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Part II

Commodity Futures Trading Commission

17 CFR Parts 1, 3, 22 et al.
Enhancing Protections Afforded Customers and Customer Funds Held by Futures Commission Merchants and Derivatives Clearing Organizations; Proposed Rule

COMMODITY FUTURES TRADING COMMISSION

17 CFR Parts 1, 3, 22, 30, and 140

RIN 3038–AD88

Enhancing Protections Afforded Customers and Customer Funds Held by Futures Commission Merchants and Derivatives Clearing Organizations

AGENCY: Commodity Futures Trading Commission.

ACTION: Notice of proposed rulemaking.

SUMMARY: The Commodity Futures Trading Commission (''Commission'' or ''CFTC'') is proposing to adopt new regulations and amend existing regulations to require enhanced customer protections, risk management programs, internal monitoring and controls, capital and liquidity standards, customer disclosures, and auditing and examination programs for futures commission merchants (''FCMs''). The proposal also addresses certain related issues concerning derivatives clearing organizations (''DCOs'') and chief compliance officers (''CCOs''). The proposed rules will afford greater assurances to market participants that: customer segregated funds and secured amounts are protected; customers are provided with appropriate notice of the risks of futures trading and of the FCMs with which they may choose to do business; FCMs are monitoring and managing risks in a robust manner; the capital and liquidity of FCMs are strengthened to safeguard their continued operations; and the auditing and examination programs of the Commission and the self-regulatory organizations (''SROs'') are monitoring the activities of FCMs in a prudent and thorough manner.

DATES: Comments must be received on or before January 14, 2013.

ADDRESSES: You may submit comments, identified by RIN 3038–AD88, 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:* Send to David A. Stawick, Secretary, Commodity Futures Trading Commission, 1155 21st Street NW., Washington, DC 20581.
- *Hand delivery/Courier:* Same as Mail above.
- *Federal eRulemaking Portal: http://www.regulations.gov/search/index.jsp.*

Follow the instructions for submitting comments.

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 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 set forth in § 145.9 of the Commission's regulations.[1]

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:

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SUPPLEMENTARY INFORMATION:

I. Background

A. General Statutory and Current Regulatory Structure

The protection of customers—and the safeguarding of money, securities or other property deposited by customers with an FCM—is a fundamental component of the Commission's disclosure and financial responsibility framework. Section 4d(a)(2)[2] of the Commodity Exchange Act (''Act'')[3] requires each FCM to segregate from its own assets all money, securities and other property deposited by futures customers to margin, secure, or guarantee futures contracts and options on futures contracts traded on designated contract markets.[4] Section 4d(a)(2) further requires an FCM to treat and deal with futures customer funds as belonging to the futures customer, and prohibits an FCM from using the funds deposited by a futures customer to margin or extend credit to any person other than the futures customer that deposited the funds. Section 4d(f) of the Act, which was added by section 724(a) of the Dodd-Frank Wall Street Reform and Consumer Protection Act,[5] requires each FCM to segregate from its own assets all money, securities and other property deposited by Cleared Swaps Customers to margin transactions in Cleared Swaps.[6]

The Commission has adopted §§ 1.20 through 1.30, and § 1.32, to implement section 4d(a)(2) of the Act, and adopted Part 22 to implement section 4d(f) of the Act. The purpose of these regulations is to safeguard funds deposited by futures customers and Cleared Swaps Customers, respectively.

Regulation 1.20 requires each FCM and DCO to separately account for and to segregate from its own proprietary funds all money, securities, or other property deposited by futures customers for trading on designated contract markets. Regulation 1.20 also provides that an FCM or DCO may deposit futures customer funds only with a bank, trust company, and for FCMs only, a DCO or another FCM. The funds must be deposited under an account

[1] Commission regulations referred to herein are found at 17 CFR Ch. 1 (2012). Commission regulations are accessible on the Commission's Web site, *www.cftc.gov.*

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

[3] 7 U.S.C. 1 *et seq.*

[4] The term '' futures customer'' is defined in § 1.3(iiii) to include any person who uses a futures commission merchant as an agent in connection with trading in any contract for the purchase or sale of a commodity for future delivery or an option on such contract (excluding any proprietary accounts under § 1.3(y)). The Commission adopted the definition of the term ''futures customer'' on October 16, 2012 as part of the final rulemaking that amended existing Commission regulations to incorporate swaps. The **Federal Register** release adopting the final rules can be accessed at *http://www.cftc.gov/ucm/groups/public/@newsroom/documents/file/federalregister101612.pdf.*

[5] *See* Dodd-Frank Act, Public Law 111–203, 124 Stat. 1376 (2010). The text of the Dodd-Frank Act may be accessed at *http://www.cftc.gov/LawRegulation/OTCDERIVATIVES/index.htm.*

[6] The term ''Cleared Swaps Customer'' is defined in § 22.1 as any person entering into a Cleared Swap, but excludes: (1) Any owner or holder of a Cleared Swaps Proprietary Account with respect to the Cleared Swaps in such account; and (2) A clearing member of a DCO with respect to Cleared Swaps cleared on that DCO.

name that clearly identifies the funds as belonging to the futures customers of the FCM or DCO and further shows that the funds are segregated as required by section 4d(a)(2) of the Act and Commission regulations. FCMs and DCOs also are required to obtain a written acknowledgment from a depository stating that the depository was informed that funds deposited are customer funds being held in accordance with the Act.

FCMs and DCOs also are restricted in their use of futures customer funds. Regulations 1.20 and 1.22 provide that the funds deposited by one futures customer may not be used to margin or to secure the contracts or option positions, or extend credit to any person, other than the futures customer that deposited the funds. An FCM or DCO, however, may for convenience commingle and hold funds deposited as margin by multiple futures customers in the same account or accounts with one of the recognized depositories. An FCM or DCO also may invest futures customer funds in certain permitted investments under § 1.25.

Part 22 of the Commission's regulations, which governs Cleared Swaps transactions, implements section 4d(f) of the Act and parallels many of the provisions in Part1 addressing the manner in which, and the responsibilities imposed upon, an FCM holding funds for futures customers trading on designated contract markets.[7] Regulation 22.2 requires an FCM to treat and to deal with funds deposited by Cleared Swaps Customers as belonging to such Cleared Swaps Customers and to hold such funds separately from the FCM's own funds. Regulation 22.4 provides that an FCM may deposit Cleared Swaps Customer Collateral with a bank, trust company, DCO, or another registered FCM. Regulation 22.6 requires that the account holding the Cleared Swaps Customers Collateral must clearly identify the account as an account for Cleared Swaps Customers of the FCM engaging in cleared swap transactions and that the funds maintained in the account are subject to the segregation provisions of section 4d(f) of the Act and Commission regulations.

Regulation 22.2(d) also prohibits an FCM from using the funds deposited by one Cleared Swaps Customer to purchase, margin, or settle cleared swap transactions of any person other the Cleared Swaps Customer that deposited the funds. Further, § 22.2(c) permits an FCM to commingle the Cleared Swaps Customer Collateral of multiple Cleared Swaps Customers into one or more accounts, and § 22.2(e)(1) permits an FCM to invest Cleared Swaps Customer Collateral in permitted investments under § 1.25.

In addition to holding funds for futures customers transacting on designated contract markets and for Cleared Swaps Customers engaging in cleared swap transactions, FCMs also hold funds for persons trading futures contracts listed on foreign boards of trade. Section 4(b) of the Act provides that the Commission may adopt rules and regulations proscribing fraud and requiring minimum financial standards, the disclosure of risk, the filing of reports, the keeping of books and records, the safeguarding of the funds deposited by persons for trading on foreign markets, and registration with the Commission by any person located in the United States who engages in the offer or sale of any contract of sale of a commodity for future delivery that is made subject to the rules of a board of trade located outside of the United States. Pursuant to the statutory authority of section 4(b), the Commission adopted Part 30 of its regulations to address foreign futures and foreign option transactions.

The segregation provisions for funds deposited by foreign futures or foreign options customers to margin foreign futures or foreign options transactions under Part 30, however, are significantly different from the requirements set forth in § 1.20 for futures customers trading on designated contract markets and Part 22 for Cleared Swaps Customers engaging in cleared swap transactions. Regulation 30.7 provides that an FCM may deposit the funds belonging to foreign futures or foreign options customers in an account or accounts maintained at a bank or trust company located in the United States; a bank or trust company located outside of the United States that has in excess of $1 billion of regulatory capital; an FCM registered with the Commission; a DCO; a member of a foreign board of trade; a foreign clearing organization; or a depository selected by the member of a foreign board of trade or foreign clearing organization. The account with the depository must be titled to clearly specify that the account holds funds belonging to the foreign futures or foreign options customers of the FCM that are trading on foreign futures markets. An FCM also is permitted to invest the funds deposited by foreign futures or foreign option customers in accordance with § 1.25.

However, unlike § 1.20 and Part 22, which require an FCM to hold a sufficient amount of funds in segregation to meet the total account equities of all of the FCM's futures customers and Cleared Swaps Customers at all times (*i.e.,* the Net Liquidating Equity Method), § 30.7 requires an FCM to maintain in separate accounts an amount of funds only sufficient to cover the margin required on open foreign futures contracts, plus or minus any unrealized gains or losses on such open positions, plus any funds representing premiums payable or received on foreign options (including any additional funds necessary to secure such options, plus or minus any unrealized gains or losses on such options) (*i.e.,* the ''Alternative Method''). Thus, under the Part 30 Alternative Method an FCM is not required to maintain a sufficient amount of funds in such separate accounts to pay the full account balances of all of its foreign futures or foreign options customers at all times.

In addition to the segregation requirements of sections 4d(a)(2) and 4d(f) of the Act, and the secured amount requirements in Part 30 of the Commission's regulations, FCMs also are subject to minimum net capital and financial reporting requirements that are intended to ensure that such firms meet their financial obligations in a regulated marketplace, including their financial obligations to customers and DCOs. Each FCM is required to maintain a minimum level of ''adjusted net capital,'' which is generally defined under § 1.17 as the firm's net equity as computed under generally accepted accounting principles, less all of the firm's liabilities and further excluding all assets that are not liquid or readily marketable. Regulation 1.17(c)(5) further requires an FCM to impose capital charges (*i.e.,* deductions) on certain of its liquid assets to protect against possible market risks in such assets.

FCMs also are subject to financial recordkeeping and reporting requirements. FCMs that carry customer accounts are required under § 1.32 to prepare a schedule each business day demonstrating their compliance with the segregation and secured amount requirements. Regulation 1.32 requires the calculation to be performed by noon each business day, reflecting the account balances and open positions as of the close of business on the previous business day.

Each FCM also is required by § 1.10 to file with the Commission and with its

[7] The Commission approved the part 22 regulations on January 11, 2012, with an effective date of April 9, 2012. Compliance with the part 22 regulations is required by November 8, 2012. *See, Protection of Cleared Swaps Customer Contracts and Collateral; Conforming Amendments to the Commodity Broker Bankruptcy Provisions,* 77 FR 6336 (Feb. 7, 2012).

designated self-regulatory organization (''DSRO'') monthly unaudited financial statements and an annual audited financial report, as well as notices of certain predefined events.[8] Regulation 1.12 requires an FCM to file a notice with the Commission and with the firm's DSRO whenever, among other things, the firm: (1) Fails to maintain compliance with the Commission's capital requirements; (2) fails to hold sufficient funds in segregated or secured amount accounts to meet its regulatory requirements; (3) fails to maintain current books and records; or (4) experiences a significant reduction in capital from the previous month-end. The purpose of the regulatory notices is to alert the Commission and the firm's DSRO as early as possible to potential financial issues at the firm that may adversely impact the ability of the FCM to comply with its obligations to safeguard customer funds, or to meet its financial obligations to other FCMs or DCOs.

The statutory mandate to segregate customer funds—to treat them as belonging to the customer and not use the funds inappropriately—takes on greater meaning in light of the devastating events experienced over the past year. Those events, which are discussed in greater detail below, demonstrate that the risks of misfeasance and malfeasance, and the risks of failing to maintain sufficient excess funds in segregation: (i) Put customer funds at risk; and (ii) are exacerbated by stresses on the business of the FCM. Many of those risks can be mitigated significantly by better risk management systems and controls, along with an increase in risk-oriented oversight and examination of the FCMs.

Determining what is a ''sufficient'' amount of excess funds in segregation for any particular FCM requires a full understanding of the business of that FCM, including a proper analysis of the factors that affect the actual amount of segregated funds held by the FCM relative to the minimum amount of segregated funds it is required to hold. Further, appropriate care must be taken to avoid withdrawing such excess funds at times of great stress to cover needs unrelated to the purposes for which excess segregated and secured funds are maintained. In times of stress, excess funds may look like an easy liquidity source to help cover other risks of the business; yet withdrawing it makes it unavailable when it may be most needed. The recent market events illustrate both the need to: (i) Require that care be taken about monitoring excess segregated and secured funds, and the conditions under and the extent to which such funds may be withdrawn; and (ii) place appropriate risk management controls around the other risks of the business to help relieve (A) the likelihood of an exigent event or, (B) if such an event occurs, the likelihood of a failure to prepare for such an event, which in either case could create pressures that result in an inappropriate withdrawal of customer funds.

Although the Commission's existing regulations provide an essential foundation to fostering a well-functioning marketplace, wherein customers are protected and institutional risks are minimized, recent events have demonstrated that additional measures are necessary to effectuate the fundamental purposes of the statutory provisions discussed above. Further, concurrently with the enhanced responsibilities for FCMs that are proposed herein, the oversight and examination systems must be enhanced to mitigate risks and effectuate the statutory purposes.

B. Self-Regulatory Structure

The Commission's oversight structure provides that SROs are the frontline regulators of FCMs, introducing brokers (''IBs''), commodity pool operators, and commodity trading advisors. In 2000, Congress affirmed the Commission's reliance on SROs by amending section 3 of the Commodity Exchange Act to state: ''It is the purpose of this Act to serve the public interests through a system of effective self-regulation of trading facilities, clearing systems, market participants and market professionals under the oversight of the Commission.''

As part of its oversight responsibility, an SRO is required to conduct periodic examinations of member FCMs' compliance with Commission and SRO financial and related reporting requirements, including the FCMs' holding of customer funds in segregated and secured accounts. The Commission oversees the SROs by examining them for the performance of their duties. More recently, the Commission has moved to conducting quarterly reviews of the SROs' FCM examination program in which the Commission selects a small sample of the SRO's FCM work papers to review. In addition, the Commission also conducts limited-scope reviews of FCMs in a ''for cause'' situation that are sometimes referred to as ''audits,'' but they are not full-scale audits as accountants commonly use that term.

In addition, because there are multiple SROs who share the same member FCMs, to avoid subjecting FCMs to duplicative examinations from SROs, the Commission has a permissive system that allows the SROs to agree how to allocate FCMs amongst them. An SRO who is allocated certain FCMs for such examination is referred to as the DSRO of those FCMs.

Under Commission regulations, FCMs must have their annual financial statements audited by an independent certified public accountant following U.S. Generally Accepted Auditing Standards (''U.S. GAAS''). As part of this certified annual report, the independent accountant also must conduct appropriate reviews and tests to identify any material inadequacies in systems and controls that could violate the Commission's segregation or secured amount requirements. Any such inadequacies are required to be reported to the FCM's DSRO and to the Commission.

C. Futures Commission Merchant Insolvencies and Failures of Risk Management

Recent events demonstrate the need for revisions to the Commission's customer protection regime. Since October 2011, two FCMs have entered into insolvency proceedings. On October 31, 2011, MF Global, Inc. (''MFGI''), which was dually-registered as an FCM with the Commission and as a securities broker-dealer (''BD'') with the U.S. Securities and Exchange Commission (''SEC''), was placed into a liquidation proceeding under the Securities Investor Protection Act by the Securities Investor Protection Corporation (''SIPC''). The trustee appointed to oversee the liquidation of MFGI has reported a potential $900 million shortfall of funds necessary to repay the account balances due to customers trading futures on designated contract markets, and an approximately $700 million shortfall in funds immediately available to repay the account balances of customers trading on foreign futures markets.[9] The shortfall in customer segregated accounts is attributable by the MFGI Trustee to significant transfers of funds out of the customer accounts that were used by MFGI for various purposes other than to meet obligations to or on

[8] The term ''self-regulatory organization'' is defined by § 1.3 to mean a contract market, a swap execution facility, or a registered futures association. A DSRO is the SRO that is appointed to be primarily responsible for conducting ongoing financial surveillance of an FCM under a joint audit agreement submitted to and approved by the Commission under § 1.52.

[9] *See Report of the Trustee's Investigation and Recommendations, In re MF Global Inc.,* No. 11–2790 (MG) SIPA (Bankr. S.D.N.Y. Jun. 4, 2012).

behalf of customers. The trustee also is attempting to recover approximately $640 million of customer funds that was deposited by MFGI with its London, U.K. affiliate, MFGUK, as margin funds for trading on foreign markets. The MFGI trustee and the Special Administrators handling the liquidation of MFGUK are disputing the legal status of the funds and whether they are customer funds under English law. The outcome of this dispute will have a significant impact on the amount of funds that are returned to MFGI.

In addition, the Commission filed a civil injunctive complaint in federal district court on July 10, 2012, against Peregrine Financial Group, Inc. (''PFG''), a registered FCM and its Chief Executive Officer (''CEO'') and sole owner, Russell R. Wasendorf, Sr., alleging that PFG and Wasendorf, Sr. committed fraud by misappropriating customer funds, violated customer fund segregation laws, and made false statements regarding the amount of funds in customer segregated accounts in financial statements filed with the Commission. The complaint states that in July 2012 during an NFA examination PFG falsely represented that it held in excess of $220 million of customer funds when in fact it held approximately $5.1 million.[10]

Recent incidents also have demonstrated the value of establishing robust risk management systems within FCMs and enhanced early warning systems to detect and address capital issues. In particular, problems that arise through an FCM's non-futures-related business can have a direct and significant impact on the FCM's regulatory capital, raising questions as to whether the FCM will be able to maintain the minimum financial requirements mandated by the Act and Commission regulations.[11]

These recent incidents have highlighted weaknesses in the customer protection regime prescribed in the Commission's regulations and through the self-regulatory system. In particular, questions have arisen on the requirements surrounding the holding and investment of customer funds, including the ability of FCMs to withdraw funds from customer segregated accounts and Part 30 secured accounts. Additionally, the incidents have underscored the need for additional safeguards—such as robust risk management systems, strengthened early-warning systems surrounding margin and capital requirements, and enhanced public disclosures—to promote the protection of customer funds and to minimize the systemic risk posed by certain actions of market participants. Further questions have arisen on the system of audits and examinations of FCMs, and whether the system functions adequately to monitor FCMs' activities, verify segregated fund and secured amount balances, and detect fraud. Consequently, the Commission has taken steps to study and address the issues raised by the incidents, and industry participants likewise have taken steps to address the issues. Such steps are described in greater detail in the next section.

D. Recent Commission Rulemakings and Other Initiatives Relating to Customer Protection

Since late 2011, the Commission has promulgated rules directly impacting the protection of customer funds. The Commission also has studied the current regulatory framework surrounding customer protection, particularly in light of the recent incidents outlined above, in order to identify potential enhancements to the systems and Commission regulations protecting customer funds. The Commission's efforts have been informed, in part, by efforts undertaken by industry participants. The proposed rule amendments set forth in this release have been informed by the efforts detailed below.

In December 2011, the Commission adopted final rule amendments revising the types of investments that an FCM or DCO can make with customer funds under § 1.25, for the purpose of affording greater protection for such funds.[12] Among other changes to §§ 1.25 and 30.7, the final rule amendments removed from the list of permitted investments: (1) corporate debt obligations not guaranteed by the United States; (2) foreign sovereign debt; and (3) in-house and affiliate transactions.

In adopted the amendments to § 1.25, the Commission was mindful that customer segregated funds must be invested by FCMs and DCOs in a manner that minimizes their exposure to credit, liquidity, and market risks both to preserve their availability to customers and DCOs, and to enable investments to be quickly converted to cash at a predictable value in order to avoid systemic risk. The amendments are consistent with the general prudential standard contained in § 1.25, which provides that all permitted investments must be ''consistent with the objectives of preserving principal and maintaining liquidity.''

The Commission also approved final regulations that require DCOs to collect initial customer margin from FCMs on a gross basis.[13] Under the final regulations, FCMs are no longer permitted to offset one customer's margin requirement against another customer's margin requirements and deposit only the net margin collateral with the DCO. As a result of the rule change, a greater portion of customer initial margin will be posted by FCMs to the DCOs.

The Commission also approved a new margining regime for cleared swaps positions.[14] Under the traditional futures margining model, DCOs hold an FCM's customer funds on a collective basis and are permitted to use the collective margin funds held for the FCM's customers to satisfy a margin deficiency caused by a single customer. The Commission approved an alternative margin rule for cleared swap transactions. Under the ''LSOC rule'' (legal segregation with operational comingling), the DCOs that clear swaps transactions have greater information regarding the margin collateral of individual Swaps Customers, and each Swaps Customer's collateral is protected individually all the way to the clearinghouse.

The Commission also included customer protection enhancements in the final rule for designated contract markets. These provisions codify into rules staff guidance on minimum requirements for SROs regarding their financial surveillance of FCMs.[15] The rules require that a DCM have arrangements and resources for effective

[10] Complaint, *U.S. Commodity Futures Trading Commission v. Peregrine Financial Group, Inc., and Russell R. Wasendorf, Sr.,* No. 12–cv–5383 (N.D. Ill. July 10, 2012). A copy of the Commission's complaint has been posted to the Commission's Web site.

[11] *See, e.g.,* Edward Krudy, Jed Horowitz and John McCrank, ''Knight's Future in Balance After Trading Disaster,'' Reuters (Aug. 3, 2012), *available at http://in.reuters.com/article/2012/08/03/knightcapital-loss-idINL2E8J27QE20120803* (noting that a software issue caused the firm to incur a $440 million trading loss, which represented much of the firm's capital); Chris Dieterich and Nathalie Tadena, ''Penson Worldwide's US Securities Accounts To Be Acquired By Apex Clearing,'' available at *http://online.wsj.com/article/BT-CO-20120531-717791.html* (discussing circumstances that led Penson to sell its futures business).

[12] *See,* Investment of Customer Funds and Funds Held in an Account for Foreign Futures and Foreign Options Transactions, 76 FR 78776 (Dec. 19, 2011).

[13] *See* Commission Regulation 39.12(g)(8)(i) and *Derivatives Clearing Organization General Provisions and Core Principles,* 76 FR 69334 (Nov. 8, 2011).

[14] *See* 77 FR 6336 (Feb. 7, 2012).

[15] *See Core Principles and Other Requirements for Designated Contract Markets,* 77 FR 36612 (June 19, 2012).

rule enforcement and trade and financial surveillance programs, including the authority to collect information and examine books and records of members and market participants. The rules also establish minimum financial standards for both member FCMs and IBs and non-intermediated market participants. The Commission expressly noted in the preamble of the Adopting Release that ''a DCM's duty to set financial standards for its FCM members involves setting capital requirements, conducting surveillance of the potential future exposure of each FCM as compared to its capital, and taking appropriate action in light of the results of such surveillance.'' [16] Further, the rules mandate that DCMs adopt rules for the protection of customer funds, including the segregation of customer and proprietary funds, the custody of customer funds, the investment standards for customer funds, intermediary default procedures and related recordkeeping.

In addition to the rulemaking efforts outlined above, the Commission has sought additional information through a series of roundtables and other meetings. On February 29 and March 1, 2012, the Commission solicited comments and held a public roundtable to solicit input on customer protection issues from a broad cross-section of the futures industry, including market participants, FCMs, DCOs, SROs, securities regulators, foreign clearing organizations, and academics.[17] The roundtable focused on issues relating to the advisability and practicality of modifying the segregation models for customer funds; alternative models for the custody of customer collateral; enhancing FCM controls over the disbursement of customer funds; increasing transparency surrounding an FCM's holding and investment of customer funds; and lessons learned from recent commodity brokerage bankruptcy proceedings.

The Commission also hosted a public meeting of the Technology Advisory Committee (''TAC'') on July 26, 2012.[18] Panelists and TAC members discussed potential technological solutions directed at enhancing the protection of customers funds by identifying and exploring technological issues and possible solutions relating to the ability of the Commission, SROs and customers to verify the location and status of funds held in customer segregated accounts.

Commission staff hosted an additional roundtable on August 9, 2012, to discuss SRO requirements for examinations of FCMs and Commission oversight of SRO examination programs. The roundtable also focused on the role of the independent public accountant in the FCM examination process, and proposals addressing various alternatives to the current system for segregating customer funds.

In developing the proposals set forth in this release, the Commission also has been informed by efforts undertaken by industry participants. On February 29, 2012, the Futures Industry Association (''FIA'') initiated steps to educate customers on the extent of the protections provided under the current regulatory structure. FIA issued a list of Frequently Asked Questions (''FAQ'') prepared by members of the FIA Law and Compliance Division addressing the basics of segregation, collateral management and investments, capital requirements and other issues for FCMs and joint FCM/BDs, and clearinghouse guaranty funds.[19] The FAQ is intended to provide existing and potential customers with a better understanding of the risks of engaging in futures trading and a clear explanation of the extent of the protections provided to customers and their funds under the Act and Commission regulations.

FIA also issued a series of initial recommendations for the protection of customer funds.[20] The recommendations were prepared by the Financial Management Committee, whose members include representatives of FIA member firms, DCOs and depository institutions. The initial recommendations address enhanced disclosure on the protection of customer funds, reporting on segregated funds balances by FCMs, FCM internal controls surrounding the holding and disbursement of customer funds, and revisions to Part 30 regulations to make the protections comparable to those provided for customers trading on designated contract markets.

On July 13, 2012, the Commission approved new FCM financial requirements proposed by the National Futures Association (''NFA'').[21] The NFA Financial Requirements Section 16 and its related Interpretive Notice entitled *NFA Financial Requirements Section 16: FCM Financial Practices and Excess Segregated Funds/Secured Amount Disbursements* (collectively referred to as ''the Segregated Funds Provisions'') were developed in consultation with Commission staff.

NFA's Segregated Funds Provisions require each FCM to: (1) Maintain written policies and procedures governing the deposit of the FCM's proprietary funds (*i.e.,* excess or residual funds) in customer segregated accounts and Part 30 secured accounts; (2) maintain a targeted amount of excess funds in segregate accounts and Part 30 secured accounts; (3) file on a daily basis the FCM's segregation and Part 30 secured amount computations with NFA; (4) obtain the approval of senior management prior to a withdrawal that is not for the benefit of customers, whenever the withdrawal equals 25 percent or more of the excess segregated or Part 30 secured amount funds; (5) file a notice with NFA of any withdrawal that is not for the benefit of customers, whenever the withdrawal equals 25 percent or more of the excess segregated or Part 30 secured amount funds; (6) file detailed information regarding the depositories holding customer funds and the investments made with customer funds as of the 15th day (or the next business day if the 15th is not a business day) and the last business day of each month; and (7) file additional monthly net capital and leverage information with NFA.

Significantly, NFA's Segregated Funds Provisions also require FCMs to compute their Part 30 secured amount requirement and compute their targeted excess Part 30 secured funds using the same Net Liquidating Equity Method that is required by the Act and Commission regulations for computing the segregation requirements for customers trading on U.S. contract markets under section 4d of the Act. FCMs are not permitted under the NFA rules to use the Alternative Method to compute the Part 30 secured amount requirement. The failure of an FCM to maintain its targeted amount of excess Part 30 funds computed using the Net

[16] *Id.* at 36646.

[17] Further information on the public roundtable, including video recordings and transcripts of the discussions, have been posted to the Commission's Web site. *See http://www.cftc.gov/PressRoom/Events/opaevent_cftcstaff022912* (relating to Feb. 29, 2012); *http://www.cftc.gov/PressRoom/Events/opaevent_cftcstaff030112* (relating to Mar. 1, 2012).

[18] Additional information, including documents submitted by meeting participants, has been posted to the Commission's Web site. See *http://www.cftc.gov/PressRoom/Events/opaevent_tac072612.*

[19] The FIA's release addressing FAQs on the protection of customer funds is accessible on the FIA's Web site at *http://www.futuresindustry.org/downloads/PCF–FAQs.PDF.*

[20] The FIA's initial recommendations are accessible on the FIA's Web site at *http://www.futuresindustry.org/downloads/Initial_Recommendations_for_Customer_Funds_Protection.pdf.*

[21] For more information relating to the new FCM financial requirements, see *http://www.nfa.futures.org/news/newsNotice.asp?ArticleID=4072.*

Liquidating Equity Method may result in NFA initiating a Membership Responsibility Action (''MRA'') against the firm.

In addition, in setting the target amount of excess funds, the FCM's management must perform a due diligence inquiry and consider various factors relating, as applicable, to the nature of the FCM's business, including the type and general creditworthiness of the FCM's customers, the trading activity of the customers, the types and volatility of the markets and products traded by the FCM's customers, and the FCM's own liquidity and capital needs. The FCM's Board of Directors (or similar governing body), CEO or Chief Financial Officer (''CFO'') must approve in writing the FCM's targeted residual amount, any changes thereto, and any material changes in the FCM's written policies and procedures.

The NFA Board of Directors also approved on August 16, 2012, amendments to NFA financial requirements for FCMs that will require each FCM to provide its DSRO with view-only access via the Internet to account information for each of the FCM's customer segregated funds account(s) maintained and held at a bank or trust company. The same requirement would apply to the FCM's customer secured account(s) held for customers trading on foreign futures exchanges.

In addition, the NFA rule amendments provide that if a bank or trust company is unable to allow the FCM to provide its DSRO with view-only full access via the Internet, the bank or trust company will not be deemed an acceptable depository to hold customer segregated and secured accounts. NFA intends to expand its oversight of FCMs under the amended rules, once the amendments are implemented, to receive daily reports from all depositories for customer segregated and secured accounts, including FCMs that are clearing members of DCOs. NFA plans to develop a program to compare the balances reported by the depositories with the balances reported by the FCMs in their daily segregation reports. An immediate alert would be generated for any material discrepancies.

E. Commission's Proposal

The incidents outlined above, coupled with the information generated through the recent efforts undertaken by the Commission and industry participants, demonstrate the need for new rules and amendments to existing rules. In particular, an examination of FCM business operations—including the non-futures business of FCMs—and the currently regulatory framework evince a need for enhanced customer protections, risk management programs, disclosure requirements, and auditing and examination programs. The amendments proposed herein address these issues in several ways.

First, recognizing problems surrounding the treatment of customer segregated funds and foreign futures or foreign options secured amounts, the Commission is proposing to amend several components of Parts 1, 22, and 30 of the Commission's regulations. The Commission believes that the proposed amendments will provide greater certainty to market participants that the customer funds entrusted to FCMs will be protected. Second, to address shortcomings in the risk management of FCMs, the Commission is proposing a new § 1.11 that will establish robust risk management programs. Third, the Commission determined that the current regulatory framework should be re-oriented to implement a more risk-based, forward-looking perspective, affording the Commission and SROs with read-only access to accounts holding customer funds and additional information on depositories and the customer assets held in such depositories. The proposed amendments to §§ 1.10, 1.12, 1.20, 1.26, and 1.32 address those and other issues. Fourth, given the difficulties that can arise in an FCM's business, and the direct and significant impact on the FCM's regulatory capital that can result from such difficulties, the Commission is proposing to amend § 1.17(a)(4) to ensure that an FCM's capital and liquidity are sufficient to safeguard the continuation of operations at the FCM. Fifth, to effect the change in orientation needed in FCM examinations programs, as well as to assure quality control over program contents, administration and oversight, the Commission is proposing to amend § 1.52, which, among other things, addresses the formation of Joint Audit Committees and the implementation of Joint Audit Programs. And sixth, recognizing the need to increase the information provided to customers concerning the risks of futures trading and the FCMs with which they may choose to conduct business, the Commission is proposing amendments to § 1.55 that will enhance the disclosures provided by FCMs. These amendments are discussed in greater detail in the next Section.

II. Section by Section Analysis of Proposed Commission Regulations and Proposed Amendments to Existing Commission Regulations

A. Proposed Amendments to § 1.10: Financial Reports of Futures Commission Merchants and Introducing Brokers

Regulation 1.10 requires each FCM to file with the Commission and with the firm's DSRO an unaudited financial report each month. The financial report must be prepared using Form 1–FR–FCM. An FCM, however, that is dually-registered as a BD, may file a Financial and Operational Combined Uniform Single Report under the Securities Exchange Act of 1934 (''FOCUS Report'') in lieu of the Form 1–FR–FCM. Each FCM also is required to file an annual report certified by an independent public accountant with the Commission and with its DSRO.

The unaudited monthly and certified annual financial reports are required to contain basic financial statements including a statement of financial condition, a statement of income (loss), and a statement of changes in ownership equity. The financial statements also are required to include additional schedules designed to address specific regulatory objectives to demonstrate that the FCM is in compliance with minimum capital and customer funds segregation requirements. These additional schedules include a statement of changes in liabilities subordinated to claims of general creditors, a statement of the computation of the minimum capital requirements (''Capital Computation Schedule''), a statement of segregation requirements and funds in segregation for customers trading on U.S. commodity exchanges (''Segregation Schedule'') and a statement of secured amounts and funds held in separate accounts for foreign futures and foreign options customers (''Secured Amount Schedule''). In addition, the certified annual report must contain a reconciliation of material differences between the Capital Computation Schedule, the Segregation Schedule, and the Secured Amount Schedule contained in the certified annual report and the unaudited monthly report for the FCM's year-end month.

The Forms 1–FR–FCM and the FOCUS Reports are necessary financial reporting for Commission and DSRO staff to assess the ongoing financial condition of an FCM and provide significant information regarding the operations of the firm that may impact the FCM's ability to maintain

compliance with Commission requirements and the protection of customer funds. The Form 1–FR–FCM and FOCUS Reports are filed electronically with the Commission and are subject to automated edits by the Commission's financial statement surveillance software. Alerts and edit checks, which may indicate a need for further analysis and follow-up by staff, are generated by the financial surveillance software and major issues are immediately and automatically forwarded to Commission staff for review.

The Segregation Schedule and the Secured Amount Schedule generally indicate, respectively, the total amount of funds held by the FCM in segregated or secured accounts, the total amount of funds that the FCM must hold in segregated or secured accounts to meet its regulatory obligations to futures customers and foreign futures or foreign options customers, and whether the firm holds excess segregated or secured funds in the segregated or secured accounts as of the reporting date. The Commission is proposing to amend § 1.10 to require each FCM to also disclose in the Segregation Schedule and in the Secured Amount Schedule [22] a target amount of ''residual interest'' (denoting the FCM's proprietary funds) that the FCM is required to maintain in customer segregated accounts and secured accounts based upon its written policies and procedures for computing a targeted amount required under the new risk management provisions in § 1.11 discussed in Section II.B below.[23] In addition to the target amount of residual interest, the FCM also will be required to report on the Segregation Schedule and the Secured Amount Schedule the sum of outstanding margin deficits of the relevant customers for each computation, to ensure that the residual interest is at all times in excess of such sum, demonstrating compliance with the newly proposed procedures in §§ 1.22 and 1.23, which shall require residual interest to exceed the sum of such margin deficits.

As more fully discussed in Section II.B below, proposed § 1.11 will require each FCM that carries customer funds to determine a necessary level of excess segregated and secured funds that the firm should hold in segregated or secured accounts to ensure against becoming undersegregated or undersecured as a result of the withdrawal of proprietary funds from segregated or secured accounts. Each FCM is required under proposed § 1.11 to compute or determine the necessary target of residual interest based upon appropriate due diligence and consideration of various factors relating to the nature of the FCM's business,[24] including the type and general creditworthiness of the customer base, the amount of the undermargined customer accounts on any given day, and the volatility and liquidity of the markets and products traded by customers.

The disclosure of the targeted amount of the FCM's residual interest in segregated or secured accounts will allow the Commission and DSRO to assess the size of the target relative to both the total funds held in segregation or secured accounts and to compare the target to other FCMs. Such information will assist the Commission and DSROs in assessing the potential risk that a firm may become undersegregated or undersecured, and will enhance the Commission's and DSRO's ability to protect customer funds.

The Commission also is proposing to revise Form 1–FR–FCM to adopt a new ''Statement of Cleared Swap Customer Segregation Requirements and Funds in Cleared Swap Customer Accounts Under Section 4d(f) of the Act'' (''Cleared Swaps Segregation Schedule''). The Commission is proposing the Cleared Swaps Segregation Schedule to implement provisions in section 724(a) of the Dodd-Frank Act.[25] Section 724(a) amended section 4d of the Act, and requires an FCM to segregate from its own assets any money, securities and other property deposited by a Cleared Swaps Customer to margin its cleared swaps positions. As part of the implementation of section 724(a) of the Dodd-Frank Act, the Commission adopted § 22.2(g) which requires an FCM to compute, as of the close of business each business day, a segregation computation demonstrating compliance with its obligation to hold sufficient funds in segregated accounts in an amount sufficient to cover the total Net Liquidating Equity of each of the FCM's Cleared Swaps Customers.[26] The proposed Cleared Swaps Segregation Schedule will be comparable to the current Segregation Schedule and will allow the Commission and the FCM's DSRO to obtain information on the FCM's holding of Cleared Swaps Customer Collateral to ensure that such funds are held in accordance with the provisions of Part 22 of the Commission's regulations and that the FCM is reporting that it has sufficient funds in segregated accounts to meet its obligations to all of its Cleared Swaps Customers computed under the Net Liquidating Equity Method.

The Commission previously proposed a Cleared Swaps Segregation Schedule as part of its proposed regulations to adopt capital requirements for swap dealers and major swap participants.[27] In light of the Commission's decision to revise the Cleared Swaps Segregation Schedule from the version that was published for comment as part of the Commission's proposed capital rules for swap dealers and major swap participants by requiring the FCM to separately disclose its targeted residual interest in Cleared Swaps Customer Accounts and the sum of margin deficits for such accounts, the Commission is republishing the Cleared Swaps Segregation Schedule as part of this proposal to provide the public with an opportunity to comment on the proposal.[28]

The Commission also is proposing to amend § 1.10(g)(2) to provide that the Cleared Swaps Segregation Schedule is a public document. Regulation 1.10 currently provides that the Commission will treat the monthly Form 1–FR–FCM

[22] The Commission also proposes to revise the title of the ''Secured Amount Schedule'' by adding the term ''30.7 Customer'' to specify that the secured amount will include both U.S.-domiciled and foreign-domiciled customers consistent with the proposed amendments to Part 30 of the Commission Regulations discussed in Section II.R below.

[23] The NFA recently adopted a similar amendment to its rules, mandating that its member FCMs maintain written policies and procedures identifying a target amount that the FCM will seek to maintain as its residual interest in customer segregated and secured accounts. *See* NFA Notice I–12–14 (July 18, 2012), available at *http://www.nfa.futures.org/news/newsNotice.asp?ArticleID=4072.*

[24] The term ''Cleared Swaps Customer Collateral'' is defined in § 22.1 to mean all money, securities, or other property received by a futures commission merchant or by a derivatives clearing organization from, for, or on behalf of a Cleared Swaps Customer to margin a Cleared Swap or the settlement value of a Cleared Swap, and includes any accruals on such Cleared Swap transactions.

[25] *See* Dodd-Frank Wall Street Reform and Consumer Protection Act, Public Law 111–203, 124 Stat. 1376 (2010). The text of the Dodd-Frank Act may be accessed at *http://www.cftc.gov/LawRegulation/OTCDERIVATIVES/index.htm.*

[26] *See* 77 FR 6336 (February 7, 2012).

[27] *See Capital Requirements of Swap Dealers and Major Swap Participants,* 76 FR 27802 (May 12, 2011).

[28] Regulation 1.10(h) provides that a dually-registered FCM/BD may file a FOCUS Report in lieu of the Form 1–FR–FCM provided that all information that is required to be included in the Form 1–FR–FCM is included in the FOCUS Report. Currently, dual-registrant FCM/BDs include a Segregation Schedule and a Secured Amount Schedule in the FOCUS Report filings as supplemental schedules. If the Commission were to adopt a Cleared Swaps Segregation Schedule, dual-registrant FCM/BDs would have to include such schedule in their Focus Report filings.

reports and monthly FOCUS Reports as exempt from mandatory public disclosure for purposes of the Freedom of Information Act and the Government in the Sunshine Act, except for certain capital numbers and other financial information including the Segregation Schedules and the Secured Amount Schedules contained in the financial reports. The Commission is proposing to amend § 1.10(g)(2) to provide that the Cleared Swaps Segregation Schedule is a public document in the same manner as the Segregation Schedule and Secured Amount Schedule, and is available by requesting copies from the Commission.

Making the Cleared Swaps Segregation Schedule publicly available will benefit customers and potential customers by allowing them to review an FCM's compliance with its regulatory obligations and will provide a certain amount of detail as to how the FCM holds customer funds, which customers and potential customers will be able to assess from a risk perspective and also use to compare to other firms. This information, coupled with additional firm risk disclosures that the Commission is proposing in § 1.55 and discussed in detail in Section II.P below, will provide customers with greater transparency regarding the risks of entrusting their funds and engaging in transactions with particular FCMs. Customers also will be able to view the total amount of the targeted residual interest each FCM holds and to assess for themselves the adequacy of the targeted residual interest and whether the FCM holds funds in excess of the targeted residual interest.

The Commission also is proposing to amend several statements in the Form 1–FR–FCM. The Commission is proposing to amend the Statement of Financial Condition by adding a new line item 1.D. Line 1 currently separately details the amount of funds in segregation or separate accounts for futures customers and foreign futures or foreign option customers. Proposed line item 1.D. will set forth the amount of funds held by the FCM in segregated accounts for Cleared Swaps Customers. This amendment is necessary due to the adoption of the Part 22 regulations, which require the segregation of Cleared Swaps Customer Collateral and the proposed adoption of the Cleared Swaps Segregation Schedule as part of the Form 1–FR–FCM.

The Commission also is proposing to amend the Statement of Financial Condition by adding a new line item 22.F., which requires the separate disclosure of the FCM's liability to Cleared Swaps Customers. The Commission also is proposing to revise current line item 27.J. to require the FCM to disclose its obligation to retail forex customers. Currently, an FCM's obligation to retail forex customers is included with other miscellaneous liabilities and reported under current line item 27.J. ''Other.'' The separate reporting of an FCM's retail forex obligation will provide greater transparency on the Statement of Financial Condition regarding the firm's obligations to its retail counterparties in off-exchange foreign currency transactions, and is appropriate given the Commission's direct jurisdiction over such activities under section 2(c) of the Act when conducted by an FCM.

The Commission also is proposing to amend § 1.10(b)(1)(ii) to require that an FCM submit its certified annual report to the Commission and to its DSRO within 60 days of its year-end date. Currently, an FCM is required to submit the annual certified financial statements within 90 days of the firm's year-end date, except for FCMs that are dually-registered as FCM/BDs, which are require to submit the certified annual report within 60 days of the year-end date under both Commission and SEC regulations. Therefore, the proposal will only impact FCMs that are not dually-registered as BDs.

The proposal will align the filing deadlines for both FCMs and dual registrant FCMs/BDs. The annual certified financial report is a key component of the Commission's and DSROs' financial surveillance program, as it represents that an independent entity has conducted an audit following U.S. generally accepted auditing standards for the purpose of expressing an opinion on the financial statements of the FCM. Requiring standalone FCMs to submit the certified financial statements within 60 days of the firm's year-end date will allow Commission and DSRO staff to review the financial statements on a more timely basis to identify and address accounting or auditing issues that may impact the financial condition of the FCM.

In addition, the Commission notes that, pursuant to § 3.3(f)(2), the annual report of an FCM's CCO must be furnished electronically to the Commission simultaneously with the submission of Form 1–FR–FCM, as required under § 1.10(b)(2)(ii); simultaneously with the FOCUS Report, as required under § 1.10(h); or simultaneously with the financial condition report, as required under section 4s(f) of the Act, as applicable. Given the 60-day deadline proposed herein, the Commission is proposing a conforming amendment to § 3.3(f)(2) to reflect the proposed 60-day deadline.

The Commission is proposing to add a new requirement in § 1.10(b)(5) to require each FCM to file with the Commission on a monthly basis its balance sheet leverage ratio. FCMs currently are required to file the same leverage information with the NFA on a monthly basis. The Commission does not expect the imposition of this regulation to have any significant impact on the FCMs as the ratio is calculated from existing reported balances and already provided to NFA.

The leverage ratio will provide information regarding the amount of assets supported by the FCM's capital base. The Commission views leverage information as an important element in assessing the financial condition of an FCM as a high degree of balance sheet leverage may indicate that the firm does not have the capital to support its investment decisions, particularly if such investments loose a significant amount of their value in a short period of time or require substantial margin payments or other payments to support.

The Commission also is proposing to amend § 1.10(c)(2)(i) to require that all monthly unaudited Forms 1–FR–FCM or FOCUS Reports be filed electronically with the Commission. The Commission also is proposing to amend § 1.10(c)(2)(i) to require an FCM to file its certified financial statement in electronic format.

FCMs currently file the monthly unaudited financial statements with the Commission using the WinJammer Online Filing System (''WinJammer'') electronic filing system, and the proposed amendments are simply codifying current practices.[29] Annual certified financial reports currently are required to be filed in paper form, and are required to contain the manual signature of the public accountant that conducted the examination. Under the Commission's proposal, an FCM will use the WinJammer system to file its certified financial report as a ''PDF'' document. The electronic filing of certified annual reports will ensure that such documents are received in a timely manner and will allow Commission staff to initiate prompt reviews of the public accountant's report to identify any accounting issues or material inadequacies that might have been identified during the examination. The

[29] WinJammer is a web-based application developed jointly by the Chicago Mercantile Exchange (''CME'') and the NFA. FCMs currently use WinJammer to transmit Forms 1–FR–FCM, FOCUS Reports, and other financial information and regulatory notices to the Commission and to the SROs.

timely review of the certified financial statements will enhance customer protections as deficiencies and other accounting issues will be promptly identified and reviewed.

The Commission also is proposing a technical amendment to § 1.10(c)(1). Regulation 1.10(c)(1) provides that any report or information required to be provided to the Commission by an IB or FCM will be considered filed when received by the Commission Regional office with jurisdiction over the state in which the FCM has its principal place of business. To ensure that reports are filed expeditiously with the correct Commission Regional office, the Commission's proposed amendment to § 1.10(c)(1) cross-references § 140.02, which sets forth the jurisdiction of each of the Commission's three Regional offices.

The Commission requests comment on all aspects the proposed amendments to § 1.10. Specifically, the Commission requests comments on the following questions:

- Should other schedules in the Form 1–FR–FCM be amended to provide additional information to the Commission and the FCM's SROs?
- The Commission is proposing to require FCMs to submit to the Commission and the firm's DSRO a monthly computation of the FCM's balance sheet leverage. The proposal is consistent with the leverage computation set forth in the rules of the NFA. Are there other measures of leverage that the Commission should consider adopting? Are there other financial statement ratios in addition to leverage that the Commission should consider requiring FCMs to submit to the Commission and DSROs?

B. Proposed § 1.11: Risk Management Program for Futures Commission Merchants

Proposed § 1.11 requires each FCM that carries customer accounts [30] to establish a risk management program designed to monitor and manage the risks associated with the FCM's activities as an FCM. It further provides: (1) That such risk management program consist of written policies and procedures; (2) that such policies and procedures be approved by the governing body of the FCM and be furnished to the Commission; and (3) that a risk management unit that is independent from the business unit be established to administer the risk management program.

Paragraph (b) of proposed § 1.11 establishes definitions for the terms ''Customer,'' ''Customer Account,'' ''Business Unit,'' ''Governing Body,'' ''Segregated Funds,'' and ''Senior Management.''

''Business Unit'' is defined to clearly delineate the separation of the risk management unit required by the proposed rule from the other personnel of an FCM.

The term ''Customer'' is defined broadly to include futures customers (as defined in § 1.3) trading futures contracts or options on futures contracts listed on designated contract markets, 30.7 Customers (as proposed to be defined in § 30.1) trading futures contract or options on futures contracts listed on foreign contract markets, and Cleared Swaps Customers (as defined in § 22.1) engaging in cleared swap transactions.

The term ''Customer Funds'' is defined to mean funds deposited by futures customers, 30.7 Customers, and Cleared Swap Customers as margin or funds accruing to such customers from open futures or cleared swap transactions. Existing Commission regulations require FCMs to hold each of these types of customer deposited funds, as applicable, in separate accounts and to segregate such Customer Funds from the FCM's own funds and from each other type.

The term ''Governing Body'' is defined as the sole proprietor, if the FCM is a sole proprietorship; a general partner, if the FCM is a partnership; the board of directors, if the FCM is a corporation; and the chief executive officer, chief financial officer, the manager, the managing member, or those members vested with the management authority if the FCM is a limited liability company or limited partnership. ''Senior Management'' is defined to mean any officer or officers specifically granted the authority and responsibility to fulfill the requirements of senior management by the Governing Body. These definitions, as used in proposed § 1.11, are designed to ensure that there is accountability at the highest levels for the FCM's key internal controls and processes designed to protect the funds of the FCM's customers.

The term ''Segregated Funds'' is defined to mean money, securities, or other property held by a futures commission merchant in separate accounts pursuant to § 1.20 for futures customers, pursuant to § 22.2 for cleared swaps customers, and pursuant to § 30.7 for foreign futures and options customers. The definition makes clear that the requirements of § 1.11 applies to all customer funds that may be held by an FCM.

Proposed § 1.11(c)(4) requires FCMs to provide copies of the risk management policies and procedures to the Commission and the FCM's DSRO in order to allow the Commission and DSROs to monitor the status of risk management practices among FCMs. Submission of such policies and procedures to the Commission without further comment or action by the Commission or Commission staff should not be construed as an endorsement of the completeness or effectiveness of the risk management policies and procedures and no FCM should make a representation to the contrary. The Commission invites comments on the submission of risk management policies and procedures and, more generally, on whether the provisions of § 1.11 have achieved a sufficient level of detail for the purposes of designing a comprehensive risk management program.

Proposed § 1.11(e) provides for a non-exclusive list of the elements that must be a part of the risk management program of an FCM. Such policies and procedures should include: (1) identifying risks (including risks posed by affiliates, all lines of business of the FCM, and all other trading activity of the FCM) and setting of risk tolerance limits; (2) providing periodic risk exposure reports to senior management and the governing body; (3) operational risk controls; (4) capital controls; and (5) establishing a risk management program that takes into account risks associated with the safekeeping and segregation of customer funds.

In regard to customer funds, the Commission notes that FCMs are required by the Act and Commission regulations to segregate and safeguard funds deposited by customers for trading futures and/or swap contracts. Recent events have emphasized that it is essential that FCMs maintain adequate systems of internal controls, involving the participation and review of the firm's senior management, in order to properly safeguard customer funds. Accordingly, proposed § 1.11(e)(3)(i) requires that the risk management policies and procedures of an FCM related to the risks associated with safekeeping and segregation of customer funds must include: (1) The evaluation and monitoring of depositories; [31] (2)

[30] Proposed § 1.11 contains an applicability provision in paragraph (a) that makes clear that the risk management program is only required of FCMs that accept money, securities, or property to margin or secure the trades or contracts of customers transacting in futures, options on futures, and swaps.

[31] The evaluation process must include documented criteria that any depository will be assessed against in order to qualify to hold funds

account opening procedures that ensure the FCM obtains the acknowledgment required under § 1.20 from the depository and that the account is properly titled as belonging to the customers of the FCM; [32] (3) establishing and maintaining an adequate targeted amount of excess funds in customer accounts reasonably designed to ensure the FCM is at all times in compliance with the segregation requirements for customer funds under the Act and Commission regulations, as discussed further below; (4) controls ensuring that withdrawal of cash, securities, or other property from accounts holding customer funds not for the benefit of customers are in compliance with the Act and Commission regulations; [33] (5) procedures for assessing the appropriateness of investing customer funds in accordance with § 1.25; [34] (6) the valuation, marketability, and liquidity of customer funds and permitted investments made with customer funds; (7) the appropriate separation of duties of personnel responsible for compliance with the Act and Commission regulations relating to the protection and financial reporting of customer funds; [35] (8) procedures for the timely recording of transactions in the firm's books and records; and (9) annual training of personnel responsible for compliance with the Act and Commission regulations relating to the protection and financial reporting of customer funds.

Regarding the proposed requirement that FCMs establish and maintain an adequate targeted amount of excess funds in customer accounts, the Commission notes that FCMs currently deposit proprietary funds into both customer segregated accounts and Part 30 secured accounts as a buffer to minimize the possibility of the firm being in violation of its segregated and secured fund obligations at any time. Under the proposal, senior management of the FCM must perform appropriate due diligence in setting the amount of this buffer and must consider the nature of the FCM's business including the type and general creditworthiness of its customer base, the types of markets and products traded by the firm's customers, the proprietary trading activities of the FCM, the volatility and liquidity of the markets and products traded by the customers and the FCM, the FCM's own liquidity and capital needs, and historical trends in customer segregation and secured account funds balances, customer debits and margin deficits. The FCM also must reassess the adequacy of the targeted residual interest quarterly.

The Commission believes that each FCM must set the amount of excess segregated and secured funds required utilizing a quantitative and qualitative analysis that reasonably ensures compliance at all times with segregated and secured fund obligations. Such analysis must take into account the various factors that could affect segregated and secured balances, and must be sufficiently described in writing to allow the DSRO of the FCM and Commission to duplicate the calculations and test the assumptions. The analysis must provide a reasonable level of assurance that the excess is at an appropriate level for the FCM.[36] A failure to adopt or maintain appropriate risk management policies and procedures or to implement, monitor and enforce controls required by § 1.11 may result in a referral to the Commission's Division of Enforcement for appropriate action.

