posted with the clearing firm and subsequently drawn upon by the clearing firm to satisfy its margin obligations to the clearing organization. The clearing organization normally has no direct dealings with such customers and has knowledge neither of their specific identities nor of the extent of their respective ownership interests in margin funds posted by its clearing firms. Consequently, to the extent that Section 4d(2) of the Act requires that clearing organizations use margin deposits on behalf of the "customers of such [depositing] futures commission merchant," we are of the view that it requires only that the clearing organization use such funds as the property of the clearing firm's customers collectively, but does not require the clearing organization to treat such funds as the property of the particular customers who deposited them or to whose positions they have accrued.

This view accords with the legislative history of Section 4d(2) of the Act. The Act did not specifically govern the treatment of commodity customer funds by clearing organizations and other depositories of customer margin funds until the enactment of Section 4d(2)'s final paragraph, quoted above, in 1968. The legislative history of this provision reflects Congress's intention to ensure that customer funds would not be used to discharge the general obligations of the FCM or otherwise diverted from their lawful purposes. According to the Senate Report, for example, the amendment was proposed "to prohibit expressly customers' funds from being used to offset liabilities of the futures commission merchants or otherwise being misappropriated." S. Rep. No. 947, 90th Cong. 2d Sess. 7 (1968). *See also* H.R. Rep. No. 743, 90th Cong., 1st Sess. 4–5 (1967).

The Commodity Exchange Authority's Administrator described the 1968 amendment as one which would afford additional protection against a situation presented in the De Angelis salad oil case "in which one of the banks actually took over funds of customers of one of the brokerage firms to offset liabilities of the firm." *Amend the Commodity Exchange Act:* Hearings on H.R. 11930 and H.R. 12317 Before the House Comm. on Agriculture 57 (1967) (Testimony of Alex C. Caldwell, Administrator, Commodity Exchange Authority). The proposed amendment would require that banks and other depositories "keep separate the funds of the customers and of the brokerage firms which they do not have to do now." *Id.* The Act's legislative history thus evinces an intention that depositories treat customers' funds as the property of the

[19] *Cf.* Roundtable at 45–46 (Statement of Mr. Prager) (DCOs have advantages over clients in conducting risk management of FCMs).

customers of the depositing FCM, as distinguished from the FCM's own property or that of any other person.

Our conclusion that Section 4d(2) generally allows clearing organizations to treat customer funds as the property of the depositing firm's customers, collectively, without regard to the respective interests of particular customers, also finds support in the legislative history of the Bankruptcy Reform Act of 1978. In recommending new provisions to govern bankruptcy liquidations of commodity firms, the Commission described the clearing house system then (and now) operant in the futures market as one in which "a clearing house deals only with its clearing members" and thus "does not know the specific customer on whose behalf a particular contract was entered into by one of its clearing members." *Bankruptcy Act Revision:* Hearings on H.R. 31 and H.R. 32 Before the Subcomm. on Civil and Constitutional Rights, House Comm. on the Judiciary, 94th Cong., 2d Sess. 2377, 2395 (Statement of William T. Bagley) (1976). The Commission explained that this system allows a clearing organization to use "whatever funds are on deposit with it on behalf of customers to meet variation margin calls with respect to customers' trades or contracts" and, following a clearing member default, the defaulting firm's "original margin deposits are immediately available to offset any losses the clearing house might incur" as a result of answering variation margin calls to the defaulting firm. *Id.* at 2397, 2405.

The Commission's regulations are also consistent with the view that the clearing organization's direct obligations under Section 4d(2) include an obligation to treat customer funds as the property of the depositing FCM's customers but do not include a duty to separately account for or to employ such funds as the property of particular customers. Regulation 1.20(b), 17 CFR 1.20(b) (1984), for example, requires that a clearing organization separately account for and segregate all customers' funds received from a member of the clearing organization to purchase, margin, guarantee, secure or settle the trades, contracts or commodity options of the clearing member's customers and all money accruing to such customers as the result of such trades, contracts, or commodity options "as belonging to such commodity or option customers," and specifies that a clearing organization shall not hold, use or dispose of such customer funds "except as belonging to such commodity or option customers." 17 CFR 1.20(b) (1984).[1]

Regulation 1.22, 17 CFR 1.22 (1984), which precludes FCMs from using or permitting the use of "the customer funds of one commodity and/or option customer to purchase, margin, or settle the trades, contracts, or commodity options of, or to secure or extend the credit of, any person other than such customer or option customer," refers only to FCMs and, hence, does not govern clearing organizations or other depositories of customer funds.[2]

Our conclusion that Section 4d(2) does not preclude a clearing organization from using all margin funds deposited by a clearing member firm to satisfy obligations arising from the account for which such funds were deposited reflects the essential function of margin deposits in the futures markets' clearing system. Clearing organizations generally stand as guarantors of the net futures and options obligations of the member firms and require margin deposits as security for the performance of obligations which, in the event of a member's default, the clearing organization must discharge. Margin deposits at the clearing level thus facilitate the clearing organization's performance of its guarantee obligations, serving to confine losses stemming from a clearing firm default to the defaulting firm and preventing their spread to the market as a whole.