Finally, to ensure the effectiveness of a risk management program, § 1.11(e)(4) requires that the risk management program include a supervisory system that is reasonably designed to ensure that the risk management policies and procedures are diligently followed. Furthermore, § 1.11(f) requires an annual review and testing of the adequacy of each FCM's risk management program by internal audit staff or a qualified external, third party service.

The Commission requests comment on all aspects of proposed § 1.11. Specifically, the Commission requests comment on the following:

- Should the Commission have different risk management requirements for FCMs based upon some measureable criteria, such as size of the firm or type of customers? How would the Commission design such criteria to distinguish between firms? Which elements in proposed § 1.11 should apply to smaller FCMs vs. larger FCMs? What elements should apply to all FCMs irrespective of the size of the firm?
- Does the proposed risk management program address the appropriate minimum elements that should be covered by an FCM risk management program?
- Regulation 3.3 requires the CCO of an FCM to provide an annual report to the Commission that must review each applicable requirement under the Act and Commission regulations, and with respect to each applicable requirement, identify the policies and procedures that are reasonably designed to ensure compliance with the requirement, and provide an assessment of the effectiveness of the policies and procedures.[37] The annual report also must include a certification by the CCO that, to the best of his or her knowledge and reasonable belief, and under penalty of law, the information contained in the annual report is accurate and complete. The Commission requests comment on whether the standard for the CCO's certification in the annual report (*i.e.,* based upon the CCO's knowledge and reasonable belief) is adequate for a certification of the FCM's compliance with policies and procedures for the safeguarding of customer funds. Should § 1.11 contain a separate CCO certification requirement

belonging to Customers. The criteria must address a depository's capitalization, creditworthiness, operational reliability, access to liquidity. The criteria must also address risks associated with concentration of Customer funds in any depository or group of depositories, the availability of deposit insurance, and the regulation and supervision of depositories. The evaluation criteria is intended to ensure that the FCM adopts an evaluation process which reviews potential depositories against substantive criteria relevant to the safe custody of Customer funds and that the FCM's process for evaluating and selecting depositories can be reviewed by regulators and auditors. The FCM also must maintain a documented process addressing the ongoing monitoring of selected depositories, including a thorough due diligence review of each depository at least annually.

[32] As required by § 1.20, such account opening documentation is necessary to ensure that the depositories are aware of their obligations regarding the accounts and the statutory and regulatory protections afforded the funds held in the accounts due to their status as Segregated Funds.

[33] The controls must include the conditions for pre-approval and the notice to the Commission for such withdrawals required by proposed § 1.23, § 22.17, or § 30.7, discussed below.

[34] The FCM's assessment must take into consideration the market, credit, counterparty, operational, and liquidity risks associated with the investments.

[35] The policies and procedures must provide for the separation of duties among personnel that are responsible for customer trading activities, and approving and overseeing cash receipts and disbursements (including investment and treasury operations). The policies and procedures must further require that any movement of funds to affiliated companies or parties be approved and documented.

[36] Separate from requiring the establishment of a target for residual interest, the Commission is further requiring, as discussed in more detail under Sections II.G, II.H, and II.I for §§ 1.20, 1.22, and 1.23, respectively, that residual interest at all times exceed the sum of outstanding margin deficits to provide a mechanism for ensuring compliance with the prohibition of the funds of one customer being used to margin or guarantee the positions of another customer under the Act and existing regulations.

[37] Such report is mandated by § 3.3 of the Commission's regulations; *See Swap Dealer and Major Swap Participant Recordkeeping, Reporting, and Duties Rules; Futures Commission Merchant and Introducing Broker Conflicts of Interest Rules; and Chief Compliance Officer Rules for Swap Dealers, Major Swap Participants, and Futures Commission Merchants,* 77 FR 20128, Apr. 3, 2012 (promulgating final rules concerning the CCOs of FCMs, swap dealers, and major swap participants); *see also* § 4d(d) of the Act, 7 U.S.C. 6d(d).

that would impose a higher duty of strict liability or some other higher obligation on a CCO?

- Should the risk management program require an FCM to conduct quarterly or periodic audits to detect any breach of the policies and procedures that address the proper segregation of customer funds?
- Should the Commission establish a phased-in compliance provision for § 1.11? If so, how long of a phase-in period should be provided? Should there be different phase-in periods for different provisions of the proposed regulation?

C. Proposed Amendments to § 1.12: Maintenance of Minimum Financial Requirements by Futures Commission Merchants and Introducing Brokers

The regulatory notices required under § 1.12 are intended to provide the Commission and SROs with prompt notice of potential adverse conditions at FCMs or IBs that may indicate or lead to a threat to the financial condition of the firm or the protection of customer funds held by the FCM. In adopting § 1.12 in 1978, the Commission stated that the establishment of an early warning system was necessary because ''[a] fundamental purpose of the Act is to protect the public from financially irresponsible FCMs who handle customer funds.'' [38]

Regulation 1.12 currently obligates FCMs and IBs to provide notice to the Commission and to the respective DSROs if certain specified reportable events occur. Reportable events include: failing to maintain the minimum level of required regulatory capital (§ 1.12 (a)); failing to maintain current books and records (§ 1.12(c)); and failing to comply with the requirements to properly segregate customer funds (§ 1.12(h)). The Commission is proposing to amend § 1.12 to include several additional reportable events and to revise the process for submitting reportable events to the Commission and DSROs.

Regulation 1.12(a) requires an FCM or IB that fails to maintain the minimum level of adjusted net capital required by § 1.17 to provide immediate notice to the Commission and to the entity's DSRO. The notice must include additional information to adequately reflect the FCM's or IB's current capital condition as of any date that the entity is undercapitalized.

The Commission is proposing to amend § 1.12(a) to explicitly provide that if the FCM or IB cannot compute or document its actual capital at the time it knows that it is undercapitalized, it must still provide the written notice required by § 1.12(a) immediately and cannot delay filing the notice until it has adequate information to compute its actual level of adjusted net capital. A purpose of the notice provision under § 1.12(a) is to provide the Commission and the DSROs with immediate notice of the undercapitalized condition of an FCM or IB. If an FCM or IB were to delay alerting the Commission that it was undercapitalized due to the fact that it could not accurately assess its capital condition, it would frustrate the intent of the notice provision. It is imperative that an FCM or IB provide immediate notice if the firm is undercapitalized. Upon the filing of a notice, Commission and SRO staff will contact the FCM or IB to obtain greater details of the financial condition of the firm, including information regarding its current financial condition or issues associated with the firm's inability to accurately determine its current financial condition.

Regulation 1.12(h) currently requires an FCM that fails to hold sufficient funds in segregated accounts to meet its obligations to futures customers, or that fails to hold sufficient funds in separate accounts for foreign futures or foreign options customers, to provide immediate notice to the Commission and to the FCM's DSRO. The Commission is proposing to amend paragraph (h) to include an explicit requirement that an FCM provide immediate notice to the Commission and to its DSRO if the FCM fails to hold sufficient funds in segregated accounts for Cleared Swaps Customers to meet its obligation to such customers.

Commencing November 8, 2012, the compliance date for certain Commission Part 22 regulations, FCMs will be required under § 22.2 to hold a sufficient amount of funds in Cleared Swaps Customer Accounts to meet the Net Liquidating Equity of each Cleared Swaps Customer.[39] Immediate notification of a failure to hold sufficient funds in segregation for Cleared Swaps Customers is essential for the Commission and DSROs to promptly assess the financial condition of an FCM and to determine if there are threats to the safety of the Cleared Swaps Customers' funds held by the FCM. The proposed amendment to § 1.12(h) also harmonizes the notice requirements whenever an FCM fails to hold sufficient funds for futures customers, 30.7 Customers, and Cleared Swaps Customers.

The Commission also is proposing to amend § 1.12 by adding new paragraph (i) to require an FCM to provide notice whenever it discovers or is informed that it has invested funds held for customers in investments that are not permitted investments under § 1.25, or if the FCM holds permitted investments in a manner that is not in compliance with the provisions of § 1.25 (such as the investment concentration limits). The proposal will apply to funds held for futures customers, 30.7 Customers, and Cleared Swaps Customers.

The protection of customer funds is a core element of the Commission's regulatory program. FCMs are entrusted with a responsibility to use customer funds only for the benefit of the depositing customers.[40] FCMs are permitted, however, to invest customer funds pursuant to the standards and conditions set forth in § 1.25. Regulation 1.25 contains a list of permitted investments and other criteria that are intended to allow an FCM to receive the benefit of investing customer funds while also preserving the principal and maintaining the liquidity of the customer funds.

Requiring an FCM to provide prompt notice of a § 1.25 violation will allow Commission and DSRO staff to assess whether customer funds are endangered and to work with the FCM to ensure that the impermissible investments are appropriately liquidated and customer funds remain intact. Commission and DSRO staff also will benefit from receiving notices of § 1.25 violations in that the notices will provide information regarding new investments that FCMs may engage in that are not permitted investments under § 1.25. Such information will be helpful for the Commission and DSRO in conducting reviews of other FCMs and in providing regulatory updates to the industry.[41]

The Commission also is proposing to amend § 1.12 to provide a new paragraph (j) that will require an FCM to provide immediate notice to the Commission and to the firm's DSRO if the FCM does not hold an amount of funds in segregated accounts for futures customers or for Cleared Swaps Customers, or if the FCM does not hold sufficient funds in separate accounts for 30.7 Customers, sufficient to meet the firm's targeted residual interest in one or more of these accounts as computed

[38] 43 FR 39956, 39967 (Sept. 8, 1978).

[39] 77 FR 6336 (Feb. 7, 2012).

[40] Regulation 1.20(a), 17 CFR 1.20(a).

[41] The Commission further notes that investing customer funds in investments that are not permitted investments under § 1.25, or holding investments in a manner that is otherwise not compliant with § 1.25 does not change the legal status of the funds as customer funds in the event of the bankruptcy of the FCM.

under proposed § 1.11, or if its residual interest in one or more of these accounts is less than the sum of outstanding margin deficits for such accounts. Proposed § 1.11 will require each FCM that carries customer funds to calculate an appropriate amount of excess funds (*i.e.,* proprietary funds) to hold in segregated or secured accounts to mitigate the FCM from being undersegregated or undersecured due to a withdrawal of proprietary funds from a segregated or secured account. The fact that an FCM is not holding a sufficient amount of excess funds in customer accounts to meet its targeted residual interest may be indicative of more severe financial or operational issues at the firm. In addition, if an FCM's residual interest is less than the sum of outstanding margin deficits in one such account, it is possible that funds of one customer in such account are at risk of margining or guaranteeing the open positions of another customer. Accordingly, the Commission is proposing to require an FCM to file immediate notice of such an event to allow Commission and DSRO staff to contact the FCM to assess the condition of the firm and the safety of customer funds.

The Commission also is proposing new paragraphs (k) and (l) for § 1.12. Paragraphs (k) and (l) will require an FCM to provide notice to the Commission and to the firm's DSRO in the event of a material adverse impact in the financial condition of the firm or a material change in the firm's operations. Proposed paragraph (k) will require an FCM to provide immediate notice if the FCM, its parent, or a material affiliate, experiences a material adverse impact to its creditworthiness or its ability to fund its obligations. Indications of a material adverse impact of an FCM's creditworthiness may include a bank or other financing entity withdrawing credit facilities, a credit rating downgrade, or the FCM being placed on ''credit watch'' by a credit rating agency. Proposed paragraph (l) will require an FCM to provide immediate notice of material changes in the operations of the firm, including: A change in senior management; the establishment or termination of a material line of business; a material change in the FCM's clearing arrangements; or a material change in the FCM's credit arrangements. Paragraph (l) is intended to provide the Commission with notice of material events, such as the departure of the FCM's CCO, CFO, or CEO.

As noted above, § 1.12 is intended to provide the Commission and DSROs with notice of potential issues that may impact the financial condition of an FCM or the safety of customer funds. The regulatory objective is for FCMs to provide material information to the Commission and DSROs as early as possible so that the Commission and DSROs can assess the information and communicate with the FCMs prior to a more serious issue developing that may impair the financial condition of the firms or the safety of customer funds. Proposed paragraphs (k) and (l) will provide the Commission and DSROs with notice of major events that will initiate a dialogue between the Commission, DSROs, and FCMs which will have the benefit of informing the Commission and DSROs of material events impacting FCMs. Such information would be used by the Commission and DSROs in setting the scope of the review and monitoring of the FCMs, including the determination of the risk of the firms for purposes of scheduling future examinations. Without paragraphs (k) and (l), the Commission and DSROs may not learn of material events at FCMs until the firms are subject to periodic examinations.

The Commission is proposing to add a new paragraph (m) to § 1.12 that will require an FCM that receives a notice, examination report, or any other correspondence from the SEC or a SRO to file a copy of such notice, examination report, or correspondence with the Commission. In order to perform comprehensive oversight of an FCM, the Commission and the DSROs need to receive prompt notice of any concern or adverse action taken by the SEC or a securities SRO. The protection of futures customers funds are not immune from issues that arise from the securities operations or business of a dual registrant FCM/BD. Requiring an FCM to provide prompt notice to the Commission and the firm's DSRO of any notice, examination report, or correspondence that the firm receives from the SEC or a securities SRO will allow the Commission and the DSRO to identify potential threats to the safety of customer funds.

The Commission is further proposing to amend the process that an FCM uses to file the notices required by § 1.12. Currently, § 1.12 requires an FCM to provide the Commission and DSROs with telephonic and facsimile notice in some situations, and to provide written notice by mail in other situations. An FCM also is permitted, but not required, to file notices and written reports with the Commission and with its DSRO using an electronic filing system in accordance with instructions issued by or approved by the Commission.

The Commission is proposing to amend § 1.12(n) to require that all notices and reports filed by an FCM with the Commission or with the FCM's DSRO must be in writing and submitted using an electronic filing system. Each FCM currently uses WinJammer to file regulatory notices with the Commission and with the firm's DSRO. The WinJammer system provides for the most effective mechanism for ensuring that regulatory notices are promptly received by the Commission and by the DSROs.[42] The regulation further provides that if the FCM cannot file a notice due to the electronic system being inoperable or for any other reason, it must contact the Commission Regional office with jurisdiction over the firm and make arrangements for the filing of the regulatory notices by filing the notice with the Commission via electronic mail at a specially designated email address established by the Commission; *fcmnotices@cftc.gov.* The Commission also is proposing to amend § 1.12(n) to require that each notice filed by an FCM, IB, or SRO under § 1.12 must include a discussion of what caused the reportable event, and what steps have been, or are being taken, to address the reportable event. The reporting entity, however, may not delay the reporting of a reportable event if it does not possess complete information on what caused the event, or the steps that have been taken or are being taken to address the event.

The amendments to §§ 1.12(b), (d), (e), (f) and (g) are necessary and technical in nature, and primarily revise internal cross-references to the filing requirements in § 1.12(n).

The Commission request comment on all aspects of the proposed amendments to § 1.12. Specifically, the Commission requests comment on the following:

- Are there other reportable events that the Commission should consider adding to § 1.12 that would benefit the Commission and the DSROs in the monitoring of the financial and operating conditions of FCMs?
- Should the Commission consider removing any of the reportable events listed in § 1.12? If so, why?
- Should any of the reportable events be made public by the Commission, SROs, or FCMs? If so, which reportable events? What benefit would the public receive from the disclosure of the reportable events? What would be the costs of disclosing the reportable events to the FCMs? Are there any negative

[42] The Commission's proposed amendment to require the electronic filing of reports applies to both registered FCMs and applicants for registration as FCMs. Applicants for FCM registration currently file regulatory notices with NFA using WinJammer.

impacts of disclosing the reportable events?

• Are the reporting standards in proposed paragraphs (k) and (l) adequately detailed and objective so that an FCM can determine when there is a reportable event? If not, what standards should the Commission use to define a reportable event under paragraphs (k) and (l)?

D. Proposed Amendments to § 1.15: Risk Assessment Reporting Requirement for Futures Commission Merchants

Regulation 1.15 requires FCMs to submit certain risk assessment reports to the Commission. The risk assessment filings include FCM organizational charts; financial, operational, risk management policies, and systems maintained by the FCM; and fiscal year-end consolidated and consolidating financial information for the FCM and its highest level material affiliate.

The Commission is proposing to amend § 1.15(a)(4) to require each FCM that is subject to § 1.15 to submit its risk assessment information to the Commission electronically in accordance with instructions issued by the Commission. The Commission intends for FCMs to file the risk assessment materials using the WinJammer electronic filing system. The Commission requests comments on its proposed amendments to § 1.15.

E. Proposed Amendments to § 1.16: Qualifications and Reports of Accountants

Regulation 1.16 sets forth the qualifications a public accountant must possess in order to conduct audits of Commission registrants. Currently, a public accountant must be registered and in good standing under the laws of the place of the public accountant's principal office in order to conduct examinations of FCMs.

The Commission is proposing to amend § 1.16(b)(1) to require that the public accountant be registered with the Public Company Accounting Oversight Board (''PCAOB'') in addition to being in good standing with the relevant state licensing authorities. In addition, the public accountant must have undergone an examination by the PCAOB and any deficiencies noted during such examination must have been remediated to the satisfaction of the PCAOB. Regulation § 1.16(b)(4) also will impose an obligation on an FCM's governing body to ensure that a public accountant is qualified to perform an audit of the FCM by assessing the firm's experience in auditing FCMs, the firm's experience and knowledge of the Act and Commission regulations, and the depth and experience of the firm's auditing staff.

The Commission also is proposing to amend § 1.16(c)(2) to require a public accountant to state in the audit opinion whether the audit was conducted in accordance with U.S. GAAS after full consideration of the auditing standards adopted by the PCAOB. Currently, all audits of the certified financial statements of FCMs must be performed under U.S. GAAS. However, as the Commission is now proposing that certified public accountants must be registered with the PCAOB, it is necessary to also require that the auditing standards promulgated by the PCAOB be considered and adhered to where applicable. PCAOB requires auditors opining on a public company financial statements to comply with all applicable auditing standards, including PCAOB standards; whereas U.S. GAAS is required for the audits of non-public companies.

In 2003, the PCAOB adopted existing U.S. GAAS as interim standards, subject to periodic revision as the PCAOB deemed necessary. Since that time, the PCAOB has issued its own auditing standards in areas of the audit in which differentiated audit procedures or reporting requirements have been considered necessary. These areas largely pertain to audits of internal control over financial reporting as well as reports on those controls, audit documentation and engagement quality review. Generally speaking, the most significant difference between U.S. GAAS and PCAOB standards relates to the auditor's testing of internal controls over financial reporting which are meant to cover the auditor's opinion on the Sarbanes-Oxley Act Section 404 report on internal controls. From a regulatory perspective, an auditor's focus on internal controls is critical to helping to ensure that material errors in financial or regulatory reporting are identified on a timely basis, and the PCAOB standards provide more focus on the auditing standards in this regard. It should also be noted that auditors of BDs are now required to register with the PCAOB and follow PCAOB standards; thus, any dually-registered FCM/BDs will already have to comply with this requirement.

The proposed amendments to §§ 1.16(b)(1) and (c)(2) are designed to reasonably ensure the quality and competence of public accountants that engage in the audits of FCMs. FCMs are sophisticated financial market participants that are subject to extensive regulation. In addition, the complexity of FCM audits is increased substantially when a firm is engaged in proprietary trading or dually-registered as an FCM/BD. Public accountants must be knowledgeable regarding the business operations, regulatory obligations and financial reporting requirements for FCMs, and the governing body of the FCM must ensure that the public accountant has the knowledge, experience, and resources to conduct the audits. Also, requiring the public accountant to be registered with PCAOB will ensure that the public accountant is subject to periodic reviews to assess its compliance with industry standards.

While the Commission does not expect the proposed PCAOB registration requirement to have a material impact on FCMs, it recognizes that not all FCMs currently use CPAs that are registered with the PCAOB or CPAs that have been subject to an examination by the PCAOB. Currently, 111 of the 116 FCMs are examined by CPAs that are registered with the PCAOB. Also, 12 CPAs that are registered with the PCAOB have not yet been subject to a PCAOB examination. These 12 CPAs conduct examinations of 20 FCMs. Therefore, currently 25 of the 116 FCMs would not satisfy the proposed requirement that only PCAOB-registered CPAs that have been subject to at least one PCAOB review may be engaged to conduct an examination of the FCM's financial statements.[43]

The Commission is proposing a technical amendment to § 1.16 to revise the definition of the term ''customer.'' Regulation 1.16 details the standards that a public accountant must meet in conducting a financial examination of an FCM. Currently, § 1.16(a)(4) defines the term ''customer'' to include futures customers, Cleared Swaps Customers, and foreign futures or foreign options customers. The Commission is proposing to amend § 1.16(a)(4) to revise the definition of customer to replace the term ''foreign futures or foreign options customer'' with the term ''30.7 Customer'' to make the provision consistent with the amendments contained in Part 30 of the Commission's regulations.

The Commission also is proposing to amend paragraph (f)(1)(i)(C) of § 1.16 to provide that any filing of a notice of the extension of time to file the audited financial reports must be submitted by the FCM to the Commission using an electronic filing system. The Commission intends for FCMs to use the WinJammer electronic filing system.

[43] The Commission further notes, however, that 7 of the 20 FCMs are audited by a PCAOB-registered CPA that also conducts audits of BDs or public companies and, therefore, will be subject to PCAOB examination at a future date.

The Commission also is proposing to remove the requirement from § 1.16(c)(1) that annual financial reports contain the manual signature of the public accountant. Under the proposed amendments to § 1.10 discussed above, FCMs will be filing annual financial reports electronically, which will preclude the use of manual signature.

The Commission requests comment on all aspects of proposed § 1.16. Specifically, the Commission request comment on the following:

- A purpose of the requirement that FCMs engage only CPAs that are registered with the PCAOB and have been reviewed by the PCAOB is to enhance the quality of the audit examination conducted by CPAs. Does the PCAOB registration and examination process enhance the quality of FCM audit engagements?
- Are there viable alternatives that the Commission should consider to enhance the quality of CPA FCM examinations in lieu of PCAOB registration and examination?
- Should the Commission consider allowing the non-PCAOB registered CPAs or PCAOB-registered CPAs that have not been subject to a PCAOB review to contractually engage for a peer review from a qualified CPA who is aware of the reason for the peer review as a short-term measure to allow the non-compliant CPAs to continue to conduct audits of FCMs?
- If the Commission adopts the PCAOB registration and examination requirement, how should the Commission implement the effective or compliance dates? What factors should the Commission consider in setting an effective date or compliance date for this provision?

F. Proposed Amendments to § 1.17: Minimum Financial Requirements for Futures Commission Merchants and Introducing Brokers

The Commission is proposing to amend § 1.17 by adding a new provision that will authorize the Commission to require an FCM to transfer its customer business and cease operating as an FCM if the FCM cannot immediately certify to the Commission, and demonstrate with verifiable evidence, that the FCM has sufficient access to liquidity to continue operating as a going concern. The Commission also is proposing to amend § 1.17 to permit an FCM that is not a dually-registered FCM/BD to develop the framework proposed by the SEC, as set forth below, to establish, maintain and enforce written policies and procedures for determining creditworthiness, and upon a determination that a particular type of security has minimal credit risk, to apply lower deductions to such securities in computing the FCM's adjusted net capital.

Section 4f(b) of the Act provides that no person may be registered as an FCM unless such person meets the minimum financial requirements that the Commission has established by regulation to ensure that an FCM meets its obligations at all times as an FCM to its customer and to market participants, including DCOs. The Commission's minimum capital requirements for FCMs are set forth in § 1.17 and generally require an FCM to maintain adjusted net capital equal to or in excess of the greater of: $1 million; 8 percent of the risk maintenance margin required on customer and non-customer futures and options on futures positions carried by the FCM;[44] the amount of adjusted net capital required by the NFA; or, for dual-registrants, the amount of net capital required by the SEC. The term ''adjusted net capital'' is generally defined as the FCM's net, liquid assets less all of the FCM's liabilities (except certain qualifying subordinated debt). In computing its adjusted net capital, an FCM is required to reduce the value of proprietary futures and securities positions included in its liquid assets by certain prescribed amounts or percentages of the market value (otherwise known as ''haircuts'') to discount for potential adverse market movements in the securities.

Commission Regulation 1.17(a)(4) currently provides that an FCM must cease operating as an FCM and transfer its customers positions to another FCM if the FCM is not in compliance with the minimum capital requirements, or is unable to demonstrate its compliance with the minimum capital requirements. The FCM, however, can initiate customer trades for liquidation purposes only. Regulation 1.17(a)(4) further provides that the Commission or the FCM's DSRO may grant the FCM up to a maximum of 10 days to come back into compliance with the minimum capital requirements without having to cease operating as an FCM or transferring customer accounts.

The Commission is proposing to add an additional clause to § 1.17(a)(4), which will specify that the Commission may request certification in writing from an FCM that it has sufficient liquidity to continue operating as a going concern, and that if such certification is not provided immediately or the FCM is not able to demonstrate its access to liquidity with verifiable evidence, the FCM must transfer all customer accounts and immediately cease doing business as an FCM. The proposed liquidity provision is intended to cover circumstances that require immediate attention. The proposal is not intended to provide a mechanism for the Commission to require FCMs to demonstrate that they are a going concern for an extended period of time into the future. Rather, the purpose of the proposal is to provide the Commission with a means of addressing exigent circumstances by requiring an FCM to produce a written analysis showing the sources and uses of funds over a short period of time not to exceed one week.

The Commission believes this clause provides additional protection to customers in the event of an imminent liquidity drain on a registrant, which may not be immediately reflected in its accounting or regulatory capital business records. Market events or other external indicators may come to the attention of the Commission which suggest an FCM is under severe liquidity stress, which demonstrates that although the firm is still able to demonstrate compliance with required regulatory capital, conditions are such that it will not be able to meet liquidity requirements out a period of time not to exceed one week. This provision will allow the Commission to essentially require an FCM on demand to be able to certify its access to liquidity sufficient to continue operating as a going concern for a period not to exceed one week. The inability of the FCM to satisfy this requirement will allow the Commission to direct the FCM to transfer customer accounts and cease doing business as an FCM.

The Commission believes the ability to certify, and if requested, demonstrate with verifiable evidence, sufficient liquidity to operate as a going concern to meet immediate financial obligations, is a minimum financial requirement necessary to ensure an FCM will continue to meet its obligations as a registrant as set forth under § 4(f)(b) of the Act. The certification required must satisfy the same oath or affirmation requirements as those required for the submission of monthly financial reports under § 1.10(d)(4), to ensure that it is made by an appropriate individual and that it is in writing under oath of the individual that it is true and correct to the best knowledge and belief of such individual. If a registrant certifies to the Commission its access to liquidity, but is not able to demonstrate with sufficient evidence such liquidity (for example such evidence may include confirmations by third parties of access

[44] The term ''noncustomer'' is generally defined under § 1.17 as affiliates or management of an FCM.

to credit lines with available credit or of unrestricted cash balances available to meet projected short term cash requirements), the Commission believes it would be prudent to require the registrant to transfer customer accounts. Circumstances related to a liquidity drain could also result in a breakdown of management controls and result in an erroneous or false certification, and in such circumstances, the protection of customers must be paramount. The Commission requests comment on the proposed additional clause to § 1.17(a)(4).

Regulation 1.17 further requires an FCM to take a haircut against the value of securities the FCM holds as investments of customer funds under § 1.25. A primary purpose of these haircuts is to provide a margin of safety against losses that might be incurred by the FCM as a result of market fluctuations in the prices of, or lack of liquidity in, the security positions.

For futures positions, an FCM that is a member of the clearing organization where the positions are cleared is required to take a haircut equal to the margin required by the clearing organization on such futures positions.[45] For securities positions, § 1.17 incorporates by reference the securities haircuts that a BD is required to take in computing its net capital under the SEC's regulations.[46] The structure of the Commission's net capital rule referring to the SEC's net capital rule is a result of the Commission's determination to defer to the SEC in areas of its expertise, specifically with respect to market risk and appropriate haircuts on securities positions.[47]

The SEC capital rule currently applies a general or ''default'' haircut of 15 percent of the market value of commercial paper, convertible debt instruments, and nonconvertible debt instruments if the securities are readily marketable, and 100 percent of the market value if the securities are not readily marketable. The SEC capital rule also provides for a lower haircut for commercial paper, convertible debt instruments, and nonconvertible debt instruments if the securities are rated in higher rating categories by at least two nationally recognized statistical rating organizations (''NRSROs''). To receive the benefit of a reduced haircut on commercial paper, the commercial paper must be rated in one of the three highest rating categories by at least two NRSROs. To receive the benefit of a reduced haircut on a nonconvertible debt security or a convertible debt security, the security must be rated in one of the four highest rating categories by at least two NRSROs.

The SEC has proposed rule amendments to implement the Dodd-Frank Act requirement to remove references to credit ratings in its regulations and substitute a standard for creditworthiness deemed appropriate, including a proposed amendment to its net capital rule for BDs at 17 CFR 240.15c3–1.[48] Under the SEC proposal, a BD may impose the default haircuts of 15 percent of the market value of readily marketable commercial paper, convertible debt, and nonconvertible debt instruments or 100 percent of the market value of nonmarketable commercial paper, convertible debt, and nonconvertible debt instruments. A BD, however, may impose lower haircut percentages for commercial paper, convertible debt, and nonconvertible debt instruments that are readily marketable, if the BD determines that the investments have only a minimal amount of credit risk pursuant to its written policies and procedures designed to assess the credit and liquidity risks applicable to a security.

Under the SEC proposal, the BD's written policies and procedures may assess a security's credit risk using the following factors, to the extent appropriate, instead of exclusively relying on NRSROs ratings:

- Credit spreads (*i.e.,* whether it is possible to demonstrate that a position in commercial paper, nonconvertible debt, and preferred stock is subject to a minimal amount of credit risk based on the spread between the security's yield and the yield of Treasury or other securities, or based on credit default swap spreads that reference the security);
- Securities-related research (*i.e.,* whether providers of securities-related research believe the issuer of the security will be able to meet its financial commitments, generally, or specifically, with respect to securities held by the broker-dealer);
- Internal or external credit risk assessments (*i.e.,* whether credit assessments developed internally by the broker-dealer or externally by a credit rating agency, irrespective of its status as an NRSRO, express a view as to the credit risk associated with a particular security);
- Default statistics (*i.e.,* whether providers of credit information relating to securities express a view that specific securities have a probability of default consistent with other securities with a minimal amount of credit risk);
- Inclusion on an index (*i.e.,* whether a security, or issuer of the security, is included as a component of a recognized index of instruments that are subject to a minimal amount of credit risk);
- Priorities and enhancements (*i.e.,* the extent to which a security is covered by credit enhancements, such as overcollateralization and reserve accounts, or has priority under applicable bankruptcy or creditors' rights provisions);
- Price, yield and/or volume (*i.e.,* whether the price and yield of a security or a credit default swap that references the security are consistent with other securities that the broker-dealer has determined are subject to a minimal amount of credit risk and whether the price resulted from active trading); and
- Asset class-specific factors (*e.g.,* in the case of structured finance products, the quality of the underlying assets).

A BD that maintains written policies and procedures and determines that the credit risk of a security is minimal is permitted under the SEC proposal to apply the lesser haircut requirement currently specified in the SEC capital rule for commercial paper (*i.e.,* between zero and ½ of 1 percent), nonconvertible debt (*i.e.,* between 2 percent and 9 percent), and preferred stock (*i.e.,* 10 percent).

For FCMs that are dually-registered as BDs, any changes adopted by the SEC to these securities haircuts will be applicable under § 1.17(c)(5)(v) unless the Commission specifically provides an alternate treatment for FCMs.[49] However, FCMs that are not dual registrants would be required to take the default haircuts of 15 percent for readily marketable securities. The Commission does not believe that it is appropriate to exclude standalone FCMs from using an internal process to assess the credit risk of certain securities. Therefore, the Commission's proposed amendment to § 1.17(c)(v) will permit an FCM that is not a BD to develop the framework proposed by the SEC to establish, maintain and enforce written policies and procedures for determining creditworthiness, and upon a determination that a particular type of security has minimal credit risk, to apply lower deductions to such

[45] *See* § 1.17(c)(5)(x)(A).

[46] Commission Regulations 1.17(c)(5)(v) and 1.32(b) both incorporate 17 CFR 240.15c3–1(c)(2)(vi) by reference.

[47] *See* 43 FR 15072 (Apr. 10, 1978) at 15077 and 43 FR 39956 (Sept. 8, 1978) at 39963.

[48] *See* 76 FR 26550 (May 6, 2011).

[49] See discussion adopting § 1.17(c)(5)(vi) for options haircuts at 43 FR 39956 at 39964, with respect to the applicability of provisions incorporating by reference and referring to the rules of the SEC for securities broker dealers also registered as futures commission merchants.

securities. An FCM will be required to maintain its written policies and procedures in accordance with the general recordkeeping requirements of § 1.31, and the implementation of the policies and procedures will be subject to review by the FCM's DSRO. An FCM that elects to develop written policies and procedures will be subject to review by its DSRO.

Regulation 1.17 also requires an FCM to reduce its capital (*i.e.,* take a capital charge) for customer, noncustomer, and omnibus accounts that are undermargined for more than a specified period of time. Regulation 1.17(c)(5)(viii) requires an FCM to take a capital charge if a customer account is undermargined for three business days after the margin call is issued. The capital charge is equal to the amount of funds necessary to restore the account to the initial margin requirement.

Regulation 1.17(c)(5)(ix) requires an FCM to take a capital charge for noncustomer and omnibus accounts that are undermargined for two business days after the margin call is issued. The capital requirement for undermargined noncustomer and omnibus accounts is the amount of funds necessary to restore the account to the maintenance margin level.

For purposes of these Commission regulations, a margin call is presumed to be issued by the FCM the day after an account becomes undermargined. Thus, if a customer's account is undermargined at the close of business on Monday, the FCM will issue a margin call on Tuesday, and the regulation requires the FCM to take an undermargined capital charge at the close of business on Friday if the margin call is not met. For noncustomer and omnibus accounts that were undermargined at the close of business on Monday, the FCM would take a capital charge as of the close of business on Thursday.

The Commission is proposing to amend §§ 1.17(c)(5)(viii) and (ix) to require an FCM to take capital charges for undermargined customer, noncustomer, and omnibus account that are undermargined for more than one business day after a margin call is issued. Therefore, an FCM will impose a capital charge as of the close of business on Wednesday for any customer, noncustomer, or omnibus account that did not fully satisfy a margin call that is issued by the FCM on Tuesday for an account that was undermargined as of the close of business on Monday.

The timely collection of margin is a critical component of an FCM's risk management program and is intended to ensure that an FCM holds sufficient funds deposited by account owners to meet potential obligations to a DCO. As guarantor of the financial performance of the customer, noncustomer, and omnibus accounts that it carries, the FCM is financially responsible if the owner of an account cannot meet its margin obligations to the FCM and ultimately to a DCO. The timeframe for meeting margin calls currently provided in §§ 1.17(c)(5)(viii) and (ix) may have been appropriate when the capital rules were adopted in the 1970s when the use of checks and the mail system were more prevalent for depositing margin with an FCM. The Commission believes, however, that in today's markets, with the increasing use of technology, 24-hour-a-day trading, and the use of wire transfers to meet margin obligations, that the timeframe for taking a capital charge should be reduced both to incentivize FCMs to exercise prudent risk management and to strengthen the financial protection of FCMs, their customers, and the clearing systems by requiring the FCMs to reserve capital for undermargined customer, noncustomer, and omnibus accounts that fail to meet a margin call on a timely basis.

The Commission also is proposing, as discussed in Section II.I below, to require an FCM to maintain a residual interest in customer segregated accounts in an amount sufficient to cover all customer accounts that are undermargined as of the close of business on the previous trading day, thereby ensuring that residual interest in customer segregated accounts exceeds the sum of outstanding margin calls for customers, and that the funds of one customer are not used to margin or guarantee the positions of another customer. The FCM may only maintain as residual interest cash and assets that qualify as permitted investments under § 1.25. Margin deficits will be calculated as enough to restore the customer's account equity to the maintenance margin requirement on the account.

The Commission also is proposing technical amendments to certain definitions in § 1.17 to reflect proposed changes discussed in Section II.R below concerning the § 30.7 secured amount calculation. The § 1.17(b)(2) and (7) definitions of the terms ''customer'' and ''customer account'' are being proposed to be amended, the first to include ''30.7 Customer'' (which is a new definition being proposed in § 30.1 to include foreign domiciled persons) and the second to remove surplus language due to the revised definition of ''customer.''

The Commission requests comment on the proposed amendments to § 1.17. Specifically, the Commission requests comment on the following:

- Does the proposed amendment to require an FCM to certify that it has sufficient liquidity to operate as a going concern provide a sufficient and objective standard for FCMs to assess whether they are in compliance with the provision? Are there alternative standards or approaches that the Commission should consider to meet its objective of ensuring that an FCM has sufficient liquidity to meet its pending short-term obligations so that customer funds would not be put at risk in the event of the insolvency of the FCM?
- Should the Commission consider alternative timeframes for the imposition of a capital charge for undermargined accounts?

G. Proposed Amendments to § 1.20: Futures Customer Funds To Be Segregated and Separately Accounted for

The Commission is proposing to reorganize the structure of § 1.20 by providing additional paragraph subdivisions to the existing specific requirements, applying headings to the regulation to assist in the reading and understanding of the regulation. The Commission also is proposing to add new provisions designed to enhance the protection of customer funds.

Regulation 1.20 implements the provisions of section 4d(a)(2) of the Act, which provides, in relevant part, that an FCM must: (1) Separately account for all futures customer funds and segregate such funds as belonging to its futures customers; (2) not commingle futures customer funds with the FCM's proprietary funds; (3) not use the funds of one futures customer to margin or extend credit to any person other than to the futures customer that deposited the funds; and (4) deposit futures customer funds in any bank, trust company or DCO.

Paragraph (a) of § 1.20 sets forth the general principle under section 4d(a)(2) of the Act by requiring an FCM to separately account for all futures customer funds and to segregate such funds from the FCM's proprietary funds by depositing them under an account name that clearly shows that the funds are futures customer funds and segregated as required by the Act. Paragraph (g)(1) applies the same general principle to futures customer funds received by a DCO from its members.

Paragraph (a) also requires each FCM to perform appropriate due diligence on all depositories in accordance with its risk management policies and procedures required under proposed

§ 1.11 to ensure that the depositories holding customer funds are financially sound. The FCM must annually update its due diligence.

Paragraph (a) of § 1.20 also provides that an FCM must be in compliance with its segregation obligations at all times. It is not sufficient for an FCM to be in compliance at the end of a business day, but to fail to meet its segregation obligations on an intra-day basis. If an FCM was not in compliance with the segregation requirements on an intra-day basis that would necessarily mean that the FCM was using the funds of one customer to margin positions of another customer or to cover losses of another customer.

Paragraph (b) of § 1.20 lists the permitted depositories for futures customer funds as any bank, trust company, derivatives clearing organization, or another FCM. These permitted depositories are listed in existing § 1.20 and the Commission is not proposing to amend the list. Proposed paragraph (g)(2) lists the permitted depositories for futures funds received by a DCO as any bank or trust company, and clarifies that the term ''bank'' includes a Federal Reserve Bank. This proposed amendment implements section 806(a) of the Dodd-Frank Act, which provides that a Federal Reserve Bank may establish and maintain a deposit account for a ''financial market utility'' (in the present case, a DCO) that has been designated as systemically important.

Paragraph (c) provides that an FCM may hold futures customer funds in depositories outside of the United States only in accordance with the current provisions of § 1.49. Paragraph (g)(3) sets forth the same limitation for a DCO. Regulation 1.49 currently permits an FCM or DCO to hold futures customer funds in certain foreign depositories provided that the FCM or DCO holds sufficient funds in the United States to meet its U.S. dollar-denominated obligations to futures customers. Regulation 1.49 also requires specific futures customer authorization for an FCM or DCO to hold futures customer funds in certain foreign jurisdictions. The Commission is not proposing to amend § 1.49 as part of this rulemaking.

Proposed § 1.20(e) prohibits an FCM from commingling futures customer funds with the FCM's proprietary funds, and prohibits the FCM from commingling funds deposited by futures customers with funds deposited by 30.7 Customers or Cleared Swaps Customers. Regulation 1.20(e), however, does permit an FCM to commingle the funds of multiple futures customers in a single account or accounts for operational convenience. Similarly, proposed § 1.20(g)(5) prohibits a DCO from commingling futures customer funds with the DCO's proprietary funds or with any proprietary account of any of its clearing members, and prohibits the DCO from commingling funds held for futures customers with funds deposited by clearing members on behalf of their Cleared Swaps Customers. DCOs would be permitted to commingle the funds of multiple futures customers in a single account or accounts for operational convenience.

Proposed § 1.20(f) restricts an FCM's use of customer funds. An FCM is prohibited from using one futures customer's funds to margin or secure another futures customer's positions. An FCM also is prohibited from using a futures customer's funds to extend credit to any other person. The FCM also may obligate futures customers' funds to a DCO or another FCM solely to purchase, margin, or guarantee futures and options positions of futures customers.

The Commission is proposing a new paragraph (h) which states that all futures customer funds deposited with a bank or trust company must be available for immediate withdrawal upon demand by the FCM or DCO. Paragraph (h) codifies a long-standing interpretation of the Commission's Division of Swap Dealer and Intermediary Oversight and predecessor divisions derived from an administration determination by the Commission's predecessor, the Commodity Exchange Authority of the U.S. Department of Agriculture.[50] The requirement, as proposed, is a practical necessity to the effective functioning of FCMs and futures markets. Should a depository have the ability to delay an FCM from withdrawing customer funds, the FCM may not be able to meet margin obligations to DCOs, or requests by futures customers for access to their funds. In addition, an inability of an FCM to have immediate access to the futures customer funds that it holds may adversely impact the transfer of futures customers positions in the event of the FCM's insolvency.[51]

- The Commission is proposing a new paragraph (i), which mirrors what was recently adopted in Part 22 for Cleared Swaps Customers, by providing more detail implementing the Net Liquidating Equity Method of calculating segregation requirements. In addition, because a customer may have Net Liquidating Equity (*i.e.,* a credit balance) in his or her account, requiring segregation of his or her funds, and still be undermargined relative to open positions, proposed paragraph (i) requires an FCM to record in the accounts of its futures customers the amount of margin required for such customers' open positions, and to calculate margin deficits for each such customer. Moreover, the Commission is proposing to require that an FCM maintain residual interest in segregated accounts in an amount that exceeds the sum of all futures customers' margin deficits. A margin deficit occurs when the value of the futures customer funds for a futures customer's account is less than the total amount of collateral required by DCOs for that account's contracts. Currently, the Commission requires FCMs to hold sufficient funds in segregated futures customer accounts to ensure that those accounts do not become undersegregated. Proposed new paragraph (i) will affirmatively require an FCM to maintain enough funds in the futures customer accounts to cover all margin deficits as well as to ensure that the accounts are not undersegregated. The Commission requests comments on all aspects of proposed new § 1.20(i), including the costs and benefits of this proposed regulation. The Commission specifically requests comment on the following:
- Will this proposal serve to increase the protections to customer funds in the event of an FCM bankruptcy?
- To what extent would this proposal increase costs to FCMs and/or futures customers?
- To what extent would this proposal benefit futures customers and/or FCMs?
- To what extent would this proposal increase or mitigate market risk?
- To what extent would this proposal lead to FCMs requiring customers to provide margin for their trades before placing them?
- To what extent is this likely to lead to a re-allocation of costs from customers with excess margin to undermargined customers?
- For purposes of margin deficit calculations, should the Commission

[50] *See* Administrative Determination No. 29 of the Commodity Exchange Administration dated Sept. 28, 1937 stating, ''the deposit, by a futures commission merchant, of customers' funds * * * under conditions whereby such funds would not be subject to withdrawal upon demand would be repugnant to the spirit and purpose of the Commodity Exchange Act. All funds deposited in a bank should in all cases by subject to withdrawal on demand.''

[51] In the case of the bankruptcy of Lehman Brothers, for example, immediate access to customer funds allowed the commodity customer accounts to be effectively transferred to Barclays over the weekend of September 20–21, 2008, immediately following the commencement of the liquidation of the firm. This transfer was authorized in the hours immediately following the commencement of Lehman's liquidation, and was implemented in the hours immediately thereafter.

address issues surrounding the timing of when an FCM must have sufficient funds in the futures customer account to cover all margin deficits? If so, how should the Commission address such issues?

In addition to the foregoing, the Commission also is proposing to revise requirements regarding the written acknowledgment letter that an FCM or DCO is required to obtain from a depository holding futures customer funds. Regulation 1.20 currently requires an FCM or DCO to obtain a written acknowledgment from each depository, unless the depository is a DCO that has rules approved by the Commission providing for the segregation of customer funds. The written acknowledgment must state that the depository was informed that the futures customer funds deposited belong to futures customers and are being held in accordance with the provisions of the Act and Commission regulations.

The Commission previously proposed amendments to the acknowledgment letter regulations. On February 20, 2009, the Commission published proposed amendments to §§ 1.20, 1.26, and 30.7 for public comment (the ''Original Proposal'').[52] The Original Proposal set out specific representations that would have been required to be included in all acknowledgment letters in order to reaffirm and to clarify the obligations that depositories incur when accepting customer funds or secured amount funds.[53]

In light of the comments on the Original Proposal, the Commission determined to re-propose the amendments with several changes made in response to comments (the ''Revised Proposal'').[54] As part of the Revised Proposal, the Commission proposed the required use of standard template acknowledgment letters which were included as Appendix A to each of § 1.20 and 1.26, and Appendix E to Part 30 of the Commission's regulations (referred to herein as the ''Template Letters'' or ''Acknowledgment Letters'').

The Commission received nine comment letters on the Revised Proposal.[55] In general, the commenters were supportive of the Commission's Revised Proposal and, in particular, were very supportive of requiring the use of Template Letters. It was noted by certain commenters that use of a standard template will simplify the process of obtaining an Acknowledgment Letter.[56] In addition, it was noted by commenters that uniformity of Acknowledgment Letters will provide consistency and legal certainty across the commodities and banking industries.[57]

The Commission is proposing revised amendments to the Acknowledgment Letters in this release to address several issues that have arisen as a result of the recent MF Global and Peregrine failures and the adverse impact on customers that had funds on deposit with these FCMs. The additional amendments are discussed below. The Commission also has revised the Acknowledgment Letters to address comments to the Revised Proposal. These revisions are discussed immediately below.

1. Obligation To Obtain New Acknowledgment Letters

Under the Revised Proposal, an FCM or DCO would be required to obtain a new Acknowledgment Letter within 60 days of changes in the name of any party to the Acknowledgment Letter or changes to the account number(s) under which customer funds are held. FIA stated that it is unduly burdensome to require the parties to execute a new Acknowledgment Letter in the event of a party changing its name within 60 days of the event.[58] FIA recommended instead including ''binding effect'' language in the Template Letters to ensure parties remain subject to the applicable provisions.[59] If the Commission determines to adopt the amendment requirement, FIA requested that the time period be extended from 60 to 120 days because a change in name often occurs in the context of a merger or acquisition in which case the relevant party will be in the process of amending numerous agreements and related documentation.

The Commission has determined to add to the Template Letter the ''binding effect'' language as proposed by FIA, as this language will ensure the continued applicability of the Acknowledgment Letter in the event of a name change to the parties. The Commission, however, is proposing to require that FCMs and DCOs file new Acknowledgment Letters in the event of a name, address, or other change as specified in the proposed rule because the Commission believes it is important to maintain current and accurate Acknowledgment Letters to provide clear legal status of the customer account, which will better protect customers in the event of a dispute regarding the legal status of the account. The Commission is proposing a 120-day time period for an FCM to obtain new Acknowledgment Letters. Given the use of the Template Letter, which is not open to negotiation, and electronic filing, the Commission believes that 120 days is a sufficient period of time for FCMs and DCOs to obtain and file the new Acknowledgment Letters.

2. Technical Amendments to Acknowledgment Letter for Omnibus Accounts; Abbreviation of Account Names

Regulation 1.20 provides that customer funds, when deposited with a depository, ''shall be deposited under an account name that clearly identifies them as such and shows that they are segregated as required by the Act and [Part 1 of the CFTC Regulations].'' FIA noted that the account naming convention used in the proposed forms of Template Letters[60] may present certain issues with respect to Acknowledgment Letters obtained by FCMs maintaining customer funds with

[52] 74 FR 7838 (February 20, 2009).

[53] The Commission notes that both the current and proposed definition of ''customer funds'' in Regulation 1.3(gg) do not include ''secured amount funds'' as defined in Regulation 30.7 (*i.e.,* funds deposited by foreign futures or foreign options customers). See 76 FR 33066, 33085 (June 7, 2011). However, as used in this notice, unless otherwise specified, the term ''customer funds'' is meant to include secured amount funds. The regulations adopted by this notice are also being amended to use the term ''customer'' as newly proposed (*i.e.,* in this rulemaking the Commission is deleting references to ''commodity or option customers''. As necessary, the Commission distinguishes between the two types of funds in this notice by referring to ''customer segregated funds'' and ''customer secured amount funds.''

[54] 75 FR 47738 (Aug. 9, 2010).

[55] Letters were submitted by: Hunton & Williams on behalf of the Working Group of Commercial Energy Firms (''Energy Working Group''); International Derivatives Clearinghouse LLC (''IDCH''); Futures Industry Association (''FIA''); Harris, N.A. (''Harris''); Katten Muchin Rosenman LLP (''Katten''); CME Group Inc. (''CME''); The Minneapolis Grain Exchange (''MGEX''); JPMorgan Chase Bank, N.A. (''JP Morgan''); and The Federal Reserve Bank of Chicago, Financial Markets Group (''FRB Chicago'').

[56] *See* MGEX CL–00007 at 1; FIA CL–00003 at 2; Harris CL–00004 at 1.

[57] *See* MGEX CL–00007 at 1; CME CL–00006 at 2; FRB Chicago CL–00010 at 1.

[58] FIA CL–00003 at page 2.

[59] FIA suggests, for example, the following language: ''The terms of this letter shall remain binding upon the parties, their successors and assigns, including for the avoidance of doubt, regardless of the change in name of any party.'' FIA CL–00003 at page 2.

[60] Proposed Appendix A to Regulation 1.20 provides that the Account will be entitled ''[Name of Futures Commission Merchant or Derivatives Clearing Organization] CFTC Regulation 1.20 Customer Segregated Account.'' 75 FR 47738, 47743 (Aug. 9, 2010); Proposed Appendix A to Regulation 1.26 provides that the Account will be entitled ''[Name of Futures Commission Merchant or Derivatives Clearing Organization] CFTC Regulation 1.26 Customer Segregated Money Market Mutual Fund Account.'' 75 FR 47738, 47744 (Aug. 9, 2010); and Proposed Appendix E to part 30 provides that the Account will be entitled ''[Name of Futures Commission Merchant] CFTC Regulation 30.7 Customer Secured Account.'' 75 FR 47738, 47745 (Aug. 9, 2010).

another FCM through a customer omnibus account relationship.[61] The first issue is with respect to operational limits on the number of characters available for account names. Secondly, naming conventions for such accounts typically include the words ''Customer Omnibus Account'' and the relevant account number. FIA accordingly requested the Commission to clarify that the Template Letters may be modified to permit the use of the words ''CFTC Regulated FCM Customer Omnibus Account'' to describe such accounts.

The Commission has modified the proposed Template Letters to provide an option to add the words ''CFTC Regulated FCM Customer Omnibus Account'' to describe such accounts when applicable. In addition, the Commission is proposing that if the name of the account as set forth in the Template Letter is too long for a depository's system to include all characters, the depository may abbreviate the name in order to accommodate its system, provided that (i) it remains clear that the account is a CFTC regulated segregated/secured account held for the benefit of customers (*e.g.,* ''segregated'' may be shortened to ''seg;'' ''customer'' may be shortened to ''cust;'' ''account'' to ''acct;'' etc.), and (ii) when completing an Acknowledgment Letter, such letter must include both the long and short versions of the account name.

3. Clarification Regarding Notice, Authentication, and Instruction Protocol for Commission Authorized Withdrawals

Four of the commenters to the Revised Proposal addressed the need for the Commission to establish specific standards with respect to the notice, authentication and instruction protocol regarding Commission instructions for the immediate release of funds from a Customer Account.[62]

The FRB Chicago pointed out that, as the Acknowledgment Letters will have been filed electronically with the Commission, the Commission will know all of the Depositories that have signed such letters, their location, and basic contact information. In light of this, the FRB Chicago suggests that the Commission could establish for each depository a basic but unique authentication identifier. The Commission believes this suggestion has merit, and it will consider implementing this type of data collection and identification as it works to implement the operational aspects of the electronic filing of Acknowledgment Letters.

JP Morgan suggests that the Acknowledgment Letter include a notice provision with contact information for the depository so that the Commission has information on how best to contact the depository. The Commission agrees with this suggestion and has revised the Template Letters to indicate where depository contact information may be inserted as optional information. The Commission recognizes that such information may be subject to frequent change and, therefore, at this time, the Commission is not requiring that an amended Acknowledgment Letter be filed in the event there are changes to such contact information.

Katten asserts that Depositories face legal uncertainty with respect to their release of customer funds in reliance on instructions from the Commission. Katten states that the Commission's reluctance to define ''proper notice'' or ''reasonable measures'' imposes on Depositories the conflicting obligations (i) to the Commission, to release customer funds ''immediately upon proper notice,'' and (ii) to its customer FCM, to take ''reasonable measures'' first to assure that such notice was ''duly authorized.''

With respect to due authorization, Katten requests that the Commission reconsider its decision to permit an instruction to transfer customer funds to be made orally, with written confirmation to follow. Katten believes that the depository's obligation to take ''reasonable measures'' may require it to await written confirmation in any event. In addition, Katten believes that the proposed amendments to §§ 1.20, 1.26, 30.7 and 140.91 do not limit the identity of the Commission officers and employees that may issue a notice to a depository or the process that must be followed before such a notice is issued. Katten submits that a depository would have a reasonable basis to conclude that an instruction to transfer customer funds was duly authorized if the depository could be assured that any instruction to transfer customer funds would be issued only by the Director of the Division of Clearing and Intermediary Oversight (or the Director's designee).[63] Katten recommends that ''the Commission revise the proposed rules to confirm that any such instruction may be made only by the Commission or by the director of DCIO (or the director's designee) acting with the concurrence of the General Counsel (or Deputy General Counsel).''[64] FIA requests, at a minimum, that the Commission define and limit the term ''appropriate officer or employee'' of the Commission (for example, authorization limited to Division Directors or other senior designated personnel such as Deputy Directors or Associate Directors).[65]

With respect to a ''duly authorized officer or employee of the CFTC,'' the Commission has determined to provide that any such instruction to transfer customer funds may be made by the Director of the Division of Clearing and Risk (or the Director's designee), or by the Director of the Division of Swap Dealer and Intermediary Oversight (or the Director's designee). Accordingly, the Template Letter now specifies that such instructions may only be given by the Director of the Division of Clearing and Risk (or any successor division), the Director of the Division of Swap Dealer and Intermediary Oversight (or any successor division), or the designees of such Directors under delegated authority.[66] With regard to the role of the General Counsel, the General Counsel will be consulted by the Director of the Division of Clearing and Risk (or any successor division), the Director of the Division of Swap Dealer and Intermediary Oversight (or any successor division), or the designees of such Directors prior to the exercise of the delegated authority.

The Commission does not believe, as asserted by Katten, that ''reasonable measures'' may require the depository to await written confirmation. For example, due to the nature of the

[61] FIA CL–00003 at 4 and 5.

[62] In the Revised Proposal, the Template Letter provides that ''the Funds in the Account(s) shall be released immediately, * * * upon proper notice and instruction from an appropriate officer or employee * * * of the CFTC. [FCM/DCO] will not hold [depository] responsible for acting pursuant to any instruction from the CFTC upon which [depository] has relied after having taken reasonable measures to assure that such instruction was provided to [depository] by a duly authorized officer or employee of the CFTC.''

[63] In October 2011, the Commission reorganized the Division of Clearing and Intermediary Oversight into two divisions, the Division of Clearing and Risk and the Division of Swap Dealer and Intermediary Oversight. With respect to a transfer of customer funds as contemplated in this rulemaking, instructions would come from either the Director of the Director of the Division of Clearing and Risk or the Director of the Division of Swap Dealer and Intermediary Oversight (or one of the Director's designees).

[64] *See* Katten CL–00005 at FN 3.

[65] FIA CL–00003 at page 3.

[66] The Commission will publish on its Web site the identity of the Director of the Division of Clearing and Risk, the Director of the Division of Swap Dealer and Intermediary Oversight, and the individual(s) who are authorized to serve as their designees. The Template Letters do not explicitly refer to instructions provided by ''the Commission'' because in exigent circumstances, it is not likely that action approved by a majority of Commissioners will be feasible.

exceptional circumstances that would prompt a call from the Commission, it is likely that the depository would already be aware of certain problems facing the FCM or DCO and would not be surprised to receive a phone call from a Division Director (or his or her designee). In addition, while the Commission believes it is desirable that any such instruction to release customer funds be in writing, or, if oral, to be confirmed in writing, the Commission is not limiting the manner of notice in the Template Letter given the potential exigencies of the situation and the need for flexibility in communication. For example, either the Commission or the depository could be experiencing unexpected technical problems in its respective email servers or facsimile machines. It is critical that the transfer of customer funds from a Segregated Account not be delayed as a result of technical or other operational issues.

With respect to the release of customer funds ''immediately upon proper notice,'' Katten commented that it appreciates the Commission's recognition of the potential practical obstacles to immediate release (*e.g.,* Fedwire is unavailable). However, Katten remains concerned that, in the absence of further guidance or clarification, the use of the term ''immediately'' may subject a depository to potential claims by either FCMs or the Commission in the event that there is a delay in the transfer of customer funds, even if such delay is the result of reasonable actions on the part of the depository or events beyond the control of the depository. In addition, FIA commented that it would like the Commission to confirm that its authority to require the transfer of customer funds would be expected to be used sparingly (*i.e.,* ''only in exceptional circumstances'').

After considering these comments, the Commission is proposing to retain the use of the word ''immediately'' in the Template Letter regarding instructions to a depository for release of customer funds. First, in response to FIA's comment, the Commission clarifies that the use of its authority to require the immediate release of customer funds would be in exceptional circumstances. As stated in the Revised Proposal, ''[t]he Commission would issue such an instruction only when, in the judgment of the Commission, it is necessary to do so for the protection of customer funds. For example, the prospective insolvency of the FCM could prompt an instruction from the Commission to release the customer funds.'' [67] Next, the Commission notes that anything less than the term ''immediate'' could leave the timing open to interpretation, which could cause delays in the transfer of funds and have a potential impact on safety and soundness of customer funds and positions. In this regard, the Commission notes that customer funds in the Segregated Account have always been subject to withdrawal immediately upon demand by the FCM.[68]

4. Limiting the ''Merger'' Clause in the Acknowledgment Letter

CME believes that the use of an integration clause (*i.e.,* the statement that the Acknowledgment Letter ''constitutes the entire understanding of the parties with respect to its subject matter'') in the Template Letters is inappropriate and could have a number of serious and unintended consequences. For example, the parties to the Acknowledgment Letter could be prevented from relying upon and enforcing terms of applicable account (or similar) agreements that do not conflict with the Acknowledgment Letter. CME believes the term ''subject matter'' is ambiguous and could be interpreted very broadly thereby casting doubt on the validity and interpretation of existing agreements between the parties. The CME suggests the following more narrowly tailored language for the integration clause in the Template Letters: ''This letter agreement supersedes and replaces any prior agreement between the parties in connection with the Account(s), including but not limited to any prior Acknowledgment Letter, to the extent that such prior agreement is inconsistent with the terms hereof.''

FIA agrees with the CME's comment that the scope of the ''merger clause'' in the Template Letters should be narrowed to make clear that these clauses do not invalidate the terms of other agreements that may have been entered into by the parties and that do not conflict with the Template Letters. The FRB Chicago also believes that this provision should be narrowed so that a bank's standard account opening agreements, corporate resolutions and other agreements incorporated by reference should govern the remainder of the account relationship, but *not* matters specific to section 4d of the Act. Should there be a conflict, the Acknowledgment Letter should govern matters specific to section 4d of the Act.

The Commission agrees with the commenters that the scope of the ''merger clause'' language in the Template Letter [69] should be narrowed. Accordingly, the Commission is replacing the clause with CME's suggested language above. In addition, in order to incorporate the comment of the FRB Chicago and to ensure that future agreements between the parties do not negate the Acknowledgment Letter, the Commission is adding the following sentence to the end of the new language: ''In the event of any conflict between this letter agreement and any other agreement between the parties in connection with the Account(s), this letter agreement shall govern with respect to matters specific to section 4d of the Act and the CFTC's regulations, as amended.''

5. New Proposed Amendments to Acknowledgment Letters

The Commission is also now proposing under Appendix A to § 1.26 and Appendix F to § 30.7 an additional acknowledgment letter template form for money market mutual funds (to the extent they are permissible investments under § 1.25). The template form for money market mutual funds is substantially the same as the Acknowledgment Letters. The Commission requests comment on all aspects of the template form.

In addition, the Commission is proposing to add language to its proposed Acknowledgment Letters (under § 1.20, § 1.26 and § 30.7) authorizing and requiring the depository to grant—at all times—read-only electronic access to such accounts to the Commission and, in the case of an FCM, to the FCM's DSRO. Given recent events, the Commission believes such access is crucial to the protection of customer funds. The Commission is also proposing a substantive requirement for

[67] 75 FR 47738, 47740. The Revised Proposal also noted that, as set forth in the Template Letter, in the event the FCM becomes subject to a voluntary or involuntary petition for relief under the U.S. Bankruptcy Code, the depository will have no obligation to release the customer funds except upon instruction from the bankruptcy trustee or pursuant to a court order. *Id.*

[68] *See* Amended Financial and Segregation Interpretation No. 10, 70 FR 24768 (May 11, 2005) (''Thus any impediments or restrictions on the FCM's ability to obtain immediate and unfettered access to customer funds are not permitted. The immediate and unfettered access requirements is [sic] intended to prevent potential delay or interruption in securing required margin payments that, in times of significant market disruption, could magnify the impact of such market disruption and impair the liquidity of other FCMs and clearinghouses.'')

[69] The merger clause language in the Revised Proposal's Template Letter reads as follows: ''This letter agreement constitutes the entire understanding of the parties with respect to its subject matter and supersedes and replaces all prior writings, including any applicable agreement between the parties in connection with the Account(s), with respect thereto.''

this access in §§ 1.20, 1.26 and 30.7 in addition to the language in the Acknowledgment Letters.

The proposal for read-only access is not intended to require a depository to have the ability to provide the Commission or an FCM's DSRO with real-time information regarding an FCM's account balance. The Commission understands that depositories may not have the capability to provide customers or any other party with real-time account balances and position information. The conditions of the proposal would be satisfied if the depository had the capability to provide read-only access to account information as of the close of the prior business day.

The Commission intends to continue to explore possible uses of technology to enhance its ability to protect customer funds. Read-only access will allow Commission staff to review an FCM's segregated account balances reported by depositories and to compare those balances to the FCM's reported account balances either as part of a review of the firm, or in circumstances where the Commission is concerned about the financial condition of the firm. The read-only access is an additional tool that Commission staff may use as part of its assessment of the financial condition of an FCM and the safety of customer funds. The Commission will continue to review how direct access to account balances and the use of technology can provide greater assurance as to the safety of customer funds held by an FCM.

The Commission requests comment on all aspects of the proposed amendments to § 1.20. Specifically, the Commission requests comment on the following:

- The proposal requires each depository to provide the Commission and an FCM's DSRO with direct, read-only access to the FCM's accounts held by the depository. What technology issues are raised by the Commission's proposal? How can the Commission adequately address such technology issues?
- What account information can depositories currently provide to the Commission and to DSROs via the internet on a read-only basis? Do all depositories (*e.g.,* banks, trust companies, derivatives clearing organizations, or other FCMs) have the capability of using the Internet to provide account access to the Commission and DSROs? Are there other options for depositories to provide read-only access to FCM accounts other than the internet?
- How should the Commission implement this requirement? What timeframe would be appropriate to make the requirement effective? Please provide analysis with your comment.

H. Proposed Amendments to § 1.22: Use of Futures Customer Funds

The Commission proposes to amend § 1.22 by clarifying that the prohibition on the FCM's use of one futures customer's funds to margin or secure the positions of another futures customer, or to extend credit to another person, applies at all times.

Regulation 1.22 provides that an FCM may not use the cash, securities or other property deposited by one futures customer to purchase, margin or settle the trades, contracts, or other positions of another futures customer, or to extend credit to any other person. Regulation 1.22 further provides that an FCM may not use the funds deposited by a futures customer to carry trades or positions, unless the trades or positions are traded through a designated contract market.

The proposed amendment to clarify that the prohibition on the FCM's use of one futures customer's funds to margin positions of another futures customer is intended to remove any question as to the permissibility of being undersegregated at any point in time during the day. Section 4d(a)(2) requires an FCM to segregate futures customers' funds from its own funds, and prohibits an FCM from using the funds of one customer to margin or extend credit to any other futures customer or person. The Commission believes that section 4d(a)(2) is intended to provide a maximum level of protection to futures customer funds, which would be thwarted and inconsistent with the reading of the Act if an FCM only recognized this principle at the end of the trading day. Further, the Commission is proposing language providing a clear mechanism to ensure compliance with this prohibition, which is to require an FCM to maintain residual interest in segregated accounts in an amount which exceeds the sum of all margin deficits for futures customers. The Commission also is proposing that the sum of all margin deficits be reported on the Segregation Schedule (as discussed previously with respect to proposed amendments to § 1.10) and also required to be reported on the daily segregation calculation (as discussed further herein with respect to proposed amendments to § 1.32), so that compliance review of this mechanism can be performed.

I. Proposed Amendments to § 1.23: Interest of Futures Commission Merchant in Segregated Futures Customer Funds; Additions and Withdrawals

The Commission is proposing to amend § 1.23 to require additional safeguards with respect to an FCM withdrawing futures customer funds from segregated accounts that are part of the FCM's residual interest in such accounts.

Regulation 1.23 provides that an FCM may deposit unencumbered proprietary funds, including securities that qualify as permitted investments under § 1.25, into segregated futures customer accounts in order to ensure that the firm always maintains sufficient funds in such accounts to meet its total obligations to futures customers. FCMs, by virtue of practical necessity, must keep proprietary funds in segregated futures customer accounts in order to act as a buffer between futures customers whose funds are commingled in such accounts. In the event that any futures customer were to experience losses such that the customer has insufficient funds to meet the margin requirements at clearing organizations associated with its positions, or if all of the funds deposited by the futures customer were depleted and the account had a debit balance, without proprietary funds of the FCMs being held in such accounts to absorb the debit balance as it accrued, funds of other futures customers would be used to guarantee the undermargined amount or the debit. For this reason, FCMs are permitted to deposit their own funds into segregated accounts and to maintain a residual financial interest in such accounts. Regulation 1.23 further provides that an FCM's books and records must always reflect the firm's residual interest in the accounts of its futures customers.

In addition, an FCM is permitted to withdraw funds from futures customer accounts for the FCM's proprietary use to the extent of the FCM's actual residual interest in such accounts. The withdrawal, however, may not result in the FCM failing to hold sufficient funds to meet its obligations to its futures customers, or in the funds of one futures customer margining or securing the positions of another futures customer. The Commission also is proposing that the residual amount maintained by an FCM be required to exceed the sum of margin deficits for futures customers, as discussed previously with respect to §§ 1.20 and 1.22, to provide a clear mechanism to ensure that the funds of one futures customer are not used to margin or guarantee the positions of

another futures customer. Irrespective of the procedures permitting withdrawals of residual interest under the amendments proposed, the proposed amendments further make clear that no withdrawals may be made of residual interest to the extent of the sum of margin deficits.

If an FCM does not have adequate internal controls governing the calculation and withdrawal of its residual interest from futures customer accounts, the FCM's actions may actually result in the withdrawal of futures customer funds and not the FCM's residual interest. Such a withdrawal would be a violation of section 4d(a)(2) of the Act.

The Commission, therefore, is proposing to amend § 1.23 to include additional safeguards applicable to an FCM's withdrawal of funds from the accounts of futures customers that are part of the FCM's residual interest in such accounts. Under proposed § 1.23(a), an FCM will still have access to its own funds deposited into futures customer accounts to the extent of the FCM's residual interest therein, subject to the restriction on withdrawal of residual interest equal to the sum of margin deficits. However, proposed § 1.23(b) will prohibit an FCM from withdrawing any of its residual interest or excess funds from futures customer accounts (any withdrawal not made for the benefit of futures customers would be considered a withdrawal of the FCM's residual interest) on any given business day unless the FCM had completed the daily calculation of funds in segregation pursuant to § 1.32 as of the close of the previous business day, and the calculation showed that the FCM maintained excess segregated funds in the futures customer accounts as of the close of business on the previous business day. Proposed § 1.23(b) further requires that the FCM adjust the excess segregated funds reported on the daily segregation calculation to reflect other factors, such as overnight and current day market activity and the extent of current customer undermargined or debit balances, to develop a reasonable basis to estimate the amount of excess funds that remain on deposit since the close of business on the previous day prior to initiating a withdrawal.

The Commission also is proposing several additional required layers of authorization and documentation if the withdrawal exceeds, individually or in the aggregate with other such withdrawals, 25 percent of the FCM's residual interest. Proposed § 1.23(c) prohibits an FCM from withdrawing more than 25 percent of its residual interest in futures customer accounts unless the FCM's CEO, CFO, or other senior official that is listed as a principal on the firm's Form 7–R registration statement and is knowledgeable about the FCM's financial requirements (''Financial Principal'') pre-approves the withdrawal in writing.

Regulation 1.23(c) will further require the FCM to immediately file a written notice with the Commission and with the firm's DSRO of any withdrawal that exceeds 25 percent of its residual interest. The written notice must be signed by the CEO, CFO, or Financial Principal that pre-approved the withdrawal, specifying the amount of the withdrawal, its purpose, its recipient(s), and contain an estimate of the residual interest after the withdrawal. The written notice also must contain a representation from the person that pre-approved the withdrawal that to such person's knowledge and reasonable belief, the FCM remains in compliance with its segregation obligations. The proposal further requires that the official in making this representation specifically consider any other factors that may cause a material change in the FCM's residual interest since the close of business on the previous business day, including known unsecured futures customer debits or deficits, current day market activity, and any other withdrawals. The written notice would be required to be filed with the Commission and with the FCM's DSRO electronically.

Proposed § 1.23(d) requires an FCM that has withdrawn funds from segregated futures customer accounts for its own purposes, and such withdrawal causes the firm to fall below its targeted residual interest in such accounts, to deposit proprietary funds into the accounts to restore the residual interest balance to the targeted amount. The FCM must deposit the proprietary funds into the segregated account prior to the close of the next business day. Alternatively, the FCM may revise its targeted residual interest amount, if appropriate, in accordance with its written policies and procedures for establishing, documenting, and maintaining its target residual interest, in accordance with the requirements of proposed § 1.11. Should an FCM's residual interest, however, be exceeded by the sum of the FCM's futures customers' margin deficits, an amount necessary to restore residual interest to that sum must be deposited immediately.

The Commission's proposal is consistent in most respects with NFA's recent rule amendments that require FCMs to maintain written policies and procedures regarding the withdrawal of proprietary funds from futures customers' segregated accounts discussed in Section I.D above. The proposal will continue to provide FCMs with flexibility to access the residual interest in segregated funds, but with the responsibility to ensure that any withdrawals of residual interest are, in fact, the firm's own funds. This responsibility exists currently by virtue of the language of section 4d(a)(2) of the Act and § 1.23, however the processes necessary to ensure that the responsibility was carried out were not specified by regulation.

By providing a prohibition on withdrawals until the segregation calculation is performed by the FCM and submitted to the Commission and to the DSRO, and further requiring written approvals by the FCM's senior officials prior to any withdrawals in excess of 25 percent of the prior day's residual interest with notice to the Commission and a DSRO, any withdrawal of funds in excess of the residual interest will be clear violations of proposed § 1.23, and the responsibility for such violations will be clear from written pre-approvals made by the CEO, CFO or Financial Principal, or the lack thereof.

J. Proposed Amendments to § 1.25: Investment of Customer Funds

The Commission is proposing to amend § 1.25(b)(3)(v) to provide that the 25-percent counterparty concentration limit for reverse repurchase agreements applies not only to a single counterparty, but to all counterparties under common control or ownership. The Commission also is proposing to delete paragraph (b)(6) of § 1.25 because the information that an FCM is required to record and maintain under paragraph (b)(6) is currently required by § 1.27. Further, the Commission is proposing to amend § 1.25(d) to clarify the conditions under which an FCM may deposit firm-owned securities into segregation.

Regulation 1.25 sets forth the financial investments that an FCM or DCO may make with customer funds. As one of the permitted investments, FCMs and DCOs may use customer funds to purchase securities from a counterparty under an agreement for the resale of the securities back to the counterparty (''reverse repurchase agreements''). Regulation 1.25 places conditions on such repurchase or reverse repurchase agreements, including limiting permitted counterparties to certain banks and government securities brokers or dealers, and prohibiting an FCM or DCO from entering into such

agreements with affiliate. Regulation 1.25(b)(3)(v) also imposes a counterparty concentration limit on reverse repurchase agreements that prohibits an FCM or DCO from purchasing securities from a single counterparty that exceeds 25 percent of the total assets held in segregation by the FCM or DCO.

Under the proposed amendment to § 1.25(b)(3)(v), an FCM or DCO must aggregate the value of the securities purchased from two or more different counterparties under repurchase agreements if the counterparties are under common control or ownership. The aggregate value of the securities purchased under the repurchase agreements from the counterparties must not exceed 25 percent of the total assets held in segregation by the FCM or DCO. The Commission believes that expanding the concentration limitation to counterparties under common control or ownership is consistent with the original intention of the concentration limitation, which was to minimize the potential losses or disruptions due to the default of a counterparty. If the counterparties are under common control or ownership, a default by one counterparty may adversely impact all of the counterparties.

The Commission also is proposing to amend § 1.25 by deleting paragraph (b)(6), which requires an FCM or DCO to prepare a record, on a daily basis, detailing the type of instruments in which customer funds were invested, the original costs of the investments, and the current market value of the investments. As noted above, the information that an FCM is required to record and maintain under paragraph (b)(6) is currently required by § 1.27.

Finally, the Commission is proposing to amend § 1.25(d)(7) to recognize that a DCO designated as systemically important (''SIDCO'') by the Financial Stability Oversight Council may keep securities transferred to the SIDCO under a repurchase or reverse repurchase agreement in a safekeeping account with a Federal Reserve Bank, as authorized by section 806 of the Dodd-Frank Act.

K. Proposed Amendments to § 1.26: Deposit of Obligations Purchased With Futures Customer Funds

As discussed above, the Commission has previously proposed to amend § 1.26 along with § 1.20 to require a template form of Acknowledgment Letter—in addition to other substantive requirements and obtaining and filing such Acknowledgment Letters—with respect to the deposit of instruments purchased with customer funds, including money market mutual funds. As discussed earlier with respect to § 1.20, the Commission received and analyzed comments on those proposals.

As noted above, the Commission is herein proposing changes to the template Acknowledgment Letter set forth in Appendix A to § 1.26 for money market mutual funds, which incorporate revisions based on the Commission's analysis of prior comments, and is proposing new additions to such template. The Commission is also proposing new substantive requirements applicable to obtaining and filing such written Acknowledgment Letters. A new substantive requirement under § 1.26, as proposed to be amended and included in the template form, is a requirement that depositories provide the Commission and, and in the case of an FCM, the FCM's DSRO—at all times—with read-only electronic access to all FCM and DCO accounts holding customer funds.

L. Proposed Amendments to § 1.29: Increment or Interest Resulting From Investment of Customer Funds

The Commission is proposing to amend § 1.29 to explicitly provide that an FCM bears sole responsibility for any losses resulting from the investment of customer funds in financial instruments permitted under § 1.25.

Regulation 1.29 provides that an FCM is not prohibited from keeping as its own any interest or other gain resulting from the investment of customer funds in financial instruments permitted under § 1.25. Regulation 1.25 also provides that an FCM must manage the permitted investments consistent with the objectives of preserving principal and maintaining liquidity.

The proposed amendment clarifies that an FCM is solely responsible for any losses that result from the investment of customer funds in the financial instruments listed under § 1.25. An FCM may not charge or otherwise allocate any such losses to the accounts of the FCM's customers. To allocate losses on the investment of customer funds would result in the use of customer funds in a manner that is not consistent with section 4d(a)(2) and § 1.20, which provides that customer fund can only be used for the benefit of futures customers and limits withdrawals from futures customer accounts, other than for the purpose of engaging in trading, to certain commissions, brokerage, interest, taxes, storage or other fees or charges lawfully accruing in connection with futures trading.

The Commission requests comment on the proposed amendment to explicitly provide that losses resulting from the investment of customer funds may not be allocated by an FCM to customers. The Commission also requests comment on how any losses associated with bank deposits should be addressed. The Commodity Exchange Authority issued an Administrative Determination (''AD'') in 1971 that provides that an FCM may not be liable for losses resulting from the deposit of customer funds with a bank that subsequently closes or is unable to repay the FCM's deposit.[70] The AD provides that an FCM would not be liable if it had used due care in selecting the bank, had not otherwise breached its fiduciary responsibilities toward the customers, and had fully complied with the requirements of the Act and the Commission regulations relating to the handling of customers' funds. The Commission requests comment on whether the regulations should be revised to impose an obligation on an FCM to repay customer funds in the event of a default by a bank holding customer funds. Should there be a distinction drawn between U.S.-domiciled and regulated banks and non-U.S.-domiciled banks?

M. Proposed Amendments to § 1.30: Loans by Futures Commission Merchants: Treatment of Proceeds

The Commission is proposing to amend § 1.30 to provide that an FCM may not loan funds to finance a customer's trading account on an unsecured basis, or accept as collateral for the loan the customer's trading account.

Regulation 1.30 provides that Commission regulations do not prevent an FCM from lending its own funds to a customer that has pledged securities and property, or from repledging or selling the customer's securities or property pursuant to specific written agreement of the customer. This provision generally allows customers to deposit non-cash collateral as initial and variation margin. Absent the provisions in § 1.30, an FCM may be required to liquidate the non-cash collateral if the customer was subject to an initial or variation margin call.

The Commission is proposing to amend § 1.30 to prohibit an FCM from loaning funds to finance a customer's trading account on an unsecured basis, or from accepting a customer's trading account as collateral for the loan. The Commission believes that extending unsecured loans to customers is not a

[70] *Liability of Futures Commission Merchants and Clearing Associations,* Administrative Determination No. 230 (Nov. 23, 1971).

common occurrence as the current capital requirements in § 1.17 would require the FCM to take a 100 percent capital charge on the unsecured receivables from the customers associated with such loans. Commission staff has, however, had to provide its views on whether a customer trading account may be used to collateralize a loan from the FCM.

A trading account does not qualify as readily marketable securities that are generally required to collateralize a loan for the FCM to avoid the 100 percent unsecured receivable capital charge.[71] Rules of the CME also prohibit an FCM from providing unsecured financing to a customer for margin purposes.[72] The Commission is proposing to explicitly prohibit unsecured lending by FCMs to customers in the proposed amendments in § 1.30. Should customers have liquidity needs sufficient to require unsecured lending, the Commission believes it to be prudent to require that such unsecured lending be done by a party other than the FCM carrying the customer account. This newly proposed prohibition comports with the Commission's existing regulatory requirement contained in § 1.56 that provides that no FCM may represent that it will not call for or attempt to collect initial and maintenance margin as established by the rules of the applicable board of trade.

N. Proposed Amendments to § 1.32: Segregated Account: Daily Computation and Record

The Commission is proposing to amend § 1.32 to require additional safeguards with respect to futures customer funds on deposit in segregated accounts, and to require FCMs to provide twice each month a detailed listing to the Commission of depositories holding customer funds.

Regulation 1.32 requires an FCM to prepare a daily record as of the close of business each day detailing the amount of funds the firm holds in segregated accounts for futures customers trading on designated contract markets, the amount of the firm's total obligation to such customers computed under the Net Liquidating Equity Method, and the amount of the FCM's residual interest in the futures customer segregated accounts. In addition, the daily record must detail the sum of the futures customers' margin deficits, to ensure that residual interest equals or exceeds such sum. In performing the calculation, an FCM is permitted to offset any futures customer's debit balance by the market value (less haircuts) of any readily marketable securities deposited by the particular customer with the debit balance as margin for the account. The amount of the securities haircuts are as set forth in SEC Rule 15c3–1(c)(vi).

FCMs are required to perform the segregation calculation prior to noon on the next business day, and to retain a record of the calculation in accordance with § 1.31. Both the CME and NFA require their respective member FCMs to file the segregation calculations with the CME and NFA, as appropriate, each business day. FCMs, however, are only required to file a segregation calculation with the Commission at month end as part of the Form 1–FR–FCM (or FOCUS Reports for dual-registrant FCM/BDs). Regulation 1.12, as discussed in Section II.C above, requires the FCM to provide immediate notice to the Commission and to the firm's DSRO if the FCM is undersegregated at any time.

The Commission is proposing to amend § 1.32 to require each FCM to file its segregation calculation with the Commission and with its DSRO each business day. The Commission also is proposing to amend § 1.32 to require FCMs to use the Segregation Schedule contained in the Form 1–FR–FCM (or FOCUS Report for dual-registrant FCM/BDs) to document its daily segregation calculation.

As noted above, the CME and NFA require their respective member FCMs to file their segregation calculations with them on a daily basis. The CME and NFA also require the FCMs to document their segregation calculation using the Segregation Schedule contained in the Form 1–FR–FCM. Therefore, the additional requirement of filing a Segregation Schedule with the Commission is not a material change to the regulation.[73]

The Commission believes that the filing of a Segregation Schedule by each FCM each day will significantly enhance its ability to monitor and protect customer funds. Commission staff will be able to determine almost immediately upon receipt of the Segregation Schedule whether a firm is undersegregated and immediately take steps to determine if the firm is experiencing financial difficulty or if customer funds are at risk.[74] Commission staff also can coordinate the review of the daily segregation computations with the additional bank and other depository information that it will have access to under proposed § 1.23.

In addition, the use of the Segregation Schedule provides a uniform way for each FCM to present its information to the Commission, in a format that both the Commission and FCMs are familiar with that will reduce significantly the possibility of a miscommunication regarding the information that is reported. The standardized Segregation Schedule will also facilitate the Commission's ability to compare one FCM to another, and to perform additional trend and other analysis to identify potential issues with the holding of customer funds. The filing of daily segregation records also will allow staff to monitor significant movements in the balances of segregated funds on a day-to-day basis.

Proposed § 1.32(d) provides that the Segregation Statement must be filed with the Commission and with the FCM's DSRO electronically using a form of user authentication assigned in accordance with procedures established or approved by the Commission. The Commission is not proposing to change the timeframe for the preparation of the Segregation Statements. The Segregation Statement must be filed by noon (based upon the location of the FCM) the next business day.

The Commission also is proposing to amend § 1.32(b) to provide that in determining the haircuts for commercial paper, convertible debt instruments, and nonconvertible debt instruments deposited by customers as margin, the FCM may develop written policies and procedures to assess the credit risk of the securities as proposed by the SEC and discussed more fully in Section II.F above. If the FCM's assessment of the credit risk is that it is minimal, the FCM may apply haircut percentages that are lower than the 15 percent default percentage under SEC Rule 15c3–1(c)(2)(vi).

The Commission is further proposing to amend § 1.32 by requiring each FCM to file detailed information regarding depositories and the substance of the investment of customer funds under § 1.25. Proposed paragraphs (f) and (j) of § 1.32 will require each FCM to submit

[71] Regulation 1.17(c)(3).

[72] CME Rule 930.G.—Loans to Account Holders—provides that clearing members may not make loans to account holders to satisfy their performance bond requirements unless such loans are secured by readily marketable collateral that is otherwise unencumbered and which can be readily converted into cash.

[73] In fact, since FCMs file the Segregation Schedules with the CME and NFA via WinJammer, the Commission already has access to the filings, and the amendment will not require an FCM to change any of its operating procedures.

[74] Each Form 1–FR–FCM and FOCUS Report is received by the Commission via WinJammer. The financial forms are automatically electronically reviewed within several minutes of being received by the Commission and if a firm is undersegregated an alert is immediately issued to Commission staff members via an email notice.

to the Commission and to the firm's DSRO a listing of every bank, trust company, DCO, other FCM, or other depository or custodian holding customer funds.

The listing must specify separately for each depository the total amount of cash and § 1.25 permitted investments held by the depository for the benefit of the FCM's customers. Specifically, each FCM must list the total amount of cash, United States government securities, United States agency obligations, municipal securities, certificates of deposit, money market mutual funds, commercial paper, and corporate notes held by each depository, computed at current market values. The listing also must specify: (1) If any of the depositories are affiliated with the FCM; (2) if any of the securities are held pursuant to an agreement to resell the securities to a counterparty (reverse repurchase agreement) and if so, how much; and (3) the depositories holding customer-owned securities and the total amount of customer-owned securities held by each of the depositories. The FCM is also required to disclose if any of the depositories are affiliated with the FCM.

Each FCM is required to submit the listing of the detailed investments to the Commission and to the firm's DSRO twice each month. The filings must be made as of the 15th day of each month (or the next business day, if the 15th day of the month is not a business day) and the last business day of the month. The filings are due to the Commission and to the firm's DSRO by 11:59 p.m. on the next business day.

Proposed paragraph (k) of § 1.32 will require each FCM to retain the Segregation Statement prepared each business day and the detailed investment information, together with all supporting documentation, in accordance with § 1.31.

The Commission's proposal is similar to existing SRO practices and rules. The CME and NFA recently adopted rules requiring member FCMs to submit detailed information on how they invest customer funds and the depositories holding customer funds. The information required to be filed by FCMs with the CME and NFA is consistent with the information that FCMs are required to file with the Commission and DSROs under the proposed amendments to § 1.32, with the exception that the current CME rule does not require member FCMs to submit information regarding the holding of customer-owned securities. The proposed timeframes for both preparing and filing both the Segregation Statements and the detailed investment information are consistent between the SRO rules and proposed § 1.32.

The Commission also notes that NFA will be publishing information on its Web site regarding how each FCM invests and holds customer funds. Commission staff is consulting with NFA and is assessing whether NFA should be the primary method for the public to obtain information on how FCMs hold and invest customer funds.

The twice monthly filing of information on the investment of customer funds will provide the Commission and SROs with more timely detailed information regarding how FCMs are holding and investing customer funds, which will allow the Commission and SROs to more closely monitor customer funds to assess their safety. In this regard, the reporting of the use of depositories that are affiliated with the FCM will alert staff to review such relationships more closely to ensure that transactions are done in an appropriate arms-length manner and not to the benefit of the affiliated depository. Staff also can compare reported the reported investment balances with information maintained directly by the depositories using the on-line access that the depositories will be required to provide to Commission staff under § 1.20 discussed above.

The Commission request comment on all aspects of the proposed amendments to § 1.32. Specifically, the Commission requests comments on the following:

- Should the Commission amend the regulations to require each FCM to disclose information regarding its investments of customer funds? If so, what information should be disclosed? What investment information would be of the most benefit to market participants in assessing whether to entrust funds to a particular FCM? How would the investment information be used by market participants?
- How frequently should investment information be disclosed? What format should be used to disclose the information? How should the information be disclosed? Should the information be posted on the FCM's internet web site?
- Should NFA act as the primary source for the disclosure of how FCMs hold and invest customer funds?

O. Proposed Amendments to § 1.52: Self-Regulatory Organization Adoption and Surveillance of Minimum Financial Requirements

SROs are required by the Act and Commission regulations to monitor their member FCMs for compliance with the Commission's and SROs' minimum financial and related reporting requirements. Specifically, DCM Core Principle 11 provides, in relevant part, that a board of trade shall establish and enforce rules providing for the financial integrity of any member FCM and the protection of customer funds.[75] In addition, section 17 of the Act requires NFA to establish minimum capital, segregation, and other financial requirements applicable to its member FCMs, and to audit and to enforce compliance with such requirements.[76]

The Commission also has established in § 1.52 minimum elements that each SRO financial surveillance program must contain to satisfy the statutory objectives of Core Principle 11 and section 17 of the Act. In this regard, § 1.52 requires, in part, each SRO to adopt and to submit for Commission approval rules prescribing minimum financial and related reporting requirements for member FCMs. The rules of the SRO also must be the same as, or more stringent than, the Commission's requirements for financial statement reporting under § 1.10 and minimum net capital under § 1.17.

In addition, the Commission adopted final amendments to § 1.52 on May 10, 2012, to codify previously issued CFTC staff guidance regarding the minimum elements of an SRO financial surveillance program.[77] The final amendments require an SRO to: (1) Maintain staff of an adequate size, training, experience, and independence to effectively implement a supervisory program; (2) maintain a program that provides for the ongoing surveillance of FCMs through review of financial statements and regulatory notices; (3) identify firms that pose a high degree of potential risk, including risk to customer funds; (4) conduct routine, periodic onsite examinations of FCMs; and (5) adequately document all aspects of the operation of the supervisory program, including the conduct of risk-based scope setting and the risk-based surveillance of high-risk member registrants, and the imposition of remedial and punitive actions for material violations.

In order to effectively and efficiently allocate SRO resources over FCMs that are members of more than one SRO, § 1.52(c) currently permits two or more SROs to enter into an agreement to establish a joint audit plan for purpose of assigning to one of the SROs (the DSRO) of the joint audit plan the function of monitoring and examining member FCMs for compliance with

[75] 7 U.S.C. 7(d)(11).

[76] 7 U.S.C. 21(p).

[77] 77 FR 36611 (June 19, 2012).

certain regulatory and financial reporting obligations. The audit plan must be submitted to the Commission for approval. The Commission may approve a joint audit plan, or part of such a plan, after notice and comment if the Commission determines that the plan: (1) Is necessary or appropriate to serve the public interest; (2) is for the protection and in the interest of customers; (3) reduces multiple monitoring and auditing for compliance with the minimum financial requirements; (4) reduces multiple reporting of financial information; (5) fosters cooperation and coordination; and (6) does not hinder the development of a registered futures association. Currently all active SROs are members of a joint audit plan that was approved by the Commission on March 18, 2009.[78]

The Commission is proposing additional amendments to § 1.52 in light of recent events that highlight a need for strengthening the minimum requirements that SROs must abide by in conducting financial surveillance to minimize the chances that FCMs that engage in unlawful activities that result, or could result, in the loss of customer funds or the inability of the firms to meet their financial obligations to market participants, including DCOs, go undetected. The proposed amendments to § 1.52 revise the current supervisory program required to be established and implemented by SROs pursuant to existing § 1.52(b) with respect to their FCM members. In addition, for SROs that choose to delegate their duties to oversee and examine FCMs that are members of two or more SROs to a DSRO pursuant to a plan established under existing § 1.52(c) in lieu of each conducting its own oversight and examinations of such common FCM members, proposed § 1.52 provides that the plan adopt certain requirements to assure the quality of the DSRO oversight and examinations conducted under the plan, both as to the substance of the oversight and examination program and the application of such program.

Proposed § 1.52(b) requires each SRO to adopt rules requiring its member FCMs to establish a risk management program that is at least as stringent as the risk management program required in proposed § 1.11. Proposed § 1.11 is discussed in Section II.B above, and requires an FCM to establish a risk management program designed to monitor and manage risks associated with the activities of the FCM.

Proposed § 1.52 does not make significant changes to the existing SRO supervisory programs with respect to the oversight and examination of retail foreign exchange dealer and IB member registrants. However, with respect to the oversight and examination of FCMs, proposed § 1.52 requires an SRO to adopt significant new requirements in its supervisory program. The supervisory program for FCMs will now explicitly require, among other things, controls testing as well as substantive testing, and the examination process for each FCM must be driven by the risk profile of each such FCM. In addition, the supervisory program must conform to U.S. GAAS after giving full consideration to those auditing standards as prescribed by the PCAOB. The supervisory program also must contain written standards addressing numerous aspects of the examination process over FCMs as provided in proposed § 1.52(c)(2)(iii), including the examination of the risk assessment process, the examination of the planning process, and the quality control procedures to ensure that the examinations maintain the level of quality expected by the SRO.

The Commission believes that an examination of an FCM must include a review and assessment of the firm's internal controls in order to identify where there may be potential weaknesses and to properly gauge the risks associated with such weaknesses including their potential impact on the financial condition of the firm and the protection of customer funds.

The SRO also must engage an ''examinations expert'' under § 1.52(c)(2) to review its supervisory program and the application of the supervisory program at least once every two years. The term ''examinations expert'' is proposed to be defined under § 1.52(a) as a nationally recognized accounting and auditing firm with substantial expertise in audits of FCMs, risk assessment and internal control reviews, and is someone acceptable to the Commission. The Commission is proposing to delegate to the Director of the Division of Swap Dealer and Intermediary Oversight the responsibility of assessing whether a particular entity is qualified and approved as an examinations expert to review the SRO's supervisory program

The review will require the examinations expert to assess the sufficiency of the SRO's risk-based approach and the internal controls testing and also whether the supervisory program is being appropriately applied by the SRO in its examinations of its member FCMs. In addition, the review will require that the examinations expert provide an opinion as to whether the supervisory program is reasonably likely to identify a material deficiency in internal controls of the FCM or in any of the other items that are the subject of an examination conducted in accordance with the supervisory program. Furthermore, the review will require that the examinations expert also provide recommendations on new or best practices prescribed by industry sources that should be incorporated in the supervisory program. The SRO must receive a written report from the examinations expert describing, among other things, the items mentioned in this paragraph.

Upon receipt of the written report, the SRO must provide such written report to the Commission. The SRO must update the supervisory program and coordinate with the Commission to resolve any issues raised by the written report and any Commission questions and comments before the updated supervisory program becomes the standard for the SRO's examinations of its registered FCM members. Proposed § 1.52(c)(2)(vi) also requires each SRO to submit an initial supervisory program within 120 days of the effective date of the regulation, or a longer period of time that Director of the Division of Swap Dealer and Intermediary Oversight (acting pursuant to authority delegated by the Commission) may approve. The initial supervisory program must contain an affirmation from the examinations expert regarding the evaluation of the supervisory program, including the sufficiency of the risk-based approach and the internal controls testing. The examinations expert also must opine as to whether the supervisory program is reasonably likely to identify a material weakness in internal controls over financial or regulatory reporting.

Consistent with the current regulation, and in order to avoid duplicative examinations and oversight of FCMs, retail foreign exchange dealers, or IBs, proposed § 1.52(d)(1) provides that when two or more SROs have a common member registrant, such SROs may voluntarily agree to establish a plan to delegate to a single DSRO the function of overseeing and examining such common member registrant otherwise required from each such SRO.

[78] The original signatories of the joint audit plan approved on March 18, 2009 are as follows: Board of Trade of the City of Chicago, Inc.; Board of Trade of Kansas City; CBOE Futures Exchange, LLC; Chicago Climate Futures Exchange, LLC; Chicago Mercantile Exchange Inc.; Commodity Exchange, Inc; ELX Futures, L.P.; HedgeStreet, Inc.; ICE Futures U.S., Inc.; INET Futures Exchange, L.L.C.; Minneapolis Grain Exchange; NASDAQ OMX Futures Exchange; National Futures Association; New York Mercantile Exchange, Inc.; NYSE Liffe US, L.L.C.; OneChicago, L.L.C.

Proposed amendments to § 1.52(d)(1) would further provide that while an SRO may delegate the functions of examining a member FCM for compliance with the minimum financial and reporting and risk management requirements, the delegating SRO retains responsibility for its member FCM's compliance with such requirements.

If SROs choose to take advantage of the efficiency provided by a joint audit plan with respect to their oversight and examinations over common member FCMs, then the plan must satisfy the requirements of proposed § 1.52(d)(2), which will assure the quality of the SROs, both as to the substance of the oversight and examination program and the application of such program. Proposed § 1.52(d)(2) requires in such a plan that the SROs form a Joint Audit Committee and adopt a Joint Audit Program pursuant to which FCMs are overseen and examined by a DSRO.

The Joint Audit Committee members will be subject to a number of duties according to proposed § 1.52(d)(2). The most important of these is that the Joint Audit Committee members establish and maintain a Joint Audit Program that the DSROs must apply in their oversight and examinations of FCMs.

The requirements for the establishment and maintenance of the Joint Audit Program are identical in many ways to the establishment and maintenance of the standalone supervisory program with respect to FCMs described in proposed §§ 1.52(b) and (c). For example, the Joint Audit Program and the standalone supervisory program both require controls testing as well as substantive testing, and the examination process for each FCM must be driven by the risk profile of each such FCM. Both programs are required to be reviewed by an examinations expert every two years. Both must have standards addressing the items listed in proposed § 1.52(c)(2)(iii), including the examination risk assessment, examination planning, and quality control to ensure that the examinations maintain the level of quality expected. The rationale for this approach is because one of the goals of proposed § 1.52(d)(2) is to ensure that the SRO and examinations of FCMs is at least up to the same heightened standard, regardless of whether the oversight and examinations are conducted by the SRO itself or by a DSRO designated by the Joint Audit Committee.

The proposed revisions to § 1.52(d) would not nullify the existing joint audit plan approved by the Commission on March 18, 2009. Furthermore, the Commission believes that the new minimum requirements for a Joint Audit Program under proposed § 1.52(d)(2) will not require revisions to the current joint audit plan. In this regard, the joint audit plan approved by the Commission includes a provision in paragraph 3 that provides that the minimum practices and procedures followed by each DSRO in the conduct of examinations of FCMs shall be established to conform with the requirements of § 1.52, Commission staff interpretations, and any other Commission requirements hereinafter in effect relating to audits and financial reviews. The Commission believes that this provision would require the DSROs of the current joint audit plan to revise their Audit Program to meet the new requirements of proposed 1.52, but not require a new joint audit plan to be submitted to the Commission.[79]

The members of the current joint audit plan would be required to establish, operate and maintain a Joint Audit Program under proposed § 1.52(d)(2)(i). The members of the current joint audit plan also would be required to submit to the Commission for its review and comment a Joint Audit Program within 120 days (or such other time as the Commission may approve) of the effective date of the amendments to § 1.52 under proposed § 1.52(d)(2)(ii)(H). The Joint Audit Program must be accompanied by a written report from an examinations expert affirming that the examinations expert has evaluated the Joint Audit Program and the examinations expert's opinion as to whether the Joint Audit Program is reasonably likely to identify a material deficiency in internal controls over financial and regulatory reporting, and other items that are subject of an examination conducted in accordance with the Joint Audit Program.

The Commission is proposing to delegate the responsibility for granting an extension of time to submit an initial Joint Audit Program to the Director of the Division of Swap Dealer and Intermediary Oversight. In this connection, the Commission anticipates that the Division of Swap Dealer and Intermediary Oversight will be performing ongoing consultation with SROs regarding the examination programs and, therefore, would be in position to assess the adequacy of, and necessity for, any request for an extension of the filing deadline. It is anticipated that the Director of the Division of Swap Dealer and Intermediary Oversight will grant requests for reasonable extensions of time for the submission of the Joint Audit Program.

The Commission requests comments on all aspects of proposed § 1.52. The Commission also requests comments on the following:

- The Commission is proposing to require that the SRO and/or JAC program be subject to an evaluation by an examinations expert at least once every two years. The examinations expert is defined as a nationally recognized accounting and auditing firm. Is the proposed definition of the examinations expert sufficiently clear or detailed to identify which entities may qualify as an examinations expert? If not, how can the Commission make the definition more objective? Should the Commission consider entities other than accounting and auditing firms (such as consulting firms) to act as examinations experts?
- Is the requirement for the examinations expert to conduct an evaluation of the SRO or JAC program at least once every two years an appropriate timeframe? Should the Commission consider a shorter interval between evaluations? If so, why? Alternatively, should the Commission consider a longer interval between evaluations? If so, why? What criteria should the Commission consider in setting the interval? Should the Commission allow SRO or JAC programs that have minimal issues raised by the examinations expert be subject to a longer evaluation interval than programs that have more issues identified by the examinations expert? If so, how would the Commission implement such a program?
- Does the requirement for an examinations expert add sufficient value to the SRO or JAC program to justify the costs of such evaluations? Please provide detail in your response to assist the Commission in assessing the costs of such evaluations.
- Are there alternatives to the examinations expert's evaluation to assess the adequacy of the SRO and JAC program that the Commission should consider? Please provide detail in your response.
- The Commission is proposing that an SRO submit an initial supervisory program and that the members of a Joint Audit Committee submit an initial Joint Audit Program within 120 days of the effective date of the regulation. The initial supervisory program and the initial Joint Audit Program must include

[79] The Commission's view is only that the current agreement does not have to be revised as a result of the proposed amendments. The SRO members of the current joint audit plan, however, are not precluded from making any amendments or otherwise revising the joint audit program consistent with the terms included in the agreement for making such revisions.

a written report containing an affirmation from an examinations expert regarding the evaluation of the supervisory program or the Joint Audit Program, including the sufficiency of the risk-based approach and the internal controls testing. The examinations expert also must opine as to whether the supervisory program or the Joint Audit Program is reasonably likely to identify a material weakness in internal controls over financial or regulatory reporting. Is the proposed 120-day period a sufficient period of time for an SRO or JAC to obtain such report from an examinations expert and to submit its respective supervisory program or Joint Audit Program? If not, what is a sufficient period of time?

P. Proposed Amendments to § 1.55: Public Disclosures by Futures Commission Merchants

The Commission is proposing to amend § 1.55 to enhance the disclosures provided to customers and potential customers regarding the extent to which customer funds are protected when deposited with an FCM as margin or to guarantee performance for trading commodity interests. The Commission also is proposing to require each FCM to disclose certain firm specific information regarding the FCM's financial condition and operations to allow customers and potential customers to assess the risks of engaging the firm to conduct futures trading and the risks of entrusting their funds to the FCM.

Regulation 1.55(a) currently requires an FCM, or an IB in the case of an introduced account, to provide each customer with a risk disclosure statement prior to opening the customer's account (''Risk Disclosure Statement').[80] Regulation 1.55(b) provides a standard form Risk Disclosure Statement that each FCM or IB is required to provide to each prospective customer. The current Risk Disclosure Statement is primarily intended to provide a customer with disclosure of the market risks of engaging in futures trading and addresses, among other things, risks associated with leverage, market movements, and the inability to exit the market due to limit moves. The FCM or IB also is required to receive a signed acknowledgment from the customer stating that the customer received and understood the Risk Disclosure Statement.

The Commission is proposing to amend § 1.55 to require FCMs to provide additional disclosures to prospective customers. Specifically, the Commission is proposing to add new provisions to paragraph (b) that will require the Risk Disclosure Statement to contain a statement that: (1) Customer funds are not protected by insurance in the event of the bankruptcy or insolvency of the FCM, or if customer funds are misappropriated in the event of fraud; (2) customer funds are not protected by SIPC, even if the FCM is a BD registered with the SEC; and (3) customer funds are not insured by a DCO in the event of the bankruptcy or insolvency of the FCM holding the customer funds. The proposed amendments also will require an FCM to disclose that each customer's funds are not held in an individual segregated account by an FCM, but rather are commingled in one or more accounts, and that FCMs may invest funds deposited by customers in investments listed in § 1.25. The proposed amendments also will require that each FCM disclose that funds deposited by customers may be deposited with affiliated entities of the FCM, including affiliated banks and brokers.

The Commission also is proposing to revise the Risk Disclosure Statement required by § 1.55(b) to include a new disclosure that informs a potential customer that each futures commission merchant is required by Commission regulations to make certain firm specific disclosures and financial information publicly available on the futures commission merchant's Web site to assist the customer with his or her assessment and selection of a futures commission merchant. The firm specific disclosures are detailed in proposed paragraph (k) of § 1.55 and are discussed below. The Risk Disclosure Statement also must include the futures commission merchant's Web site address where the additional firm specific and financial information may be obtained by the customer.

The Commission is proposing the additional disclosures in response to the recent failures of MF Global and Peregrine. The Commission is concerned that the current Risk Disclosure Statement does not provide customers with adequate or complete information regarding the risks of engaging in trading through an FCM. Current disclosures in the Risk Disclosure Statement focus on the market risks of engaging in futures trading. However, the Commission understands that many of MF Global's former customers did not have adequate and meaningful information regarding the risks that their funds were exposed to beyond general market risks. Specifically, the Commission understands that some customers believed that their funds were covered by insurance or other protection. Some customers also believed that DCOs guaranteed customer funds in the event of a bankruptcy of an FCM.

The proposed additional disclosures in the Risk Disclosure Statement are intended to provide customers with a greater understanding of the risks of entrusting their funds with an FCM. This includes disclosures regarding the meaning and operation of the term ''segregation'' under the Act and Commission regulations. In addition, the Commission believes that customers will benefit from an awareness that FCMs may use affiliated entities to hold customer funds.

The Commission also is proposing that the Risk Disclosure Statement include a new provision that informs potential customers to the fact that additional firm specific disclosures and financial information about a particular FCM may be obtained from information maintained on each FCM's respective Web site. The content of the additional firm specific and financial disclosures are discussed below.

The Commission also is proposing to amend § 1.55, by adding new paragraphs (i) through (n) which will require an FCM to provide to each customer an additional disclosure document that will set forth firm specific information and address firm-specific risk factors to allow customers to have more information regarding the FCM and the risks associated with entrusting their funds to the FCM, or otherwise conducting business with or through the FCM (''Firm Specific Disclosure Document''). The additional risk information provided also will enable customers to make more meaningful judgments regarding the appropriateness of selecting an FCM by providing tools and information for the meaningful comparisons of business models and risks across FCMs. Such additional information will greatly enhance the due diligence that a customer can conduct both prior to opening an account and on an ongoing basis, as the proposal will require that the FCM update the risk disclosure information on a periodic basis. The Commission believes that the proposed Firm Specific Disclosure Document, coupled with the existing Risk Disclosure Statement, will provide customers with a more complete perspective regarding the risks of participating in the futures markets.

[80] FCMs and IBs are not required to provide disclosure documents to institutional customers, defined as eligible contract participants under section 1a of the Act. See § 1.55(f).

Under the proposal, in addition to providing general firm contact information, the Firm Specific Disclosure Document will contain the names, business contacts, and backgrounds for the FCM's senior management and members of the FCM's board of directors. The Firm Specific Disclosure Document also will include firm risk disclosures including: (1) A discussion of the significant types of business activities and product lines that the FCM engages in; (2) a discussion of the FCM's significant lines of business and the approximate amount of assets and capital devoted to each line of business; (3) a discussion of the material risks of the firm including the FCM's creditworthiness, leverage, capital and liquidity condition, and an explanation of how such risks may be material to customers that deposit funds for futures trading with the firm; and (4) a discussion of any material administrative, civil, criminal, or enforcement actions pending or any enforcement actions taken in the last three years.