In sum, we conclude that clearing organization rules and by-laws awarding clearing organizations the right to apply all customer margin funds within their custody to satisfy nonproprietary obligations of defaulting clearing firms are not inconsistent with Section 4d(2) of the Act or the Commission's regulations. Clearing organizations' rights with regard to the use of customer margin deposits of their member firms are not, however, wholly unlimited. A clearing organization may not use the margin deposits of one clearing member firm to satisfy obligations of another clearing firm or of any other person. In addition, as noted above, the final paragraph of Section 4d(2) of the Act was enacted to present use of customer funds to satisfy the FCM's own obligations. Consequently, customer margin funds deposited by a member FCM may not be used to margin, guarantee or settle the futures or options transactions or to satisfy any other proprietary obligation of the depositing firm. Such funds must be used to margin, guarantee, secure, or settle trades or contracts of the depositing FCM's customers or for charges "lawfully accruing in connection with" such contracts and not for any other purpose.[3] Finally, a clearing organization's rights with respect to the use of customer margin funds may be limited in particular circumstances by reason of the clearing organization's knowledge of or participation in a violation of the Act or other provision of law that precludes it from obtaining rights to such funds superior to those of one or more customers of the defaulting clearing member. Such a violation could occur, for example, in circumstances in which the clearing organization received particular margin funds with actual knowledge that the depositing firm has breached its duty under Section 4d(2) to segregate and separately account for customer funds and that the funds in question have been deposited with it to margin, secure, guarantee or settle the trades or contracts of a person other than the customer who deposited such funds or to whom they have accrued. The clearing organization's knowing participation in such use of customer funds could subject it to aiding and abetting liability under Section 13(a) of the Act and would preclude it from obtaining rights to such funds superior to those of the innocent customer.

Statement of Chairman Gary Gensler: Protection of Cleared Swaps Customers Before and After Commodity Broker Bankruptcies

I support the advance notice of proposed rulemaking concerning protection of collateral of customers entering into cleared swaps. There has been much public input into these matters, but I think it is appropriate to have a formal ANPR soliciting input on a number of options and questions on how best to protect customers' collateral in the event of another customer's default. This is particularly important as we move forward to implement Congress's mandate that for the first time standardized swaps

[1] To the extent that the final sentence of Regulation 1.20(a), 17 CFR 1.20(a) (1984), may be read to require that clearing organizations treat customer funds as the property of the particular customer who deposited them, we consider it inconsistent with Regulation 1.20(b), which more specifically addresses the obligations of clearing organizations, and with this agency's view of clearing organizations' obligations. The current language of Regulation 1.20(a)'s final sentence apparently reflects an unintentionally broad modification of that provision made in connection with amendments of a number of Commission regulations to reflect establishment of the Commission's exchange-traded options program. Until these 1981 revisions of the Commission's regulations, Regulation 1.20(a)'s last sentence referred to "customers" in the plural, made no express reference to clearing organizations and was substantially consistent with the final sentence of Section 4d(2). The Commission's proposed rules regarding exchange-traded options would have modified this language only to the extent of including option customers within its protections: "Nor shall any such funds be held, disposed of, or used as belong [sic] to the depositing futures commission merchant or any person other than the commodity or option customers of such futures commission merchant." 46 FR 33315 (1981). As adopted, however, the Commission's final rules concerning the regulation of exchange-traded commodity options included Regulation 1.20(a)'s final sentence in its current form, a modification that apparently was not intended to be substantive. In the preamble to these rules, the Commission stated that it was adopting revised Regulations 1.20 through 1.30 "essentially as proposed." 46 FR 54508 (1981). We suggest that a technical amendment to Regulation 1.20(a) be proposed in the near future to conform its final sentence to its intended meaning.

[2] *See also* Regulation 1.36, which governs recordkeeping concerning securities and other property received from customers and option customers. Regulation 1.36 requires FCMs to maintain a record, showing "separately for each customer or option customer" the securities or property received, name and address of the depositing customer and other pertinent information. By contrast, clearing organizations with which clearing member firms deposit securities or property belonging to particular customers or option customers of such members in lieu of cash margin are required to maintain records "which will show separately for each member" the date of receipt of such securities and property and other pertinent data but are not required to maintain records of the names of the particular customers of the member firm from whom such securities and property were received.

[3] This prohibition includes a proscription against the use of customer margin funds deposited in connection with futures or option transactions to discharge obligations, including customers' obligations, incurred in connection with transactions that are not within the purview of the Act or the rules and regulations promulgated thereunder.

must be cleared. I am hopeful that we will hear from a broad range of market participants, including clearinghouses, futures commission merchants, pension funds, asset managers and other end-users, on the costs, benefits and feasibility of various approaches to protecting customers' money.

[FR Doc. 2010–29836 Filed 12–1–10; 8:45 am]

BILLING CODE 6351–01–P