The proposed Firm Specific Disclosure Document also will require each FCM to disclose firm specific information regarding its operations in the futures marketplace. An FCM will be required to disclose the name of the firm's DSRO, and to provide an overview of customer funds segregation protections and limitations, and how it manages its collateral management and investments. Each FCM also will be required to disclose the clearinghouses and carrying brokers that its uses to conduct its business, as well as its policies and procedures concerning the choice of depositories, custodians and counterparties.

The proposed Firm Specific Disclosure Document also will require the FCM to disclose certain financial and risk management information including the firm's total equity, regulatory capital, and net worth as of the most recent month end when the disclosure document is prepared. The FCM also is required to disclose information regarding: (1) The amount of the FCM's proprietary margin requirements as a percentage of the total segregated and secured funds that the FCM holds; (2) the number of customers that comprise 50 percent of the firm's total customer segregated and secured amount requirements; (3) the aggregate notional value, by asset class, of all non-hedged, principal over-the-counter transactions into which the FCM has entered; (4) the amount, generic source and purpose of any unsecured lines of credit (or similar short-term funding) the FCM has obtained but not yet drawn upon; (5) the aggregate amount of financing the FCM provides for customer transactions involving illiquid financial products for which it is difficult to obtain timely and accurate prices; (6) the percentage of customer receivables that the FCM had to write-off as uncollectable during the prior year compared to the current segregated and secured amount balances; and (7) a summary of the FCM's current risk practices, controls and procedures.

An FCM is obligated to update the Firm Specific Disclosure Document as necessary to keep the information accurate, but at least on an annual basis. An FCM also is required to make the Firm Specific Disclosure Document available to its customers and the general public on its Web site. An FCM may, however, use an alternative electronic means to make the Firm Specific Disclosure Document available to its customers provided that the electronic version is presented in a format that is readily communicated to its customers. The Proposal further provides that an FCM shall provide a paper copy of the Firm Specific Disclosure Document to a customer upon the customer's request.

The Commission also is proposing to amend § 1.55 to require each FCM to disclose on its Web site to the general public financial information that is publicly available under existing Commission regulations. Specifically, proposed paragraph (o) of § 1.55 will require each FCM to make available on its Web site the daily Segregation Schedule; the daily Secured Amount Schedule; and the daily Cleared Swaps Segregation Schedule. Each FCM will be required to maintain 12 months of the above segregation and secured schedules available on its Web site.

Proposed paragraph (o) also requires each FCM to disclose on its Web site a summary schedule of the firm's adjusted net capital, net capital, and excess net capital for the 12 most recent month-end dates. Each FCM also will be required to disclose on its Web site the following statements and schedules from the most current year end annual report that is certified by an independent public accountant in accordance with § 1.16: the Statement of Financial Condition; the Segregation Schedule; Secured Amount Schedule; the Cleared Swaps Segregation Schedule; and all footnotes related to the above statement and schedules.

The information that the proposal requires each FCM to disclose on its Web site is information that is currently publicly available under Commission regulations, or proposed by this rulemaking in the case of the Cleared Swaps Segregation Schedule, to be public information. Regulation 1.10(g) currently provides that the Segregation Schedules and Secured Amount Schedules contained in the monthly unaudited Forms 1–FR–FCM are public information. Regulation 1.10(g) further provides that the amounts of an FCM's adjusted net capital, minimum net capital requirement, and excess net capital as reported in the firm's unaudited monthly Form 1–FR–FCM are public information. Lastly, § 1.10(g) provides that the Statement of Financial Condition, Segregation Schedule, Secured Amount Schedule, and related footnote disclosures contained in an FCM's audited annual financial report are public documents.

The Commission also is proposing in paragraph (o) of § 1.55 to require each FCM to include a statement on its Web site that is available to the public that additional information, including information on how the FCM invests customer funds, may be obtained from the NFA. The FCM also is required to include a link on its Web site to the NFA web page which shows financial information for the FCM. Lastly, proposed paragraph (o) requires each FCM to include a statement regarding the Commission's reporting of select FCM financial information and a link to the Commission's Web site.

The Commission is proposing paragraph (o) as it believes that customers will make more informed choices regarding which FCMs to use to carry their account and to entrust their funds to if they have the opportunity to have access to FCM financial information. Requiring FCMs to make the information available to the public on their respective Web sites will allow customers and potential customers with a convenient method of obtaining and reviewing the information to assist with their selection process. Customers will have the ability to compare and contrast financial data from all FCMs to assist with the decision making process of determining which firms meet their criteria for holding their funds.

The Commission requests comment on all aspects of proposed amendments to § 1.55. Specifically, the Commission requests comment on the following:

- Do the existing and proposed disclosures required to be included in the Risk Disclosure Statement and Firm Specific Disclosure Document adequately convey to retail and/or institutional investors the market and firm specific risks of engaging in futures trading and the risks of using an FCM to execute trades on customers' behalf and to hold customers' funds? If not, how should the Risk Disclosure

Statement and Firm Specific Disclosure Document be amended?

• Are there other disclosures that the Commission should require to be included in Risk Disclosure Statement? If so, what are the additional disclosures and how would such disclosures benefit customers?

• Are there other disclosures that the Commission should require to be included in a Firm Specific Disclosure Document? If so, what are the additional disclosures and how would such disclosures benefit customers?

• Are the proposed additional firm-specific disclosures too broad? If so, how should the Commission refine the disclosures to be more specific, yet provide the type of information that the Commission would like customers to receive?

• The Commission is proposing to require an FCM to disclose in the Firm Specific Disclosure Document the number of customers that comprise 50 percent of the FCM's customer fund balances for futures customers, Cleared Swaps Customers, and 30.7 Customers. Should the Commission consider additional or different percentages? If so, what should the percentages be and why?

• The Commission requests comment on how the new or revised Risk Disclosure Statement and Disclosure Documents should be provided to existing customers. Should FCMs be required to obtain new signature acknowledgments from existing customers for a revised Risk Disclosure Statement? How should existing customers be informed of the new Firm Specific Disclosure Statement? How can the Commission be assured that all existing customers have been informed of the new disclosure documents, and the availability of the FCM financial data?

• If FCMs are required to provide existing customers with new Risk Disclosure Statements, how should Commission address the implementation of the requirement? What would be an adequate period of time for FCMs to obtain new acknowledgment from existing customers?

Q. Proposed Amendments to Part 22

The Commission recently adopted final regulations in Part 22 implementing the provisions of the Dodd Frank Act that provide for the protection of Cleared Swaps Customer contracts and collateral.[81] Although substantive differences in the segregation regimes between futures and cleared swaps at the clearing level exist under the final Part 22 regulations as adopted, requirements with respect to collateral which is not posted to clearinghouses and maintained by FCMs for Cleared Swaps Customers replicate or incorporate by reference the same regulatory requirements applicable to the segregation of futures customer funds under section 4d(a)(2) of the Act (for example, holding funds separate and apart from proprietary funds, limitations on the FCM's use of customer funds, titling of depository accounts, Acknowledgment Letter from depository requirements, and limitations on investment of swap customers' funds are currently contained in Part 22 regulations).

The determination that appropriate enhancements are necessary with respect to the regulatory requirements discussed above for segregated futures customer funds under section 4d(a)(2) of the Act is equally applicable to Cleared Swaps Customer Collateral. The written policies and procedures requirements proposed in § 1.11 would be applicable to Cleared Swaps Customer Collateral, the new withdrawal limitations requirements proposed in § 1.23 are proposed to be replicated in a new § 22.17, and the changes to the daily segregation calculations and filing of such calculations, as well as requirements for detailed depository and investment information, are proposed to apply to Cleared Swaps Customer funds through proposed amendments to § 22.2(g). In addition, changes discussed above regarding § 1.17 with respect to securities haircuts are also proposed with respect to § 22.2(f), which similarly incorporates by reference the applicable SEC securities haircuts. Finally, the proposed § 1.20(i) requirement that an FCM maintain residual interest in segregated accounts in an amount that exceeds the sum of all futures customers' margin deficits is also proposed with respect to Cleared Swaps. As stated above, this requirement provides a clear mechanism for demonstrating FCM compliance with the prohibition under the Act and existing Commission regulations on using the collateral of one Cleared Swaps Customer to support the obligations of another Cleared Swaps Customer.

R. Amendments to § 1.3: Definitions; and § 30.7: Treatment of Foreign Futures or Foreign Options Secured Amount

Part 30 of the Commission's regulations were adopted in 1987 and govern trading on foreign futures markets.[82] Regulation 30.7 requires an FCM to set aside in separate accounts for the benefit of its foreign futures or foreign options customers an amount of funds defined as the ''foreign futures or foreign options secured amount.'' The term ''foreign futures or foreign options secured amount'' is defined in § 1.3(rr) as the amount of funds necessary to margin the foreign futures or foreign options positions held by the FCM for its foreign futures or foreign options customers, plus or minus any gains or losses on such open positions. The calculation of the foreign futures or foreign options secured amount is referred to as the ''Alternative Method.''

Foreign futures or foreign options customers receive substantially less protection for their account deposits under the Alternative Method than futures customers receive for their account deposits under section 4d(a)(2) of the Act and Commission regulations. Section 4d(a)(2) of the Act and Commission regulations require an FCM to segregate in separate accounts sufficient funds to satisfy the full account equities of all of its futures customers trading on designated contract markets *(i.e.,* the Net Liquidating Equity Method). The regulatory objective of the Net Liquidating Equity Method is to ensure that an FCM has sufficient funds in segregated accounts to cover the full account equities of all of its futures customers. This would allow the FCM to transfer the futures customers' positions and margin collateral in the event of the insolvency of the FCM to another firm that was financial sound. If the FCM does not maintain sufficient funds in segregation to cover the full account equities, the futures customers may not be able to be transferred to another FCM, or the futures customers may be required to deposit margin funds with the transferee FCM to adequately margin the positions.

In contrast, the Alternative Method only obligates an FCM to set aside an amount of funds in separate accounts sufficient to cover the margin required on open foreign futures and foreign options positions, plus or minus any unrealized gains or losses on such positions. Any funds deposited by foreign futures or foreign options customers in excess of the required amount to be set aside in separate accounts under the Alternative Method may be held by the FCM in operating cash accounts and may be used by the FCM as if it were its own capital. Therefore, an FCM is not required to set aside in separate accounts a sufficient

[81] 77 FR 6336 (February 7, 2012).

[82] 52 FR 28980 (Aug. 5, 1987).

amount funds to repay the full account balances of each of its foreign futures or foreign options customers, and, in the event of an FCM insolvency, the foreign futures or foreign options customers may not recover 100 percent of the value of their accounts or be able to transfer their positions to another FCM.

The Commission is proposing to amend the Part 30 regulations to eliminate the Alternative Method and to require FCMs to use the Net Liquidating Equity Method to compute the amount of funds they must set aside in separate accounts for the benefit of its foreign futures or foreign options customers. The amount of funds held for foreign futures and foreign options customers has grown dramatically in the last 10 years. FCMs held approximately $36.4 billion for foreign futures or foreign options customers as of June 30, 2012, compared to a total of $7.9 billion held as of March 31, 2002 (an approximate 470 percent increase).[83] In addition, the amount of funds held by FCMs for foreign futures or foreign options customers has increased relative to the amount of segregated funds held by FCMs during the last 10 years. Funds held for foreign futures or foreign options customers represented approximately 13 percent of the total customer funds held by FCMs as of March 31, 2002, and represented approximately 21 percent of total customer funds as of June 30, 2012.[84]

Accordingly, the Commission is proposing to amend § 1.3(rr) to define the term ''foreign futures or foreign options secured amount'' to mean the amount of funds an FCM needs to satisfy the full account balances of each 30.7 Customer at all times (i.e., the Net Liquidating Equity Method).

The term ''30.7 Customer'' is proposed to be defined in § 30.1 to mean both U.S.-domiciled customers and foreign-domiciled customers trading foreign futures or foreign options. As originally adopted, FCMs were only required to hold funds for U.S.-domiciled customers. The Net Liquidating Equity Method will require the FCM to set aside a sufficient amount of funds in secured accounts to repay the total account balances of all of its 30.7 Customers, which will align the requirement with the segregation requirements for both futures customers and Cleared Swaps Customers. The proposed amendments will significantly enhance the protection afforded to funds deposited by customers trading on foreign markets.

The Commission also is proposing to substantively revise the regulations governing an FCM's holding of funds deposited by a customer for trading on foreign futures markets. The proposed amendments to the foreign futures or foreign options secured amount requirement establish many of the regulatory requirements that currently exist, or are proposed to be adopted under this rulemaking, with regard to segregated funds deposited by customers trading on a designated contract market under Part 1 and deposited by Cleared Swaps Customers under Part 22 of the Commission's Regulations.

Regulation 30.7(a) requires an FCM to set aside in separate accounts sufficient funds to meet its current obligations to foreign futures or foreign option customers denominated as the ''foreign futures or foreign options secured amount.'' The term ''foreign futures or foreign options customer'' is defined in § 30.1 to mean any person located in the United States, its territories, or possessions. The term ''foreign futures or foreign options secured amount'' is defined at § 1.3(rr) and means an amount of money, securities, or other property sufficient to margin, guarantee, or secure open foreign futures contracts plus any unrealized gains or losses on such contracts, and any money securities or property representing premiums paid or received, and any other funds necessary to guarantee or secure, open foreign option transactions (*i.e.,* the Alternative Method of computing the secured amount requirement). Thus, an FCM is not required to set aside in separate accounts all funds deposited by or otherwise belonging to foreign futures or foreign option customers. Funds deposited by foreign futures or foreign options customers that exceed the foreign futures or foreign options secured amount may be commingled with the FCM's proprietary funds and used by the FCM as part of its business capital.

In addition, § 30.7(b) requires only that an FCM set aside the required margin funds for foreign futures customers that are located within the United States, its territories, or possessions. Regulation 30.7 permits the FCM to include foreign futures customers that are located outside of the United States, but the FCM is not obligated to include such foreign-domiciled customers.

Furthermore, Commission staff previously issued guidance to FCMs stating that an FCM could carry positions other than foreign futures and foreign option positions in foreign futures or foreign options customers' accounts. Thus, FCMs could commingle and carry customers' non-foreign futures positions, such as foreign currency positions and over-the-counter positions, in such customers' foreign futures or foreign options account.

The intent of the following amendments is to align the regulatory approach and customer protections by raising the requirements for foreign futures or foreign options secured amount to make it consistent with the FCM's segregation requirements for customers trading on designated contract market or engaging in cleared swap transactions.

As stated above, the Commission is proposing to require FCMs to compute the foreign futures or foreign options secured amount using the Net Liquidating Equity Method by amending the definition in § 1.3(rr) of the term ''foreign futures or foreign options secured amount'' to match structurally the definition in § 1.3(gg) of the term ''customer funds,'' which encompasses the Net Liquidating Equity Method of computing the amount of funds an FCM is required to maintain in customer segregated accounts. Specifically, the proposed definition of the term ''foreign futures or foreign options secured amount'' would be amended to mean all money, securities and property received by an FCM for, or on behalf of, ''30.7 Customers'' to margin, guarantee, or secure foreign futures contracts and foreign option transactions, and all funds accruing to ''30.7 Customers'' as a result of such foreign futures and foreign options transactions. The term ''30.7 Customer'' is proposed to be defined in § 30.1 to mean any person, whether domiciled within or outside of the United States, that engages in foreign futures or foreign options transactions through the FCM.

Requiring an FCM to set aside in separate accounts the funds deposited by both domestic and foreign-domiciled customers provides comparable customer protections to customers notwithstanding their place of domicile. In addition, requiring the FCM to hold U.S.-domiciled and foreign-domiciled customer funds in separate accounts under § 30.7 ensures that such customers receive equal protections in the event of the bankruptcy of the firm. Part 190 of the Commission's regulations and the U.S. Bankruptcy Code[85] provide that in the event of a commodity broker bankruptcy liquidation, customers in the account

[83] The total amount of customer funds held by FCMs is available on the Commission's Web site at *http://www.cftc.gov/MarketReports/FinancialDataforFCMs/index.htm.*

[84] Id.

[85] *See* 11 U.S.C. 761–766.

class entitled to a preference to the amounts in set-aside accounts for customers trading on foreign boards of trade include both U.S.-domiciled and foreign-domiciled customers.[86] The Commission is proposing to require funds to be set aside equally for U.S.-domiciled and foreign-domiciled customers trading on foreign boards of trade in the computation under § 30.7 by establishing a new definition of 30.7 Customers that includes existing foreign futures or foreign options customers (which are U.S.-domiciled persons trading foreign futures or foreign options) as well as any foreign-domiciled persons trading foreign futures or foreign options through the registered FCM. The secured amount definition, as proposed to be amended in § 1.3(rr), will reference ''30.7 Customers'' instead of ''foreign futures or foreign options customers,'' to ensure FCMs are required to set aside funds equal to the net liquidating equity of all such persons. Combined with the proposed amendment to require net liquidating equity, this should result in at all times an amount required to be set aside for all persons equal to the amount owed to such persons that would share in the account class for foreign futures in a commodity broker liquidation. The Commission is also proposing amendments in § 1.10 and § 1.17 to reference ''30.7 Customers'' instead of foreign futures or foreign options customers in the title of the schedules prepared by an FCM.

In addition, the Commission is proposing to add language to § 30.7(a) to provide an equivalent offset to that available in the futures customer segregation calculation under § 1.32(b) for deficits in accounts secured by securities, subject to language updating the reference to applying securities haircuts in calculating the offset as discussed in Section II.F above. The result of these amendments as discussed should be accord between the methodologies applied in the 4d segregation calculation and the § 30.7 calculation.

Consistent with proposed changes in § 1.20(i) and Part 22, the Commission also is proposing to add language to § 30.7(a) to provide that an FCM must hold residual interest in accounts set aside for the benefit of 30.7 Customers equal to the sum of all margin deficits for such accounts, to provide an equivalent clear mechanism for ensuring that the funds of one 30.7 Customer are not margining or guaranteeing the positions of another 30.7 Customer. Although this prohibition is not specified in the Act as it is with respect for futures customers and Cleared Swaps Customers, the Commission is proposing to the extent possible to replicate wherever practical and advisable customer protection provisions for futures customers and Cleared Swaps Customers to 30.7 Customers. As a result, most of the amendments proposed earlier in various provisions for these customers also are being proposed in § 30.7.

The Commission requests comment on the proposed amendments to § 30.7(a).

Proposed paragraph (b) of § 30.7 sets forth the permitted depositories for holding 30.7 Customer funds. The proposal does not alter the list of depositories that are currently permitted under § 30.7 to hold 30.7 Customers' funds: (1) A bank or trust company located in the United States; (2) a bank or trust company located outside of the United States that maintains in excess of $ 1 billion of regulatory capital; (3) an FCM registered with the Commission; (4) a DCO; (5) the clearing organization of a foreign board of trade; (6) a member of a foreign board of trade; and (7) the depositories used by the clearing organization of a foreign board of trade or a member of a foreign board of trade.

Proposed § 30.7(c) would limit the amount of 30.7 Customers' funds that an FCM could hold in non-U.S. jurisdictions. Under the proposal, an FCM must hold 30.7 Customer funds in the United States, except to the extent that the funds held outside of the United States are necessary to margin, guarantee, or secure (including any prefunding obligations) the foreign futures or foreign options positions of an FCM's 30.7 Customers. The Commission also is proposing to allow an FCM to deposit additional 30.7 Customer Funds equal to 10 percent of the total amount of funds required to be held by non-U.S. brokers or foreign clearing organizations for 30.7 Customers as a cushion to the required margin requirements, so that the FCM has a certain degree of flexibility in managing its daily cash movements and to ensure that the foreign futures or foreign options positions are not undermargined at foreign brokers or clearing organizations. The Commission recognizes that due to differences in time zones, trading hours, banking holidays, as well needs for cash transfers to foreign jurisdictions to settle and to be credited to accounts, a customer may not be able to immediately transfer funds to its FCM, and an FCM may not be able to immediately transfer funds to a foreign broker or foreign clearing organization to meet a margin call. The proposed cushion is intended to provide an FCM with sufficient flexibility to meet its customers' trading obligations on foreign markets, while also requiring as much of the total 30.7 Customer funds to be held within the United States in order to minimize the impact of the repatriation risk in the event of an FCM insolvency.

The Commission previously proposed changes to the form of the Acknowledgment Letter required from depositories holding funds set aside as the foreign futures or foreign options secured amount.[87] The Commission here re-proposes in a revised paragraph (d) to § 30.7 the requirements for obtaining and submitting Acknowledgment Letters for § 30.7 accounts, which proposed changes include further revised template forms of Acknowledgment Letter included as Appendices E and F. The proposed template forms, in addition to incorporating earlier proposed changes previously summarized with respect to the § 1.20 Acknowledgment Letters, have been further revised to include a depository's agreement to provide read-only account access to Commission or DSRO staff, in order for Commission or DSRO staff to directly verify balances as necessary. The Commission is also proposing subparagraphs (3), (4) and (5) of § 30.7(d), which substantively require 24 hour a day direct read-only electronic access to the depository account by the Commission and the DSRO, require the depository to file the written Acknowledgment Letter directly with the Commission and the FCM's DSRO, and require the depository to provide confirmations to the Commission and the FCM's DSRO directly upon request. The Commission requests comment on the revised requirements for Acknowledgment Letters for § 30.7 accounts as proposed in paragraph (d) and the new template forms of the Acknowledgment Letters proposed in Appendices E and F.

As part of its participation in the public roundtable discussed in the Background section above, FIA recommended that the Commission eliminate the ability of FCMs to commingle funds from unregulated

[86] *Id.* By definition, ''foreign future'' under section 761 of the Bankruptcy Code is not limited to transactions entered on foreign boards of trade on behalf of U.S. domiciled persons, and ''customer'' is not limited to U.S. domiciled persons. The result is that by the application of these definitions a preferential account class at a commodity broker for customers trading foreign futures would not be limited to U.S. domiciled customers.

[87] *See* Acknowledgment Letters for Customer Funds and Secured Amount Funds, 75 FR 47738 (Aug. 9, 2010).

transactions with funds for foreign futures and options trading in Part 30 set aside accounts, except by Commission order, as is the case under 4d(a)(2) of the Act for segregated funds. The Commission agrees with this recommendation. The comments cited in the release adopting Part 30 with respect to back office operational difficulties of establishing multiple ''customer'' origins were persuasive at the time Part 30 was adopted.[88] With the technological changes of intervening decades, however, these concerns should no longer dictate the advisability of commingling the funds of regulated foreign futures and foreign options transactions with unregulated transactions. Therefore, the Commission is proposing to amend § 30.7 by adopting new paragraph (e), which will extend the prohibition against commingling to any funds of account holders of an FCM unrelated to trading foreign futures or foreign options, except as the Commission shall by order permit, under terms and conditions as specified. Should there be a need to permit commingling of funds, the Commission will continue to have the ability to permit such commingling under the formalities of processes associated with a Commission order. The Commission requests comment on this proposed amendment to § 30.7(e).

The Commission has proposed to adopt a new paragraph (f) and a new paragraph (k) in § 30.7, to extend regulatory provisions from §§ 1.20, 1.21, 1.22 and 1.24, that previously were applicable only to 4d segregated funds, to funds set aside as the foreign futures or foreign options secured amount under § 30.7. The Commission requests comment on replicating these regulatory requirements applicable to segregated funds to funds set aside as the foreign futures or foreign options secured amount. These proposed requirements would make clear that FCMs would not be permitted to use funds set aside as the foreign futures or foreign options secured amount other than for the benefit of 30.7 Customers, and that funds set aside as the foreign futures or foreign options secured amount should not be invested in any obligations of clearing organizations or boards of trade, and that further, no funds placed at foreign brokers should be included as funds set aside as the foreign futures or foreign options secured amount unless those funds are on deposit to margin the foreign futures or foreign options trading of 30.7 Customers. In addition to extending these existing Commission regulations to § 30.7 in proposed paragraphs (f) and (k), the Commission is also proposing a new requirement prohibiting a FCM from imposing any liens or allowing any liens to be imposed on funds set aside as the foreign futures or foreign options secured amount. The Commission has previously adopted a lien prohibition with respect to the segregation of Cleared Swaps Customer collateral at § 22.2(d)(2) and therefore proposes to extend this lien prohibition to funds set aside as the foreign futures or foreign options secured amount in § 30.7. The Commission requests comment on the proposed amendments providing limitations on use and permitted withdrawals as contained in §§ 30.7(f) and (k).

As discussed in Section II.I above, the Commission has proposed new limitations on withdrawals of segregated funds in § 1.23. The proposed amendments provide for an FCM's residual interest in segregated funds, and permits withdrawals from segregated funds for the proprietary use of the FCM to the extent of such residual interest, subject to the requirement that the withdrawal must not occur prior to the completion of the daily segregation computation for the prior day, and should the withdrawal (individually or aggregated with other withdrawals) exceed 25 percent of the prior day residual interest, the withdrawal must be subject to specific approvals by senior management and appropriately documented, and further subject to a complete prohibition on withdrawals of residual interest to the extent of margin deficits. The Commission has proposed paragraph (g) of § 30.7 to apply the same restrictions on withdrawals of an FCM's residual interest in funds set aside as the foreign futures or foreign options secured amount. The Commission requests comment on proposed paragraph (g) of § 30.7.

Regulation 30.7(g) was recently adopted by the Commission to provide that the investment of § 30.7 funds be subject to the investment limitations contained in § 1.25.[89] The Commission is proposing to now move this permitted investment requirement to a new paragraph § 30.7(h), and further to adopt a new paragraph § 30.7(i), which makes clear that FCMs are solely responsible for any losses resulting from the permitted investment of funds set aside as the foreign futures or foreign options secured amount. The new paragraph § 30.7(i) is intended to apply the same standard as is being proposed in the amendment to § 1.29 for segregated funds discussed above. The Commission is also requesting comment on whether the investment of 30.7 property should be restricted in cases of jurisdictions where client asset protection of such property cannot be assured? If so, what assurances should be required? For example, in cases of jurisdictions where client asset protections can be waived, should the Commission require that the Commission or a DSRO be practicably able to audit for evidence of such waiver? What are the relevant costs and benefits of adopting any of these alternatives?

The Commission also is proposing in an amended paragraph (j) to § 30.7 to clarify the circumstances under which an FCM may make secured loans to 30.7 Customers and to adopt the same restriction on unsecured lending to 30.7 Customers as has been proposed with respect to futures customers and 4d segregated funds in the proposed amendment to § 1.30 discussed above. The Commission requests comment on applying this restriction in relation to 30.7 Customers.

Finally, the Commission is proposing an amended paragraph (l) to § 30.7 to require the daily computation of the foreign futures or foreign options secured amount and the filing of such daily computation with the Commission and DSROs, as well as to require the FCM to provide investment detail of the foreign futures or foreign options secured amount as of the middle and end of the month. The proposed amendments to paragraph (l) of § 30.7 are intended to be consistent with the requirements for the daily segregation calculation for segregated customer funds and the provision of the segregation investment detail which are proposed in § 1.32. The Commission requests comment on the proposed changes requiring the filing of the daily secured amount computation and the investment detail as proposed in § 30.7(l).

III. Consideration of Costs and Benefits

The misuse or mishandling of customer funds at specific FCMs like MF Global or Peregrine not only imposes a burden on those customers whose funds have been misused, but also creates a burden to the public by eroding the trust of the American public in all market intermediaries. This loss of trust could deter market participants from the benefits of using regulated, transparent markets and clearing. The overarching purpose of this rule is to provide regulators the means by which to detect and deter the misuse or mishandling of customer funds by FCMs in order to produce the benefits that

[88] *See* 52 FR 28980 at 28985–28986.

[89] 76 FR 78776 at 78802 (December 19, 2011).

accrue by virtue of avoiding similar defaults in the future and to prevent the costs, including lost customer funds, decreased market liquidity that follows from a crisis in confidence, and the potential for the failure of one FCM to cause instability in other clearing members.[90]

The Commission's proposal builds on recent efforts by the Commission and industry to better protect customer funds. As discussed above in section I.D., in December 2011 the Commission amended § 1.25 of its regulations to eliminate certain options for the permissible investments of customer funds.[91] Two months later, the Commission approved a margin rule for cleared swap transactions referred to as ''LSOC'' (legal separation with operational commingling) in which each swaps customer's collateral is protected individually all the way to the clearinghouse.[92] The Commission also convened a roundtable in late February 2012 to discuss what amendments should be made to Commission regulations in order to provide additional protection to customer funds. Further, in June 2012, the Commission finalized rules for DCMs and included amendments to § 1.52 which codify staff guidance on minimum requirements for SROs regarding their financial surveillance of FCMs.[93] With the recent default of another FCM, Peregrine, the Commission held two additional roundtables to discuss, among other things, technological approaches to mitigating the risk of fraud, and possible amendments to the Commission's rules regarding protection of customer funds.[94]

In this rulemaking, the Commission is proposing amendments to improve the protection of customer funds. The content of the Commission's proposal can be categorized in seven parts: (1) Requiring FCMs to implement extensive risk management programs including written policies and procedures related to various aspects of their handling of customer funds; (2) increasing reporting requirements for FCMs related to segregated customer funds, including daily reports to the Commission and DSRO; (3) requiring FCMs to establish target amounts of residual interest to be maintained in segregated accounts as well as creating restrictions and increased oversight for FCM withdrawals out of such residual interest in customer segregated accounts, specifically including clear sign off and accountability from senior management for such withdrawals; (4) strengthening requirements for the acknowledgment letters that FCMs and DCOs must obtain from their depositories; (5) eliminating the Alternative Method for calculating 30.7 Customer funds segregation requirements and requiring FCMs to include foreign investors' funds in segregated accounts; (6) strengthening 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 (7) requiring FCMs to provide additional disclosures to investors.

Statutory Mandate To Consider the Costs and Benefits of the Commission's Action: Commodity Exchange Act Section 15(a)

Section 15(a) of the Act requires the Commission to consider the costs and benefits of its actions before promulgating a regulation under the Act or issuing certain orders. Section 15(a) further specifies that the costs and benefits shall be evaluated in light of the following five broad areas of market and public concern: (1) Protection of market participants and the public; (2) efficiency, competitiveness and financial integrity of futures markets; (3) price discovery; (4) sound risk management practices; and (5) other public interest considerations. The Commission considers the costs and benefits resulting from its discretionary determinations with respect to the section 15(a) considerations.

There are four considerations relevant to this proposal. These are: (1) Protection of market participants and the public; (2) efficiency, competitiveness and financial integrity of futures markets; (3) sound risk management practices; and (4) other public interest considerations. The Commission proposes that the amendments would not have any effect on price discovery.

In the discussion that follows, the Commission provides an overview of the proposed rules in light of the three relevant 15(a) cost-benefit considerations previously identified, and then considers the costs and benefits of each section individually in light of the same 15(a) public interest considerations. The Commission concludes with additional requests for public comment on all aspects of its preliminary consideration of the costs and benefits of the rule proposals.

Overview of the Costs and Benefits of the Proposed Rules and Amendments in Light of the 15(a) Considerations

Protection of Market Participants and the Public

As stated above, the Commission is proposing amendments to improve protection of customer funds. Each of the seven parts of the proposal[95] would increase levels of protection for customer funds. Requiring FCMs to implement risk management programs that include documented policies and procedures regarding various aspects of handling customer funds would help protect customer funds by promoting robust internal risk controls and reducing the likelihood of errors or fraud that could jeopardize customer funds. In addition, by requiring each FCM to document certain policies and procedures, the proposed rules would enable the Commission, DSROs, and

[90] The failure of one clearing member could lead to instability in other clearing members if the losses due to the first member's failure are large enough to exhaust the guarantee fund and require additional capital infusion from other clearing members.

[91] In the final rule amending § 1.25, the Commission stated, ''the Commission is narrowing the scope of investment choices in order to eliminate the potential use of portfolios of instruments that may pose an unacceptable level of risk to customer funds.'' *See* ''Investment of Customer Funds and Funds Held in an Account for Foreign Futures and Foreign Options Transactions,'' 76 FR 78776, December 19, 2011.

[92] 77 FR 6336 (Feb. 7, 2012) (Protection of Cleared Swaps Customer Contracts and Collateral; Conforming Amendments to the Commodity Broker Bankruptcy Provisions).

[93] 77 FR 36612 (June 19, 2012) (Core Principles and Other Requirements for Designated Contract Markets).

[94] Public Meeting of the Technology Advisory Committee, July 26, 2012. *See http://www.cftc.gov/PressRoom/Events/opaevent_tac072612.* Public Roundtable to Discuss Additional Customer Protections, August 9, 2012. *See http://www.cftc.gov/PressRoom/Events/opaevent_cftcstaff080912.*

[95] The seven parts of the proposal are: (1) Requiring FCMs to implement risk management programs including extensive written policies and procedures related to various aspects of their handling of customer funds; (2) increasing reporting requirements for FCMs related to segregated customer funds, including daily reports to the Commission and DSROs; (3) requiring FCMs to establish target amounts of residual interest to be maintained in segregated accounts as well as creating restrictions and increased oversight for FCM withdrawals out of such residual interest in customer segregated accounts, including clear sign off and accountability from senior management for such withdrawals; (4) strengthening requirements for the acknowledgment letters that FCMs and DCOs must obtain from their depositories; (5) eliminating the Alternative Method for calculating 30.7 Customer funds segregation requirements and requiring FCMs to include foreign-domiciled customers' funds in segregated accounts; (6) strengthening the regulatory requirements applicable to SRO and DSRO oversight of FCMs, including regulating oversight provided under the function of a Joint Audit Committee (Joint Audit Program) that would establish standards for, and oversee the execution of, FCM audits; and (7) requiring FCMs to provide additional disclosures to investors.

other auditors to evaluate each FCM's compliance with their own policies and procedures. Moreover, the proposed requirement that FCMs establish a program for quarterly audits by independent or external people that is designed to identify any breach of the policies and procedures would help to ensure regular, independent validation that the procedures are followed diligently. Audits of this sort provide more thorough review of internal procedures than the Commission or DSROs would be able to perform regularly with existing resources, which would provide helpful scrutiny of each FCM's procedures on a regular basis. This, together with the proposed requirement that FCMs establish a program of governing supervision that is designed to ensure the policies required in § 1.11 are followed, will tend to promote compliance with the FCM's own policies and procedures. And by promoting such compliance, the requirements would reduce the risk of operational errors, lax risk management, and fraud, and thus the risk of consequent loss of customer funds.

Increasing reporting requirements for FCMs related to segregated customer funds would help the Commission and DSRO identify FCMs that should be monitored more closely in order to safeguard customer funds. Moreover, by making some additional reported information public, the proposed rules would facilitate additional market discipline that further promotes protection of customer funds.

Creating restrictions and increased oversight for FCM withdrawals out of its residual interest in customer segregated accounts, and requiring sign off from senior management for large withdrawals would protect customers by helping to ensure that such withdrawals do not cause segregated account balances to drop below their segregation requirements. Moreover, it would promote effective oversight of customer segregated accounts by senior management by increasing their accountability for withdrawals that affect the balance of such accounts.

The acknowledgments and commitments depositories would be required to make through proposed §§ 1.20, 1.26, and 30.7 would provide additional protection for customer funds by, among other things, requiring depositories that accept customer funds to acknowledge that customer funds cannot be used to secure the FCM's obligations to the depository. Such an acknowledgment would provide additional protection of customer funds in the event of an FCM's default. In addition, depositories would agree in the acknowledgment letter to give the Commission and DSROs read-only electronic access to an FCM's segregated accounts, which would benefit customers by enabling the Commission and DSROs to monitor the accounts for discrepancies between the FCM's reports and the balances on deposit at various depositories. This would provide an additional mechanism by which customers would be protected against a shortfall in customer funds due to operational errors or fraud.

Requiring FCMs to include foreign-domiciled investors' funds in segregated accounts ensures that all customers placing funds on deposit for use in trading foreign futures and foreign options will benefit from the same protections provided by the Act and Commission regulations. As discussed below, the Commission understands that most, if not all FCMs currently extend the same protections to U.S.-domiciled and to foreign-domiciled customers. However, incorporating foreign-domiciled customers within the protections provided to 30.7 Customers places regulatory weight behind the protections and ensures that FCMs are not permitted to cut corners with respect to protecting foreign-domiciled customers' funds during a time of financial strain. Similarly, eliminating the Alternative Method provides additional protection to customer funds by ensuring that FCMs are not allowed to reduce their segregation requirements for 30.7 Accounts during a time financial strain. As discussed below, this change would provide protection to both U.S-domiciled and foreign-domiciled customers with funds in 30.7 Accounts.

The proposed provisions in § 1.52 include additional requirements for both the supervisory program for SROs as well as for the formation of a Joint Audit Committee to oversee the implementation and operation of a Joint Audit Program that directs audits of FCMs by DSROs. By requiring both the SRO supervisory programs and the Joint Audit Program to comply with U.S. generally accepted audit standards, to develop written policies and procedures, to require controls testing as well as substantive testing, and to have an examinations expert review the programs at least once every two years, the proposed amendments would help to ensure that audits of FCMs by SROs or DSROs are thorough, effective, and continue to incorporate emerging best practices for such audits. As a consequence, the proposed amendments would help to ensure that audits are as effective as possible at identifying potential fraud, strengthening internal controls, and verifying the integrity of FCMs' financial reports, each of which tend to provide protection for FCMs' customers, counterparties, and investors.

In addition the proposed § 1.55 would require disclosure of firm-specific risks to customers. This additional information would assist them with due diligence when selecting an FCM and would help to ensure that they are aware of any changes at the FCM that could prompt them to reconsider their decision to deposit funds with the FCM. In doing so, the proposed rules would promote market discipline that incents FCMs to manage their risks carefully and would assist customers in understanding how their funds are held and what risks may be relevant to the safety of their funds.

Efficiency, Competitiveness and Financial Integrity of Futures Markets

The proposed amendments would increase the efficiency and financial integrity of the futures markets by ensuring that FCMs have strong risk management controls that are subject to multiple and enhanced external checks, by enhancing reporting requirements, facilitating increased oversight by the Commission and DSROs, by allowing FCMs flexibility in the development of newly required policies and procedures wherever the Commission has determined that such flexibility is appropriate, and by requiring FCMs to implement training regarding the handling of customer funds. In addition, the proposed rules include some requirements that many industry participants have requested as necessary for the adequate protection of customers and also highlighted as best practices already adopted within the industry. Requiring such standards to be adopted by all FCMs will promote the competitiveness of futures markets by ensuring a level playing field at a minimum level necessary for the protection of customers, and not allowing any FCMs to, at the expense of customers, maintain an unfair competitive advantage to their counterparts who utilize best practices and may have such protections already in place. There are also provisions in the proposal that permit FCMs that are not broker-dealers to implement certain securities net capital haircuts that have been proposed to apply to jointly registered FCM/BDs by the SEC, which similarly enhances competition by keeping a level playing field between sole FCMs and jointly registered FCM/BDs with respect to such requirements.

More specifically, the proposed amendments to §§ 1.10, 1.11, 1.12, 1.32,

22.2, and 30.7 would increase reporting requirements for FCMs related to segregated customer funds, including daily, bi-monthly, and additional event-triggered reports to the Commission and DSROs. The expanded range and frequency of information that the Commission and DSRO would receive under the proposed regulations would enhance their ability to monitor each FCM's segregated accounts, which would promote the integrity of futures markets by helping to ensure proper handling of customer funds at FCMs.

In addition, the proposed changes would facilitate increased oversight by the Commission and DSROs by including additional notification requirements, obligating FCMs to alert the Commission when certain events occur that could indicate an FCM's financial strength is deteriorating or that important operational errors have occurred. Such notifications would enable the Commission and DSROs to increase monitoring of such FCMs to ensure that customer funds are handled properly in such circumstances. The proposed rules would also require FCMs and DCOs to obtain an acknowledgment letter from depositories that would give the Commission and DSROs electronic access to view customer accounts at each depository. That would enable both the Commission and DSROs to verify the presence of customer funds which would provide a safeguard against fraud and would promote the integrity of markets for futures, cleared options, and cleared swaps.

The proposed rules would also require FCMs to establish policies and procedures regarding several aspects of how they handle customer funds. The rules would give FCMs the flexibility, where appropriate, to develop policies and procedures tailored to the unique composition of their customer base, size, and other operational disincentives. This flexible approach protects FCMs from additional regulatory compliance costs that could otherwise result from rules requiring every FCM to operate in exactly the same way without sacrificing the additional accountability that results from written policies and procedures that the Commission or DSRO can review and use as the basis for FCM audits.

The proposed requirement that FCMs would provide annual training to all finance, treasury, operations, regulatory, compliance, settlement and other relevant employees regarding the segregation requirements for segregated funds, for notices under § 1.12, procedures for reporting non-compliance, and the consequences of failing to comply with requirements for segregated funds, would enhance the integrity of the futures markets by promoting a culture of compliance by the FCM's personnel. The training would help to ensure that FCM employees understand the relevant policies and procedures, that they are empowered and incented to abide by them, and that they know how to report non-compliance to appropriate authorities.

Last, the proposing form of the rule would allow FCMs that are not dual registrants *(i.e.,* are not both FCMs and BDs) to follow the same procedures as dual registrants when determining what regulatory capital haircut applies to certain types of securities in which the FCM invests its own capital or customer funds. This proposed change is needed as the SEC has proposed a change for broker-dealers which would permit joint registrants to possibly apply a lower regulatory haircut for certain securities, but which would not be applicable to sole FCMs without the proposal. Therefore, the proposal would ensure that sole FCMs are not competitively disadvantaged and are able to continue applying the same regulatory capital haircuts for such securities as joint registrants.

Sound Risk Management

The amendments proposed here, if adopted, would promote sound risk management by facilitating market discipline, enhancing internal controls, enabling the Commission and DSROs to monitor FCMs for compliance with those controls, by minimizing the risk that an FCM's financial strain could interfere with customers' ability to manage their positions, by requiring FCMs to notify the Commission in additional circumstances that could indicate emerging financial strain, and by requiring senior management to be involved in the process of setting targets for residual interest.

The proposed reporting requirements would enhance market discipline by providing additional information to investors regarding the location of their funds, and the size of residual interest buffer that an FCM targets and maintains in its segregated accounts. This additional information would be valuable to customers selecting an FCM and monitoring the location of their funds deposited with the FCM which would promote market discipline. For example, if an FCM were to establish a low target for residual interest, or maintain a very low residual interest, market participants would likely recognize this as a practice that could increase risk to the funds they have on deposit at the FCM, and would likely either apply pressure to the FCM to raise their target, or take their business to a different FCM that maintains a larger residual interest in customer fund accounts. This market discipline would incent FCMs to maintain a level of residual interest that is adequate to ensure that a shortfall does not develop in the customer segregated accounts.

The proposed rules would also enhance FCM internal controls by requiring them to establish a risk management program that includes policies and procedures related to various aspects of how segregated customer funds are handled. For example, FCMs would be required to establish procedures for continual monitoring of depositories where segregated customer funds are held, and would have to establish a process for evaluating the marketability, liquidity, and accuracy of pricing for § 1.25 compliant investments.

In addition, documented policies and procedures would benefit the FCM customers and the public by providing the Commission and DSROs greater ability to monitor and enforce procedures that FCMs perform to ensure that the protection of customer funds is achieved, with the effect that the Commission would have a greater ability to address and protect against operational errors and fraud that put customer funds at risk of loss.

Further, through the proposed amendments to § 1.17(a)(4), FCMs will need to manage their access to liquidity so as to be able to certify to the Commission, at its request, that they have sufficient access to liquidity to continue operating as a going concern. This proposal will provide the Commission with the flexibility to deal with emerging liquidity drains at FCMs which may endanger customers, potentially prior to instances of regulatory capital non-compliance, allowing customer positions and funds to be transferred intact and quickly to another FCM. This change would promote sound risk management practices by helping to ensure that customers maintain control of their positions without interruption.

The proposed additions to notification requirements established in § 1.12 would enhance the Commission's ability to identify situations that could lead to financial strain for the FCM, which makes it possible for the Commission to monitor further developments with that FCM more carefully and to begin planning earlier for the possibility that the FCM's customer positions may need to be transferred to other FCMs, in the event

that the FCM currently holding those positions defaults. Advance notice helps to ensure customers' positions are protected by enabling the Commission to work closely with DCOs and DSROs to identify other FCMs that have requisite capital to meet regulatory requirements if they were to take on additional customer positions, thus facilitating smooth transition of those positions in the event that it is necessary.

Last, residual interest is an important aspect of protection for customer funds because it enables the FCM to ensure that it can meet all customer obligations at any time without using another customer's funds to do so. In general, the larger the residual interest, the more secure customer funds are in this respect. By requiring that senior management set the target for residual interest, and that they conduct adequate due diligence in order to inform that decision, the proposed rule promotes both informed decision making about this important form of protection, and accountability among senior management for this decision, both of which are consistent with sound risk management practices.

Other Public Interest Considerations

As discussed above, the recent failures of MF Global and Peregrine, FCMs to which customers have entrusted their funds, sparked a crisis of confidence regarding the security of those funds. This crisis in confidence could deter market participants from using regulated, transparent markets and clearing which would create additional costs for market participants and losses in efficiency and safety that could create additional burdens for the public. The Commission anticipates that this rule will not only address the current crisis of confidence, but that it will produce benefits for the public by virtue of avoiding similar defaults in the future.

These proposed amendments are not, however, without costs. The most significant costs created by the proposed amendments are those that increase the amount of capital that FCMs would be required to contribute to segregated accounts as part of establishing a target for their residual interest, incent them to hold additional capital, prevent them from holding excess segregated funds overseas, and that are created operationally by the formation of a risk management unit and adoption of new policies and procedures.

Multiple proposed changes would incent or require FCMs to increase the amount of residual interest that they maintain in segregated accounts including: (1) Requiring FCMs to establish a target for residual interest that reflects proper due diligence on the part of senior management; (2) disclosing the FCMs' targeted residual interest publicly; and (3) requiring them to report to the Commission and their DSRO any time their residual interest drops below that target. In addition by restricting FCMs' ability to withdraw residual interest from segregated accounts and obligating FCMs to report to the Commission and their respective DSRO each time the residual interest drops below the target, the proposed regulations would incent FCMs to hold additional capital, which is also likely to be a significant cost.

When FCMs hold excess customer funds overseas, such funds will likely be held at depositories that are themselves subject to foreign insolvency regimes, which may provide protections for customer funds that are less effective than those applicable under U.S. law. By prohibiting FCMs from holding excess customer funds overseas, the proposed regulations could reduce the returns that FCMs may obtain on invested customer funds.

And last, the proposed requirements related to operational procedures are likely to create significant costs, particularly related to creating and documenting policies and procedures, as well as complying with ongoing training, due diligence, and audit requirements. However, in several cases the implementation costs of proposed changes would be minimal. For example, some proposed requirements would obligate FCMs to provide the Commission and DSROs more regular access to information that FCMs and their depositories are already required to maintain, or in some cases are already reporting to their DSROs. The Commission also anticipates that some of the changes proposed codify best practices for risk management that many FCMs and DCOs may already follow. In such cases, the costs of compliance would be mitigated by the compliance programs or best practices that the firm already has in place. Moreover, in other cases the proposed changes codify practices that are already required by SROs, and therefore would impose no additional costs.

The initial and ongoing costs of the proposed rules for FCMs would vary significantly depending on the size of each FCM, the policies and procedures that they already have in place, and the frequency with which they experience certain events that would create additional costs under the proposed rules. The Commission estimates that the initial operational cost [96] of implementing the proposed rules would be between $193,000 and $1,850,000 per FCM.[97] And the initial cost to the SROs and DSROs would be between $41,100 and $63,500 per SRO or DSRO. The Commission estimates that the ongoing operational cost to FCMs would be between $287,000 and $2,300,000 per FCM per year.[98] As described below in § 1.52, the Commission does not have adequate information to determine the ongoing cost of the proposed requirements for SROs and DSROs.

In the sections that follow, the Commission considers the costs and benefits of the proposed changes, section by section, in light of the relevant 15(a) public interest, cost-benefit considerations.

[96] The Commission is not able to quantify the costs that would result from increased residual interest held in customer segregated accounts, from increased capital held by the FCM, or from lost investment opportunities due to restrictions on the amount of funds that may be held overseas. The Commission does not have sufficient data to estimate the amount of additional residual interest FCMs are likely to need as a consequence of proposed, the amount of additional capital they may hold for operational purposes, the cost of capital for FCMs, or the opportunity costs FCMs may experience because of restrictions on the amount of customer funds they can hold overseas, each of which would be necessary in order to estimate such costs.

[97] The lower bound assumes an FCM requires the minimum estimated number of personnel hours to be compliant with these new rules and that, when possible, they already have policies, procedures, and systems in place that would satisfy the proposed requirements. The upper bound assumes an FCM requires the maximum amount of personnel hours and do not have pre-existing policies, procedures, and systems in place that would satisfy the proposed requirements. The greatest amount of variation within in the range would depend on the number of new depositories an FCM must establish relationships with due to current depositories that would not be willing to sign the required acknowledgment letter. The lower bound assumes that an FCM does not need to establish any new relationships with depositories. The Commission estimates that the largest FCMs may have as many as 30 depositories, and as a conservative estimate, the Commission assumes for the upper bound that an FCM would have to establish new relationships with 15 depositories.

[98] As above, the lower bound assumes that an FCM requires the minimum estimated number of personnel hours to be compliant and that for event-triggered costs, the FCM bears the minimum number of possible events. The upper bound assumes an FCM requires the maximum number of personnel hours to be compliant. It also assumes an FCM has to notify the Commission pursuant to the proposed amendments in § 1.12 five times per year, and that an FCM withdraws funds from residual interest for proprietary use 50 times per year. The estimate does not include additional costs that would result if FCMs increase the amount of residual interest or capital that they hold in response to the proposed rules, or certain operational costs that the Commission does not have sufficient information to estimate.

Consideration of Costs and Benefits Related to Proposed Changes in Each Section

§ 1.3(rr)—Definition of ''Foreign Futures or Foreign Options Secured Amount''

Proposed Changes

As described above in II.R, the proposed amendments to § 1.3(rr) would replace the term ''foreign futures or foreign options customers'' with the term ''30.7 Customers.'' The former only includes U.S.-domiciled customers, whereas the term ''30.7 Customers'' includes both U.S.-domiciled and foreign-domiciled customers who place funds in the care of an FCM for trading on foreign boards of trade. This change expands the range of funds that the FCM must include as part of the foreign options or foreign futures secured amount.

In addition, the definition of ''foreign futures or foreign options secured amount'' currently means ''all money, securities and property held by or held for or on behalf of a futures commission merchant from, for, or on behalf of foreign futures or foreign options customers as defined in § 30.1.'' The proposed definition would change the meaning of ''foreign futures or foreign options secured amount'' so that it is equal to the amount of funds an FCM needs in order to satisfy the full account balances of each of its customers at all times. This definitional change supports the shift in § 30.7 from the ''Alternative Method'' to the ''Net Liquidating Equity Method'' of calculating the foreign futures or foreign options secured amount.

Benefits and Costs

These definitional changes would determine what funds are considered part of the ''foreign futures or foreign options secured amount.'' However, the costs and benefits of these changes are attributable to the substantive requirements related to the definitions and, therefore, are discussed in the cost and benefit considerations related to § 30.7.

§ 1.10—Financial Reports of Futures Commission Merchants and Introducing Brokers

Proposed Changes

As described above in II.A, the proposed amendments would make four changes. First, they would amend the 1–FR–FCM to create a new schedule called the ''Cleared Swap Segregation Schedule'' that would be included in the FCM's monthly report, together with the Segregation Schedule and Secured Amount Schedule. Second, it would make the Cleared Swap Segregation Schedule a public document.[99] Third, the proposed amendments would require each of the Schedules to include the FCM's target for residual interest in the accounts relevant to that Schedule, as well as a calculation of any surplus or deficit in residual interest with respect to that target. And fourth, the proposed rule would require each FCM to submit to the Commission a monthly statement reporting the FCM's leverage.

Benefits

The proposal to include target residual interest and monthly calculation of the deviation from that target on the monthly Schedules provides important benefits with respect to the safety of customer funds. The data in the reports is public information. Public disclosure incentivizes FCMs to set a reasonable target for residual interest. Under proposed regulations, FCMs would have to notify the Commission and their respective DSRO each time they drop below their targeted residual interest, which gives them an incentive to set a low target, even if they intend to keep more residual interest in their accounts. However, by disclosing an FCM's targeted residual interest to the public, the proposed rule would enable customers and potential customers of an FCM to incorporate the size of the FCM's targeted residual interest, and the corresponding amount of protection to customers' funds provided by that level of residual interest, into their selection of an FCM. Holding all other considerations constant, FCMs that have higher targets relative to their segregation requirements would presumably be more attractive to customers than FCMs that target smaller levels of residual interest relative to their segregation requirements because of the additional protection of customer funds it provides. This additional information permits customers to weigh this consideration along with considerations of price in selecting an FCM. Last, by requiring FCMs to report their leverage monthly, the proposed amendments would assist the Commission in monitoring each FCM's overall risk profile, which would help the Commission to identify FCMs that should be monitored more closely for further developments that could weaken their financial position.

Costs

As stated above, all else equal, by requiring FCMs to include their residual interest target in the monthly report, and by making the contents of those reports public, the proposed rule would incent FCMs to set a higher target for their residual interest in customer segregated funds. However, maintaining a larger targeted residual interest would create some costs for FCMs. Proprietary funds deposited into customer segregated accounts by an FCM are only allowed to be invested in § 1.25 investments and, therefore, are not available for other investments. In addition, placing additional capital in the customer segregated accounts reduces the amount of capital that an FCM has to meet operational needs, which would likely prompt the firm to raise or retain additional capital. Estimating the lost revenue that would result from the investment opportunities an FCM misses is not possible because the Commission is not able to estimate either the amount of increased residual interest that an FCM would, on average, maintain as the result of this proposed change, or the differential in return on investment between FCM funds placed into customer segregated accounts versus proprietary funds not held in such accounts. Similarly the Commission does not have adequate information to determine the average cost of capital for FCMs or the amount of additional capital that they would likely raise or retain as a consequence of this proposed change. The proposed requirement regarding monthly leverage statements will require FCMs to produce an additional report each month. The Commission anticipates that each FCM will incur a one-time cost in order to modify their systems to create the report, and then ongoing costs will be negligible because the report is likely to be automated. The Commission estimates that the one-time setup costs are likely to be between $2,800 and $5,700.[100]

Requests for Comment [101]

Question 1: The Commission requests comment regarding the costs and

[99] The Segregation Schedule and Secured Amount Schedule are already public documents.

[100] This assumes 40–80 hours of time from both a programmer and 20–40 hours from an intermediate accountant. The average compensation for a programmer is $53.64/hour [$82,518 per year/(2000 hours per year)*1.3 = $53.64/hour]; $53.64*40= $2,145.47 and $53.64*80= $4,290.94. The average compensation for an intermediate accountant is $34.11/hour [$52,484.00 per year/(2000 hours per year)*1.3 is $34.11per hour]; $34.11*20= $682.29 and $34.11*40= $1,364.58. All figures are taken from the 2011 SIFMA Report on Management and Professional Earnings in the Securities Industry.

[101] The Commission has numbered its questions throughout the Cost Benefit Considerations section. When responding to specific questions, please reference the number of the question. In addition,

Continued

benefits of these proposed rules, including making residual interest targets public information. Please explain and, if possible, quantify the relevant costs and benefits.

Question 2: In addition, the Commission requests comment regarding the costs and benefits that would result from providing each FCM's daily calculation of residual interest public. Would the disclosure of an FCM's daily calculations of residual interest pose a risk to such FCM, the markets, to customers, or the public? If so, please explain. Or, conversely, would a lack of disclosure exacerbate risks to FCM customers or the public? If so, please explain.

Question 3: Market participants have suggested that additional information from FCMs' daily, bi-monthly, and monthly reports should be disclosed to the public. What alternatives should the Commission consider in this respect? What would be the costs and benefits of that alternative?

Question 4: In addition, the Commission requests information or data that would assist the Commission in quantifying the cost to FCMs of placing additional proprietary funds into the customer segregated account and the benefit to customers of having such additional funds in the segregated accounts.

§ 1.11 Risk Management Program for Futures Commission Merchants

Proposed Changes

As discussed in II.B above, proposed § 1.11 would require an FCM that carries accounts for customers to establish a risk management unit that is independent from the business unit and reports directly to senior management. In addition, it would require each FCM to establish and document a risk management program, approved by the governing body of the FCM, that, at a minimum: (a) Identifies risks and establishes risk tolerance limits related to various risks that are approved by senior management; (b) includes policies and procedures for detecting breaches of risk tolerance limits, and for reporting them to senior management; (c) provides risk exposure reports quarterly and whenever a material change in the risk exposure of the FCM is identified; (d) includes annual review and testing of the risk management program; and (e) meets specific requirements related to segregation risk, operational risk, and capital risk.

Regarding segregation risk, the proposed rule would require that each FCM must establish written policies and procedures that require, at a minimum: (1) Documented criteria for selecting depositories that would hold segregated funds; (2) a program to monitor depositories on an ongoing basis; (3) an account opening process that ensures the depository acknowledges that funds in the account are customers' funds before any deposits are made to the account, and that also ensures accounts are titled appropriately; (4) a process for determining a residual interest target for the FCM that involves due diligence from senior management; (5) a process for the withdrawal of an FCM's residual interest when such a withdrawal is not made for the benefit of the FCM's customers; (6) a process for determining the appropriateness of investing funds in § 1.25 compliant investments; (7) procedures to assure that securities and other non-cash collateral held as segregated funds are properly valued and readily marketable and highly liquid; (8) procedures that help to ensure appropriate separation of duties between those who account for funds and are responsible for statutory and regulatory compliance vs. those who act in other capacities with the company (*e.g.,* those who are responsible for treasury functions); (9) a process for the timely recording of all transactions; and (10) a program for annual training of FCM employees regarding the requirements for handling customer funds.

The proposed rule would require automated financial risk management controls that address operational risk, and written procedures reasonably designed to ensure that an FCM has sufficient capital to be in compliance with the Act and regulations and to meet its liquidity needs for the foreseeable future.

Benefits

Establishing a risk management unit with adequate authority; qualified personnel; and financial, operational and other resources to carry out the Risk Management Program would enhance protection of customer funds by mitigating the risk that the effectiveness of the Program is compromised by a lack of resources. Moreover, separation of the Risk Management Unit from the Business Unit mitigates the risk that conflicts of interest could interfere with the effectiveness of the risk management unit in avoiding situations that may lead to a loss of customer funds.

Furthermore, by requiring that the risk management unit report directly to senior management, § 1.11(d) would help ensure that the risk management unit's operations and concerns receive prompt attention from personnel who are able to address any problems that arise, and also minimizes the risk that conflicts of interest could cause a breakdown in communications that undermines the effectiveness of the risk management unit or the Risk Management Program. Each of these elements, by promoting the risk management unit's effectiveness, would help to ensure that the unit will identify and address emerging risks before such risks threaten the health of the FCM or the security of segregated customer funds.

The Commission believes the establishment of the proposed risk management program would provide several benefits to FCMs, customers, and the public, in particular with respect to the protection of customer funds.

a. The proposed requirement for FCMs to establish, as part of their risk management program, specific risk tolerance limits, would provide additional protection to FCMs by helping to ensure that they have a system in place to identify emergent risks to the business. By requiring an underlying methodology for establishing the limits, the proposed rule would promote reasoned decision making regarding the limits as they are set and updated. Quarterly review of the risk limits by senior management and annual review by the Governing Body would help to ensure that limits are current as the market, business, and customer base evolve, and also provide accountability for periodic evaluation of such risks at the most senior levels of the organization, which helps to ensure that senior leaders are proactively discussing and addressing the full range of risks that are facing the business. As a consequence, these measures would help ensure that an FCM is taking whatever steps are necessary in order to reduce and mitigate the effects of emerging risks. Moreover, customer funds held at the FCM may face elevated risk of loss due to misuse or operational errors during times of financial strain at the FCM. By protecting the health of the FCM, the proposed requirements mitigate the risk that financial strain at the FCM would lead to a loss of customer funds that it holds.

b. By requiring policies and procedures for detecting breaches of the risk tolerance limits and notifying appropriate personnel, the proposed

commenters should provide analysis and empirical data to support their views on the costs and benefits associated with the proposed rule, and should provide information to the Commission that would enable it to replicate and verify any quantitative estimates.

rule would promote objectivity when monitoring of each risk that the policies address, thus mitigating the risk that poor individual judgment could cause important emerging risks to go unnoticed, or could prevent proper personnel from being notified, leading to a loss of customer funds.

c. The contents of the proposed Risk Exposure Reports would help to ensure that attention is regularly given to an evaluation of each risk that is covered in the FCM's Risk Management Program and that senior management and the Governing Body of the FCM are made aware of the findings. They will also help to ensure that the Risk Management Program is continuously updated to reflect changing risks that face the business by requiring recommendations to be included in such reports, which promotes the effectiveness of the Program in protecting customer funds. Moreover, status updates on any incomplete implementation of previous recommendations from such reports provide accountability at the most senior levels of the FCM regarding implementation of initiatives to improve the Program.

d. Similar to above, review and testing of the risk management program on an annual basis as well as whenever there is a material change in the business, would help to ensure that the Risk Management Program continues to evolve as the risks facing the business evolve, thus promoting the effectiveness of the program, which in turn, would help protect the FCM. By requiring an analysis of adherence to the program the proposed requirement would promote compliance with it. And requiring the review and testing to be conducted by staff that are independent of the Business Unit or by an external third party promotes objectivity and rigor in the findings that would result, and requiring senior management and the Governing Body of the FCM to review the findings promptly helps to ensure that any breaches of compliance or other findings of the review are addressed promptly and effectively. As above, each of these elements promotes protection for the FCM, which in turn, reduces the likelihood that risk to the FCM could cause elevated risk of operational errors that could result in a loss of customer funds.

e. Regarding segregation risk, the requirements set forth in proposed § 1.11 would benefit customers and the financial integrity of markets by requiring FCMs to implement rigorous internal controls designed to detect and mitigate the risk that operational errors or fraud could lead to a loss of customer funds. More specifically, and as discussed above, proposed § 1.11 requires FCMs to establish written policies and procedures that address 12 components of segregation risk. The Commission addresses each of those components below.

1. Proposed § 1.11(e)(3)(i)(A) would establish a minimum set of factors that the FCM would have to incorporate into its due diligence standards and depositories would have to meet those standards in order to be eligible to be selected by the FCM to hold customer segregated funds. As a consequence, customers would have greater clarity about what factors were considered as their FCM selected individual depositories, leading to market discipline that encourages the protection of customer funds.

Documenting the process would enable regulators to review and audit for rigor of the process and adherence to it. Such documentation would help regulators identify risk creating operational patterns or errors that could increase risk to customer funds before those risks are realized. In addition, documenting such criteria helps to ensure that the depository is evaluated against substantive criteria that are relevant to the safety of customer funds held by the depository as a precondition for placing customer funds there. The proposed requirement, by specifying certain criteria that must be included in the FCM's policies and procedures, would also promote market discipline by giving customers clarity about what factors, at a minimum, are considered as part of the FCM's program for evaluating potential depositories.

Together, these benefits help to ensure that the FCM and depository have developed and adhere to procedures that minimize risk to customer funds, which reduces the risk that an FCM would experience a shortfall in their customer segregated funds account.

2. Regulation 1.11(e)(3)(i)(B) would require each FCM to establish a program to monitor depositories on an ongoing basis. This would mitigate the risk of loss of customer funds resulting from depository default or malfeasance because FCMs would be better able to discern emerging problems at the depository in time to move such funds to another depository before the customer segregated funds are affected. In addition, as above, documenting such a program would enable the Commission and DSRO to evaluate the FCM's diligence in monitoring its depositories by auditing the FCM's compliance with its own procedures in this respect, which would again lead to more effective protection of customer funds.

3. The proposal makes it clear that before an FCM is permitted to deposit any customer segregated funds at a depository, the depository must agree that, if instructed to do so by the Director of DSIO or the Director of DCR, it will make such transfers without delay. Requiring the acknowledgment letter to be signed before any funds are deposited removes uncertainty about whether the depository has been put on notice that it is required to move funds without delay when directed by the Director of DSIO or the Director of DCR. In the event of a default by an FCM, the Commission and relevant DCOs would immediately move customer funds in order to move open positions to a different FCM.

4. The proposal requires senior management to conduct due diligence to understand various factors that could impact the amount of residual interest that would be prudent to maintain in the segregated funds account, and then reach a determination about a targeted amount. The benefit of such a requirement is that it would protect customer funds by creating accountability for senior management. Requiring such due diligence helps ensure that senior management is attentive to the causes of segregated funds account underfunding. The requirement allows both flexibility and accountability in that it allows FCMs to account for relevant factors that vary across firms when determining an appropriate target, rather than requiring all FCMs to maintain a common target for residual interest. However, by requiring them to establish such a target and to conduct due diligence in doing so, it allows the Commission and DSROs to audit the FCMs to ensure that they reached their target through a reasoned decision-making process, and ensures that the respective boards approve and are responsible for the target.

Maintaining a target enhances market discipline by creating public accountability for an FCM. It communicates to customers that the FCM intends to maintain a certain residual interest in the account, and gives customers an opportunity to consider, when selecting an FCM, the additional security that varied levels of residual interest may provide for their funds.

5. A process for the withdrawal of residual interest that is not for the benefit of customers would help to ensure good communication and that senior managers are appropriately involved in the decision to remove

residual interest from segregated customer accounts. Good communication, deliberate decision-making, and proper involvement of senior managers would promote accountability when an FCM is removing residual interest. These benefits are particularly important at times when FCMs experience financial stress because good communication, deliberate decision-making, and proper involvement of senior management in decisions related to residual interest may be more likely to fail at such times, creating risk to segregated customer funds. By requiring FCMs to establish and follow procedures for withdrawals of residual interest, the rule would help to ensure that such failures do not occur.

An additional, related benefit is that by ensuring proper communication with and approval from relevant senior managers before such withdrawals occur, the proposed changes would enhance accountability among those managers for decisions that could create risk for segregated customer funds.

6. FCMs have a range of potential investments that are compliant with § 1.25. By requiring FCMs to establish a process for deciding how to invest those funds, the requirement would provide the Commission and DSRO with a standard by which such investment decisions could be judged, which would help prevent the FCM from investing primarily in the least credit-worthy § 1.25 investments. FCMs have an incentive to invest customer funds in § 1.25 compliant investments that offer the highest rate of return possible, but it is possible that the § 1.25 investments offering the highest rates of return are also less credit-worthy or less liquid than other § 1.25 investments. Requiring FCMs to set up, document and follow a process for assessing the appropriateness of investing segregated funds in § 1.25 investments ensures that FCMs take steps not only to determine whether an investment complies with § 1.25 as required by current regulation, but that the investment is also evaluated with respect to any risk it may pose to the FCM's primary responsibilities of preserving principal and maintaining liquidity when handling customer funds. In other words, this provision would help to prevent the possibility of a ''race to the bottom'' for FCMs investing in § 1.25 compliant assets.

7. If the FCM is not able to get accurate pricing for § 1.25 assets, it is difficult to know whether or not sufficient funds are in the segregated account. A shortage (and thus, in the event of insolvency, a loss of customer funds) could occur simply because the FCM can't accurately estimate the value of the assets that are there, or it could also make it easier for the FCM to intentionally skew their reports regarding funds in the customer segregated accounts by making favorable assumptions about the value of assets that are difficult to price. Requiring the FCM to establish a program for assessing the ease of pricing for § 1.25 assets helps reduce these risks and gives the Commission and DSRO an opportunity to understand the FCM's procedures and to enforce the FCM's compliance with them. This, in turn, promotes reasoned and disciplined decision-making with respect to the FCM's investment of customer funds in § 1.25 investments. Establishing procedures to evaluate the liquidity of § 1.25 instruments will help FCMs minimize the risk of such problems.

8. Appropriate internal controls are critical to the prevention of fraud. The Commission understands that FCMs typically require that certain duties are performed by separate people or separate groups of people in order to ensure that a proper system of checks and verification remains in place.[102] In particular, FCMs generally ensure that the individuals responsible for reporting and associated calculations are separate from the individuals responsible for operational transfers of funds. In the absence of such internal controls, one person or group of people with access to both movement and reporting of funds could transfer funds and then, for a time, hide those transfers from senior management, auditors, and the public.

The proposed rule would help protect customer funds by establishing a regulatory requirement that all FCMs develop procedures to ensure that the individuals responsible for calculating and reporting segregation account requirements and segregation account funds do not share duties with those who are responsible for transferring or investing segregated funds. This should result in controls to prevent fraudulent fund transfers.

9. The Commission regulations already require timely recording of transactions in § 1.35(b), but this proposed addition would require that FCMs develop written policies and procedures ensure that they have a consistent process to achieve that outcome. Again, requiring FCMs to document their procedures helps protect customer funds by enabling the Commission and DSROs to audit for compliance, detecting and preventing operational issues that could pose risk to customer funds before those risks result in an actual loss to customer funds.

10. Proper training of employees would help to ensure that employees understand the written procedures regarding segregated funds. The proposed training requirement provides flexibility for an FCM to determine whether it should develop the required training in house, or to pay a vendor to develop a training program. Training regarding the requirements of the Act and Commission regulations regarding handling customer funds will help to ensure that employees understand how the procedures and requirements related to customer funds apply to various situations they face in their work for the FCM. Training regarding the second and third points mentioned above will help to ensure that the Commission and DSRO are notified promptly whenever any of the circumstances covered in § 1.12 occur, or whenever there is a breach of the FCM's own policies and procedures, even if the circumstances in § 1.12 have not occurred. Moreover, by requiring broad participation in training focused on these points, the proposed requirement would protect customer funds by encouraging a culture of accountability and transparency through self-disclosure. Training regarding the consequences of failing to comply will help to ensure that employees understand the seriousness with which the Commission regards violation of these standards, thereby providing an incentive to diligently adhere to them. In addition, requiring FCMs to provide the training annually helps ensure that the critical content of this training is not lost due to the passing of time, or employee turnover.

In addition, by requiring automated financial risk management controls, the proposed Risk Management Program would reduce operational risk that could result from ''fat finger'' errors when submitting trades, or from technological ''glitches'' using automated trading. Several events have demonstrated that such operational risks are difficult to predict, tend to emerge so quickly that non-automated forms of risk management may not be able to contain them, and can threaten an FCM's continued viability. Automated controls would help to reduce these operational risks, thereby providing additional protection to FCMs and mitigating the risk of loss to customer funds.

Last, by requiring an FCM to develop and implement written policies that ensure it has sufficient capital and liquidity not only to comply with the

[102] *See* ''Initial Recommendations for Customer Funds Protection'' by the FIA Futures Markets Financial Integrity Task Force.

Act and Commission regulations but also to meet its foreseeable needs, the proposed rule would promote reasoned decision making regarding capital retention and allocation decisions because such decisions would have to be made according to the established policies and procedures, weighing the factors and inputs included therein. Moreover, written procedures could be used by the Commission and relevant SROs as the basis for audits to check for compliance with such procedures, which would help the Commission and relevant SRO identify operational problems that could lead to loss of customer funds.

In many cases the proposed rules provide flexibility to FCMs by requiring that they develop and document their own policies and procedures rather than prescribing specific procedures for them. In so doing, the proposal gives FCMs an opportunity to tailor policies and procedures that accommodate their specific needs and operational patterns, which may vary from one FCM to another based on differences in their size, involvement in specific markets, and the characteristics of their investor base. This approach is likely to be less costly for FCMs when compared to the alternative of a more prescriptive approach because it is less likely to require changes to operational patterns if existing procedures are adequate to provide the same protections to customer funds. In addition, the flexibility of this approach benefits market participants and customers alike because it is the FCM that is in the best position to define the precise form of internal controls that will best protect customer funds from operational errors and fraud.

In addition, as suggested above, requiring FCMs to document their policies and procedures regarding their Risk Management Program would enable the Commission and DSRO to audit for operational problems that could put customer funds at risk before those risks turn into actual losses. This would strengthen the critical first line of defense against operational errors and fraud.

Costs

The risk management unit, required by the proposed rule, would create certain personnel costs. The Commission estimates that such a unit would require between one and ten full-time staff depending on the size and complexity of the FCM. Therefore, the Commission estimates that the annual cost for the risk management unit would be between $171,000 and $1,934,000.[103]

There are costs associated with the Risk Management Program proposed in § 1.11.

a. Each FCM would likely have to review its operations, business model, market conditions, customer base, and a number of other factors in order to identify the risks that it should be monitoring. In addition, each FCM would have to develop and document methodologies for establishing risk tolerance limits for each risk that they choose to monitor. Last, for each FCM, the risks and proposed limits for those risks would have to be reviewed and approved quarterly by its senior management and annually by the board. The Commission estimates that the initial cost for identifying relevant risks and developing and documenting methodologies for establishing thresholds would be between $28,800 and $68,400.[104] The ongoing cost for reviewing the risks and limits and approving them would be between $27,900 and $99,700 per year.[105]

b. Developing these policies and procedures for detecting breaches of the risk tolerance limits and notifying appropriate personnel would create an initial cost, but little ongoing cost since most of the monitoring costs are included in other elements (quarterly reports, annual audits, etc.). The Commission estimates that the initial cost to develop these policies and procedures is between $3,400 and $6,800.[106]

c. Many of the activities necessary for completing the quarterly review of risk thresholds will overlap with the activities necessary for completing the Risk Exposure Reports. However, some additional time will be required to compile the Report and to incorporate information that is distinct from that which is required for the quarterly review of risk thresholds. In addition, the FCM's board and senior management are obligated to review the report. Therefore, the Commission estimates that each Risk Exposure Report will cost between $8,800 and $13,300 per year.[107]

[103] This assumes 2,000–10,000 hours per year from compliance attorneys (*i.e.,* 1–5 full time compliance attorneys) and 0–10,000 hours per year from a senior risk management specialist (*i.e.,* 0–5 full time senior risk management specialists). The average compensation for a compliance attorney is $85.35/hour [$131,303 per year/(2000 hours per year)*1.3 is $85.35 per hour]; $85.35*2000 = $170,693.90 and $85.35*10,000 = $853,469.50. The average compensation for a senior risk management specialist is $83.13/hour [$166,251.00 per year/(2000 hours per year)*1.3 is $83.13 per hour]; $83.13*0 = $0 and $83.13*10,000 = $1,080,631.50.

[104] For initial costs, this estimates initial costs of 50–250 hours from compliance attorneys, 10–100 hours from risk management personnel, 36 hours (total) of time from the board, and 10–20 hours each from the CEO, CFO, COO, and CCO. The average compensation for a compliance attorney is $85.35/hour [$131,303 per year/(2000 hours per year)*1.3 is $85.35 per hour]; $85.35*50 = $4,267.35 and $85.35*250 = $21,336.77. The average compensation for a risk management specialist is $65.33/hour [$100,500 per year/(2000 hours per year)*1.3 is $65.33 per hour]; $65.33*10 = $653.25 and $65.33*100 = $6,532.50. The average compensation for a member of a firm's board of directors is estimated by the Commission to be $200.00/hour [$100,000 per year/(500 hours per year) is $200 per hour]; $200.00*36 = $7,200.00. The average compensation for a chief executive officer is estimated by the Commission to be $650.00/hour [$1,000,000 per year/(2000 hours per year)*1.3 is $650.00 per hour]; $650.00*10 = $6,500.00 and $650.00*20 = $13,000. The average compensation for both a chief financial officer and a chief operations officer is estimated by the Commission to be $455.00/hour [$700,000 per year/(2000 hours per year)*1.3 is $455.00 per hour]; $455.00*10 = $4,550.00 and $455.00*20 = $9,100.00. The average compensation for a chief compliance officer is $110.97/hour [$170,727 per year/(2000 hours per year)*1.3 = $110.97/hour]; $110.97*10 = $3,329.18 and $110.97*20 = $11,097.26.

[105] For ongoing costs, this estimates annual costs of 20–200 hours from compliance attorneys, 50–300 hours from risk management personnel, 48 hours (total) of time from the board, and 8–32 hours each from CEO, CFO, COO, and CCO. Using the same compensation figures listed above, this is $85.35 *20 = $1,706.94 and $85.35*200 = $17,069.39 for a compliance attorney; $65.33*50 = $3266.25 and $65.33*300 = $19,597.50 for a risk management specialist; $200.00*48 = $9,600.00 for the board; $650.00*8 = $5,200.00 and $650.00*32 = $20,800.00 for the CEO; $455.00*8 = $3,640.00 and $455.00*32 = $14,560.00 for both the CFO and COO; and $110.97*8 = $887.78 and $110.97*32 = $3,551.12 for the CCO. The compensations of an average CEO and CFO are estimates by the Commission; the compensation of the board of directors is based on the average compensation of the boards of several large FCMs. All other figures are taken from the 2011 SIFMA Report on Management and Professional Earnings in the Securities Industry.

[106] This estimates 40–80 hours of time from a compliance attorney. The average compensation for a compliance attorney is $85.35/hour [$131,303 per year/(2000 hours per year)*1.3 is $85.35 per hour]; $85.35*40 = $3,413.88 and $85.35*80 = $6,827.76. These figures are taken from the 2011 SIFMA Report on Management and Professional Earnings in the Securities Industry.

[107] This estimates 20–50 hours of compliance attorney time, 20–50 hours from risk management personnel, 12 hours of board time, and 2 hours from each of the CEO, CFO, COO, and CCO. The average compensation for a compliance attorney is $85.35/hour [$131,303 per year/(2000 hours per year)*1.3 is $85.35 per hour]; $85.35*20 = $1,706.94 and $85.35*50 = $4,267.35. The average compensation for a risk management specialist is $65.33/hour [$100,500 per year/(2000 hours per year)*1.3 is $65.33 per hour]; $65.33*20 = $1,306.50 and $65.33*50 = $3,266.25. The average compensation for a member of a firm's board of directors is estimated by the Commission to be $200.00/hour [$100,000 per year/(500 hours per year) is $200 per hour]; $200.00*12 = $2,400.00. The average compensation for a chief executive officer is estimated by the Commission to be $650.00/hour [$1,000,000 per year/(2000 hours per year)*1.3 is $650.00 per hour]; $650.00*2 = $1,300.00. The average compensation for both a chief financial officer and a chief operations officer is estimated by

Continued

d. The Commission estimates that review and testing of the Risk Management Program will cost between $6,000 and $24,300.[108] An FCM must conduct such a review and testing annually as well as any time it experiences a material change in the business that is reasonably likely to alter the risk profile of the FCM. The Commission does not have adequate information to estimate how frequently such a change in the business will occur, so it has assumed one review and testing per year.

e. Regarding the policies and procedures that are required to address segregation risk, proposed § 1.11 would create three sets of costs: (1) costs related to developing and documenting all required policies and procedures; (2) initial implementation costs; and (3) ongoing costs.[109]

1. The Commission estimates that developing and documenting requisite policies and procedures would require one or more compliance attorneys to be heavily involved interpreting and explaining the Act and Commission requirements to other affected employees, guiding other subject matter experts in the development of compliant operations, and drafting the required documentation. Risk management personnel would also likely be involved in developing procedures to review banks and § 1.25 investments as well as to support the due diligence that senior management will have to conduct in order to establish a target residual interest for the FCM. The CFO and other senior personnel reporting to the CFO would likely be involved with selecting a target for the firm's residual interest and developing procedures for making withdrawals of residual interest for proprietary use. The CEO and board would be involved in reviewing and approving the policies and procedures required under § 1.11. The Commission estimates that the likely cost for developing and documenting the policies and procedures that would be required under the proposed § 1.11 would be between $54,800 and $131,000.[110]

2. The policies and procedures must not only be documented, they must be implemented, which will create some one-time costs that will depend significantly on the extent to which an FCM already practices some of the operational procedures that the Commission is requiring here. While the Commission expects that some FCMs are likely to have certain policies and procedures in place already that comply with § 1.11, the Commission does not have adequate information to determine to what extent this is true. Therefore, for the purposes of estimation we have estimated the one-time costs for an entity that does not yet have any of the required policies and procedures in place. The Commission anticipates that in such a circumstance, implementing new policies and procedures would require risk management personnel to conduct initial due diligence on depositories and existing as well as prospective § 1.25 investments. Human Resource (''HR'') personnel would have to revise job descriptions to comply with policies to separate critical functions related to handling of customer funds, and would also have to develop new annual training.[111] One or more compliance attorneys would be involved ensuring that accounts are titled appropriately, securing requisite acknowledgment letters from depositories, setting up quarterly audits of policies and procedures, and providing general oversight of the implementation process. IT personnel will likely be required to automate certain aspects of the information collection that is necessary, and the CCO would likely be involved on virtually a full-time basis for some period of time as well, overseeing the implementation of critical new policies and procedures. The Commission estimates the cost for such an implementation would range between $90,800 and $275,300.[112]

the Commission to be $455.00/hour [$700,000 per year/(2000 hours per year)*1.3 is $455.00 per hour]; $455.00*2 = $910.00. The average compensation for a chief compliance officer is $110.97/hour [$170,727 per year/(2000 hours per year)*1.3 = $110.97/hour]; $110.97*2 = $221.95. The compensations of an average CEO and CFO are estimates by the Commission; the compensation of the board of directors is based on the average compensation of the boards of several large FCMs. All other figures are taken from the 2011 SIFMA Report on Management and Professional Earnings in the Securities Industry.

[108] This assumes four weeks' worth of time from one to four intermediate compliance specialists. The average compensation of an intermediate compliance specialist is $37.90/hour [$58,303.00 per year/(2000 hours per year)*1.3 is $37.90]; $37.90*40 hours/week*1 = $6,063.51 and $37.90*40 hours/week*4 = $24,254.05. These figures are taken from the 2011 SIFMA Report on Management and Professional Earnings in the Securities Industry.

[109] Developing, documenting, and implementing the requisite policies and procedures would require personnel hours from compliance attorneys, senior management, and limited involvement from others such as risk management, HR, and IT. Those costs are would vary, perhaps significantly, depending on the extent to which each FCM already has compliant procedures in place and the extent to which such procedures may already be documented. However, the Commission has endeavored to estimate broad ranges of costs that would likely result from efforts to develop and document the requirements of § 1.11, to implement compliant procedures, and then to sustain such procedures on an ongoing basis. And while the benefits are enumerated separately because their substantive benefits, in several cases, vary from one requirement to the next, the substantive costs are, in many cases, overlapping, and therefore the Commission has addressed them collectively.

[110] This estimate assumes 400–1000 hours of time from one or more compliance attorneys re: all aspects of the requirements (interpreting, summarizing, guiding compliance discussions, drafting, etc.), 80–160 hours from a firm's chief compliance officer re: All aspects of the program, 10–100 hours from risk management personnel re: bank selection, monitoring, process to assess § 1.25 investment decisions, and due diligence to support targeted residual amount decision, 4–20 hours from a firm's chief financial officer re: selection of target for residual funds and process for withdrawal of segregated account funds not for the benefit of FCM customers, 2–4 hours from a firm's CEO, and 40–50 hours from board collectively re: discussion and approval of written policies and procedures. The average compensation for a compliance attorney is $85.35/hour [$131,303 per year/(2000 hours per year)*1.3 is $85.35 per hour]; $85.35*400 = $34,140.00 and $85.35*1000 = $85,350.00. The average compensation for a chief compliance officer is $110.97/hour [$170,727 per year/(2000 hours per year)*1.3 = $110.97/hour]; $110.97*60 = $6,658.35 and $110.97*100 = $11,097.26. The average compensation for a risk management specialist is $65.33/hour [$100,500 per year/(2000 hours per year)*1.3 is $65.33 per hour]; $65.33*10 = $653.25 and $65.33*100 = $6,532.50. The average compensation for a chief financial officer is estimated by the Commission to be $455.00/hour [$700,000 per year/(2000 hours per year)*1.3 is $455.00 per hour]; $455.00*4 = $1,820.00 and $455.00*20 = $9,100.00. The average compensation for a chief executive officer is estimated by the Commission to be $650.00/hour [$1,000,000 per year/(2000 hours per year)*1.3 is $650.00 per hour]; $650.00*2 = $1,300.00 and $650.00*4 = $2,600.00. The average compensation for a member of a firm's board of directors is estimated by the Commission to be $200.00/hour [$100,000 per year/(500 hours per year) is $200 per hour]; $200.00*40 = $8,00.00 and $200.00*50 = $10,000.00. The compensations of an average CEO and CFO are estimates by the Commission; the compensation of the board of directors is based on the average compensation of the boards of several large FCMs. All other figures are taken from the 2011 SIFMA Report on Management and Professional Earnings in the Securities Industry.

[111] However, they are likely to outsource some pieces of the implementation (e.g. annual training would likely be developed by vendors to meet the needs of multiple market participants) which will mitigate associated costs. If a firm chooses to use training created by a vendor, that would likely reduce the HR one-time costs significantly.

[112] This estimate assumes 100–200 hours of risk management personnel time (from employees of varying levels of pay) conducting initial due diligence on depositories and evaluating § 1.25 investments, 800–1000 hours of human resources personnel time (400–500 at a junior level and 400–500 at a senior level) revising job descriptions to accommodate separation of roles and developing annual training, 20–400 hours of time from one or more compliance attorneys for retitling accounts, securing requisite acknowledgements from depositories, setting up quarterly audits, and general oversight of implementation of new policies and procedures, 4–12 weeks of the time of a firm's Chief Compliance Officer, or 160–480 hours, and 160–800 hours of the time of IT personnel (140–700 at a junior to intermediate level and 20–100 at a senior level) as the firm will likely seek to automate some types of information collection and other steps necessary to support requirements. The average compensation for a senior risk management specialist is $108.06/hour [$166,251 per year/(2000

3. The costs necessary to sustain the policies and procedures required under § 1.11 are difficult to estimate because they would depend on variables such as the size of the firm, the program of governing supervision that they develop, and the degree of automation they achieve in their various ongoing processes (monitoring depositories, evaluating § 1.25 investments, reevaluating residual funds target, etc.), and the degree to which their operations are already compliant with the policies and procedures they would develop pursuant to the proposed § 1.11. However, as a lower bound, the ongoing costs would include expenses related to the time for: (1) The CCO to review quarterly audits and conduct due diligence that is necessary before providing certification of compliance with the Act, regulations and its policies and procedures with respect to segregated funds in the annual report; (2) risk management personnel to evaluate § 1.25 investments for liquidity and marketability and to monitor depository institutions where customer segregated funds are held; (3) the CFO and other senior management to review and determine the continued appropriateness of the FCM's target for residual interest; and (4) HR personnel to organize and deliver annual training. The Commission estimates that the lower bound for these costs is approximately $20,000 and that costs may be higher, depending on the variables mentioned above.[113]

In addition, FCMs would have to implement automated financial risk management controls that are reasonably designed to prevent entering of erroneous trades. The Commission anticipates that some, but not all, FCMs already have such systems in place. For those FCMs that do not yet have such systems in place, the Commission proposes that it would cost an FCM between $10,300 and $89,400 to implement such a system.[114]

§ 1.12 Maintenance of Minimum Financial Requirements by Futures Commission Merchants and Introducing Brokers

Proposed Changes

As described in the section by section discussion at II.C, the proposed changes to § 1.12 would alter the notice requirement so that it is no longer acceptable to give ''telephonic notice to be confirmed, in writing, by facsimile.'' Instead, all notices would be made in writing and submitted through an electronic medium acceptable to the Commission (currently, WinJammer).

In addition, as described above in II.C, the proposed changes would require that if an FCM has a shortfall in net capital but is not sure of their financial condition, the FCM should not delay notifying the Commission about the shortfall in net capital. The FCM must communicate each piece of information (knowledge of the shortfall and knowledge of the financial condition of the FCM) to the Commission as soon as it is known.

The proposed requirements in paragraphs (i), (j), (k) and (l) of § 1.12 identify additional circumstances in which the FCM must provide immediate written notice to the Commission, relevant SRO and to the SEC if the FCM is also a broker-dealer. Those circumstances are: (1) If an FCM discovers that any of the funds in segregated accounts are invested in investments not permitted under § 1.25; (2) if an FCM does not have sufficient funds in any of their segregated accounts to meet their targeted residual interest; (3) if the FCM experiences a material adverse impact to its creditworthiness or ability to fund its obligations; (4) whenever the FCM has a material change in operations including changes to senior management, lines of business, clearing arrangements, or credit arrangements that could have a negative impact on the FCM's liquidity; and (5) if the FCM receives a notice, examination report, or any other correspondence from a DSRO, the SEC, or a securities industry self-regulatory organization, the FCM must notify the Commission, and provide a copy of the communication as well as a copy of their response to the Commission.

Last, proposed changes in paragraph (n) of § 1.12 would require that every notice or report filed with the Commission pursuant to § 1.12 would include a discussion of how the reporting event originated and what steps have been, or are being taken, to address the event.

Benefits

The proposed changes requiring that notice to the Commission be given in written form via specified forms of electronic communication not only adapt the rule to account for modern forms of communication, but also reduce the possibility of notification being delayed in reaching appropriate Commission staff. The proposed requirement would ensure that such

hours per year)*1.3 is $108.06 per hour]; $108.06*100 = $10,806.00 and $108.06*500 = $54,030.00. The average compensation for a risk management specialist is $65.33/hour [$100,500 per year/(2000 hours per year)*1.3 is $65.33 per hour]; $65.33*100 = $6,532.50 and $65.33*500 = $32,665.00. The average compensation for a junior human resources representative is $40.95/hour [$62,989 per year/(2000 hours per year)*1.3 is $40.95 per hour]; $40.95*800 = $32,760.00 and $40.95*1000 = $40,950.00. The average compensation for a senior human resources representative is $71.45/hour [$109,921 per year/(2000 hours per year)*1.3 is $71.45 per hour]; $71.45*100 = $7,144.87 and $71.45*500 = $35,724.33. The average compensation for a compliance attorney is $85.35/hour [$131,303 per year/(2000 hours per year)*1.3 is $85.35 per hour]; $85.35*20 = $1,706.94 and $85.35*400 = $34,138.78. The average compensation for a chief compliance officer is $110.97/hour [$170,727 per year/(2000 hours per year)*1.3 = $110.97/hour]; $110.97*160 = $17,755.61 and $110.97*480 = $53,266.82. The average compensation for a programmer is $53.64/hour [$82,518 per year/(2000 hours per year)*1.3 = $53.64/hour]; $53.64*140 = $7,509.14 and $53.64*700 = $37,545.69. The average compensation for a senior programmer is $74.56/hour [$114,714 per year/(2000 hours per year)*1.3 = $74.56/hour]; $74.56*20 = $1,491.28 and $74.56*100 = $7,456.41. All figures are taken from the 2011 SIFMA Report on Management and Professional Earnings in the Securities Industry.

[113] This estimate assumes 20+ hours per year from the CCO for due diligence and certification of compliance on annual report and reviewing quarterly audits, 40+ hours each per year from junior and senior risk management personnel evaluating § 1.25 investments for liquidity and marketability and monitoring depository institutions where customer segregated funds are held, 6+ hours per year from the CFO and other senior management for reviewing the target for the firm's residual interest, and 20+ hours each per year from junior and senior HR—organizing and delivering annual training, as well as at least a day's training for 20 employees, or 160 hours from an average financial employee, such as a general intermediate trader. The average compensation for a chief compliance officer is $110.97/hour [$170,727 per year/(2000 hours per year)*1.3 = $110.97/hour]; $110.97*20 = $2,219.45. The average compensation for a senior risk management specialist is $108.06/hour [$166,251 per year/(2000 hours per year)*1.3 is $108.06 per hour]; $108.06*40 = $4,322.53. The average compensation for a risk management specialist is $65.33/hour [$100,500 per year/(2000 hours per year)*1.3 is $65.33 per hour]; $65.33*40 = $2,613.00. The average compensation for a chief financial officer is estimated by the Commission to be $455.00 per/hour [$700,000 per year/(2000 hours per year)*1.3 is $455.00 per hour]; $455.00*6 = $2,730. The average compensation for a junior human resources representative is $40.94/hour [$62,989.00 per year/(2000 hours per year) = $40.94/hour]; $40.94*20 = $818.86. The average compensation for a senior human resources representative is $71.45/hour [$109,921.00 per year/(2000 hours per year) = $71.45/hour]; $71.45*20 = $1,428.97. The average compensation for a general intermediate trader is $36.48/hour [$56,130.00 per year/(2000 hours per year)*1.3 is $36.48 per hour]; $36.48*160 = $5,837.52. The compensations of an average CFO is an estimate by the Commission. All other figures are taken from the 2011 SIFMA Report on Management and Professional Earnings in the Securities Industry.

[114] This estimates 150–1500 hours of mid-level IT programming time and 30–120 hours of senior level IT personnel time. The average compensation for a programmer is $53.64/hour [$82,518 per year/(2000 hours per year)*1.3 = $53.64/hour]; $53.64*150 = $8,045.51 and $53.64*1500 = $80,455.05. The average compensation for a senior programmer is $74.56/hour [$114,714 per year/(2000 hours per year)*1.3 = $74.56/hour]; $74.56*30 = $2,236.92 and $74.56*120 = $8,947.69. All figures are taken from the 2011 SIFMA Report on Management and Professional Earnings in the Securities Industry.

notices are submitted to WinJammer, which forwards notices to appropriate personnel within the Commission via email within a matter of minutes, if not seconds.

With respect to the proposed change in § 1.12(a)(2), if an FCM knows that it does not have adequate capital to meet the requirements of § 1.17 or other capital requirements, and is also not able to calculate or determine its financial condition, it is likely that the FCM is in a period of extraordinary stress. In these circumstances, time is of the essence for the solvency of the FCM and to the protection of its customers and counterparties. Therefore, it is important that the Commission, DSRO, and SEC (if the FCM is also a broker-dealer) be notified immediately so that they can begin assessing the FCM's condition, and if necessary, making preparations to allow the transfer of the customers' positions to another FCM in the event that the FCM currently holding those positions has insufficient regulatory capital. These preparations help to ensure that the customers' funds are protected in the event of the FCM's default, and that the positions of its customers are transferred expeditiously to another FCM where those customers may continue to hold and control those positions without interruption to the customer's positions.

The situations enumerated in proposed §§ 1.12(i) and (j) are more specific indicators of potential or existing problems in the customer segregated funds accounts. Notifying the Commission in such circumstances will enable it to monitor steps the FCM is taking to address a shortfall in targeted residual interest, or to direct the FCM as it takes steps to address improperly invested segregated funds. In either case, the Commission will be able to be much more closely involved in rectifying the situation and ensuring the continued protection of customer segregated funds.

The situations enumerated in proposed §§ 1.12(k) through (l) are circumstances indicating that the FCM is undergoing changes that could indicate or lead to financial strain. Alerting the Commission and relevant SRO in such circumstances will enable both to protect customer funds by monitoring the FCM more closely in order to ensure that any developing problems are identified quickly and addressed proactively by the FCM with the oversight of the Commission and relevant SRO.

The proposed amendment requiring that the FCM notify the Commission whenever it receives a notice or results of an examination from the DSRO, SEC, or securities-industry self-regulatory body, would ensure that the Commission is aware of any significant developments affecting the FCM that have been observed or communicated by other regulatory bodies. Such communications could prompt the Commission to heighten its monitoring of specific FCMs, or create an opportunity for the Commission to work collaboratively and proactively with other regulators to address any concerns about how developments in the FCM's business could affect customer funds.

The proposed requirement that notifications to the Commission pursuant to § 1.12 include a discussion of what caused the reporting event and what has been, or is being done about the event would provide additional information to Commission staff that help them quickly gauge the potential severity of related problems that have been or are developing at the reporting FCM, IB, or SRO. It would also help Commission staff discern how effectively the reporting entity is responding to such problems, which could assist the staff in determining whether the situation is likely to be corrected quickly or to continue deteriorating.

Costs

As discussed above, the proposed rule requires that FCMs provide immediate notice to the Commission and its DSRO in five additional circumstances. These additional requirements create some minimal reporting costs when such circumstances arise. The Commission estimates that the total cost of completing and sending the requisite form is approximately $9,700 and $19,400 per form.[115]

Ongoing monitoring for any of the five additional circumstances that require reporting to the Commission, relevant SRO, and to the SEC if the FCM is a broker-dealer will also create some costs. In its consideration of the proposed rule, the Commission assumes that FCMs will automate the process for monitoring residual interest for any shortfall against the firm's target. Furthermore, the Commission anticipates that FCMs will build on the systems that they already have in place to calculate residual interest once per day at the close of business. The incremental cost of modifying such systems to monitor residual interest compared to the target value on an ongoing basis is likely to be between $1,800 and $6,300.[116] Identifying instances where their FCM has experienced a material adverse impact to its creditworthiness or ability to fund its obligations, as would be required by proposed § 1.12(k), would likely require deliberation among senior leaders at the FCM. Such deliberations, however, would likely be prompted by observations that such leaders make in the ordinary course of business, and therefore would not require proactive monitoring. The Commission estimates that deliberations among senior leaders to determine whether there is evidence suggesting a material decrease in the FCM's creditworthiness has occurred would cost at least $6,600 per year.[117]

Material changes to the FCM's leadership or business would create some incremental costs. Some of the material changes envisioned, such as changes in senior leadership, are discrete events that do not require monitoring in order to identify. On the other hand, events that constitute a material change in operations, credit arrangements, or ''any change that could adversely impact the firm's liquidity

[115] This estimates 8–16 hours of time from both the CCO and the CFO, 10–20 from the General Counsel, 20–40 from a compliance attorney, and 10–20 from a senior accountant. The average compensation for a chief compliance officer is $110.97/hour [$170,727 per year/(2000 hours per year)*1.3 = $110.97/hour]; $110.97*2 = $221.95 and $110.97*4 = $443.89. The average compensation for a chief financial officer is estimated by the Commission to be $455.00/hour [$700,000 per year/(2000 hours per year)*1.3 is $455.00 per hour]; $455.00*2 = $910.00 and $455.00*4 = $1,820.00. The average compensation for a general counsel is estimated by the Commission to be $260.00/hour [$400,000 per year/(2000 hours per year)*1.3 is $260.00 per hour]; $260.00*10 = $2,600.00 and $260.00*20 = $5,200.00. The average compensation for a senior accountant is $44.18/hour [$67,971 per year/(2000 hours per year)*1.3 = $44.18/hour]; $44.18*10 = $441.81 and $44.18*20 = $883.62. These figures are taken from the 2011 SIFMA Report on Management and Professional Earnings in the Securities Industry.

[116] This estimates 20–90 hours of personnel time from a programmer and 10–20 hours of personnel time from a senior programmer. The average compensation for a programmer is $53.64/hour [$82,518 per year/(2000 hours per year)*1.3 = $53.64/hour]; $53.64*20 = $1,072.73 and $53.64*90 = $4,827.30. The average compensation for a senior programmer is $74.56/hour [$114,714 per year/(2000 hours per year)*1.3; $74.56*10 = $745.64 and $74.56*20 = $1,491.28. All figures are taken from the 2011 SIFMA Report on Management and Professional Earnings in the Securities Industry.

[117] This estimates at least 8 hours per year from the CFO, the CCO, and the General Counsel. The average compensation for a chief compliance officer is $110.97/hour [$170,727 per year/(2000 hours per year)*1.3 = $110.97/hour]; $110.97*8 = $887.78. The average compensation for a chief financial officer is estimated by the Commission to be $455.00/hour [$700,000 per year/(2000 hours per year)*1.3 is $455.00 per hour]; $455.00*8 = $3,640. The average compensation for a general counsel is estimated by the Commission to be $260.00/hour $400,000.00 per year/(2000 hours per year)*1.3 is $260.00 per hour]; $260.00*8 = $2,100.00. The figure for the CCO is taken from the 2011 SIFMA Report on Management and Professional Earnings in the Securities Industry; other compensations are estimates by the Commission.

resources,'' [118] would only be reliably recognized as a material change by someone with a broad knowledge of the firm's operations and finances, so the Commission assumes that senior management would fulfill these requirements. However, identifying and addressing material changes to the business is a function that senior management already plays, and therefore monitoring for such changes would not create any incremental costs. The proposed rule would make it necessary for senior management, in addition to identifying changes to the business, to make a decision about whether or not those changes are material and therefore should be reported. The Commission proposes that the additional time senior management spends making determinations about the materiality of changes to the business, as defined by the proposed rule, would require approximately twenty hours of time from both the CCO and CFO. Therefore, the Commission estimates that the monitoring costs would be $11,300 and $22,600.[119]

The proposed requirement that notices or reports filed with the Commission pursuant to § 1.12 include a discussion of how the reporting event originated and what has been, or is being done to address the reporting event, will increase the cost of such reports. The Commission anticipates that this requirement would prompt the CFO, General Counsel, and CCO of a reporting entity to invest additional time in developing and reviewing the report. The Commission anticipates that the incremental cost associated with the additional time spent by the CFO, General Counsel, and CCO would be between $3,300 and $6,600 per report.[120]

Additional proposed changes would introduce only minimal, if any, additional costs. For example, all FCMs already use WinJammer to submit certain reports to DSROs and to the Commission, so there would not be any additional cost involved with § 1.12(n)(3) requirement that such notices to be submitted through that platform rather than via fax.[121] Nor is there any cost associated with this proposed change to § 1.12(a)(1). The FCM is still required to disclose its financial condition to the Commission, DSRO and SEC (if applicable) as soon as it can be ascertained. The proposed change does not alter the information that the FCM must gather, calculate, or report. It merely requires that each of the two pieces of information relevant to the requirements in § 1.12(a)(1–2) are submitted as soon as they are known.

Request for Comment

Question 5: The Commission requests additional information regarding the costs of these additional notification requirements. Specifically, how much time will information technology and compliance personnel have to invest in order to modify systems to calculate residual interest on a continual basis? How much time would be necessary to monitor for material changes in the business and what level of personnel would have to participate in that in order to draw reliable conclusions about whether or not a material event had occurred?

§ 1.16 Qualifications and Reports of Accountants

Proposed Changes

As discussed above in II.E, the proposed changes would require that in order for an accountant to be qualified to conduct an audit of an FCM, that accountant would have to be registered with the Public Company Accounting Oversight Board (''PCAOB''),[122] have undergone at least one examination by the PCAOB, and have addressed any deficiencies noted by the PCAOB within three years of the report noting such a deficiency.

Second, the amendments would require that the governing body of the FCM ensure that the accountant engaged for an audit is duly qualified, and specifies certain qualifications that must be considered when evaluating an accountant for such purpose.

Last, the Commission is proposing to require a public accountant to state in the audit opinion whether the audit was conducted in accordance with U.S. generally accepted auditing standards after full consideration of the auditing standards adopted by the PCAOB.

Benefits

By requiring accountants to be registered with PCAOB and to have undergone at least one examination by the same, the proposed rule would help to ensure that the accountant is qualified to audit publicly traded companies, which are often more complex than those that are privately held. As a consequence, the proposed requirement would promote selection of accounting firms that are more sophisticated and experienced than would necessarily be the case in the absence of the proposed amendment, which would help to ensure that the accountant is large enough to maintain independence in its examination and has adequate experience to deal with the unique aspects of an FCM's business model, operational processes, and financial records.

Requiring the FCM's board to evaluate and approve accountants conducting audits for the FCM would tend to enhance protection of customer funds by increasing accountability among the board for any errors resulting from an accountant's lack of relevant experience. Consequently, the requirement would incent the board to choose auditors carefully, or to provide diligent oversight as senior management makes such selections. This would promote selection of highly qualified accountants, which would help to ensure that audits are as effective as possible in identifying problems with operational controls, potential indications of fraud, or other warning signs that could enable senior

[118] § 1.12(l).

[119] This estimates 20–40 hours of time each from the CCO and CFO. The average compensation for a chief compliance officer is $110.97/hour [$170,727 per year/(2000 hours per year)*1.3 = $110.97/hour]; $110.97*20 = $2,219.45 and $110.97*40 = $4,438.90. The average compensation for a chief financial officer is estimated by the Commission to be $455.00/hour [$700,000 per year/(2000 hours per year)*1.3 is $455.00 per hour]; $455.00*20 = $9,100.00 and $455.00*40 = $18,200.00. The compensations of an average CFO is an estimate by the Commission. The figure for a CCO is taken from the 2011 SIFMA Report on Management and Professional Earnings in the Securities Industry.

[120] This estimates that the CFO, General Counsel, and CCO will each spend an additional 4–8 hours developing and reviewing the report. The average compensation for a chief financial officer is estimated by the Commission to be $455.00/hour [$700,000 per year/(2000 hours per year)*1.3 is $455.00 per hour]; $455.00*4 = $1,780.00 and $455.00*8 = $3,640.00. The average compensation for a general counsel is estimated by the Commission to be $260.00/hour [$400,000.00 per year/(2000 hours per year)*1.3 is $260.00 per hour]; $260.00*4 = $1,040.00 and $260.00*8 = $2,100.00. The average compensation for a chief compliance officer is $110.97/hour [$170,727 per year/(2000 hours per year)*1.3 = $110.97/hour]; $110.97*4 = $443.88 and $110.97*8 = $887.78. The figure for the CCO is taken from the 2011 SIFMA Report on Management and Professional Earnings in the Securities Industry; other compensations are estimates by the Commission.

[121] *See* NFA Interpretive Notice 9028—NFA Financial Requirements: The Electronic Filing of Financial Reports. Available at: *http://prodwebvip.futures.org/nfamanual/NFAManual.aspx?RuleID=9028&Section=9. See also* CME Advisory Notice: Enhanced Customer Protections & Rule Amendments, June 27, 2012. Available at: *http://www.cmegroup.com/tools-information/lookups/advisories/clearing/AIB12-08.html.*

[122] ''PCAOB is a nonprofit corporation established by Congress to oversee the audits of public companies in order to protect the interests of investors and further the public interest in the preparation of informative, accurate and independent audit reports. The PCAOB also oversees the audits of broker-dealers, including compliance reports filed pursuant to federal securities laws, to promote investor protection.'' *See http://pcaobus.org/Pages/default.aspx.*

management and the Commission or DSRO to protect customer funds more effectively.

Costs

The Commission anticipates that auditors that are registered with the PCAOB and that have undergone at least one examination by the PCAOB are likely to charge more for audits, than those that do not have those qualifications. However, the Commission does not have adequate information to estimate the difference in costs.

Request for Comment

Question 6: The Commission requests comment regarding the cost of audits for an FCM. Specifically, what is the range of costs and average cost of an audit conducted by auditors with the credentials required in the proposed rule? What is the range of costs and the average cost of an audit conducted by auditors without such qualifications?

§ 1.17 Minimum Financial Requirements for Futures Commission Merchants And Introducing Brokers [123]

Proposed Changes

As described in the section by section discussion at II.F, the Commission is proposing to amend § 1.17 by adding a new provision that will authorize the Commission to require an FCM to cease operating as an FCM and transfer its customer accounts if the FCM is not able to certify and demonstrate sufficient access to liquidity to continue operating as a going concern.

In addition, FCMs that are dual registrants (FCM and BD) are allowed to use the Securities and Exchange Commission's broker-dealer approach [124] to evaluating the credit risk of securities that the FCM invests in and assigning smaller haircuts [125] to those that are deemed to be a low credit risk, should the SEC adopt as final its proposed rule to eliminate references to credit ratings. The proposed change to § 17(c)(5)(v) would allow FCMs that are not dual registrants to use the same approach. Reducing the haircut assigned to low credit risk securities that the FCM invests in (which would potentially include some investments compliant with the requirements of § 1.25), reduces the capital charge that the FCM must take for investing in those securities.

Last, the proposed amendments would change the period of time that an FCM can wait for margin payments from a customer before taking a capital charge from three days to one day.

Benefits

As discussed in II.F, an FCM's ability to meet capital requirements and segregation requirements is not necessarily a sufficient indicator of the FCM's continued viability as a going concern. If an FCM does not have access to liquidity to meet identifiable, imminent financial obligations, the FCM will likely default, regardless of the amount of capital that is recognized on its balance sheet. In such circumstances, transferring customer positions to another FCM before the current FCM enters into bankruptcy provides additional protection to customer funds. Once the FCM enters into bankruptcy, the transfer of customer positions may be slowed by the trustee's involvement, which could interrupt customers' ability to actively manage those positions. In addition, if the FCM enters into bankruptcy before transferring customers' positions, customer segregated funds may be subject to trustee fees. Transferring the positions before the FCM enters into bankruptcy, therefore, provides additional protection to customers by preserving their ability to continuously manage their accounts and by protecting their funds from being subject to trustee fees.

By allowing FCMs that are not dual registrants to follow the same rules as those that are dual registrants, the change would harmonize the regulation of FCMs with respect to minimal financial requirements. This would place FCMs that are not dual registrants on a level playing field with those that are dual registrants, which contributes to the competitiveness of the financial markets.

In § 1.17(c)(5)(viii), the Commission proposes to reduce the period of time an FCM can wait to receive margin call payments from customers before taking a capital charge, which will incent FCMs to exercise increased diligence when seeking such payments, and therefore will likely prompt customers to provide such payments more quickly. As a consequence, the risk that a debit balance could develop in a customer's account due to tardy margin call payments would be reduced, and the amount of residual interest that the FCM would need to maintain in the segregated accounts in order to protect against the possibility that such debit balances could cause them to have less that is required in their segregated accounts would also be reduced. This provides benefits for the FCM by reducing the amount of capital that it must contribute to the customer segregated accounts, and for customers, by promoting more rapid margin call payments from other customers to support their own positions.

Costs

With respect to costs, the proposed amendment § 1.17(a)(4), allowing the Commission to require an FCM to transfer its customer positions if the FCM is not able to immediately certify that its liquidity is adequate to continue as a going concern, would give the Commission the authority to force the FCM to transfer its customer positions to another FCM in such circumstances. This could create additional costs for the FCM in two different ways. First, it is possible that while the FCM may not be able to immediately certify that it has sufficient liquidity to continue as a going concern but may nevertheless obtain sufficient liquidity before its impending obligations become due. If the FCM is forced to transfer its positions before it obtains the liquidity necessary to demonstrate that it may continue as a going concern, the FCM will have lost its FCM business. Second, if the FCM is working on obtaining sufficient liquidity to continue as a going concern, it may be able to obtain such liquidity under more favorable terms if it has time to consider multiple offers. However, if the FCM has a

[123] CEA 4(d)(2), referenced in § 1.17, states, ''It shall be unlawful for any person, including but not limited to any clearing agency of a contract market or derivatives transaction execution facility 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.''

[124] As stated above in II.F above, under the SEC proposal, a BD may impose the default haircuts of 15 percent of the market value of readily marketable commercial paper, convertible debt, and nonconvertible debt instruments or 100 percent of the market value of nonmarketable commercial paper, convertible debt, and nonconvertible debt instruments. A BD, however, may impose lower haircut percentages for commercial paper, convertible debt, and nonconvertible debt instruments that are readily marketable, if the BD determines that the investments have only a minimal amount of credit risk pursuant to its written policies and procedures designed to assess the credit and liquidity risks applicable to a security. A BD that maintains written policies and procedures and determines that the credit risk of a security is minimal is permitted under the SEC proposal to apply the lesser haircut requirement currently specified in the SEC capital rule for commercial paper (*i.e.,* between zero and ½ of 1 percent), nonconvertible debt (*i.e.,* between 2 percent and 9 percent), and preferred stock (*i.e.,* 10 percent).

[125] As stated above in II.F, in computing its adjusted net capital, an FCM is required to reduce the value of proprietary futures and securities positions included in its liquid assets by certain prescribed amounts or percentages of the market value (otherwise known as ''haircuts'') to discount for potential adverse market movements in the securities.

shortened timeline to consider offers before being forced to transfer its customer positions to another FCM, it may be forced to accept an offer that is less attractive than what otherwise would have been the case.

Regarding the proposed amendment to § 1.17(c)(5)(v) changing the haircutting procedures for FCMs, lowering the amount of capital that the FCM must hold reduces the buffer it has to absorb any losses that result from its own investments. However, the Commission proposes that even in the absence of the amendment proposed here dual registrants will be able to use the SEC's haircutting procedure. Therefore, only FCMs that are not dual registrants would be impacted by the proposed change to § 1.17. Moreover, the Commission proposes that FCMs that are not dual registrants do not typically invest in securities that would be subject to reduced haircuts under the SEC's proposed rules, and therefore the change would not have a significant impact on the capital requirements for such FCMs.

Reducing the period of time FCMs can wait for customers' margin call payments before taking a capital charge may increase the capital charge that FCMs take due to tardy margin call payments. As a consequence, proposed § 1.17(c)(5)(viii) would likely force FCMs to hold more capital, or to more diligently collect margin from customers on a prompt basis. The Commission does not have adequate information to estimate the amount of additional capital that FCMs would likely be required to hold, or the cost of that capital, and therefore is not able to quantify this cost at this time.

Request for Comment

Question 7: The Commission requests comment regarding whether FCMs that are not dual registrants typically invest in securities that would be subject to reduced haircutting procedures under the SEC's proposed rules. If an FCM would be subject to reduced haircutting, please quantify the effect that such investments are likely to have on the capital requirements for such FCM.

Question 8: In addition, the Commission requests information that would assist it in quantifying the costs and benefits associated with reducing the number of days an FCM can wait for margin call payments before taking a capital charge. Specifically, how much margin is typically owed by those customers?

Question 9: The Commission also requests comment regarding the amount of additional capital that FCMs would likely be required to hold and the average cost of capital for an FCM. In addition, please provide data and calculations that would enable the Commission to replicate and validate the estimates you provide.

§ 1.20 Futures Customer Funds To Be Segregated and Separately Accounted for

Proposed Changes

As described in the section by section discussion at II.G, the proposed amendments to § 1.20 reorganize the section, but also alter the substance of the section's requirements in certain places.

Proposed § 1.20 includes a new Appendix A which is a template for the acknowledgment letter that FCMs and DCOs must obtain from their depositories. The proposed changes would require FCMs and DCOs to use the letter in Appendix A to provide the acknowledgment that they must obtain, and to clarify that the acknowledgment letter must be obtained before depositing any funds with a depository. The proposed amendments to § 1.20 also requires FCMs and DCOs file the acknowledgment letter with the Commission promptly, and to update the acknowledgment letter whenever there are changes to the business name, address, or account numbers referenced in the letter. Last, proposed § 1.20 requires that customer funds deposited at a bank or trust company must be available for immediate withdrawal upon demand by the FCM or DCO, which effectively prevents them from placing funds into time-deposit accounts with depositories.

Benefits

Proposed § 1.20(d)(2) would require that FCMs and DCOs use the template in Appendix A when obtaining written acknowledgments from their depositories holding futures customer funds. Through this change would require depositories accepting customer funds to: (1) Recognize that the funds are customer segregated funds subject to the Act and CFTC regulations; (2) agree not to use the funds to secure any obligation of the FCM to the depository; (3) agree to allow the CFTC and the FCM's SRO to examine accounts at any reasonable time; (4) agree to provide CFTC and SRO user login to have read-only access to segregated accounts 24 hours a day; (5) and agree to release funds in segregated accounts when instructed to do so by an appropriate officer of FCM, the Director of DSIO, or the Director of DCR.

These acknowledgments and commitments would result in important benefits. First, by acknowledging that the funds are subject to the Act and CFTC regulations, the depository would become accountable for complying with relevant statutory and regulatory requirements related to its handling of those funds. Second, the depository would acknowledge that the FCM is not permitted to use customer funds as belonging to any person other than the customer which deposited them, which would also prohibit an FCM from using customer funds to secure its own obligations. By requiring the FCM or DCO to obtain a statement from depositories holding customer funds acknowledging these limitations on use, the proposed rule would ensure that each depository is aware that the customers' funds cannot be used to secure the FCM's obligations to the depository. Third, the letter constitutes written permission by the depository to allow CFTC or DSRO officials to examine the FCM's customer accounts at any reasonable time, and to view the those accounts online at any time. As a consequence, the letter would enable both the Commission and the DSRO to monitor actual balances at the depository more easily and regularly. This would increase the probability that any discrepancy between balances reported by the FCM on its daily customer segregation account reports, and balances actually held by the depository would be identified quickly by the Commission or the DSRO. Moreover, with standing authorization from the depository to examine customer segregated accounts, both the Commission and DSRO would be better able to move quickly to verify that there is a problem.

The commitment to distribute funds when directed to do so by the Director of DSIO, the Director of DCR, or appropriate officials of the DSRO facilitates the immediate movement of customer funds, and avoids delay in the release such funds which expedites to the transfer the customers' positions or to return the customers' funds without delay.

The acknowledgment letter also provides some assurances to the depository, namely, that it is not liable to the FCM for following instructions to distribute funds from customer segregated accounts at the direction of the Director of DSIO or the Director of DCR and that the depository is not responsible for the FCM's compliance with the Act or Commission regulations beyond what is expressly stated in this letter. The letter places depositories holding customer funds on notice that they must release customer funds without delay when directed to do so by

the Director of DSIO or the Director of DCR. The assurance that the FCM will not hold the depository liable for following instructions from the Director of DSIO or of DCR should reduce this potential cause for delay in time-critical situations. Moreover, under the proposed amendments, depositories must sign the acknowledgment letter in Appendix A in order to receive funds from an FCM or DCO. If some depositories were not willing to sign the letter, it would reduce the number of available depositories for FCMs and DCOs and may force them to move some existing depository accounts.

The benefit of requiring FCMs and DCOs to obtain an acknowledgment letter from their depository prior to or contemporaneously with transferring any customer funds to that depository is that it ensures that all the protections provided for by the depository's consent to the terms of the letter are in place for the full time during which a depository holds customer segregated funds. In other words, it prevents the possibility of a gap in the protections created by the requirements of this section.

By requiring FCMs and DCOs to submit the acknowledgment letters, signed by their depositories, to both the Commission and the relevant SRO, the proposed rules should make it easier for the Commission or relevant SRO to act quickly, when necessary, being confident that the correct legal permissions are in place. Additionally, requiring the letters to be retained for five years past the time when customer segregated funds are no longer held by each depository would ensure that proper documentation of all relevant acknowledgments and commitments is in the possession of each party that relies upon the existence of those commitments in order to effectuate the protections created by this section.

Last, § 1.12(h) requires that funds deposited by an FCM be available for immediate withdrawal. If an FCM places customer funds in time-deposit accounts the depository has the contractual right to require a period of notice from the FCM before distributing funds at the FCM's request. Under the proposed regulation, a period of notice would not be acceptable given the obligation that the FCM has to return customer funds to customers upon request. Moreover, placing funds in a time-deposit account could prevent the DCO, Commission, or Trustee from being able to effect the immediate movement of customer funds if required to do so in the event of a default by the FCM. Requiring that funds be available for immediate withdrawal at the request of the FCM ensures prompt access to customer funds by all concerned.

Prohibiting FCMs from placing customer funds in time-deposit accounts would codify a long-standing staff interpretation that prohibits FCM's from placing customer funds in such accounts.[126] The interpretation and proposed amendment prohibit such deposits because time-deposit accounts, by law, must retain the right to a certain number of days advance notice before allowing a customer to withdrawal funds. This delay could prevent an FCM from returning all customer funds in a prompt manner if those customers all demanded their funds and could prevent the DCO from porting open positions to another FCM in the event that the FCM currently holding those funds defaulted. The benefits of codifying the current staff interpretation are that it will provide additional clarity about the legal force of the requirement, and will put the requirement in a location where relevant market participants are much more likely to see it, which reduces the likelihood that FCMs would violate this prohibition unknowingly.

Costs

FCMs and DCOs are likely to bear some initial and ongoing costs as a result of the proposed amendment requiring them to use the template in Appendix A to obtain the acknowledgment letter from their depositories. Regarding initial costs, the letter includes new requirements that existing depositories want to discuss with the FCM or DCO's staff. In addition, some existing depositories may not be willing to sign the new letter, which would force the FCM or DCO to move any customer funds held by that depository to a different depository, creating certain due diligence and operational costs. The Commission estimates that the cost of obtaining a new acknowledgment letter from each existing depository is between $1,300 and $4,200.[127] Based on conversations with industry participants, the Commission estimates that FCMs and DCOs would have approximately 1–30 depositories each, from which they must obtain a new acknowledgment letter. Therefore, the Commission estimates that the cost of obtaining new acknowledgment letters from existing depositories is between $2,700 and $82,000 per FCM or DCO.[128] In addition, based on conversations with industry participants, the Commission estimates that identifying new potential depositories, conducting necessary due diligence, formalizing necessary agreements, opening accounts, and transferring funds to a new depository is likely to take between three to six months and is likely to require support from compliance attorneys, as well as operations, risk management, and administrative personnel. The Commission estimates that the cost of moving accounts from an existing depository that is not willing to sign the letter is between $50,000 and $102,000.[129]

Ongoing costs include those created by the additional requirements the FCM or DCO will have to explain to new depositories when obtaining the required letter. There may be additional operational costs involved with monitoring depositories for any change that would necessitate updating the letter. The per-entity cost of obtaining the letter from new depositories is likely to be the same as it would for obtaining the letter from existing depositories (*i.e.,*

[126] See Administrative Determination No. 29 of the Commodity Exchange Administration dated Sept. 28, 1937 stating, ''the deposit, by a futures commission merchant, of customers' funds * * * under conditions whereby such funds would not be subject to withdrawal upon demand would be repugnant to the spirit and purpose of the Commodity Exchange Act. All funds deposited in a bank should in all cases by subject to withdrawal on demand.''

[127] This estimate assumes 10–40 hours of time from a compliance attorney and 10–20 hours from an office services supervisor. The average compensation for a compliance attorney is $85.35/hour [$131,303 per year/(2000 hours per year)*1.3 is $85.35 per hour]; $85.35*10 = $853.47 and $85.35*40 = $3,413.88. The average compensation for an office services supervisor is $40.15/hour [$61,776.00 per year/(2000 hours per year)*1.3 is $40.15 per hour]; $40.15*10 = $401.54 and $40.15*20 = $803.09. These figures are taken from the 2011 SIFMA Report on Management and Professional Earnings in the Securities Industry.

[128] Total figures are taken from previous calculation. ($1,255.01+$4,216.97)/2 = $2,735.99; $2,735.99*1 = $2,735.99 and $2,735.99*30 = $82,079.69.

[129] This estimate assumes one compliance attorney working full-time for 3–6 months, 50–200 hours from an office services supervisor, 80–160 hours of time from a risk management specialist, and 40–60 hours from an intermediate accountant. The average compensation for a compliance attorney is $85.35/hour [$131,303 per year/(2000 hours per year)*1.3 is $85.35 per hour]; $85.35*40 hours/week*4 weeks/month*3 months = $40,966.54 and $85.35*40 hours/week*4 weeks/month*6 months = $81,933.07. The average compensation for an office services supervisor is $40.15/hour [$61,776.00 per year/(2000 hours per year)*1.3 is $40.15 per hour]; $40.15*50 = $2,007.72 and $40.15*200 = $8,030.88. The average compensation for a risk management specialist is $65.33/hour [$100,500 per year/(2000 hours per year)*1.3 is $65.33 per hour]; $65.33*80 = $5,226.00 and $268.84*160 = $10,452.00. The average compensation for an intermediate accountant is $34.11/hour [$52,484.00 per year/(2000 hours per year)*1.3 is $34.11 per hour]; $34.11*40 = $1,364.58 and $34.11*60 = $2,046.88. These figures are taken from the 2011 SIFMA Report on Management and Professional Earnings in the Securities Industry.

$1,300 and $4,200). The Commission estimates that the ongoing cost associated with monitoring for changes that would require the acknowledgement letter to be updated is between $1,100 and $2,800 per year.[130]

The proposed requirement, embedded in the acknowledgment letter, that depositories provide to the Commission and DSRO online, read-only access to accounts where customer segregated funds are held, would create certain costs for depositories that would likely be passed onto FCMs. The NFA Board of Directors recently approved rule amendments that will require FCMs to provide their respective DSROs with on-line view-only access to customer segregated/secured amount bank account information. NFA has submitted the rule amendments to the Commission for approval.[131] Therefore, the pending NFA rule and the Commission's proposed requirement would require banks and trust companies to provide the Commission and the DSROs with the same read-only access to account information. The Commission estimates that the cost of this additional access is between $270 and $540 per account.[132]

For all other depositories, the Commission believes that providing access read-only access to balances and transactions in cash accounts is possible with existing technology and therefore, for depositories that already provide such access to their customers, the cost of providing that access to the Commission and DSRO is likely to be relatively low. Based on conversations with industry participants, the Commission estimates that on average an FCM or DCO is likely to have approximately 5–30 accounts. The Commission estimates that the initial set-up cost of providing access to each account at depositories that already provide online access to their customers is approximately $270 and $550 per account.[133]

On the other hand, for depositories that do not currently provide such access to their customers, setting up the capability to provide it to the Commission and DSRO will require that the depository implement additional technology. The Commission does not have adequate data to estimate the cost for establishing such a system.

The Commission proposes that the requirement embedded in the acknowledgment letter that depositories consent to release customer funds whenever requested to do so by the Director of DCR or Director of DSIO will not create any additional costs for FCMs, depositories, or market participants.

The Commission does not anticipate any costs associated with proposed § 1.20(h) prohibiting an FCM from placing customer funds in time-deposit accounts since it is codifying a current staff interpretation and FCMs already abide by this standard.

The remaining requirements in proposed § 1.20 are virtually identical to those in the existing rule, but are reorganized in order to improve readability. The changes that are merely the result of reorganizing identical requirements do not result in any costs for market participants.

Request for Comment

Question 10: The Commission requests data from which to estimate the initial and ongoing costs for a depository to establish the capability to provide read-only access to account balances and transaction history.

Question 11: The Commission requests comment from the public regarding the initial and ongoing cost of services provided by vendors that have the ability to provide regular confirmation of balances at depositories on both a scheduled and unscheduled basis. Also, would such services be applicable to custodial accounts, and accounts held at non-bank depositories (e.g. other FCMs or Money Market Mutual Funds)?

Question 12: The Commission requests comment regarding whether depositories currently have systems that provide their customers with continuous read-only access to accounts where securities are held that provide: (1) Real time or end of day balances for each segregated account; and (2) descriptions of the types of assets contained in each account with balances associated with each type of asset. How do the capabilities of systems that provide continuous read-only access to customers vary across different types of depositories, foreign or domestic (i.e. banks, FCMs, DCOs, or Money Market Mutual Funds)?

Question 13: If depositories do not currently have the ability to provide continuous read-only access to accounts holding customer funds that display transactions and balances for those accounts, what costs would be required in order to create such a system?

Question 14: The Commission assumes that the costs and benefits enumerated above capture the range of costs and benefits that would be experienced by each type of depository. The Commission requests comment and quantification regarding any additional costs or benefits that would be experienced by certain types of depositories such FCMs, bank and trust companies, depositories of an international affiliate.

§ 1.22 Use of Customer Funds Restricted

Proposed Changes

As described in the section by section discussion at II.H, the Commission recently approved amendments to the definition of the term ''commodity and/or options customer.'' [134] In order to retain the meaning of the term ''commodity and/or options customer'' as it was originally defined, the Commission is replacing the term with ''futures customer.'' As above, the new term has the same meaning as the original definition of the term that it is replacing, and therefore there are no costs or benefits associated with this change.

In addition, the proposed amendments to 1.22 clarify that the prohibition against use of a futures customer's funds to extend credit to, or to purchase, margin, or settle the contracts of another person applies at all times. Last, the proposed amendments would clarify that in order to comply with the prohibition against using one customer's funds to ''purchase, margin, or settle the trades, contracts, or commodity options of, or to secure or extend the credit'' [135] of any other

[130] This assumes 20–50 hours per year from an office manager for monitoring costs. The average compensation for an office manager is $55.82/hour [$85,875 per year/(2000 hours per year)*1.3 = $55.82/hour]; $55.82*20 = $1,116.38 and $55.82*50 = $2,790.94. This figure is taken from the 2011 SIFMA Report on Management and Professional Earnings in the Securities Industry.

[131] A copy of the NFA rule submission is available on the NFA Web site, *www.nfa.futures.org.*

[132] This assumes 4–8 hours per account from a senior database administrator. The average compensation for a senior database administrator is $$68.09/hour [$104,755 per year/(2000 hours per year)*1.3 = $68.09/hour]; $68.09*4 hour = $272.36 and $68.09/hour *8 hours = $554.73. This figure is taken from the 2011 SIFMA Report on Management and Professional Earnings in the Securities Industry.

[133] This assumes 4–8 hours per account from a senior database administrator. The average compensation for a senior database administrator is $$68.09/hour [$104,755 per year/(2000 hours per year)*1.3 = $68.09/hour]; $68.09*4 hour = $272.36 and $68.09/hour *8 hours = $554.73. This figure is taken from the 2011 SIFMA Report on Management and Professional Earnings in the Securities Industry.

[134] The final rulemaking is available on the Commission's Web site, *www.cftc.gov.*

[135] *See* proposed § 1.22. N.B., the current form of § 1.22 also includes a prohibition against using one

Continued

person, the FCM would be required to ensure that its residual interest in futures customer funds exceeds the sum of all its futures customer margin deficits.

Benefits

The benefit of the proposal is that it protects customer funds by requiring continual customer segregation balancing thereby avoiding the potential that an FCM could employ end-of-day balancing to obscure a shortfall the FCM experienced in the middle of the day.

Under current regulations it is not permitted for an FCM to use one customer's funds to purchase, margin, secure or settle positions for another customer. However, the current regulations do not specify how FCMs must comply with this requirement. The proposed rule would specify that FCMs must maintain residual interest in customer segregated accounts that is larger than the sum of all customer margin deficits, which would ensure that the FCM is not using one customer's funds to purchase, margin, secure, or settle positions for another customer. Furthermore, when combined with the reporting requirements in §§ 1.10, 1.32, 22.2, and 30.7, which require the FCM to report both the sum of their customer margin deficits as well as their residual interest in customer segregated accounts, the proposed approach would provide the Commission and the public with sufficient information to verify that FCMs are not using one customer's funds to purchase, margin, secure or settle positions for another customer.

Costs

If the sum of an FCM's customer margin deficits is greater than the residual interest an FCM typically maintains in their customer accounts, then the FCM would have to increase the amount of residual interest it maintains in customer segregated accounts, which would reduce the range of investment options the FCM has for those additional funds and may prompt the FCM to maintain additional capital to meet operational needs. On the other hand, if an FCM typically maintains residual interest in customer segregated accounts that is greater than the sum of their customer margin deficits, then the proposed rule would not create any additional costs. In the past, the Commission has not required FCMs to report the sum of their customers' margin deficits. Therefore, the Commission does not have adequate information to determine whether FCMs typically hold residual interest that is greater than the sum of their customers' margin deficits and cannot estimate the cost of the proposed rule.

Request for Comment

Question 15: The Commission requests comment regarding whether FCMs typically maintain residual interest in their customer segregated accounts that is greater than the sum of their customer margin deficits, and data from which the Commission may quantify the average difference between the amount of residual interest an FCM maintains in customer segregated accounts and the sum of customer margin deficit.

Question 16: How much additional residual interest would FCMs hold in their customer segregated accounts in order to comply with the proposed regulation? What is the opportunity cost to FCMs associated with increasing the amount of capital FCMs place in residual interest, and data that would allow the Commission to replicate and verify the calculated estimates provided.

Question 17: The Commission request information regarding the additional amount of capital that FCMs would likely maintain in their customer segregated accounts, if any, to comply with the proposed regulation. What is the average cost of capital for an FCM? Please provide data and calculations that would allow the Commission to replicate and verify the cost of capital that you estimate?

§ 1.23 Interest of Futures Commission Merchants in Segregated Funds; Additions and Withdrawals

Proposed Changes

As described in the section by section discussion at II.I, the proposed text changes the term ''customer funds'' to ''futures customer funds.'' This is a conforming change in order to retain the same meaning once the term ''customer'' is redefined in § 1.3.[136] The Commission anticipates that there are no costs or benefits associated with this change.

The proposed § 1.23 also places new restrictions regarding an FCM's withdrawal of residual interest funds for proprietary use. Under the proposed § 1.23, an FCM cannot withdraw funds for proprietary use unless they have prepared the daily segregation calculation from the previous business day and must adjust for any activity or events that may have decreased residual interest since close of business the previous day. In addition, an FCM is only permitted to withdrawal more than 25% of its residual interest for proprietary use within one day if it: (1) Obtains a signature from the CEO, CFO or other senior official as described in § 1.23(c)(1) confirming approval to make such a withdrawal; and (2) sends written notice to the CFTC and DSRO indicating that the requisite approvals from the CEO, CFO or other senior official has been obtained, providing reasons for the withdrawal, listing the names and amounts of funds provided to each recipient, and providing an affirmation from the signatory indicating that he or she has knowledge and reasonable belief that the FCM is still in compliance with segregation requirements after the withdrawal.

In addition, if the FCM drops below its target threshold for residual interest because of a withdrawal of residual interest for proprietary use, the next day it must either replenish residual interest enough to surpass its target, or if senior leadership believes the original target is excessive, the FCM may revise its target in accordance with its policies and procedures established in proposed § 1.11.

Benefits

The proposed restrictions on withdrawals of residual interest provide an additional layer of protection for customer funds contained in segregated accounts. An FCM may withdraw residual interest as long as it always maintains sufficient FCM funds in the account to cover any shortfall that exists in all of its customers' segregated accounts. However, as a practical matter, the segregation requirements fluctuate constantly with market movements, and customer surpluses or deficits also fluctuate depending on the speed with which customers meet margin calls. As a consequence, an FCM is not expected to have a precise, real-time knowledge of the amount of residual interest it has in a segregated account. The Commission recognizes that any precise, real-time, single calculation would almost immediately become obsolete as the value of customers' accounts and their obligations to the FCM continue to fluctuate. Moreover, a sufficient amount of residual interest to cover deficiencies in customers' accounts at one point in time may be inadequate to cover such deficiencies an hour later, or even a few minutes later. Therefore, it is important

customer's funds to ''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 commodity option customer.''

[136] The Commission recently approved final amendments to § 1.3 that revised the definition of the term ''customer'' to include commodity customers, options customers, and swap customers. A copy of the **Federal Register** release is available on the Commission's Web site, *www.cftc.gov.*

for an FCM to maintain sufficient residual interest to cover both current deficiencies in customer accounts as well as any additional deficiencies that could develop over a relatively short period of time. Restrictions on withdrawals of residual interest help to ensure that the FCM does not withdraw too much residual interest, either knowingly or unknowingly, and jeopardize customer funds in the segregated account.

Prohibiting any withdrawal of residual interest until the customer segregation account calculations are complete for the previous day and requiring the FCM take into account any subsequent developments in the market or the account that could impact the amount of residual interest before withdrawing funds protects customer funds by reducing the likelihood that lack of current information could cause the FCM to make a withdrawal from customer funds that is large enough to cause the account to fall below its segregated funds requirement.

In addition, the proposed amendment would require several steps in order for an FCM to remove more than 25% of their residual interest in a single day. Large, single-day withdrawals of the FCM's residual interest in the customer segregated account could be an indication of current or impending capital or liquidity strains at the FCM. The additional steps ensure that senior management is knowledgeable of and accountable for such withdrawals, that no shortfall in the customer segregated accounts is created by the withdrawals and that the CFTC and DSRO are both alerted and can monitor the FCM and its segregated accounts closely over subsequent days and weeks. Additional monitoring, in turn, would help to ensure that the integrity and sufficiency of the FCM's customer segregated accounts are carefully protected. In addition, notifying the CFTC and DSRO gives both an opportunity to ask questions about the FCM's reasonable reliance on its estimations of the adequacy of its funds necessary to meet segregation requirements. Such questions may give the Commission and DSRO comfort that the transaction does not indicate any strain on the FCMs financial position, or conversely, may raise additional questions and alert the CFTC and DSRO to the need for heightened monitoring of the FCM or further investigation of its activities. Also, while the proposed regulations would reduce the risk that customer funds could be missing in the event of an FCM's bankruptcy, the proposed rule would establish a second layer of protection by ensuring that the Commission has records regarding the name and address of parties receiving funds from the distribution of residual interest.

In addition, requiring an FCM to replenish its residual funds the following day any time a withdrawal causes it to drop below the FCM's target amount helps to ensure that residual interest is not used by the firm to address liquidity needs in other parts of the firm unless those needs are very short-term in nature (*i.e.,* less than 24 hours).

Costs

These procedural requirements will create some costs for FCMs. Restricting an FCMs ability to withdraw residual interest until daily calculations have been completed may prevent the FCM from withdrawing funds quickly in order to meet certain operational needs, or to take advantage of specific investment opportunities. This restriction may also force the FCM to hold additional capital in order to reduce the potential that it would need funds from its residual interest in order to meet any operational needs. The Commission does not have adequate information to estimate the amount of additional capital that an FCM might be likely to hold, or the cost of capital for those funds. Moreover, calculating the opportunity cost for an FCM's potential missed opportunities is not possible since, by definition, they depend on the alternative opportunities available to the FCM and the Commission does not have adequate information to determine what those opportunities might be.

In addition, abiding by the procedures for withdrawals of residual interest for proprietary use, whether the withdrawals are less than or greater than 25% of the FCM's residual interest, would create operational costs as these percentages must be calculated and requisite permissions will require time to obtain. The additional cost created by procedures that are required for additional withdrawals below 25% of the FCM's residual interest will depend significantly on the procedures the FCM develops, and the extent to which the FCM has already implemented similar procedures. The Commission does not have adequate information to estimate these incremental costs. If an FCM withdraws more than 25% in a given day they have to get certain signatures and have to send a notification to the Commission. It is also likely that the Commission would follow up with questions about the withdrawal. The Commission proposes that obtaining the necessary signatures, reviewing the notification sent to the Commission, and conducting any follow-up conversations would require time from an attorney and office staff personnel. Therefore, the Commission estimates that the additional cost to an FCM for complying with procedures to withdraw 25% or more of their residual interest in a single day is likely to be between $850 and $1,100 each time an FCM needs to make such withdrawals.[137]

Request for Comment

Question 18: The Commission invites comment regarding the amount of additional capital that FCMs would likely hold because of restrictions on their ability to withdraw residual interest and the cost of capital for those funds.

Question 19: In addition, the Commission requests comment regarding the extent to which FCMs already have procedures in place that would satisfy the requirements in §§ 1.11 and 1.23 regarding withdrawals of residual interest. For an FCM that do not have such procedures in place already, please quantify the additional cost that the FCM will bear as a consequence of complying with any policies and procedures it may develop and implement in order to satisfy the requirements of §§ 1.11 and 1.23 with respect to withdrawals of residual interest.

§ 1.25 Investment of Customer Funds

Proposed Changes

As described in the section by section discussion at II.J, § 1.25 permits FCMs and DCOs to use customer funds to purchase securities from a counterparty under an agreement for the resale of the securities back to the counterparty. This type of transaction is often referred to as a ''repo,'' and in effect, is a collateralized loan by the FCM to its counterparty. Currently, § 1.25(b)(3)(v) establishes a counterparty concentration limit, prohibiting FCMs and DCOs from using more than 25% of the total funds in the customer segregated account to conduct reverse repos with a single counterparty. The proposed amendment would expand the definition of a counterparty to include additional entities under common ownership or control. The proposed amendment

[137] This assumes 6–8 hours of a compliance attorney's time and 6–8 hours of an office manager's time. The average compensation for a compliance attorney is $85.35/hour [$131,303 per year/(2000 hours per year)*1.3 is $85.35 per hour]; $85.35*6 = $512.08 and $85.35*8 = $682.78. The average compensation for an office manager is $55.82/hour [$85,875 per year/(2000 hours per year)*1.3 = $55.82/hour]; $55.82*6 = $334.91 and $55.82*8 = $446.55. These figures are taken from the 2011 SIFMA Report on Management and Professional Earnings in the Securities Industry.

incorporates the Commission's interpretation of the existing rule, and therefore does not alter its meaning. Therefore, the Commission does not anticipate that the proposed amendment will create any costs or benefits.

The additional proposed changes to § 1.25 are conforming amendments proposed in order to harmonize this section with other amendments proposed in this release, and therefore do not create any additional costs or benefits.

§ 1.26 Deposit of Instruments Purchased With Customer Funds

Proposed Changes

As described in the section by section discussion at II.K, proposed § 1.26 would change the term ''commodity or option customers'' to ''futures customers.'' This is a conforming change in order to retain the same meaning once the term ''customer'' is redefined in § 1.3.

In addition, the other changes proposed for § 1.26(a–b) require that FCMs and DCOs obtain a written acknowledgment letter from depositories in accordance with the requirements established in § 1.20. This change introduces significant additional specificity regarding the timing and content of the letter that FCMs and DCOs must obtain from their depositories. The specifics of those requirements, as well as the costs and benefits of them, are detailed in the discussion of costs and benefits for § 1.20, discussed in the cost benefit considerations section related to § 1.20.

If, however, an FCM or DCO invests funds with a money market mutual fund and those funds are held directly by the money market mutual fund or its affiliate, then the FCM or DCO must use the acknowledgment letter proposed in Appendix A of § 1.26 rather than the acknowledgment letters in the appendices of § 1.20. The content of the letter in § 1.26 is identical to those in § 1.20 except that it includes three additional provisions related specifically to funds held by the money market mutual fund or its affiliate (''MMMF''). Specifically, it requires that: (1) the value of the fund must be computed and made available to the FCM or DCO by 9:00 a.m. of the following business day; (2) that the fund must be legally obligated to redeem shares and make payments to its customers (i.e. the FCM or DCO) by the following business day; and (3) the money market mutual fund does not have any agreements in place that would prevent the FCM or DCO from pledging or transferring fund shares.

Benefits

The benefits are largely the same as for the acknowledgment letters required in § 1.20, described above in the cost benefit section related to § 1.20. However, requiring FCMs and DCOs to have Money Market Mutual Funds (''MMMFs'') sign a different acknowledgment letter if customer funds are held directly with the money market mutual fund or its affiliate has some benefits.

First, requiring the MMMF to compute the value of the fund and make that available to the FCM or DCO by 9:00 a.m. the following business day ensures that FCMs will have the information they need in order to produce their daily segregation calculations by 12:00 p.m. the following business day (*i.e.,* three hours later), which is an existing requirement for FCMs.[138] This is important not only because it enables the FCM to comply with the requirement to produce segregation calculations by 12:00 p.m. the following day, but because under the proposed rule, FCMs would not be allowed to withdraw residual interest until the daily segregation calculations are completed. Second, by requiring the fund to redeem shares and make payments to their customers by the following business day, the proposed requirement prohibits MMMFs from entering into any agreement with an FCM or DCO that gives the MMMF a contractual right to delay payment, thus preventing similar risks to what would occur if FCMs were allowed to place funds in time-deposit accounts. Last, by prohibiting the MMMF from imposing restrictions that would prevent the FCM or DCO from pledging or transferring fund shares, the letter would ensure that FCMs are able to use their shares as collateral at the DCO and that those shares could be transferred from one FCM to another in the event of the first FCM's default.

Costs

As discussed above in the cost benefit considerations section related to § 1.20 the NFA already requires electronic read-only access to customer accounts, so the Commission does not anticipate that providing the same access to the Commission will create additional costs.

In addition, if an FCM or DCO currently has an account with a money market mutual fund that, either directly or through an affiliate, holds its own funds, and that fund is either not compliant with the additional provisions of the letter in Appendix A § 1.26 or is unwilling to sign the proposed acknowledgment letter, the FCM or DCO would bear some costs related to identifying a compliant money market mutual fund, conducting due diligence, and moving its accounts to that fund. This would force the FCM or DCO to identify a new MMMF that is qualified to accept its customer funds, creating the same costs that are described above in the cost benefit considerations section related to § 1.20.

Request for Comment

Question 20: The Commission requests comment regarding the likelihood that money market mutual funds holding segregated funds from FCMs or DCOs are not compliant with the additional terms contained in the proposed acknowledgment letter. In addition, what costs would an FCM or DCO bear when identifying a compliant money market mutual fund and transferring their customer funds to that money market?

Question 21: In addition, the Commission requests comment regarding whether the requirements contained in the acknowledgment letter, discussed in § 1.20, would impact money market mutual funds differently from any other depositories.

§ 1.29 Gains and Losses Resulting From Investment of Customer Funds

Proposed Changes

As described in the section by section discussion at II.L, under the Commission's existing regulations, § 1.29(a) states that FCMs or DCOs investing customer funds in § 1.25 investments are entitled to the return on those investments. Proposed § 1.29(b) provides that FCMs or DCOs investing customer segregated funds in instruments described in § 1.25 also bear sole responsibility for the losses that result from those investments.

Benefits and Costs of the Proposed Changes

This change was recommended by FIA, which stated its belief that the FCM or DCO's responsibility for losses in § 1.25 investments ''is clear and is implicit in the Act and the Commission's rules.''[139] The Commission believes that market participants already recognize this and act accordingly. Therefore the Commission does not believe that

[138] *See* §§ 1.32, 22.2, and 30.7.

[139] FIA, ''Initial Recommendations for Customer Funds Protection.'' Available at: *http://www.futuresindustry.org/downloads/Initial_Recommendations_for_Customer_Funds_Protection.pdf.*

proposed § 1.29(b) would create any additional costs.

§ 1.30 Loans by Futures Commission Merchants; Treatment of Proceeds

Proposed Changes

As described in the section by section discussion at II.M, § 1.30 permits the FCM to lend its own funds to a customer on securities and property pledged by the customer, effectively performing a collateral transformation service. The proposed amendment to § 1.30 clarifies that, while an FCM may provide secured loans to a customer, it may not make loans to a customer on an unsecured basis or use a customer's futures or options positions as security for a loan from the FCM to that customer.

Benefits

The proposed prohibition against FCMs providing unsecured loans to customers reduces counterparty risk borne by the FCM position because it prevents the FCM from accumulating exposures to customers that have not margined their positions. In addition, the proposed rule would prohibit an FCM from using a customer's positions to secure loans made to customers, which would also reduce the FCM's counterparty risk. If an FCM used a customer's positions to secure a loan to that customer, the FCM would be using the same collateral to secure two different liabilities: the liability associated with the open position; and the liability associated with the unsecured loan. By prohibiting FCMs from using a customer's positions to secure a loan to that customer, the proposed rule would prevent the additional exposure that would otherwise result from using the same collateral to secure two different liabilities, which again, reduces the FCM's counterparty risk.

In addition, to the extent that the proposed change would force customers to obtain such loans from another lender, it diversifies the counterparty risk across multiple entities. That benefits the FCM that would otherwise bear more concentrated customer risk, and likely would be good for the markets more generally because of the additional protection that it provides to any clearinghouse of which the FCM is a member.

Costs

Regarding costs associated with the proposed restriction—customers that need or prefer to use borrowed funds to meet their initial and maintenance margin requirements for certain positions would be forced to obtain loans necessary to fund their futures or options positions from another lender. That would increase the customer's operational costs since they would have to transfer funds from one institution to another and would have to administer both accounts. In addition, it is likely that lenders will conduct more due diligence than would be the case if the FCM were to loan the requisite funds, which will create additional costs related to such a loan, both for the customer and for the party lending the funds.

Request for Comment

Question 22: The Commission requests comment regarding how often FCMs currently make loans to customers on either a secured or unsecured basis, and what the processes and terms typify such loans (including details regarding the process for evaluating credit risk, size of such loans, payment terms, collateral, and any other details that commenters believe the Commission should consider).

Question 23: In addition, the Commission requests information regarding the additional operational costs that customers would bear if they have to obtain a loan from an entity other than the FCM holding their funds in a customer segregated account. If possible, please quantify the additional costs.

§ 1.32 Reporting of Segregated Account Computation and Details Regarding the Holding of Customer Funds

Proposed Changes

As described in the section by section discussion at II.N, The proposed changes would allow an FCM that is not a dual registrant to follow the same procedures as dual registrants (FCM/BDs) when assessing a haircut to securities purchased with customer funds if the FCM determines that those securities have minimal credit risk. This is the same change as is proposed in § 1.17 except that in § 1.17 the proposed change refers to securities purchased by an FCM with its own capital, whereas the proposed change here would apply to securities purchased with customer funds. The change proposed here would create the same costs and benefits as described above in the cost benefit considerations section related to § 1.17.

In addition, the proposed changes would: (1) Require FCMs to report daily Segregation Statements to the Commission and their DSRO electronically by noon the following business day; (2) require that twice per month, each FCM submit a detailed list of depositories report listing of all the depositories and custodians where customers segregated funds are held, including the amount of customer funds held by each entity and a break-down of the different categories of § 1.25 investments held by each entity; and (3) require that the detailed list of depositories be submitted to the Commission electronically by 11:59 p.m. the following business day and that both Segregation Statements and Detailed list of depositories be retained by the FCM in accordance with § 1.31.

Benefits

Requiring FCMs to submit their daily calculations to the Commission and DSRO, together with the proposed amendments to §§ 1.20 and 1.26 giving the Commission and DSRO electronic access to view the balances of all depository accounts where customer segregated funds are held, will enable the Commission and DSRO to better protect customer funds by more closely monitoring for any discrepancies between the assets in segregated accounts reported by the FCM and their depositories. The ability of the Commission and DSRO to check for discrepancies more regularly, without notice, is likely to provide an additional disincentive to fraud. Moreover, it will enable both the Commission and DSROs to monitor for any trends that would indicate operational or financial problems are developing at the FCM, which would give the Commission an opportunity to enhance its supervision and to intervene, if necessary, to protect customer segregated funds.

The detailed list of depositories would provide additional information to the Commission and DSRO beyond what would be available to both by virtue of the electronic read-only access that has been proposed in §§ 1.20, 1.26, and 30.7. First, the detailed list of depositories will provide additional account detail including the types of securities and investments that constitute each account's assets rather than existing reports that only include the total value securities. Second, the reports will account for any pending transactions that would not necessarily be apparent when viewing a depository account online. Third, FCMs will, in these reports, provide to the Commission and DSRO a reconciled balance, which would not be available to the Commission or DSRO simply by viewing an FCM's depository accounts online. Each of these additional forms of information would enable the Commission and DSRO to provide better oversight and create additional accountability for the FCM.

Costs

FCMs are already calculating segregated funds information daily and reporting the results to the NFA via WinJammer by noon the following day. Similarly, the detailed list of depositories that would be required to be submitted twice per month is already required by NFA to be produced and submitted to NFA via WinJammer.[140] Requiring FCMs to submit these reports to the Commission via the same platform should not create any additional costs.

§ 1.52 Self-Regulatory Organization Adoption and Surveillance of Minimum Financial Requirements

Proposed Changes

As described in the section by section discussion at II.O, the proposed amendments to 1.52 would revise the supervisory program that SROs are required to create and adopt. In addition, for SROs that choose to delegate the function to examine FCMs that are members of two or more SROs to a DSRO, the amended rules would require a plan that establishes a Joint Audit Committee which, in turn, must propose, approve, and oversee the implementation of a Joint Audit Program. The amended rules specify a number of additional requirements for the SRO supervisory program as well as for the Joint Audit Program.

Benefits

Regarding SROs' supervisory programs, the proposed amendments would provide significant additional protection to FCMs' counterparties, investors, and customers by ensuring that SRO audits of member FCMs are thorough and effective. The proposed amendments would help to ensure thorough audits by requiring that an SRO's audit program be designed to address ''all areas of risk to which futures commission merchants can reasonably be foreseen to be subject,'' that the scope and focus of such audits would be determined by the risk profile that the SRO develops for each FCM, and that the audit itself include both controls testing as well as substantive testing. The last requirement, in particular, would help to ensure that audits give adequate attention to testing and review of internal controls, which are critical to help ensure that each FCM is not only compliant with capital and segregation requirements at the time of the audit, but that they continue to operate in such a manner after the audit is completed by preventing fraud or operational errors that could jeopardize the FCM and its customers.[141]

By requiring that the supervisory program for the SRO must be compliant with U.S. Generally Accepted Auditing Standards and standards prescribed by the Public Company Accounting Oversight Board, the proposed rules would ensure that the SROs' supervisory programs draw from established best practices, and that they address the full range of issues that would impact the effectiveness of the SRO's audits of FCMs. This benefit is enhanced by the proposed list of specific issues that each SRO must address in the standards they develop for their supervisory program. And by promoting audits that are thorough, the proposed rules would, again, promote protection of the FCM's counterparties, investors, and customers.

By requiring that an examinations expert evaluate the SRO's supervisory program at least once every two years, and that the results of such examinations include a discussion and recommendation of any new or best practices, the proposed rules would ensure that the supervisory program and SRO audits continue to build on best practices, for audits, which further promotes thorough and effective audits of FCMs.

The proposed rules for the Joint Audit Program would require the Joint Audit Program to: (1) Establish standards covering all the same issues; (2) require controls testing as well as substantive testing; (3) address all areas of risk to which the registered FCM can reasonably be foreseen to be subject; (4) conform to U.S. generally accepted auditing standards and as well as those prescribed by the Public Company Accounting Oversight Board; and (5) have an examinations expert evaluate the Joint Audit Program at least once every two years. Therefore, the proposed rules would produce identical benefits related to audits conducted by a DSRO.

In addition, by requiring that the DSRO audits include examination of an FCM's compliance with rules and regulations governing minimum net capital, obligations to segregate customer funds, financial reporting requirements, etc., the proposed rule would ensure that these critical elements of the FCM's operations and finances are reviewed during each audit. Each of these elements safeguard customers. Additionally, by requiring the Joint Audit Committee to develop procedures to identify high risk firms and perform enhanced monitoring of such firms, the proposed rules would help to ensure that any risk to customer funds that begins to materialize (e.g. the FCM's residual interest begins to drop) is identified and corrected quickly, thus reducing the risk of a loss of customer funds.

In addition, commenters at the Commission's August 9th roundtable on customer protection noted that when audits take several months to complete, the findings are less relevant when they are delivered to the business than they would have been if they were communicated more promptly.[142] Therefore, by requiring that the Joint Audit Program maintain adequate levels of staff with adequate training and experience, the proposed requirements would facilitate timely completion of audits, which is likely to enhance the protection of customer funds by promoting more prompt identification and correction of weaknesses identified in such audits. Moreover, if auditors are not independent of the FCM they are auditing, their findings may be compromised by conflicts of interest. By requiring standards related to independence together with annual ethics training, the proposed rule would help to ensure that the results of any audit conducted by the DSRO are not compromised by the influence of any conflict of interests. Each of these, in turn, facilitate thorough, effective, and timely audits, which help protect the FCM's customers, counterparties, and investors by ensuring that the FCM's financial reports are accurate, and that internal controls are reviewed and tested.

Costs

SROs are already required to establish and operate supervisory programs for auditing FCMs. The proposed amendments require further detail and documentation with regard to specific elements of such supervisory programs. The Commission estimates that the cost for developing these policies and procedures would be between $20,700 and $31,000 per SRO.[143]

[140] *See* Segregated Investment Detail Report at: *http://www.nfa.futures.org/NFA-compliance/NFA-futures-commission-merchants/fcm-reporting.pdf.*

[141] While many auditors and market participants have noted the importance of controls testing, the Commission understands that currently, many audits tend to emphasize substantive testing and give lesser attention to controls testing. *See* Public Roundtable to Discuss Additional Customer Protections, August 9, 2012. A recording of the roundtable is available at: *http://www.cftc.gov/PressRoom/Events/opaevent_cftcstaff080912. See* [customer protection roundtable from 8/9].

[142] *See* Public Roundtable to Discuss Additional Customer Protections, August 9, 2012. A recording of the roundtable is available at: *http://www.cftc.gov/PressRoom/Events/opaevent_cftcstaff080912 See* [roundtable on Aug 9th].

[143] This estimate assumes 160–240 hours of time from both a compliance attorney and a senior

The Joint Audit Committee would have to develop policies and procedures concerning the application of the Joint Audit Program in the examination of FCMs. The standards would have to, at minimum, conform to the U.S. GAAS and would also have to address the items in § 1.52(c)(2)(iii). The development of such policies and procedures is likely to require input from one attorney and one senior accountant at each SRO, and therefore the Commission estimates that such involvement will cost each SRO between $2,400 and $6,000.[144] In addition, the work required to further develop Joint Audit Program is likely to be supported by full time staff at the DSRO. The Commission estimates that such support will cost the DSRO between $18,000 and $26,400.[145] In addition the Joint Audit Program would be required to have an examinations expert review the policies and procedures they develop.

Ongoing costs to the SRO and Joint Audit Program would include fees charged by the examinations expert for a review every other year, the incremental cost of more extensive controls testing when auditing each FCM, and the incremental cost resulting from standards that the SRO develops to comply with the list of standards that must be addressed in the supervisory program.[146] The Commission does not have adequate information to estimate the ongoing costs for biennial reviews by an examinations expert, or the incremental costs of additional controls testing or ongoing compliance with standards that the FCMs develop pursuant to § 1.52(c)(2)(iii).

Request for Comment

Question 24: The Commission requests comment regarding the costs associated with increased controls testing. To what extent do SROs currently conduct controls testing when auditing FCMs? What additional testing would likely be involved in order to comply with the proposed regulations?

Question 25: In addition, the Commission requests comment regarding the costs for an expert examiner to conduct a review such as the one contemplated in the proposed rules.

Question 26: Also, regarding costs associated with the Joint Audit Committee and Joint Audit Program, which costs are likely to be borne by the SROs and which are likely to be borne by the DSROs?

§ 1.55 Public Disclosures by Futures Commission Merchants

Proposed Changes

As described in the section by section discussion at II.P, the proposed rules would add new provisions to the disclosure document that FCMs are required to provide to prospective customers, detailed in § 1.55(b). The new provisions would require the disclosure document to contain a statement that: (1) Customer funds are not protected by insurance in the event of the bankruptcy or insolvency of the FCM, or if customer funds are misappropriated in the event of fraud; (2) customer funds are not protected by SIPC, even if the FCM is a BD registered with the SEC; (3) customer funds are not insured by a DCO in the event of the bankruptcy or insolvency of the FCM holding the customer funds; (4) each customer's funds are not held in an individual segregated account by an FCM, but rather are commingled in one or more accounts; (5) FCMs may invest funds deposited by customers in investments listed in § 1.25; and (6) funds deposited by customers may be deposited with affiliated entities of the FCM, including affiliated banks and brokers.

In addition, the proposed rule would require each FCM to provide a Firm Specific Disclosure Document that would address firm specific information regarding its business, operations, risk profile, and affiliates that would be material to a customer's decision to entrust funds to and do business with the FCM.

As stated above, the Firm Specific Disclosure Document would be made available on the FCM's Web site and would provide material information about: (1) General firm contact information; (2) the names, business contacts, and backgrounds for the FCM's senior management and members of the FCM's board of directors; (3) a discussion of the significant types of business activities and product lines that the FCM engages in and the approximate percentage of the FCM's assets and capital devoted to each line of business; (4) the FCM's business on behalf of its customers, including types of accounts, markets traded, international businesses, and clearinghouses and carrying brokers used, and the futures commission merchant's policies and procedures concerning the choice of bank depositories, custodians, and other counterparties; (5) a discussion of the material risks of entrusting funds to the FCM and an explanation of how such risks may be material to its customers;[147] (6) the name and Web site address of the FCM's DSRO and the location of annual audited financial statements; (7) a discussion of any material administrative, civil, criminal, or enforcement actions pending or any enforcement actions taken in the last three years (8) a basic overview of customer fund segregation, FCM collateral management and investments, and of FCMs and joint FCM/BDs; (9) information regarding how customers may file complaints about the FCM with the Commission or appropriate DSRO; (10) certain financial data from the most recent month-end when the disclosure document is prepared; and (11) a summary of the FCMs current risk practices, controls and procedures.

FCMs would be required to update the Firm Specific Disclosure Document at least annually.

As described in the section by section discussion at II.P, FCMs would also be

accountant. The average compensation for a compliance attorney is $85.35/hour [$131,303 per year/(2000 hours per year)*1.3 is $85.35 per hour]; $85.35 *160 = $13,655.51 and $85.35 *240 = $20,483.27. The average compensation for a senior accountant is $44.18/hour [$67,971.00 per year/(2000 hours per year)*1.3 is $44.18 per hour]; $44.18*160 = $7,068.98 and $44.18*240 = $10,603.48. These figures are taken from the 2011 SIFMA Report on Management and Professional Earnings in the Securities Industry.

[144] This estimate assumes 20–50 hours of time from both a compliance attorney and an intermediate accountant. The average compensation for a compliance attorney is $85.35/hour [$131,303 per year/(2000 hours per year)*1.3 is $85.35 per hour]; $85.35*20 = $1,706.94 and $85.35*50 = $4,267.35. The average compensation for an intermediate accountant is $34.11/hour [$52,484.00 per year/(2000 hours per year)*1.3 is $34.11 per hour]; $34.11*20 = $682.29 and $34.11*50 = $1,705.73. These figures are taken from the 2011 SIFMA Report on Management and Professional Earnings in the Securities Industry.

[145] This estimate assumes 320–400 hours from an office services supervisor and 40–80 hours from both a compliance attorney and a senior accountant. The average compensation for an office services supervisor is $40.15/hour [$61,776.00 per year/(2000 hours per year)*1.3 is $40.15 per hour]; $40.15*320 = $12,849.41 and $40.15*400 = $16,061.76. The average compensation for a compliance attorney is $85.35/hour [$131,303 per year/(2000 hours per year)*1.3 is $85.35 per hour]; $85.35*40 = $3,413.88 and $85.35*80 = $6,827.76. The average compensation for a senior accountant is $44.18/hour [$67,971.00 per year/(2000 hours per year)*1.3 is $44.18 per hour]; $44.18*40 = $1,767.25 and $44.18*80 = $3,534.49. These figures are taken from the 2011 SIFMA Report on Management and Professional Earnings in the Securities Industry.

[146] *See* § 1.52(c)(2)(iii).

[147] The material risks addressed must include, without limitation, ''the nature of investments made by the futures commission merchant (including credit quality, weighted average maturity, and weighted average coupon); the futures commission merchant's creditworthiness, leverage, capital, liquidity, principal liabilities, balance sheet leverage and other lines of business; risks to the futures commission merchant created by its affiliates and their activities, including investment of customer funds in an affiliated entity; and any significant liabilities, contingent or otherwise, and material commitments.''

required to disclose on their Web sites their daily Segregation Schedule, daily Secured Amount Schedule, and daily Cleared Swaps Segregation Schedule. Each FCM would be required to maintain 12 months of the segregation and secured schedules on its Web site. Each FCM would also be required to disclose on its Web site as well as summary schedules of its adjusted net capital, net capital, and excess net capital for the 12 most recent month-end dates as well as the Statement of Financial Condition, Segregation Schedule, Secured Amount Schedule, Cleared Swaps Segregation Schedule, and all footnotes related to the above statements and schedules from its most current year end annual report that is certified by an independent public accountant.

Benefits

As explained above in the section by section discussion at II.P, current regulations require FCMs to provide a risk disclosure to potential customers before accepting customer funds. That risk disclosure statement is primarily intended to provide a customer with disclosure of the market risks of engaging in futures trading. The proposed additions to that disclosure would help to ensure that customers are aware of certain non-firm-specific risks that have been relevant in recent FCM bankruptcies and that could be relevant in the event of future FCM bankruptcies or insolvencies.

The Firm Specific Disclosure Document that would be required by the proposed rules would address firm-specific risk, which would give potential customers additional information that they could use when conducting due diligence and selecting an FCM. By requiring that the disclosure address several specific topics, the proposed rule would ensure that certain topics that are relevant are addressed, even if potential customers might not otherwise think to ask about them when selecting or conducting due diligence on potential FCMs.

Specifically, by requiring the disclosure to provide information about the business activities and product lines the FCM engages in, and the percentage of the FCM's assets and capital that are used in each type of activity, the proposed rules would assist customers in acquiring information that may assist them in determining the extent to which the FCM's business is focused on providing the types of services that the customer needs, and the extent to which other business interests could impact either the focus or stability of the FCM.

By requiring that FCMs provide the policies and procedures by which it selects depositories, the proposed rules would assist potential and existing customers in evaluating the sufficiency of due diligence conducted by the FCM when selecting such depositories. This additional measure of transparency would incent FCMs to be rigorous in conducting such due diligence because potential or existing customers that are not satisfied with the FCM's policies and procedures in this respect could take their business elsewhere.

Requiring FCMs to discuss their business on behalf of customers, the proposed rules would ensure that customers and potential customers are able to make a more thorough assessment of risks that the FCM or customer funds held by the FCM might bear due to the markets or businesses in which the FCM is active, the clearinghouses and carrying brokers it uses, or the depositories that hold funds on behalf of the FCM. Such an assessment could impact customers' decisions as they select the FCM(s) with which they will conduct business. Moreover, additional transparency would promote market discipline, which would provide additional incentive for FCMs to manage such risks diligently.

By requiring FCMs to disclose material risks together with an explanation of how such risks may be material to its customers, the proposed rules would ensure that the FCM is responsible to identify and communicate such risks, which helps to ensure that potential and existing customers would be aware of those risks when placing or keeping funds on deposit with the FCM. In the absence of such a requirement, potential or existing customers may not know the FCM's business as well as the FCM does, and therefore may not ask about certain risks that are material to customers, may not have access to adequate information to determine the magnitude of such risks, or may not understand how certain risks could impact the FCM's customers.[148] The proposed amendment would make the FCM responsible both to identify and provide information regarding all material risks and to provide explanations that would help educate customers about how such risks could affect them.

Requiring FCMs to provide information regarding how they may file a complaint about the FCM with the Commission or the firm's DSRO would help to ensure that if customers perceive problems at an FCM, those concerns are communicated to the proper regulatory bodies, giving the Commission and DSRO an opportunity to investigate further, if appropriate. As a consequence, the required information would promote more effective oversight by the Commission and DSRO.

By requiring that FCMs provide an overview of customer fund segregation and FCM collateral management and investment, the proposed rules would promote the protection of customer funds by enhancing market discipline through customer education. The proposed rules would help customers understand how statutory and regulatory requirements are designed to provide protections for their funds, and what steps FCMs must take in order to comply with such regulations. Educated customers, in turn, provide an additional layer of accountability for the FCM in complying with such requirements. Moreover, customers will be better able to understand public disclosures regarding disciplinary actions against FCMs, updates regarding material risks to customer funds, financial disclosures made by the FCM, and to make informed decisions in response.

In particular, the disclosures proposed in § 1.55(k)(10) could assist customers in evaluating fellow customer risk that they would bear at each FCM with which they consider doing business. By requiring FCMs to disclose specific financial data as of the most recent month-end when the disclosure document is produced, the proposed requirements would further ensure that all customers have access to data that would be helpful when considering potential risks associated with entrusting funds to the FCM.

Requiring FCMs to disclose the dollar value of their proprietary trading margin requirements as a percentage of margin required for futures customers, Cleared Swap Customers, and 30.7 Customers would help customers understand the magnitude of risk created by the FCM's proprietary positions relative to the magnitude of risk created by customers' positions. This information could prompt customers to ask additional questions about the relationship between the risks created by the firm's

[148] In the Public Roundtable to Discuss Additional Customer Protections on August 9, 2012, participants suggested that FCMs may not provide all customers and potential customers with equivalent access to firm-specific data. *See http://www.cftc.gov/PressRoom/Events/opaevent_cftcstaff080912.*

As a result, larger customers may be able to conduct more thorough due diligence when selecting an FCM. The proposed requirements would help ensure that all customers have access to FCM-specific data that is helpful when evaluating the risks that would be relevant to customer funds entrusted to an FCM.

proprietary trading and trading on behalf of customers. It could also prompt questions about how the firm's operations related to proprietary trading may impact their operations related to customer accounts.

By requiring FCMs to disclose the number of customers that constitute 50% of the FCMs total funds held for futures customers, Cleared Swaps Customers, and 30.7 Customers, customers would have additional insight into the potential exposure that the FCM could have due to a default by one of its largest customers.

The aggregate notional value of non-hedged, principal over-the-counter transactions into which the FCM has entered, when calculated and reported for each class of swaps, would give customers some sense of the potential exposure the FCM has due to potential changes in the value of its proprietary portfolio.

The aggregate amount of financing FCMs provide for customer transactions involving illiquid financial products would give customers additional insight into the potential challenges FCMs would face if a fellow customer defaulted and the FCM had to liquidate such products in order to mitigate the losses caused by the customer's default.

Requiring FCMs to disclose the amount, source, and purpose of any unsecured and uncommitted short term funding the FCM has access to would help potential and existing customers gain insight into the FCM's capacity to meet unexpected liquidity needs that might occur due to a fellow customer's default.

Requiring FCMs to disclose the percentage of customer debts the FCM experienced during the past 12-month period, as compared to the balance of funds held for futures customers, Cleared Swaps Customers, and 30.7 Customers would give customers a sense for how effective the firm's risk management program is, as well as a sense for the quality of the customer pool that the FCM has accepted.

Requiring FCMs to provide a summary of their current risk management practices, controls and procedures would give customers insight into the procedures that FCMs use to manage the risks associated with fellow customers, which would be valuable to customers when evaluating potential fellow customer risk at various FCMs.

By requiring each FCM to adopt policies and procedures reasonably designed to ensure that its advertising and solicitation activities are not misleading to its FCM customers, the proposed rules would strengthen accountability for communication related to an FCM's sales and solicitation activities. Moreover, the Commission and DSROs would be better equipped to monitor FCMs' internal controls related to sales and solicitation, and compliance with those controls, if FCMs have established policies and procedures. In this way, the proposed rules would promote consistently reliable communication associated with each FCM's sales and solicitation efforts.

By requiring FCMs to update the disclosure proposed in rule 1.55(i) annually as well as any time there is a ''material change to its business operation, financial condition and other factors material to the customer's decision to entrust the customer's funds and otherwise do business with the futures commission merchant,'' and requiring the FCM to provide each updated disclosure to its customers, the rule would make FCMs responsible to communicate with customers whenever such events occur. This requirement would help to ensure that the FCM's financial condition, business operations, or other important factors do not change in material ways without customers being aware of such changes, and would likely prompt some customers to conduct additional due diligence in such situations in order to determine whether their funds are at risk, which would provide additional accountability for FCMs.

By requiring FCMs to provide their daily Segregation Schedules, daily Secured Amount Schedules, and daily Cleared Swaps Segregation Schedules, as well as additional month end and annual financial data, the proposed rules would facilitate transparency. All of the information that firms would be required to post on their Web site is information that would be public based on the requirements of this rule even if it were not posted on each FCM's Web site. However, if the schedules mentioned above were not posted on each FCM's Web site, market participants would have to submit a request to the Commission in order to access that information. Requiring each FCM to post the above schedules and data on its Web site would help to ensure that market participants are aware that it is available, and would also improve the speed and efficiency of obtaining it.

Similarly, by requiring FCMs to provide a link to the Web site of the NFA's Basic System facilitate transparency by promoting awareness of the additional information that is public regarding each FCM's investment of customer funds and by minimizing search costs for obtaining that information.

Costs

FCMs would have to create the Firm Specific Disclosure Document which would likely require time from compliance, legal, accounting, and administrative personnel. The Commission estimates that the cost for producing the content of the initial disclosure would be between $6,000 and $22,200.[149] In addition, each FCM would have to update the disclosure annually as well as any time there is a material change to the business that could affect the customer's willingness to do business with the FCM. Producing the content of each update is likely to be less costly than the initial disclosure, since some parts of the disclosure will likely remain the same from one version to the next. The Commission estimates that such updates would cost between $6,000 and $12,000.[150]

Posting the Firm Specific Disclosure Document and the schedules and data that would be required by § 1.55(o) would require firms to update their Web site on a daily, monthly, and annual basis with the information that would be required under § 1.55(o). The Commission estimates that these

[149] This assumes 40–200 hours from a compliance attorney, 10–50 hours from a senior accountant, 40–60 hours from an office services supervisor, and 5 hours from the CCO. The average compensation for a compliance attorney is $85.35/hour [$131,303 per year/(2000 hours per year)*1.3 is $85.35 per hour]; $85.35 *40 = $3,143.88 and $$85.35 *200 = $17,069.39. The average compensation for a senior accountant is $44.18/hour [$67,971.00 per year/(2000 hours per year)*1.3 is $44.18 per hour]; $44.18*10 = $441.81 and $44.18*50 = $2,209.06. The average compensation for an office services supervisor is $40.15/hour [$61,776.00 per year/(2000 hours per year)*1.3 is $40.15 per hour]; $40.15*40 = $1,606.18 and $40.15*60 = $2,409.26. The average compensation for a chief compliance officer is $110.97/hour [$170,727 per year/(2000 hours per year)*1.3 = $110.97/hour]; $110.97*5 = $554.86. These figures are taken from the 2011 SIFMA Report on Management and Professional Earnings in the Securities Industry.

[150] This estimate assumes 40–80 hours from a compliance attorney, 20–40 hours from an intermediate accountant, and 30–60 hours from an office services supervisor. The average compensation for a compliance attorney is $85.35/hour [$131,303 per year/(2000 hours per year)*1.3 is $85.35 per hour]; $85.35*40 = $3,413.88 and $85.35*80 = $6,827.768. The average compensation for an intermediate accountant is $34.11/hour [$52,484.00 per year/(2000 hours per year)*1.3 is $34.11 per hour]; $34.11*40 = $1364.58 and $34.11*80 = $2729.17. The average compensation for an office services supervisor is $40.15/hour [$61,776.00 per year/(2000 hours per year)*1.3 is $40.15 per hour]; $40.15*20 = $803.09 and $40.15 *60 = $2,409.26. These figures are taken from the 2011 SIFMA Report on Management and Professional Earnings in the Securities Industry.

updates would cost between $2,300 and $7,000 per year.[151]

Request for Comment

Question 27: What modifications to the requirements of § 1.55(k)(10) should the Commission consider in order to ensure that the data provided from FCMs' most recent month-end is valuable to customers evaluating potential fellow customer risk?

- In particular, Is there additional information FCMs could provide related to the value of the FCM's proprietary margin requirements and customers' margin requirements that would assist current and potential customers when conducting due diligence on an FCM?
- Is there additional information FCMs could provide that would give customers a more complete picture of its ability to meet unexpected liquidity needs that could occur due to the default of one of its customers?

Question 28: Would the data from an FCM's most recent month-end be more valuable to customers if it were coupled together with similar data or the same data from other points in time? If so, what points in time should the Commission consider?

§ 22.2 Futures Commission Merchants: Treatment of Cleared Swaps and Associated Cleared Swap Customer Collateral

Proposed Changes

As described in the section by section discussion at II.Q, the proposed amendments to § 22.2 would incorporate changes with respect to protection of funds for customers trading cleared swaps that are identical to the changes proposed for protection of futures customer funds. Those changes include: (1) Incorporating the same change to haircutting procedures as was proposed above in § 1.17 and § 1.32 but for swaps; (2) requiring the FCM to send daily Segregation Calculations for cleared swaps to the Commission and DSRO; and (3) requiring that segregated investment detail report that FCMs produce twice per month, listing assets on deposit at each depository, to be sent to CFTC and DSRO electronically by 11:59 p.m. the following business day. Records of both reports would be required to be maintained in accordance with § 1.31.

In addition, the proposed rule would specify that FCMs must maintain residual interest in customer segregated accounts that is larger than the sum of all customer margin deficits. This proposed requirement is substantially identical to the proposed requirement in §§ 1.22 and 30.7.

Benefits

As discussed above with reference to § 1.32, requiring FCMs to submit their daily segregation reports to the Commission and DSRO will enhance protection of customer funds by giving both of them additional information that, together with permission to view depository accounts online at any time, would enable both the Commission and DSRO to monitor those accounts more closely for any discrepancies that may result from operational errors or fraud. Moreover, requiring FCMs to submit their detailed list of depositories to the Commission and DSRO twice per month would give both organizations additional information that could help them perform spot checks to ensure that the FCM is valuing and haircutting securities correctly and, more generally, to verify that the value of each account that is computed by the FCM is accurate.

As described in the discussion of cost and benefit considerations related to § 1.22, by requiring that FCMs maintain residual interest in their cleared swap customer segregated accounts, the proposed rule would ensure that the FCM is not using one customer's funds to purchase, margin, secure, or settle positions for another customer and when combined with the reporting requirements in § 22.2 would provide the Commission and the public with sufficient information to verify that FCMs are not using one customer's funds to purchase, margin, secure or settle positions for another customer.

Costs

With respect to costs, as described above, changes to the reporting requirements codify requirements that are already established by the DSROs. Therefore, the additional requirements will not introduce new costs for market participants. On the other hand, reducing the haircut increases the likelihood that adverse developments affecting the FCM's § 1.25 investments could cause financial strain for the FCM, or could cause losses that the FCM would not be able to cover, either of which could increase risk to customer funds. However, as described above in the cost benefit considerations section related to § 1.17, the Commission proposes that FCMs that are dual registrants will be able to use the SEC's haircutting procedures, and that FCMs that are not dual registrants do not typically invest in securities that would be subject to reduced haircuts under the SEC's proposed rules.

By requiring FCMs to maintain residual interest in the cleared swap customer segregated accounts that is greater than the sum of their customers' margin deficits, the proposed rule would create costs and benefits that are substantially identical to those described in the cost and benefit considerations related to § 1.22. As discussed in that section, the Commission does not have information to determine whether FCMs typically maintain residual interest in their cleared swap customer segregated accounts that is greater than or less than the sum of their customers' margin deficits, and requests information sufficient to make such a determination, and to quantify the associated costs, if any.

Request for Comment

Question 29: The Commission requests comment regarding whether FCMs typically maintain residual interest in their customer segregated accounts that is greater than the sum of their customer margin deficits, and data from which the Commission may quantify the average difference between the amount of residual interest an FCM maintains in customer segregated accounts and the sum of customer margin deficit.

Question 30: How much additional residual interest would FCMs hold in their customer segregated accounts in order to comply with the proposed regulation? What is the opportunity cost to FCMs associated with increasing the amount of capital FCMs place in residual interest, and data that would allow the Commission to replicate and verify the calculated estimates provided.

Question 31: The Commission request information regarding the additional amount of capital that FCMs would likely maintain in their customer segregated accounts, if any, to comply with the proposed regulation. What is the average cost of capital for an FCM? Please provide data and calculations that would allow the Commission to replicate and verify the cost of capital that you estimate?

§ 22.17 Policies and Procedures Governing Disbursements of Cleared Swaps Customer Collateral From Cleared Swap Customer Accounts

Proposed Changes

As described in the section by section discussion at in II.Q, proposed § 22.17 would impose restrictions on an FCM's withdrawal of its residual interest, and

[151] This assumes 10–30 minutes of time per day from a programmer. The average compensation for a programmer is $53.64/hour [$82,518 per year/(2000 hours per year)*1.3 = $53.64/hour]; $53.64*43 = $2,145.47 and $53.64*130 is $6,972.77.

requires that if a withdrawal of residual interest for proprietary use causes the FCM to fall below its targeted residual interest that the funds be replenished the following business day or the residual interest target be lowered in accordance with its policies and procedures established under § 1.11.

Benefits and Costs of the Proposed Changes

The costs and benefits are similar to those created by §§ 1.23 and 1.11 but apply to customer funds in Cleared Swaps Customer Accounts rather than customer segregated accounts, and therefore are in addition to those specified in §§ 1.23 and 1.11.

§ 30.1 Definitions

Proposed Changes

Proposed § 30.1 establishes definitions for ''30.7 Customer,'' ''30.7 Account,'' and ''30.7 Customer Funds.'' The first is defined as any foreign futures or foreign option customer, together with any foreign-domiciled person who trades in foreign futures or foreign options trough an FCM. ''30.7 Account'' and ''30.7 Customer Funds'' are then defined accordingly. These definitions would replace the terms ''foreign futures or foreign options customer,'' ''foreign futures or foreign options customer account,'' and ''foreign futures or foreign options customer funds,'' respectively. The existing term ''foreign futures or foreign options customer'' only includes U.S.-domiciled customers that deposit funds with an FCM for use in trading foreign futures or foreign options. The proposed definitions, on the other hand, would include both U.S. and foreign customers that deposit funds with an FCM for use in trading foreign futures or foreign options.

Benefits and Costs of the Proposed Changes

These definitions play a 'gatekeeping' function with respect to other rules by determining what customers are included as ''30.7 Customers.'' However, the costs and benefits of these changes are attributable to the substantive requirements related to the definitions, and therefore are discussed in the cost benefit considerations related to § 30.7.

§ 30.7 Treatment of Foreign Futures or Foreign Options Secured Amount

Proposed Changes

As described in the section by section discussion at II.R, the proposed amendments would: (1) Incorporate the funds of foreign-domiciled investors deposited with an FCM for investment in foreign futures and foreign options within the protections provided in 30.7; (2) eliminate the Alternative Method and require the Net Equity Liquidation Method for calculating 30.7 customer segregation requirements; (3) add specificity to the written acknowledgments that FCMs and DCOs must obtain from their depositories by providing required templates; [152] (4) add restrictions on withdrawing from residual interest; [153] (5) require that 30.7 Customer Funds deposited in a bank must be available for immediate withdrawal at the request of the FCM; (6) clarify that the FCM is responsible for any losses related to investing 30.7 Customer Funds in investments that comply with § 1.25; (7) add a prohibition against making unsecured loans to customers or using the funds in the customer's trading account as security for the loan; (8) require daily segregation reports and detailed list of depositories be submitted to the Commission and DSRO, and that targeted residual interest be included in both of those reports; (9) allow FCMs that are not dual registrants to use the broker-dealer (''BD'') procedure for assigning a smaller haircut to instruments with low default risk; (10) establish a limit on the amount of funds in a 30.7 Account that can be held outside the United States; [154] and (11) require FCMs to maintain residual interest in 30.7 Accounts that is larger than the sum of all 30.7 Customer margin deficits. This proposed requirement is substantially identical to the proposed requirement in §§ 1.22 and 22.2.

A. Compared to Customer Protections Under §§ 1.20–1.32 and § 22

The result of the proposed changes is that the regulatory requirements established in § 30.7 for the protection of 30.7 Customer Funds would be substantially the same as those established for segregated customer funds under 4(d) and §§ 1.11–1.32, and for cleared swaps customer funds in § 22. However, the 30.7 regime would have distinct requirements with respect to: (1) the definition of the minimum amount that must be deposited in a 30.7 Account for each 30.7 Customer is different than in the corresponding requirements in §§ 1.12 and 22.2.[155] The difference is due to the fact that 30.7 Customers' funds may be deposited overseas under a different regulatory regime. The rule requires that FCMs abide by the highest requirement that is relevant to those funds, whether it is the United States or the foreign regime; (2) the list of acceptable depositories for 30.7 Funds includes banks or trusts outside of the United States with more than $1 billion in regulatory capital, and various other participants of foreign boards of trade and their depositories; and (3) 30.7 limits the amount of funds from a 30.7 Account that can be held outside the United States. Of these three differences, the third is the only one created by the proposed rule, and therefore is the only one incorporated in the cost benefit considerations discussion.

Benefits and Costs of the Proposed Changes

The proposed changes would establish regulations for the protection of customer funds deposited for trading in foreign futures and options that, with limited exceptions, is substantively identical to the protections that exist for futures customer funds and cleared swaps customer funds. Therefore, many of the costs and benefits of the changes that are proposed are identical to those described above in the cost benefit considerations related to §§ 1.11–1.32 and § 22.

1. Incorporating funds of foreign-domiciled investors deposited with an FCM for investment in foreign futures and foreign options within the protections provided in 30.7

[152] The additional specificity incorporates the same requirements for acknowledgment and agreement that are contained in the templates in the appendices of §§ 1.20 and 1.26.

[153] The same requirements as are proposed for futures customers' funds and cleared swaps customers' funds, including a requirement for the FCM to abide by its policies and procedures required in § 1.11.

[154] As a result of the proposed changes, the rules in § 30.7 for the protection of 30.7 Customer Funds would be substantially the same as the rules for the protection of segregated customer funds under 4(d) and §§ 1.11–1.32, and the rules for the protection of cleared swaps customer funds in § 22. However, there are a few proposed changes to § 30.7 that are dissimilar to current or proposed regulations protecting futures customer funds and cleared swap customer funds. They are: (1) the definition of the minimum amount that must be deposited in a 30.7 Account for each 30.7 Customer is different than in the corresponding requirements in 1.20 and 22.2. The difference is due to the fact that 30.7 Customers' funds may be deposited overseas under a different regulatory regime and the proposed rule would require an FCM to comply with the highest requirement that is relevant to those funds, whether it is the U.S. or the foreign regime; (2) the list of acceptable depositories for 30.7 Funds includes banks or trusts outside of the U.S. with more than $1 billion in regulatory capital, and various other participants of foreign boards of trade and their depositories; and (3) 30.7 limits the amount of funds from a 30.7 Account that can be held outside the U.S.

[155] See § 30.7(a).

Benefits

Currently, when an FCM receives funds from foreign customers for use in trading foreign futures and foreign options, the FCM may choose, but is not required, to keep foreign customer funds in a segregated account. If the funds are not kept in a segregated account, they are not subject to the same level of oversight and protection as other customer funds. For example, those funds are not incorporated in the daily or bi-monthly calculations that are submitted to the Commission and DSRO, and the FCM is permitted to use the assets of one foreign customer to cover the obligations of another foreign customer, may allow a net deficiency to exist in the funds of foreign customers held for use in foreign futures or foreign options, and is allowed to commingle such funds with the FCM's proprietary funds and use them as part of its business capital.

The benefit or requiring customer funds to be kept in segregated accounts is that those funds would receive the same protections as funds deposited by U.S.-domiciled investors. This enhances the safety of funds deposited by both U.S. and foreign investors by ensuring that the FCM maintains sufficient funds in segregated accounts to satisfy its obligations regarding all customer funds that have been deposited at the FCM.

The proposed change would extend equivalent oversight and protection to the money, securities and property received by an FCM for or on behalf of a foreign-domiciled customer for foreign futures or foreign options trading. Specifically, FCMs would be required to hold the funds of foreign-domiciled customers in 30.7 secured accounts, to include such funds in daily and bi-monthly calculations of 30.7 requirements and funds set aside for 30.7 customers, and to abide by other policies and procedures regarding handling of customer funds. This is a benefit because FCMs would be required to hold sufficient funds in 30.7 accounts at all times to cover the obligations they have to their foreign-domiciled customers as well as their U.S.-domiciled customers. Various regulations designed to ensure that this requirement is met at all times would also apply, including the § 30.7(g) restrictions on an FCM's withdrawal of its residual interest which is commingled with customer 30.7 funds, and policies and procedures developed by the FCM pursuant to § 1.11 that are designed to ensure safe handling of such funds.

Application of the additional protections designed for customer funds will help to ensure that in the event an FCM has insufficient regulatory capital, all 30.7 Customer Funds are available to be ported to another FCM. This benefit is relevant both to foreign-domiciled customers and to U.S.-domiciled customers holding money at an FCM where foreign-domiciled customers also hold funds because, as described above, in the event of a bankruptcy both groups of customers are entitled to equivalent protections regardless of whether their funds were held apart in separate accounts. Consequently, under the current rules, if an FCM keeps foreign-domiciled customer funds out of 30.7 accounts and then defaults, there may not be sufficient funds to cover the obligations of the FCM to all of their U.S.-domiciled as well as foreign-domiciled customers. If this occurs, all customers would receive a pro-rata share of the funds that were kept in 30.7 accounts, regardless of which customers' funds were kept in the 30.7 account. U.S.-domiciled customers would possibly suffer a pro rata loss of their funds in the event of the FCM's bankruptcy because an FCM may not have included foreign-domiciled customer funds in 30.7 accounts. The proposed rule would prevent this situation from occurring, thus providing increased protection not only to the foreign-domiciled customers that deposited funds, but to the U.S.-domiciled customers as well.

According to FIA, ''FCMs have generally adopted policies and procedures designed to provide protections to all customers trading on foreign boards of trade that are comparable to the protections afforded customers trading on U.S. futures markets.'' [156] If true, the proposed change would not create substantial costs or benefits in periods of normal activity for the FCM. However, under current regulations, FCMs still have the ability to diverge from the aforementioned practices they have generally adopted, and can pull foreign-domiciled customer funds out of 30.7 accounts and use those funds as if they were their own. It is precisely in a time of stress for an FCM that these protections for customer funds are most needed to prevent the FCM from commingling such funds with its own capital and using it to meet the general obligations of the firm. It is not possible to quantify the value of the additional protection that would be provided to non-U.S.-based customers on the basis of the proposed change. To do so would require data sufficient to estimate the probability and expected magnitude of losses due to lesser protections for funds deposited by foreign-domiciled customers, and the Commission does not have such data. The Commission, however, requests public comment regarding these benefits, and specifically requests any data commenters can provide that would assist the Commission in quantifying such benefits.

Costs

With respect to costs the Commission understands that in practice, FCMs have generally adopted practices that provide equivalent protections to funds deposited by customers domiciled in the U.S. and those who are not. Therefore, during normal operations the proposed requirement would not create any additional costs. However, the proposed amendment will prevent an FCM from using foreign-domiciled customer funds for trading foreign futures and foreign options as its own capital, thus reducing the FCM's liquidity which increases risk to the FCM in times of stress. As a consequence, the FCM will have an incentive to keep more capital in order to protect itself since it will no longer be able to use such funds to meet or secure its own obligations. The Commission does not have adequate data to quantify the cost of FCMs' decreased liquidity or the cost of the additional capital they may hold as a result. Doing so would require estimates of probabilities regarding the likelihood of an FCM's liquidity crisis, likelihood they hold foreign-domiciled customer funds for use in foreign futures and foreign options trading, the amount of such funds, the duration of the liquidity crisis, and a number of other factors that the Commission does not have adequate information to estimate.

Request for Comment

Question 32: The Commission requests comment from the public regarding the extent to which FCMs currently provide equivalent protections to U.S.-domiciled and foreign-domiciled customers for trading foreign futures and foreign options, as well as the probability and expected size of losses that foreign-domiciled customers may face due to lesser regulatory protection. In addition, the Commission requests comment about any additional impact this change may have on U.S. domiciled investors, foreign investors, or the public.[157]

[156] FIA ''Initial Recommendations for Customer Funds Protection,'' p. 10.

[157] Questions posed to the public have been numbered for commenters' convenience. The Commission requests that commenters identify the

2. Eliminate the Alternative Method and require the Net Equity Liquidation Method for calculating 30.7 Customer segregation requirements

Benefits

Under the current regulations FCMs are allowed to use the Alternative Method, which only requires the maintenance of sufficient funds in the foreign futures or foreign options account to satisfy the margin required on open positions plus or minus any unrealized gains or losses on such positions, and any funds representing option premiums or funds necessary to margin or guarantee such options.

By removing the Alternative Method, which the Commission understands is not in use, and requiring the Net Liquidating Equity Method, the proposed rules benefit customers by reducing the risk that a shortfall in customer funds could exist where an FCM operates in compliance with Commission regulations. More specifically, by requiring the FCM to segregate in separate accounts sufficient funds to satisfy the full account equities of all of its customers trading foreign futures or foreign options, the FCM would have sufficient funds in segregated accounts to meet all of their obligations to all such customers at any time, including in the event the FCM defaults. Further, in the event of default, the proposed regulations would facilitate the transfer of assets to another FCM by assuring the receiving FCM that there are sufficient funds to cover the liabilities that it may be assuming.

Costs

With respect to costs, as described above, the Commission understands that in practice, all FCMs are currently using the Net Liquidating Equity Method. However, FCMs currently have the option to switch to the Alternative Method, which they would have an incentive to do if the FCM needed additional liquidity. The proposal would prohibit an FCM switching to the Alternative Method, thereby preventing an FCM from using some portion of customer funds as if it were its own operational capital. In doing so, the proposed rule would reduce the FCM's options for obtaining liquidity.

The Commission does not have adequate data to quantify the cost of this change. Doing so would require estimates of probabilities regarding the likelihood of an FCM's liquidity crisis, likelihood they hold foreign-domiciled customer funds for use in foreign futures and foreign options trading, the amount of such funds, the amount that are typically required to margin open positions for 30.7 Customers, and a number of other factors that the Commission does not have adequate information to estimate. However, as above, the Commission notes that it does not believe that FCMs should consider any customer funds a source of liquidity.

3. Specific requirements contained in the written acknowledgments that FCMs and DCOs must obtain from their depositories

The costs and benefits resulting from this change are similar to those discussed the cost benefit considerations sections related to §§ 1.20 and 1.26, but affect 30.7 Customer funds rather than futures customer funds, and therefore are in addition to the costs and benefits discussed in the cost benefit considerations sections related to § 1.20 and § 1.26.

4. Restrictions on withdrawing from residual interest, including a requirement for the FCM to abide by its policies and procedures required in § 1.11

The costs and benefits resulting from this change are similar to those discussed the cost benefit sections related to §§ 1.23 and 1.11, but affect 30.7 Customer funds rather than futures customer funds, and therefore are in addition to the costs and benefits discussed in cost benefit considerations sections related to §§ 1.23 and 1.11.

5. Require that 30.7 Customer Funds deposited in a bank must be available for immediate withdrawal at the request of the FCM

The costs and benefits resulting from this change are similar to those discussed cost benefit considerations sections related to §§ 1.20, but affect 30.7 Customer Funds rather than futures customer funds, and therefore are in addition to the costs and benefits discussed in the cost benefit considerations section related to § 1.20.

6. Clarification that the FCM is responsible for any losses related to investing 30.7 Customer Funds in investments that comply with § 1.25

The costs and benefits resulting from this change are similar to those discussed in the cost benefit considerations section related to § 1.29, but affect 30.7 Customer Funds rather than futures customer funds, and therefore are in addition to the costs and benefits discussed in the cost benefit considerations sections related to §§ 1.20 and 1.29.

7. Prohibition against making unsecured loans to customers and against using the funds in the customer's trading account as security for the loan

The costs and benefits resulting from this change are similar to those discussed the cost benefit considerations section related to § 1.30, but affect 30.7 Customer funds rather than futures customer funds, and therefore are in addition to the costs and benefits discussed in that section.

8. Require daily segregation reports and segregated investment detail reports be submitted to the Commission and DSRO, and that targeted residual interest be included in those reports

The costs and benefits resulting from this change are similar to those discussed the cost benefit considerations sections related to § 1.32, but affect 30.7 Customer funds rather than futures customer funds, and therefore are in addition to the costs and benefits discussed in that section.

9. Allow FCMs that are not dual registrants to abide by the BD procedure for assigning a smaller haircut to investments purchased with customer funds that have low default risk

The costs and benefits resulting from this change are similar to those discussed in the cost benefit sections related to §§ 1.32 and 22.2, but affect 30.7 Customer funds rather than futures customer funds, and therefore are in addition to the costs and benefits discussed in those sections.

Question

Question 33: However, the Commission requests comment regarding the extent to which 30.7 Customer funds held outside the United States may be invested in instruments that are subject to reduced haircuts under the proposed SEC rules, and the effect that will have on the capital requirements of U.S. domiciled FCMs.

10. Proposed § 30.7(c) limits the amount of funds from a 30.7 Account that can be held outside the U.S.

Funds held overseas are subject to different regulatory and bankruptcy regimes that may not offer comparable protections for customer funds, creating additional repatriation risks to those funds. For example, if an FCM carrying 30.7 funds, some of which were held in depositories outside the U.S., were to default, it is possible that the Trustee would not be able to recover sufficient funds to repay all the FCM's obligations to 30.7 Customers. As noted above, this is especially true if the funds are deposited with an overseas affiliate of the FCM, as the likelihood of coincident bankruptcies of affiliated financial firms

number of the question they are addressing when responding to specific questions posed by the Commission.

is exceedingly high. In such an event, the funds held at the affiliate would be distributed in accordance with the insolvency rules of the foreign jurisdiction. In such a case each 30.7 Customer would likely receive a pro-rata share of the funds that the Trustee is able recover, when the Trustee is able to recover them. The proposed limit on amount of funds that can be held outside the U.S. would ensure that as much of the customers' funds as possible remain subject to the U.S. regulatory and bankruptcy regimes, eliminating repatriation risk to those funds. By eliminating this risk for a larger percentage of the 30.7 funds, the proposed rule promotes higher recovery rates for 30.7 account funds if the FCM defaults, which helps ensure that 30.7 Customers receive the largest pro rata distribution possible.

Regarding costs, the proposed change effectively prohibits FCMs from increasing the amount of 30.7 Customer Funds they hold overseas. This restriction may reduce the return that FCMs may be able to achieve through their investment of customer funds.

11. As described in the discussion of cost and benefit considerations related to § 1.22, by requiring that FCMs maintain residual interest in segregated accounts, the proposed rule would ensure that the FCM is not using one customer's funds to purchase, margin, secure, or settle positions for another customer and when combined with the reporting requirements in § 30.7 would provide the Commission and the public with sufficient information to verify that FCMs are not using one customer's funds to purchase, margin, secure or settle positions for another customer.

Regarding costs, by requiring FCMs to maintain residual interest in their 30.7 Accounts that is greater than the sum of their 30.7 Customers' margin deficits, the proposed rule would create costs and benefits that are substantially identical to those described in the cost and benefit considerations related to § 1.22. As discussed in that section, the Commission does not have information to determine whether FCMs typically maintain residual interest in their 30.7 Accounts that is greater than or less than the sum of their 30.7 Customers' margin deficits, and requests information sufficient to make such a determination, and to quantify the associated costs, if any.

Additional Requests for Comment Related to the Commission's Proposed Consideration of Costs and Benefits

Question 34: The Commission requests comment on all aspects of its proposed consideration of the costs and benefits of the rulemaking. More specifically, the Commission requests dollar estimates of the costs and the value of the benefits of the proposed rules described herein, including supporting data. In addition, the Commission requests comment on whether there are additional costs or benefits related to the proposed rules that the Commission should consider, as well as whether there are alternative approaches that would be more effective in light of the purpose of the proposal. Commenters should provide analysis and empirical data to support their views on the costs and benefits associated with the proposed rule.

Question 35: The Commission requests comment regarding the different ways in which the proposed rules will impact FCMs that are different sizes and that are operating with different business models. In particular, are there any specific proposed requirements that would be particularly costly for either small or large FCMs to follow? Are there any specific proposed requirements that would be especially costly for FCMs with a particular business model to follow? If so, please explain and where possible please quantify specific costs.

Question 36: The Commission requests comment regarding the effects of the proposed amendments on the composition of the FCM industry including bank subsidiaries versus stand-alone FCMs, large versus small, retail customer oriented versus wholesale, possible consolidation, etc. Please explain and provide supporting data.

Question 37: The Commission also requests comment regarding the potential impact of the proposed regulations on specific groups of customers. Will the proposed rules make it more difficult for certain groups of customers to obtain FCM services?

IV. Administrative Compliance

A. Regulatory Flexibility Act

The Regulatory Flexibility Act (''RFA'') [158] requires Federal agencies, in promulgating regulations, to consider the impact of those regulations on small entities. The Commission has previously established certain definitions of ''small entities'' to be used by the Commission in evaluating the impact of its rules on small entities in accordance with the RFA.[159] The proposed regulations would affect FCMs and DCOs. The Commission previously has determined that FCMs are not small entities for purposes of the RFA, and, thus, the requirements of the RFA do not apply to FCMs.[160] The Commission's determination was based, in part, upon the obligation of FCMs to meet the minimum financial requirements established by the Commission to enhance the protection of customers' segregated funds and protect the financial condition of FCMs generally.[161] The Commission also has previously determined that DCOs are not small entities for the purpose of the RFA.[162] Accordingly, the Chairman, on behalf of the Commission, hereby certifies pursuant to 5 U.S.C. 605(b) that the proposed regulations will not have a significant economic impact on a substantial number of small entities.

The Commission invites comments on the impact of this proposed regulation on small entities.

B. Paperwork Reduction Act

The Paperwork Reduction Act (''PRA'') provides that a federal agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a currently valid control number issued by the Office of Management and Budget (''OMB''). This proposed rulemaking contains several collections of information that have not been approved previously by OMB. The collections contained in this rulemaking are proposed to be mandatory.

To avoid double accounting for the PRA burden hours of collections that already have been assigned control numbers by OMB, or for burden hours contained in pending collections of information—in particular existing collection 3038–0024 and proposed revisions thereto, and existing collections 3038–0052 and 3038–0091—this PRA analysis contains only burden estimates for collections of information that have not previously been submitted to OMB. The Commission seeks comment on those collections of information contained in this rulemaking that would increase the burden hours contained in each of the related currently valid or proposed collections.

In particular, the Commission will submit to OMB information collection requests (''ICR'') that address the new collection burdens that would result from the finalization of these proposed rules on or before the publication of the proposed rules, as required by 44 U.S.C. 3506(c)(2)(B) and 5 CFR 1320.11. All interested parties may submit comments

[158] 5 U.S.C. 601 et seq.

[159] 47 FR 18618 (Apr. 30, 1982).

[160] Id. at 18619.

[161] Id.

[162] See 66 FR 45605, 45609, Aug. 29, 2001.

on this analysis and the associated ICR to the Commission and to OMB, as provided below.

The Commission will protect proprietary information according to the Freedom of Information Act (''FOIA'') and 17 CFR part 145, ''Commission Records and Information.'' In addition, section 8(a)(1) of the Act strictly prohibits the Commission, unless specifically authorized by the Act, from making public ''data and information that would separately disclose the business transactions or market positions of any person and trade secrets or names of customers.'' The Commission is also required to protect certain information contained in a government system of records according to the Privacy Act of 1974.

1. Collections of Information

The proposed amendments would require FCMs to adopt new policies and procedures, keep records related to such policies and procedures and submit reports of such policies and procedures, including certain management approvals, to the Commission. In addition, the proposals alter existing FCM reporting requirements in process and substance, including changes to certain schedules and proposed schedules to the Form 1–FR–FCM (the Segregation Schedule and Secured Amount Schedule); changes to the process for filing such schedules and additional frequency for such filings; and requiring detailed information supporting such schedules to also be reported to the Commission and the FCM's designated self-regulatory organization.

Further FCMs and depositories accepting customer funds will be required to obtain acknowledgment letters in specified formats and file them directly with the Commission and the FCM's designated self-regulatory organization. Records will have to be kept of approvals of certain withdrawals made of an FCM's residual interest in customer funds and further reported to the Commission. Additional notices will also be required to be filed with the Commission under the proposed amendments. The examination process of SROs and DSROs is proposed to be amended with new recordkeeping and reporting requirements being imposed, as well as a required report to be obtained from an examinations expert and filed with the Commission. Lastly, disclosures made by FCMs to customers will be enhanced and records of such disclosures will have to be maintained and reported to the Commission.

As noted, some of these proposed amendments will result in the alteration of existing regulations covered by existing collections which have already been assigned OMB control numbers. Others will result in additional or new collection burdens, which will be incorporated into the most relevant existing collection maintained by the Commission and previously approved by or submitted for approval to OMB.

a. Proposed Revision to Collection 3038–0024

Collection 3038–0024 is currently in force, with its control number having been provided by OMB. In addition, the collection was proposed to be revised in May 2011, with the approval of and issuance of a control number by OMB presently pending. Certain collections contained in this rulemaking would result in further revisions to the collection, as discussed herein.

First, the Segregation Schedules and the Secured Amount Schedule, required to be filed under § 1.10, have been proposed to be changed to reflect the FCM's target for residual amounts and the sum of margin deficits. The proposed amendments will also increase the frequency of filing these schedules to daily under §§ 1.32 and 30.7. However, daily computations were previously required with respect to the subject matter of these schedules and monthly filing procedure for these schedules is already in place, and these schedules are already subject to an OMB control number. Thus, the revision of collection 3038–0024 requires only incremental change to capture the new elements of § 1.10. One time initial system changes, if any, that will need to be made to effect daily filing of the detail previously required in the monthly report is anticipated to require between 40 and 80 burden hours for the approximately 72 firms required to comply with the new provisions of § 1.10, depending on the size of the firm the complexity of their systems. The additional filing requirement, which may be effected electronically by the approximately 72 firms that will be required to make daily filings, is anticipated to increase the burdens associated with § 1.10 by an anticipated 10–20 minutes for each of the approximately 20 days per month that such reports were not previously required to be filed.

Additionally, the proposed amendments include new requirements for FCMs to establish comprehensive risk management programs under new § 1.11, and maintain associated recordkeeping as well as furnish reports related to such risk management programs to the Commission and the FCM's DSRO. Included within the risk management programs will be specific requirements for FCMs to establish and maintain written policies and procedures regarding the safeguarding of all customer funds.

Collection burdens associated with the safeguarding of customer funds under the Commission's regulations prior to the proposed amendments are already subject to OMB control numbers. Accordingly, the proposed revisions to collection 3038–0024 require only incremental change to capture the new elements of § 1.11. The estimated burden associated with § 1.11 will be divided into two components, a onetime cost to establish the written policies and procedures and an annual burden to maintain the such policies and procedures. Currently there are 72 respondents subject to this change, many of which are expected simply to establish and maintain policies and procedures around their existing risk management programs. The estimated number of hours to create the initial set of policies and procedures by consolidation of existing risk management practices is anticipated to average 75 hours across the 72 respondents that will be obligated to comply. The estimated total annual maintenance burden on each respondent is anticipated increase by an average 25 hours annually across the 72 recordkeepers.

The collection is further being revised to reflect additional proposed requirements for notifications under § 1.12, and the additional required filings contained in the proposed amendments under §§ 1.20, 1.23, 1.32, and 30.7. Currently there are 72 respondents estimated to be subject to these changes. The total of all proposed changes to the Schedules of the Form 1–FR, which is already subject to an OMB control number, is anticipated to be incremental, and it is estimated that the proposed changes will add 15 minutes to the preparation and filing of each report.

The proposed revision to § 1.12(i) will require FCMs to report to the Commission if the FCM discovers or is informed that it has invested funds held for futures customers in instruments that are not permitted investments under § 1.25. This new report will be done on an as required basis. It is estimated that this report will be completed by two respondents per year with a burden of one hour for each report.

The proposed revision to § 1.12(j) will require FCMs to immediately report to the Commission if a withdrawal of funds from accounts holding futures customers funds causes the amount on

deposit in such accounts to be less than the FCM's targeted excess or residual interest in such accounts, or if the residual interest is less than the sum of all margin deficits. The accounting needed to make these reports is already conducted under the Commission's regulations for the purpose of ensuring compliance with the Commission's existing customer protection regulations. Once an event requiring notice is identified, it is anticipated that five respondents per year will be obligated to provide notices to the Commission under § 1.12(j), with an additional burden of up to two hours for each notice.

The Commission is also proposing to amend paragraphs (k) and (l) of § 1.12 which will require an FCM to provide notice to the Commission in the event of a material change in the financial condition of the firm or the firm's operations. These new reports each will be prepared and submitted on an as required basis, and are similar to other notices required to be filed by FCMs in Parts 1 and 190, for example, of the Commission's regulations. Moreover, FCMs are already subject to significant regulations in Part 1 that require each FCM to continuously monitor their financial condition and report shortfalls in net capital. It is estimated that the notices that would be required under paragraphs (k) and (l) of § 1.12 will be made by five respondents per year with a burden of up to three hours for each notice.

FCMs will be required under § 1.20 to obtain and submit to the Commission written acknowledgments, in a form and format being proposed and expected to be required by the Commission, from any depository institution, including certain DCOs, at which futures customer funds will be segregated. It is estimated that the execution and filing of new acknowledgment letters will be completed by five respondents per year with a burden of up to two hours for completion and filing. It is estimated that the maintaining of acknowledgment letters prescribed by the Commission will be conducted by as many as 40 depository institutions annually with an estimated burden of 45 minutes per respondent.

FCMs are currently required to obtain and maintain in its files an acknowledgment letter from depositories for each account holding customer funds, in the form specified by the Commission. The obtaining and maintaining of the acknowledgement letters will be done on an as required basis and are already subject to an OMB control number. Proposed revisions to § 1.20(d) additionally would require FCMs to retain and file these acknowledgment letters electronically with the Commission. This new retention and filing will be done on an as required basis. It is estimated that the filing of an estimated 1 to 2 new acknowledgment letters will be conducted by 72 respondents per year, with a burden of 30 minutes associated with the retention and filing of each of these acknowledgments.

Finally with respect to § 1.20, a derivatives clearing organization may adopt and submit to the Commission rules providing for the segregation of customer funds that may be carried by the DCO that would substitute for the acknowledgment letters completed by other depositories. It is anticipated that approximately 17 of the DCOs registered with the Commission will adopt and submit such rules, with an estimated burden of 45 hours for the adoption and submission of such rules. The DCO also must obtain acknowledgment letters from any depository institution at which the DCO places segregated funds, and these depository institutions must provide the Commission with direct access to the customer account information at all times. It is anticipated that as many as 40 depository institutions may complete such letters, and provide ongoing access to the Commission, with a one-time burden of 45 minutes per respondent for the completion of such letters, and an estimated annual burden of 60 hours associated with providing account access to the Commission.

Similarly, § 30.7(d) is being revised to require FCMs that maintain 30.7 Customer Accounts to obtain and maintain in its files, an acknowledgment letter from depositories for each account holding 30.7 Customer Funds, in the form specified by the Commission, and § 1.26 provides for the same from any institution segregating customer funds in a money market mutual fund account. The proposed revisions to these regulations require FCMs to file such acknowledgment letters electronically with the Commission. The obtaining and maintaining of the acknowledgement letters will be done on an as required basis. It is estimated that the maintaining of acknowledgment letters will be completed by 56 respondents with a burden of 45 minutes per respondent. The completion of the acknowledgment letters by the depositories, estimated at approximately 90 institutions, is expected to be 45 minutes per letter. Additionally, the requirement that these acknowledgement letters be electronically filed with the Commission is anticipated to result in 6 minutes of burden to 56 respondents per year with respect to the proposed revisions to § 30.7 and the same for the proposed revisions to § 1.26.

The Commission is also proposing to amend § 1.23(c) to require an FCM to immediately file written notice with the Commission if the firm withdraws more than 25 percent of its residual interest in segregated accounts. This new filing will be done on an as required basis. It is estimated that the filing of these notices will be completed by ten respondents per year with a burden of one hour for each filing.

Pursuant to the proposed revisions of §§ 1.32(c) and (d), the Segregation Statement shall be completed on a daily basis and filed by noon the following business day. Although the rule proposed herein now require daily filing of the Segregation Statement, it should be noted that the Segregation Statement is statement is already required to be prepared and retained on a daily basis, thus the additional time electronically filing the statement on a daily basis is minimal. Currently there are 72 respondents subject to this change. The estimated total annual burden on each respondent is 2 hours.

Pursuant to the proposed revisions of § 1.32(g) each FCM that holds customer funds is required to file the segregated investment detail report twice monthly. Although the rule proposed herein requires twice monthly filing of the segregated investment detail report, it should be noted that the segregated investment detail report is already required to be prepared twice monthly by the FCM's designated self-regulatory organization. Thus the additional time to electronically file the statement with the Commission is minimal. Currently there are 72 respondents subject to this change. The estimated total annual burden on each respondent is 5 minutes per report.

Similar to the proposed revisions of § 1.32 discussed above, § 30.7(m) requires that the Statement of Secured Amounts shall be completed on a daily basis and filed electronically by noon the following business day. Although the rule proposed herein now require daily filing of the Secured Amounts Statement, it should be noted that the Secured Amounts is statement is already required to be prepared and retained on a daily basis, thus the additional time electronically filing the statement on a daily basis is minimal. Currently there are 56 respondents subject to this change. The estimated total annual burden on each respondent is 2 hours.

Revisions to § 30.7(i) will also require that FCMs keep records of customer funds including a daily valuation of each instrument and supporting documentation of such daily valuation. Currently there are 56 respondents subject to this change. The estimated total annual burden on each respondent is 100 hours.

Finally, § 1.55 would require public disclosures to be made by an FCM to its customers respecting the limitations applicable to and risks associated with the segregation of funds, among other things. It is anticipated that 72 FCMs will provide such notices through the standardization of account opening documents or distribution of the notices therewith. Each FCM is expected to expend up to 4–20 hours incorporating the notice, which is prescribed by regulation, into its account opening process for customers that will establish new accounts, and up to 10 minutes per customer providing the notices on a one-time basis to as many as 3,000 customers and accounts opened by existing customers.

b. Proposed Revision to Collection 3038–0052

The above-referenced collection titled ''Part 38—Designated Contract Markets'' includes all burden associated with § 1.52, ''Self-regulatory organization adoption and surveillance of minimum financial requirements''. The proposed amendments include additional requirements for SROs to adopt for their examination procedures, including the requirement to have examination programs reviewed by an examinations expert and having the report of such examinations expert filed with the Commission at least once every two years. Regulation 1.52 already contains significant requirements with respect to the examination programs to be established and maintained by SROs, which are subject already to an OMB control number. The increase in the burden under this collection for the adoption of enhanced examination procedures, including the recordkeeping and reporting, to the extent such may be necessary by any SRO to which § 1.52 is necessary, is estimated to add up to 50 burden hours to as many as 15 DCMs.

c. Proposed Revision to Collection 3038–0091

Collection 3038–0091was established with the adoption of Part 22 of the Commissions regulations concerning Cleared Swaps in .February 2012 The proposed amendments would require revisions to this collection with respect to recordkeeping and reporting associated with additional filings of the Cleared Swaps Segregation Schedule daily under § 22.2(g), and the associated recordkeeping and reporting with respect to notices of withdrawals under a newly proposed § 22.17. The collection burden associated with the proposed amendments is anticipated to increase by 10 minutes per day and is anticipated to affect 100 entities.

2. Information Collection Comments

The Commission invites the public and other Federal agencies to comment on any aspect of the proposed information collection requirements discussed above. Pursuant to 44 U.S.C. 3506(c)(2)(B), the Commission will consider public comments on such proposed requirements in:

○ Evaluating whether the proposed collections of information are necessary for the proper performance of the functions of the Commission, including whether the information will have a practical use;

○ Evaluating the accuracy of the estimated burden of the proposed information collection requirements, including the degree to which the methodology and the assumptions that the Commission employed were valid;

○ Enhancing the quality, utility, and clarity of the information proposed to be collected; and

○ Minimizing the burden of the proposed information collection requirements on FCMs, SDs, and MSPs, including through the use of appropriate automated, electronic, mechanical, or other technological information collection techniques, e.g., permitting electronic submission of responses.

Copies of the submission from the Commission to OMB are available from the CFTC Clearance Officer, 1155 21st Street NW., Washington, DC 20581, (202) 418–5160 or from *http://RegInfo.gov.* Organizations and individuals desiring to submit comments on the proposed information collection requirements should send those comments to the OMB Office of Information and Regulatory Affairs at:

○ The Office of Information and Regulatory Affairs, Office of Management and Budget, Room 10235, New Executive Office Building, Washington, DC 20503, Attn: Desk Officer of the Commodity Futures Trading Commission;

○ (202) 395–6566 (fax); or

○ *OIRAsubmissions@omb.eop.gov* (email).

Please provide the Commission with a copy of submitted comments so that all comments can be summarized and addressed in the final rulemaking. Please refer to the **ADDRESSES** section of this rulemaking for instructions on submitting comments to the Commission. OMB is required to make a decision concerning the proposed information collection requirements between thirty (30) and sixty (60) days after publication of the NPRM in the **Federal Register**. Therefore, a comment to OMB is best assured of receiving full consideration if OMB (as well as the Commission) receives it within thirty (30) days of publication of this NPRM. The time frame for commenting on the PRA does not affect the deadline established by the Commission on the proposed rules, provided in the **DATES** section of this rulemaking.

V. Text of Proposed Rules

List of Subjects

17 CFR Part 1

Brokers, Commodity futures, Consumer protection, Reporting and recordkeeping requirements.

17 CFR Part 3

Associated persons, Brokers, Commodity futures, Customer protection, Major swap participants, Registration, Swap dealers.

17 CFR Part 22

Brokers, Clearing, Consumer protection, Reporting and recordkeeping requirements, Swaps.

17 CFR Part 30

Commodity futures, Consumer protection, Currency, Reporting and recordkeeping requirements.

17 CFR Part 140

Authority delegations (Government agencies), Organization and functions (Government agencies).

In consideration of the foregoing and pursuant to the authority contained in the Act, as indicated herein, 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 be read as follows:

Authority: 7 U.S.C. 1a, 2, 5, 6, 6a, 6b, 6c, 6d, 6e, 6f, 6g, 6h, 6i, 6j, 6k, 6m, 6n, 6o, 6p, 6r, 6s, 7, 7a, 7b, 8, 9, 10a 12, 12a, 12c, 13a, 13a–1, 16, 16a, 19, 21, 23, and 24 as amended by Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. 111–203, 124 Stat. 1376 (2010).

2. Amend § 1.3 by revising paragraph (rr) to read as follows:

§ 1.3 Definitions.

* * * * *

(rr) *Foreign futures or foreign options secured amount.* This term means all money, securities and property received by a futures commission merchant from, for, or on behalf of 30.7 Customers as defined in § 30.1 of this chapter:

(1) To margin, guarantee, or secure foreign futures contracts and all money accruing to such 30.7 Customers as the result of such contracts;

(2) In connection with foreign options transactions representing premiums payable or premiums received, or to guarantee or secure performance on such transactions; and

(3) All money accruing to such 30.7 Customers as the result of trading in foreign futures contracts or foreign options.

* * * * *

3. Amend § 1.10 by:

a. Revising paragraph (b)(1)(ii);

b. Adding paragraph (b)(5); and

c. Revising paragraphs (c)(1), (c)(2)(i), (d)(1)(v), (d)(2)(iv), (d)(2)(vi), and (g)(2)(ii).

The revisions and addition read as follows:

§ 1.10 Financial reports of futures commission merchants and introducing brokers.

* * * * *

(b) * * *

(1) * * *

(ii) In addition to the monthly financial reports required by paragraph (b)(1)(i) of this section, each person registered as a futures commission merchant must file a Form 1–FR–FCM as of the close of its fiscal year, which must be certified by an independent public accountant in accordance with § 1.16, and must be filed no later than 60 days after the close of the futures commission merchant's fiscal year: *Provided, however,* that a registrant which is registered with the Securities and Exchange Commission as a securities broker or dealer must file this report not later than the time permitted for filing an annual audit report under § 240.17a–5(d)(5) of this title.

* * * * *

(5) Each futures commission merchant must file with the Commission the measure of the future commission merchant's leverage (*i.e.,* total balance sheet assets, less any instruments guaranteed by the U.S. Government and held as an asset or to collateralize an asset (*e.g.,* a reverse repo) divided by total capital (the sum of stockholders' equity and subordinated debt) all computed in accordance with U.S. generally accepted accounting principles as of the close of business each month. The filing is required to be made to the Commission within 17 business days of the close of the futures commission merchant's month end.

(c) *Where to file reports.* (1) Form 1–FR filed by an introducing broker pursuant to paragraph (b)(2) of this section need be filed only with, and will be considered filed when received by, the National Futures Association. Other reports or information provided for in this section will be considered filed when received by the Regional office of the Commission with jurisdiction over the state in which the registrant's principal place of business is located (as set forth in § 140.02 of this chapter) and by the designated self-regulatory organization, if any; and reports or other information required to be filed by this section by an applicant for registration will be considered filed when received by the National Futures Association. Any report or information filed with the National Futures Association pursuant to this paragraph shall be deemed for all purposes to be filed with, and to be the official record of, the Commission.

(2)(i) All filings or other notices prepared by a futures commission merchant pursuant to this section must be submitted to the Commission in electronic form using a form of user authentication assigned in accordance with procedures established by or approved by the Commission, and otherwise in accordance with instructions issued by or approved by the Commission, if the futures commission merchant or a designated self-regulatory organization has provided the Commission with the means necessary to read and to process the information contained in such report. A Form 1–FR required to be certified by an independent public accountant in accordance with § 1.16 which is filed by a futures commission merchant must be filed electronically.

* * * * *

(d) * * *

(1) * * *

(v) For a futures commission merchant only, the statements of segregation requirements and funds in segregation for customers trading on U.S. commodity exchanges and for customers' dealer options accounts, the statement of secured amounts and funds held in separate accounts for 30.7 Customers (as defined in § 30.1 of this chapter) in accordance with § 30.7 of this chapter, and the statement of cleared swaps customer segregation requirements and funds in cleared swaps customer accounts under section 4d(f) of the Act as of the date for which the report is made; and

* * * * *

(2) * * *

(iv) For a futures commission merchant only, the statements of segregation requirements and funds in segregation for customers trading on U.S. commodity exchanges and for customers' dealer options accounts, the statement of secured amounts and funds held in separate accounts for 30.7 Customers (as defined in § 30.1 of this chapter) in accordance with § 30.7 of the chapter, and the statement of cleared swaps customers segregation requirements and funds in cleared swaps customer accounts under section 4d(f) of the Act as of the date for which the report is made;

* * * * *

(vi) A reconciliation, including appropriate explanations, of the statement of the computation of the minimum capital requirements pursuant to § 1.17 of this part and, for a futures commission merchant only, the statements of segregation requirements and funds in segregation for customers trading on U.S. commodity exchanges and for customers' dealer option accounts, the statement of secured amounts and funds held in separate accounts for 30.7 Customers (as defined in § 30.1 of this chapter) in accordance with § 30.7 of this chapter, and the statement of cleared swaps customer segregation requirements and funds in cleared swaps customer accounts under section 4d(f) of the Act, in the certified Form 1–FR with the applicant's or registrant's corresponding uncertified most recent Form 1–FR filing when material differences exist or, if no material differences exist, a statement so indicating; and

* * * * *

(g) * * *

(2) * * *

(ii) The following statements and footnote disclosures thereof: the Statement of Financial Condition in the certified annual financial reports of futures commission merchants and introducing brokers; the Statements (to be filed by a futures commission merchant only) of Segregation Requirements and Funds in Segregation for customers trading on U.S. commodity exchanges and for customers' dealer options accounts, the Statement (to be filed by a futures commission merchant only) of Secured Amounts and Funds held in Separate Accounts for 30.7 Customers (as defined in § 30.1of this chapter) in accordance with § 30.7 of this chapter, and the Statement (to be filed by futures

commission merchants only) of Cleared Swaps Customer Segregation Requirements and Funds in Cleared Swaps Customer Accounts under section 4d(f) of the Act.

* * * * *

4. Add § 1.11 to read as follows:

§ 1.11 Risk Management Program for Futures Commission Merchants.

(a) *Applicability.* Nothing in this section shall apply to a futures commission merchant that does not accept any money, securities, or property (or extend credit in lieu thereof) to margin, guarantee, or secure any trades or contracts that result from soliciting or accepting orders for the purchase or sale of any commodity interest.

(b) *Definitions.* For purposes of this section:

(1) ''*Business Unit*'' means any department, division, group, or personnel of a futures commission merchant or any of its affiliates, whether or not identified as such that:

(i) Engages in soliciting or in accepting orders for the purchase or sale of any commodity interest and that, in or in connection with such solicitation or acceptance of orders, accepts any money, securities, or property (or extends credit in lieu thereof) to margin, guarantee, or secure any trades or contracts that result or may result therefrom; or

(ii) Otherwise handles Segregated Funds, including managing, investing, and overseeing the custody of Segregated Funds, or any documentation in connection therewith, other than for risk management purposes; and

(iii) Any personnel exercising direct supervisory authority of the performance of the activities described in paragraph (b)(1)(i) or (ii) of this section.

(2) ''*Customer*'' means a futures customer as defined at § 1.3 of this part, Cleared Swaps Customer as defined at § 22.1 of this chapter, and 30.7 Customer as defined at § 30.1 of this chapter.

(3) ''*Governing Body*'' means the proprietor, if the futures commission merchant is a sole proprietorship; a general partner, if the futures commission merchant is a partnership; the board of directors if the futures commission merchant is a corporation; the chief executive officer, the chief financial officer, the manager, the managing member, or those members vested with the management authority if the futures commission merchant is a limited liability company or limited liability partnership.

(4) ''*Segregated Funds*'' means money, securities, or other property held by a futures commission merchant in separate accounts pursuant to § 1.20 of this part for futures customers, pursuant to § 22.2 of this chapter for Cleared Swaps Customers, and pursuant to § 30.7 of this chapter for § 30.7 Customers; and

(5) ''*Senior Management*'' means, any officer or officers specifically granted the authority and responsibility to fulfill the requirements of senior management by the Governing Body.

(c) *Risk Management Program.* (1) Each futures commission merchant shall establish, maintain, and enforce a system of risk management policies and procedures designed to monitor and manage the risks associated with the activities of the futures commission merchant as such. For purposes of this section, such policies and procedures shall be referred to collectively as a ''Risk Management Program.''

(2) Each futures commission merchant shall maintain written policies and procedures that describe the Risk Management Program of the futures commission merchant.

(3) The Risk Management Program and the written risk management policies and procedures, and any material changes thereto, shall be approved in writing by the Governing Body of the futures commission merchant.

(4) Each futures commission merchant shall furnish a copy of its written risk management policies and procedures to the Commission and its designated self-regulatory organization upon application for registration and thereafter upon request.

(d) *Risk management unit.* As part of the Risk Management Program, each futures commission merchant shall establish and maintain a risk management unit with sufficient authority; qualified personnel; and financial, operational, and other resources to carry out the risk management program established pursuant to this section. The risk management unit shall report directly to Senior Management and shall be independent from the Business Unit.

(e) *Elements of the Risk Management Program.* The Risk Management Program of each futures commission merchant shall include, at a minimum, the following elements:

(1) *Identification of risks and risk tolerance limits.* (i) The Risk Management Program shall take into account market, credit, liquidity, foreign currency, legal, operational, settlement, segregation, technological, capital, and any other applicable risks together with a description of the risk tolerance limits set by the futures commission merchant and the underlying methodology in the written policies and procedures. The risk tolerance limits shall be reviewed and approved quarterly by Senior Management and annually by the Governing Body. Exceptions to risk tolerance limits shall be subject to written policies and procedures.

(ii) The Risk Management Program shall take into account risks posed by affiliates, all lines of business of the futures commission merchant, and all other trading activity engaged in by the futures commission merchant. The Risk Management Program shall be integrated into risk management at the consolidated entity level.

(iii) The Risk Management Program shall include policies and procedures for detecting breaches of risk tolerance limits set by the futures commission merchant, and alerting supervisors within the risk management unit and Senior Management, as appropriate.

(2) *Periodic Risk Exposure Reports.* (i) The risk management unit of each futures commission merchant shall provide to Senior Management and to its Governing Body quarterly written reports setting forth all applicable risk exposures of the futures commission merchant; any recommended or completed changes to the Risk Management Program; the recommended time frame for implementing recommended changes; and the status of any incomplete implementation of previously recommended changes to the Risk Management Program. For purposes of this section, such reports shall be referred to as ''Risk Exposure Reports.'' The Risk Exposure Reports also shall be provided to the Senior Management and the Governing Body immediately upon detection of any material change in the risk exposure of the futures commission merchant.

(ii) *Furnishing to the Commission.* Each futures commission merchant shall furnish copies of its Risk Exposure Reports to the Commission within five (5) business days of providing such reports to its Senior Management.

(3) *Specific risk management considerations.* The Risk Management Program of each futures commission merchant shall include, but not be limited to, policies and procedures necessary to monitor and manage the following risks:

(i) *Segregation Risk.* The written policies and procedures shall be reasonably designed to ensure that Segregated Funds are separately accounted for and segregated or secured as belonging to Customers as required

by the Act and Commission regulations and must, at a minimum, include or address the following:

(A) A process for the evaluation of depositories of Segregated Funds, including, at a minimum, documented criteria that any depository that will hold Segregated Funds, including an entity affiliated with the futures commission merchant, must meet, including criteria addressing the depository's capitalization, creditworthiness, operational reliability, and access to liquidity. The criteria should further consider the extent to which Segregated Funds are concentrated with any depository or group of depositories. The criteria also should include the availability of deposit insurance and the extent of the regulation and supervision of the depository;

(B) A program to monitor an approved depository on an ongoing basis to assess its continued satisfaction of the futures commission merchant's established criteria, including a thorough due diligence review of each depository at least annually;

(C) An account opening process for depositories, including documented authorization requirements, procedures that ensure that Segregated Funds are not deposited with a depository prior to the futures commission merchant receiving the acknowledgment letter required from such depository pursuant to § 1.20 of this part, and §§ 22.2 and 30.7 of this chapter, and procedures that ensure that such account is properly titled to reflect that it is holding Segregated Funds pursuant to the Act and Commission regulations;

(D) A process for establishing a targeted amount of residual interest that the futures commission merchant seeks to maintain as its residual interest in the Segregated Funds accounts and such process must be designed to reasonably ensure that the futures commission merchant maintains the targeted residual amounts and remains in compliance with the Segregated Funds requirements at all times. The policies and procedures must require that Senior Management, in establishing the total amount of the targeted residual interest in the Segregated Funds accounts, perform appropriate due diligence and consider various factors, as applicable, relating to the nature of the futures commission merchant's business including, but not limited to, the composition of the futures commission merchant's Customer base, the general creditworthiness of the Customer base, the general trading activity of the Customers, the types of markets and products traded by the Customers, the proprietary trading of the futures commission merchant, the general volatility and liquidity of the markets and products traded by Customers, the futures commission merchant's own liquidity and capital needs, and the historical trends in Customer Segregated Fund balances, including margin debit and net deficit balances in Customers' accounts. The analysis and calculation of the targeted amount of the future commission merchant's residual interest must be described in writing with the specificity necessary to allow the Commission and the futures commission merchant's designated self-regulatory organization to duplicate the analysis and calculation and test the assumptions made by the futures commission merchant. The adequacy of the targeted residual interest and the process for establishing the targeted residual interest must be reassessed periodically by Senior Management and revised as necessary;

(E) A process for the withdrawal of cash, securities, or other property from accounts holding Segregated Funds, where the withdrawal is not for the purpose of payments to or on behalf of the futures commission merchant's Customers. Such policies and procedures must satisfy the requirements of § 1.23 of this part, § 22.17 of this chapter, or § 30.7 of this chapter, as applicable;

(F) A process for assessing the appropriateness of specific investments of Segregated Funds in permitted investments in accordance with § 1.25 of this part. Such policies and procedures must take into consideration the market, credit, counterparty, operational, and liquidity risks associated with such investments, and assess whether such investments comply with the requirements in § 1.25 of this part including that the futures commission merchant manage the permitted investments consistent with the objectives of preserving principal and maintaining liquidity;

(H) Procedures requiring the appropriate separation of duties among individuals responsible for compliance with the Act and Commission regulations relating to the protection and financial reporting of Segregated Funds, including the separation of duties among personnel that are responsible for advising customers on trading activities, approving or overseeing cash receipts and disbursements (including investment operations), and recording and reporting financial transactions. The policies and procedures must require that any movement of funds to affiliated companies and parties are properly approved and documented;

(I) A process for the timely recording of all transactions, including transactions impacting Customers' accounts, in the firm's books of record;

(J) A program for conducting annual training of all finance, treasury, operations, regulatory, compliance, settlement, and other relevant officers and employees regarding the segregation requirements for Segregated Funds required by the Act and regulations, the requirements for notices under § 1.12 of this part, procedures for reporting of suspected breaches of the policies and procedures required by this section to the chief compliance officer, without fear of retaliation, and the consequences of failing to comply with the segregation requirements of the Act and regulations; and

(K) Policies and procedures for assessing the liquidity, marketability and mark-to-market valuation of all securities or other non-cash assets held as Segregated Funds, including permitted investments under § 1.25 of this part, to ensure that all non-cash assets held in the Customer segregated accounts, both customer-owned securities and investments in accordance with § 1.25 of this part, are readily marketable and highly liquid. Such policies and procedures must require daily measurement of liquidity needs with respect to Customers; assessment of procedures to liquidate all non-cash collateral in a timely manner and without significant effect on price; and application of appropriate collateral haircuts that accurately reflect market and credit risk.

(ii) *Operational Risk.* The Risk Management Program shall include automated financial risk management controls reasonably designed to prevent the placing of erroneous orders, including those that exceed pre-set capital, credit, or volume thresholds. The Risk Management Program shall ensure that the use of automated trading programs is subject to policies and procedures governing the use, supervision, maintenance, testing, and inspection of such programs.

(iii) *Capital Risk.* The written policies and procedures shall be reasonably designed to ensure that the futures commission merchant has sufficient capital to be in compliance with the Act and the regulations, and sufficient capital and liquidity to meet the reasonably foreseeable needs of the futures commission merchant.

(4) *Supervision of the Risk Management Program.* The Risk Management Program shall include a supervisory system that is reasonably

designed to ensure that the policies and procedures required by this section are diligently followed.

(f) *Review and testing.* (1) The Risk Management Program of each futures commission merchant shall be reviewed and tested on at least an annual basis, or upon any material change in the business of the futures commission merchant that is reasonably likely to alter the risk profile of the futures commission merchant.

(2) The annual reviews of the Risk Management Program shall include an analysis of adherence to, and the effectiveness of, the risk management policies and procedures, and any recommendations for modifications to the Risk Management Program. The annual testing shall be performed by qualified internal audit staff that are independent of the Business Unit or by a qualified third party audit service reporting to staff that are independent of the Business Unit. The results of the annual review of the Risk Management Program shall be promptly reported to and reviewed by the chief compliance officer, Senior Management, and Governing Body of the futures commission merchant.

(3) Each futures commission merchant shall document all internal and external reviews and testing of its Risk Management Program and written risk management policies and procedures including the date of the review or test; the results; any deficiencies identified; the corrective action taken; and the date that corrective action was taken. Such documentation shall be provided to Commission staff, upon request.

(g) *Distribution of risk management policies and procedures.* The Risk Management Program shall include procedures for the timely distribution of its written risk management policies and procedures to relevant supervisory personnel. Each futures commission merchant shall maintain records of the persons to whom the risk management policies and procedures were distributed and when they were distributed.

(h) *Recordkeeping.* (1) Each futures commission merchant shall maintain copies of all written approvals required by this section.

(2) All records or reports, including, but not limited to, the written policies and procedures and any changes thereto, that a futures commission merchant is required to maintain pursuant to this regulation shall be maintained in accordance with § 1.31 and shall be made available promptly upon request to representatives of the Commission.

5. Amend § 1.12 by revising paragraphs (a)(1) and (2), (b)(1), (2), and (4), (c), (d), (e), (f)(2) through (4), (f)(5)(i), (g), (h), and (i), and by adding new paragraphs (j), (k), (l), (m), and (n), to read as follows:

§ 1.12 Maintenance of minimum financial requirements by futures commission merchants and introducing brokers.

(a) * * *

(1) Give notice, as set forth in paragraph (n) of this section, that the applicant's or registrant's adjusted net capital is less than required by § 1.17 of this part or by other capital rule, identifying the applicable capital rule. The notice must be given immediately after the applicant or registrant knows or should have known that its adjusted net capital is less than required by any of the aforesaid rules to which the applicant or registrant is subject; and

(2) Provide together with such notice documentation, in such form as necessary, to adequately reflect the applicant's or registrant's capital condition as of any date on which such person's adjusted net capital is less than the minimum required; *Provided, however,* that if the applicant or registrant cannot calculate or otherwise immediately determine its financial condition, it must provide the notice required by paragraph (a)(1) of this section and include in such notice a statement that the entity cannot presently calculate its financial condition. The applicant or registrant must provide similar documentation of its financial condition for other days as the Commission may request.

(b) * * *

(1) 150 percent of the minimum dollar amount required by § 1.17(a)(1)(i)(A) of this part;

(2) 110 percent of the amount required by § 1.17(a)(1)(i)(B) of this part;

* * * * *

(4) For securities brokers or dealers, the amount of net capital specified in Rule 17a–11(c) of the Securities and Exchange Commission (17 CFR 240.17a–11(c)), must file notice to that effect, as set forth in paragraph (n) of this section, as soon as possible and no later than twenty-four (24) hours of such event.

(c) If an applicant or registrant at any time fails to make or keep current the books and records required by these regulations, such applicant or registrant must, on the same day such event occurs, provide notice of such fact as specified in paragraph (n) of this section, specifying the books and records which have not been made or which are not current, and as soon as possible, but not later than forty-eight (48) hours after giving such notice, file a report as required by paragraph (n) of this section stating what steps have been and are being taken to correct the situation.

(d) Whenever any applicant or registrant discovers or is notified by an independent public accountant, pursuant to § 1.16(e)(2) of this part, of the existence of any material inadequacy, as specified in § 1.16(d)(2) of this part, such applicant or registrant must give notice of such material inadequacy, as provided in paragraph (n) of this section, as soon as possible but not later than twenty-four (24) hours of discovering or being notified of the material inadequacy. The applicant or registrant must file, in the manner provided for under paragraph (n) of this section, a report stating what steps have been and are being taken to correct the material inadequacy within forty-eight (48) hours of filing its notice of the material inadequacy.

(e) Whenever any self-regulatory organization learns that a member registrant has failed to file a notice or report as required by this section, that self-regulatory organization must immediately report this failure by notice, as provided in paragraph (n) of this section.

(f) * * *

(2) Whenever a registered futures commission merchant determines that any position it carries for another registered futures commission merchant or for a registered leverage transaction merchant must be liquidated immediately, transferred immediately or that the trading of any account of such futures commission merchant or leverage transaction merchant shall be only for purposes of liquidation, because the other futures commission merchant or the leverage transaction merchant has failed to meet a call for margin or to make other required deposits, the carrying futures commission merchant must immediately give notice, as provided in paragraph (n) of this section, of such a determination.

(3) Whenever a registered futures commission merchant determines that an account which it is carrying is undermargined by an amount which exceeds the futures commission merchant's adjusted net capital determined in accordance with § 1.17 of this part, the futures commission merchant must immediately provide notice, as provided in paragraph (n) of this section, of such a determination to the designated self-regulatory organization and the Commission. This paragraph (f)(3) shall apply to any account carried by the futures

commission merchant, whether a customer, noncustomer, omnibus or proprietary account. For purposes of this paragraph (f)(3), if any person has an interest of 10 percent or more in ownership or equity in, or guarantees, more than one account, or has guaranteed an account in addition to its own account, all such accounts shall be combined.

(4) A futures commission merchant shall provide immediate notice, as provided in paragraph (n) of this section, whenever any commodity interest account it carries is subject to a margin call, or call for other deposits required by the futures commission merchant, that exceeds the futures commission merchant's excess adjusted net capital, determined in accordance with § 1.17 of this part, and such call has not been answered by the close of business on the day following the issuance of the call. This applies to all accounts carried by the futures commission merchant, whether customer, noncustomer, or omnibus, that are subject to margining, including commodity futures, cleared swaps, and options. In addition to actual margin deposits by an account owner, a futures commission merchant may also take account of favorable market moves in determining whether the margin call is required to be reported under this paragraph.

(5)(i) A futures commission merchant shall provide immediate notice, as provided in paragraph (n) of this section, whenever its excess adjusted net capital is less than six percent of the maintenance margin required by the futures commission merchant on all positions held in accounts of a noncustomer other than a noncustomer who is subject to the minimum financial requirements of:

(A) A futures commission merchant, or

(B) The Securities and Exchange Commission for a securities broker or dealer.

* * * * *

(g) A futures commission merchant shall provide notice, as provided in paragraph (n) of this section, of a substantial reduction in capital as compared to that last reported in a financial report filed with the Commission pursuant to § 1.10 of this part. This notice shall be provided as follows:

(1) If any event or series of events, including any withdrawal, advance, loan or loss cause, on a net basis, a reduction in net capital (or, if the futures commission merchant is qualified to use the filing option available under § 1.10(h) of this part, tentative net capital as defined in the rules of the Securities and Exchange Commission) of 20 percent or more, notice must be provided as provided in paragraph (n) of this section within two business days of the event or series of events causing the reduction stating the reason for the reduction and steps the futures commission merchant will be taking to ensure an appropriate level of net capital is maintained by the futures commission merchant; and

(2) If equity capital of the futures commission merchant or a subsidiary or affiliate of the futures commission merchant consolidated pursuant to § 1.17(f) of this part (or 17 CFR 240.15c3–1e) would be withdrawn by action of a stockholder or a partner or a limited liability company member or by redemption or repurchase of shares of stock by any of the consolidated entities or through the payment of dividends or any similar distribution, or an unsecured advance or loan would be made to a stockholder, partner, sole proprietor, limited liability company member, employee or affiliate, such that the withdrawal, advance or loan would cause, on a net basis, a reduction in excess adjusted net capital (or, if the futures commission merchant is qualified to use the filing option available under § 1.10(h) of this part, excess net capital as defined in the rules of the Securities and Exchange Commission) of 30 percent or more, notice must be provided as provided in paragraph (n) of this section at least two business days prior to the withdrawal, advance or loan that would cause the reduction: *Provided, however,* That the provisions of paragraphs (g)(1) and (g)(2) of this section do not apply to any futures or securities transaction in the ordinary course of business between a futures commission merchant and any affiliate where the futures commission merchant makes payment to or on behalf of such affiliate for such transaction and then receives payment from such affiliate for such transaction within two business days from the date of the transaction.

(3) Upon receipt of such notice from a futures commission merchant, or upon a reasonable belief that a substantial reduction in capital has occurred or will occur, the Director of the Division of Swap Dealer and Intermediary Oversight or the Director's designee may require that the futures commission merchant provide or cause a Material Affiliated Person (as that term is defined in § 1.14(a)(2) of this part) to provide, within three business days from the date of request or such shorter period as the Division Director or designee may specify, such other information as the Division Director or designee determines to be necessary based upon market conditions, reports provided by the futures commission merchant, or other available information.

(h) Whenever a person registered as a futures commission merchant knows or should know that the total amount of its funds on deposit in segregated accounts on behalf of customers trading on designated contract markets, or the amount of funds on deposit in segregated accounts for customers transacting in Cleared Swaps under part 22 of this chapter, or that the total amount set aside on behalf of customers trading on non-United States markets under part 30 of this chapter, is less than the total amount of such funds required by the Act and the regulations to be on deposit in segregated or secured amount accounts on behalf of such customers, the registrant must report such deficiency immediately by notice to the registrant's designated self-regulatory organization and the Commission, as provided in paragraph (n) of this section.

(i) A futures commission merchant must provide immediate notice, as set forth in paragraph (n) of this section, whenever it discovers or is informed that it has invested funds held for futures customers trading on designated contract markets pursuant to § 1.20 of this part, Cleared Swaps Customer Collateral, as defined in § 22.1 of this chapter, or 30.7 Customer Funds, as defined in § 30.1 of this chapter, in instruments that are not permitted investments under § 1.25 of this part, or has otherwise violated the requirements governing the investment of funds belonging to customers under § 1.25 of this part.

(j) A futures commission merchant must provide immediate notice, as provided in paragraph (n) of this section, whenever the futures commission merchant does not hold a sufficient amount of funds in segregated accounts for futures customers under § 1.20 of this part, in segregated accounts for Cleared Swaps Customers under part 22 of this chapter, or in secured amount accounts for customers trading on foreign market under part 30 of this chapter to meet the futures commission merchant's targeted residual interest in the segregated or secured amount accounts pursuant to its policies and procedures required under § 1.11 of this part, or whenever the futures commission merchant's amount of residual interest in any such accounts is less than the sum of all margin deficits for such accounts.

(k) A futures commission merchant must provide immediate notice, as provided in paragraph (n) of this section, whenever the futures commission merchant, or the futures commission merchant's parent or material affiliate, experiences a material adverse impact to its creditworthiness or ability to fund its obligations.

(l) A futures commission merchant must provide immediate notice, as provided in paragraph (n) of this section, whenever the futures commission merchant experiences a material change in its operations or risk profile, including a change in the senior management of the futures commission merchant, the establishment or termination of a line of business, a material adverse change in the futures commission merchant's clearing arrangements, or a material adverse change to the futures commission merchant's credit arrangements, including any change that could adversely impact the firm's liquidity resources.

(m) In the event that a futures commission merchant receives a notice, examination report, or any other correspondence from a designated self-regulatory organization, the Securities and Exchange Commission or a securities industry self-regulatory organization, the futures commission merchant must immediately file a copy of such notice, examination report, or any other correspondence, and the registrant's response, as appropriate, as provided in paragraph (n) of this section.

(n) *Notice.* (1) Every notice and report required to be filed by this section by a futures commission merchant or a self-regulatory organization must be filed with the Commission, with the designated self-regulatory organization, if any, and with the Securities and Exchange Commission, if such registrant is a securities broker or dealer. Every notice and report required to be filed by this section by an applicant for registration as a futures commission merchant must be filed with the National Futures Association (on behalf of the Commission), with the designated self-regulatory organization, if any, and with the Securities and Exchange Commission, if such applicant is a securities broker or dealer. Every notice or report that is required to be filed by this section by a futures commission merchant or a self-regulatory organization must include a discussion of how the reporting event originated and what steps have been, or are being taken, to address the reporting event.

(2) Every notice and report which an introducing broker or applicant for registration as an introducing broker is required to file by paragraphs (a), (c), and (d) of this section must be filed with the National Futures Association (on behalf of the Commission), with the designated self-regulatory organization, if any, and with every futures commission merchant carrying or intending to carry customer accounts for the introducing broker or applicant for registration as an introducing broker. Any notice or report filed with the National Futures Association pursuant to this paragraph shall be deemed for all purposes to be filed with, and to be the official record of, the Commission. Every notice or report that is required to be filed by this section by an introducing broker or applicant for registration as an introducing broker must include a discussion of how the reporting event originated and what steps have been, or are being taken, to address the reporting event.

(3) Every notice or report that is required to be filed by a futures commission merchant with the Commission or with a designated self-regulatory organization under this section must be in writing and must be filed via electronic transmission using a form of user authentication assigned in accordance with procedures established by or approved by the Commission, and otherwise in accordance with instructions issued by or approved by the Commission; *Provided, however,* that if the registered futures commission merchant cannot file the notice or report using the electronic transmission approved by the Commission due to a transmission or systems failure, the futures commission merchant must immediately contact the Commission's Regional office with jurisdiction over the futures commission merchant as provided in § 140.02 of this chapter, and by email to *FCMNotice@CFTC.gov.* Any such electronic submission must clearly indicate the futures commission merchant on whose behalf such filing is made and the use of such user authentication in submitting such filing will constitute and become a substitute for the manual signature of the authorized signer.

6. Amend § 1.15 by revising paragraph (a)(4) to read as follows:

§ 1.15 Risk assessment reporting requirements for futures commission merchants.

(a) * * *

(4) The reports required to be filed pursuant to paragraphs (a)(1) and (2) of this section must be filed via electronic transmission using a form of user authentication assigned in accordance with procedures established by or approved by the Commission, and otherwise in accordance with instructions issued by or approved by the Commission. Any such electronic submission must clearly indicate the registrant on whose behalf such filing is made and the use of such user authentication in submitting such filing will constitute and become a substitute for the manual signature of the authorized signer.

* * * * *

7. Amend § 1.16 by revising paragraphs (a)(4), (b)(1), (c)(1), (c)(2), and (f)(1)(i)(C), and by adding paragraph (b)(4) to read as follows:

§ 1.16 Qualifications and reports of accountants.

(a) * * *

(4) *Customer.* The term ''customer'' means customer, as defined in § 1.3 of this part, and 30.7 Customer, as defined in § 30.1 of this chapter.

(b) *Qualifications of accountants.* (1) The Commission will recognize any person as a certified public accountant who is duly registered and in good standing as such under the laws of the place of his residence or principal office; *Provided, however,* that a certified public accountant engaged to conduct an examination of a futures commission merchant must be registered with the Public Company Accounting Oversight Board, have undergone an examination by the Public Company Accounting Oversight Board, and any deficiencies noted during such examination must have been remediated to the satisfaction of the Public Company Accounting Oversight Board within three years of such report.

* * * * *

(4) The governing body of each futures commission merchant must ensure that the certified public accountant engaged is duly qualified to perform an audit of the futures commission merchant. Such an evaluation of the qualifications of the certified public accountant should include, among other issues, the certified public accountant's experience in auditing futures commission merchants, the depth of the certified public accountant's staff, the certified public accountant's knowledge of the Act and Regulations, the size and geographic location of the futures commission merchant, and the independence of the certified public accountant.

(c) * * *

(1) *Technical requirements.* The accountant's report must:

(i) Be dated;

(ii) Indicate the city and State where issued; and

(iii) Identify without detailed enumeration the financial statements covered by the report.

(2) *Representations as to the audit.* The accountant's report must state whether the audit was made in accordance with U.S. generally accepted auditing standards after full consideration to the auditing standards adopted by the Public Company Accounting Oversight Board, and must designate any auditing procedures deemed necessary by the accountant under the circumstances of the particular case which have been omitted and the reasons for their omission. However, nothing in this paragraph (c)(2) shall be construed to imply authority for the omission of any procedure which independent accountants would ordinarily employ in the course of an audit made for the purposes of expressing the opinion required by paragraph (c)(3) of this section.

* * * * *

(f)(1) * * *

(i) * * *

(C) Any copy that under this paragraph (f)(1)(i) is required to be filed with the Commission must be filed via electronic transmission using a form of user authentication assigned in accordance with procedures established by or approved by the Commission, and otherwise in accordance with instructions issued by or approved by the Commission. Any such electronic submission must clearly indicate the registrant on whose behalf such filing is made and the use of such user authentication in submitting such filing will constitute and become a substitute for the manual signature of the authorized signer.

* * * * *

8. Amend § 1.17 by revising paragraphs (a)(4), (b)(2), (b)(7), (c)(5)(v), (c)(5)(viii), and (c)(5)(ix) to read as follows:

§ 1.17 Minimum financial requirements for futures commission merchants and introducing brokers.

(a) * * *

(4) A futures commission merchant who is not in compliance with this section, or is unable to demonstrate such compliance as required by paragraph (a)(3) of this section, or who cannot certify to the Commission immediately upon request and demonstrate with verifiable evidence that it has sufficient access to liquidity to continue operating as a going concern, must transfer all customer accounts and immediately cease doing business as a futures commission merchant until such time as the firm is able to demonstrate such compliance; *Provided, however,* The registrant may trade for liquidation purposes only unless otherwise directed by the Commission and/or the designated self-regulatory organization; *And, Provided further,* That if such registrant immediately demonstrates to the satisfaction of the Commission or the designated self-regulatory organization the ability to achieve compliance, the Commission or the designated self-regulatory organization may in its discretion allow such registrant up to a maximum of 10 business days in which to achieve compliance without having to transfer accounts and cease doing business as required above. Nothing in this paragraph (a)(4) shall be construed as preventing the Commission or the designated self-regulatory organization from taking action against a registrant for non-compliance with any of the provisions of this section.

* * * * *

(b) * * *

(2) *Customer.* This term means a futures customer as defined in § 1.3 of this chapter, a cleared over the counter customer as defined in paragraph (b)(10) of this section, and a 30.7 Customer as defined in § 30.1 of this chapter.

* * * * *

(7) *Customer account.* This term means an account in which commodity futures, options or cleared over the counter derivative positions are carried on the books of the applicant or registrant which is an account that is included in the definition of customer as defined in § 1.17(b)(2).

* * * * *

(c) * * *

(5) * * *

(v) In the case of securities and obligations used by the applicant or registrant in computing net capital, and in the case of a futures commission merchant that invests funds deposited by futures customers as defined in § 1.3 of this part, Cleared Swaps Customers as defined in § 22.1 of this chapter, and 30.7 Customers as defined in § 30.1 of this chapter in securities as permitted investments under § 1.25 of this part, the deductions specified in Rule 240.15c3–1(c)(2)(vi) or Rule 240.15c3–1(c)(2)(vii) of the Securities and Exchange Commission (17 CFR 240.15c3–1(c)(2)(vi) and 17 CFR 240.15c3–1(c)(2)(vii)) (''securities haircuts''). Futures commission merchants that establish and enforce written policies and procedures to assess the credit risk of commercial paper, convertible debt instruments, or nonconvertible debt instruments in accordance with Rule 240.15c3–1(c)(2)(vi) of the Securities and Exchange Commission (17 CFR 240.15c3–1(c)(2)(vi)) may apply the lower haircut percentages specified in Rule 240.15c3–1(c)(2)(vi) for such commercial paper, convertible debt instruments and nonconvertible debt instruments. Futures commission merchants must maintain their written policies and procedures in accordance with § 1.31 of this part;

* * * * *

(viii) In the case of a futures commission merchant, for undermargined customer commodity futures accounts and commodity option customer accounts the amount of funds required in each such account to meet maintenance margin requirements of the applicable board of trade or if there are no such maintenance margin requirements, clearing organization margin requirements applicable to such positions, after application of calls for margin or other required deposits which are outstanding no more than one business day. If there are no such maintenance margin requirements or clearing organization margin requirements, then the amount of funds required to provide margin equal to the amount necessary, after application of calls for margin or other required deposits outstanding no more than one business day, to restore original margin when the original margin has been depleted by 50 percent or more: *Provided,* To the extent a deficit is excluded from current assets in accordance with paragraph (c)(2)(i) of this section such amount shall not also be deducted under this paragraph (c)(5)(viii). In the event that an owner of a customer account has deposited an asset other than cash to margin, guarantee or secure his account, the value attributable to such asset for purposes of this subparagraph shall be the lesser of (A) the value attributable to the asset pursuant to the margin rules of the applicable board of trade, or (B) the market value of the asset after application of the percentage deductions specified in this paragraph (c)(5);

(ix) In the case of a futures commission merchant, for undermargined commodity futures and commodity option noncustomer and omnibus accounts the amount of funds required in each such account to meet maintenance margin requirements of the applicable board of trade or if there are no such maintenance margin requirements, clearing organization margin requirements applicable to such positions, after application of calls for margin or other required deposits which

are outstanding no more than one business day. If there are no such maintenance margin requirements or clearing organization margin requirements, then the amount of funds required to provide margin equal to the amount necessary after application of calls for margin or other required deposits outstanding no more than one business day to restore original margin when the original margin has been depleted by 50 percent or more: *Provided,* To the extent a deficit is excluded from current assets in accordance with paragraph (c)(2)(i) of this section such amount shall not also be deducted under this paragraph (c)(5)(ix). In the event that an owner of a noncustomer or omnibus account has deposited an asset other than cash to margin, guarantee or secure his account the value attributable to such asset for purposes of this subparagraph shall be the lesser of the value attributable to such asset pursuant to the margin rules of the applicable board of trade, or the market value of such asset after application of the percentage deductions specified in this paragraph (c)(5);

* * * * *

9. Revise § 1.20 to read as follows:

§ 1.20 Futures customer funds to be segregated and separately accounted for.

(a) *General.* A futures commission merchant must separately account for all futures customer funds and segregate such funds as belonging to its futures customers. A futures commission merchant shall deposit futures customer funds under an account name which clearly identifies them as futures customer funds and shows that such funds are segregated as required by sections 4d(a) and 4d(b) of the Act and this part. A futures commission merchant must at all times maintain in the separate account or accounts money, securities and property in an amount at least sufficient in the aggregate to cover its total obligations to all futures customers. The futures commission merchant must perform appropriate due diligence as required by § 1.11 of this part on any and all locations of futures customer funds, as specified in paragraph (b) of this section, to ensure that the location in which the futures commission merchant has deposited such funds is a financially sound entity.

(b) *Location of futures customer funds.* A futures commission merchant may deposit futures customer funds, subject to the risk management policies and procedures of the futures commission merchant required by § 1.11 of this part, with the following depositories:

(1) A bank or trust company;

(2) A derivatives clearing organization; or

(3) Another futures commission merchant.

(c) *Limitation on the holding of futures customer funds outside of the United States.* A futures commission merchant may hold futures customer funds with a depository outside of the United States only in accordance with § 1.49 of this part.

(d) *Written acknowledgment from depositories.* (1) A futures commission merchant must obtain a written acknowledgment from each bank, trust company, derivatives clearing organization, or futures commission merchant prior to or contemporaneously with the opening of an account by the futures commission merchant with such depositories; *Provided, however,* that a written acknowledgment need not be obtained from a derivatives clearing organization that has adopted and submitted to the Commission rules that provide for the segregation of futures customer funds in accordance with all relevant provisions of the Act and the rules and orders promulgated thereunder.

(2) The written acknowledgment must be in the form as set out in Appendix A to this part.

(3) A futures commission merchant may deposit futures customer funds only with a depository that provides the Commission and the futures commission merchant's designated self-regulatory organization with direct, read-only access to account information on 24-hour a day basis. The Commission and the futures commission merchant's designated self-regulatory organization must receive the direct access when the account is opened. The written acknowledgment must contain the futures commission merchant's authorization to the depository to provide direct and immediate account access to the Commission and the futures commission merchant's designated self-regulatory organization without further notice to or consent from the futures commission merchant.

(4) A futures commission merchant may deposit futures customer funds only with a depository that agrees to provide the Commission and the futures commission merchant's designated self-regulatory organization with a copy of the executed written acknowledgment within three business days of the opening of the account. The Commission must receive the written acknowledgment from the depository via electronic mail at *acknowledgmentletters@cftc.gov.* The written acknowledgment must contain the futures commission merchant's authorization to the depository to provide the written acknowledgment to the Commission and to the futures commission merchant's designated self-regulatory organization without further notice to or consent from the futures commission merchant.

(5) A futures commission merchant may deposit futures customer funds only with a depository that agrees to reply promptly and directly to the Commission's or to the futures commission merchant's designated self-regulatory organization's requests for confirmation of account balances or other account information without further notice to or consent from the futures commission merchant. The written acknowledgment must contain the futures commission merchant's authorization to the depository to respond directly and immediately to requests from the Commission or the futures commission merchant's designated self-regulatory organization for confirmation of account balances and other account information without further notice to or consent from the futures commission merchant.

(6) The futures commission merchant shall promptly file a copy of the written acknowledgment with the Commission in the manner specified by the Commission and in no event later than the later of:

(i) The effective date of this rule; or

(ii) Three business days after the account is opened.

(7) A futures commission merchant shall amend the written acknowledgment and promptly file the amended acknowledgment with the Commission within 120 days of any changes in the following:

(i) The name or business address of the futures commission merchant;

(ii) The name or business address of the bank, trust company, derivatives clearing organization or futures commission merchant receiving futures customer funds; or

(iii) The account number(s) under which futures customer funds are held.

(8) A futures commission merchant must maintain each written acknowledgment readily accessible in its files in accordance with § 1.31 of this part, for as long as the account remains open, and thereafter for the period provided in § 1.31 of this part.

(e) *Commingling.* (1) A futures commission merchant may for convenience commingle the futures customer funds that it receives from, or on behalf of, multiple futures customers in a single account or multiple accounts with one or more of the depositories listed in paragraph (b) of this section.

(2) A futures commission merchant shall not commingle futures customer funds with the money, securities or property of such futures commission merchant, or with any proprietary account of such futures commission merchant, or use such funds to secure or guarantee the obligation of, or extend credit to, such futures commission merchant or any proprietary account of such futures commission merchant; *Provided, however,* a futures commission merchant may deposit proprietary funds in segregated accounts as permitted under § 1.23 of this part.

(3) A futures commission merchant may not commingle futures customer funds with funds deposited by 30.7 Customers as defined in § 30.1 of this chapter and set aside in separate accounts as required by part 30 of this chapter, or with funds deposited by Cleared Swaps Customers as defined in § 22.1 of this chapter and held in segregated accounts pursuant to Section 4d(f) of the Act; *Provided, however,* that a futures commission merchant may commingle futures customer funds with funds deposited by 30.7 Customers or Cleared Swaps Customers if expressly permitted by a Commission regulation or order, or by a derivatives clearing organization rule approved in accordance with § 39.15(b)(2) of this chapter.

(f) *Limitation on use of futures customer funds.* (1) A futures commission merchant shall treat and deal with the funds of a futures customer as belonging to such futures customer. A futures commission merchant shall not use the funds of a futures customer to secure or guarantee the commodity interests, or to secure or extend the credit, of any person other than the futures customer for whom the funds are held.

(2) A futures commission merchant shall obligate futures customer funds to a derivatives clearing organization, a futures commission merchant, or any depository solely to purchase, margin, guarantee, secure, transfer, adjust or settle trades, contracts or commodity option transactions of futures customers; *Provided, however,* that a futures commission merchant is permitted to use the funds belonging to a futures customer that are necessary in the normal course of business to pay lawfully accruing fees or expenses on behalf of the futures customer's positions including commissions, brokerage, interest, taxes, storage and other fees and charges.

(3) No person, including any derivatives clearing organization or any depository, that has received futures customer funds for deposit in a segregated account, as provided in this section, may hold, dispose of, or use any such funds as belonging to any person other than the futures customers of the futures commission merchant which deposited such funds.

(g) *Derivatives clearing organizations.* (1) *General.* All futures customer funds received by a derivatives clearing organization from a member to purchase, margin, guarantee, secure or settle the trades, contracts or commodity options of the clearing member's futures customers and all money accruing to such futures customers as the result of trades, contracts or commodity options so carried shall be separately accounted for and segregated as belonging to such futures customers, and a derivatives clearing organization shall not hold, use or dispose of such futures customer funds except as belonging to such futures customers. A derivatives clearing organization shall deposit futures customer funds under an account name that clearly identifies them as futures customer funds and shows that the futures customer funds are segregated as required by section 4(d)(a) and 4d(b) of the Act and this part.

(2) *Location of futures customer funds.* A derivatives clearing organization may deposit futures customer funds with a bank or trust company, which shall include a Federal Reserve Bank with respect to deposits of a systemically important derivatives clearing organization.

(3) *Limitation on the holding of futures customer funds outside of the United States.* A derivatives clearing organization may hold futures customer funds with a depository outside of the United States only in accordance with § 1.49 of this part.

(4) *Written acknowledgment from depositories.* (i) A derivatives clearing organization must obtain a written acknowledgment from each depository prior to or contemporaneously with the opening of a futures customer funds account;

(ii) The written acknowledgment must be in the form as set out in Appendix A to this part;

(iii) A derivatives clearing organization may deposit futures customer funds only with a depository that provides the Commission with direct, read-only access to account information on 24-hour a day basis. The Commission must receive the direct access when the account is opened. The written acknowledgment must contain the derivatives clearing organization's authorization to the depository to provide direct and immediate account access to the Commission without further notice to or consent from the derivatives clearing organization;

(iv) A derivatives clearing organization may deposit futures customer funds only with a depository that agrees to provide the Commission with a copy of the executed written acknowledgment within three business days of the opening of the account. The Commission must receive the written acknowledgment from the depository via electronic mail at *acknowledgmentletters@cftc.gov.* The written acknowledgment must contain the derivatives clearing organization's authorization to the depository to provide the written acknowledgment to the Commission without further notice to or consent from the derivatives clearing organization;

(v) A derivatives clearing organization may deposit futures customer funds only with a depository that agrees to reply promptly and directly to the Commission's requests for confirmation of account balances or other account information without further notice to or consent from the derivatives clearing organization. The written acknowledgment must contain the derivatives clearing organization's authorization to the depository to respond directly and immediately to requests from the Commission for confirmation of account balances and other account information without further notice to or consent from the derivatives clearing organization;

(vi) A derivatives clearing organization shall promptly file a copy of the written acknowledgment with the Commission in the manner specified by the Commission and in event later than the later of:

(A) The effective date of this rule; or

(B) Three business days after the account is opened.

(vii) A derivatives clearing organization shall amend the written acknowledgment and promptly file the amended acknowledgment with the Commission within 120 days of any changes in the following:

(A)The name or business address of the derivatives clearing organization;

(B) The name or business address of the depository receiving futures customer funds; or

(C) The account number(s) under which futures customer funds are held.

(viii) A derivatives clearing organization must maintain each written acknowledgment readily accessible in its files in accordance with § 1.31 of this part, for as long as the account remains open, and thereafter for the period provided in § 1.31 of this part.

(5) *Commingling.* (i) A derivatives clearing organization may for

convenience commingle the futures customer funds that it receives from, or on behalf of, multiple futures commission merchants in a single account or multiple accounts with one or more of the depositories listed in paragraph (g)(2) of this section.

(ii) A derivatives clearing organization shall not commingle futures customer funds with the money, securities or property of such derivatives clearing organization or with any proprietary account of any of its clearing members, or use such funds to secure or guarantee the obligations of, or extend credit to, such derivatives clearing organization or any proprietary account of any of its clearing members.

(iii) A derivatives clearing organization may not commingle funds held for futures customers with funds deposited by clearing members on behalf of their 30.7 Customers as defined in § 30.1 of this chapter and set aside in separate accounts as required by part 30 of this chapter, or with funds deposited by clearing members on behalf of their Cleared Swaps Customers as defined in § 22.1 of this chapter and held in segregated accounts pursuant section 4d(f) of the Act; *Provided, however,* that a derivatives clearing organization may commingle futures customer funds with funds deposited by clearing members on behalf of their 30.7 Customers or Cleared Swaps Customers if expressly permitted by a Commission regulation or order, or by a derivatives clearing organization rule approved in accordance with § 39.15(b)(2) of this chapter.

(h) *Immediate availability of bank and trust company deposits.* All futures customer funds deposited by a futures commission merchant or a derivatives clearing organization with a bank or trust company must be immediately available for withdrawal upon the demand of the futures commission merchant or derivatives clearing organization.

(i) *Requirements as to Amount.* (1) For purposes of this paragraph (i), the term ''account'' shall mean the entries on the books and records of a futures commission merchant pertaining to the futures customer funds of a particular futures customer.

(2) The futures commission merchant must reflect in the account that it maintains for each futures customer:

(i) The market value of any futures customer funds that it receives from such customer, as adjusted by:

(A) Any uses permitted under § 1.20(f) of this part;

(B) Any accruals on permitted investments of such collateral under § 1.25 of this part that, pursuant to the futures commission merchant's customer agreement with that customer, are creditable to such customer;

(C) Any gains and losses with respect to contracts for the purchase or sale of a commodity for future delivery and any options on such contracts;

(D) Any charges lawfully accruing to the futures customer, including any commission, brokerage fee, interest, tax, or storage fee; and

(E) Any appropriately authorized distribution or transfer of such collateral.

(ii) The amount of collateral required for the futures customer's contracts for the purchase or sale of a commodity for future delivery and any options on such contracts at each derivatives clearing organization on which the futures commission merchant is a member, or by each other futures commission merchant through which the futures commission merchant clears futures customer contracts, and the total of such required collateral amounts.

(3)(i) If the market value of futures customer funds in the account of a futures customer is positive after adjustments, then that account has a credit balance. If the market value of futures customer funds in the account of a futures customer is negative after adjustments, then that account has a debit balance.

(ii) If the value of the futures customer funds, as calculated in paragraph (i)(2)(i) of this section, for a futures customer's account is less than the total amount of collateral required for that account's contracts for the purchase or sale of a commodity for future delivery and any options on such contracts at derivatives clearing organizations, as calculated in paragraph (i)(2)(ii) of this section, the difference is a margin deficit.

(4) The futures commission merchant must maintain in segregation an amount equal to the sum of any credit balances that the futures customers of the futures commission merchant have in their accounts, excluding from such sum any debit balances that the futures customers of the futures commission merchant have in their accounts. In addition, the futures commission merchant must at all times maintain residual interest in segregated fund sufficient to exceed the sum of all margin deficits that the futures customers of the futures commission merchant have in their accounts. Such residual interest may not be withdrawn pursuant to § 1.23 of this part.

Appendix A to § 1.20—Acknowledgment Letter for CFTC Regulation 1.20 Customer Segregated Account

[Date]

[Name and Address of Bank, Trust Company, Derivatives Clearing Organization or Futures Commission Merchant]

We refer to the Segregated Account(s) which [Name of Futures Commission Merchant or Derivatives Clearing Organization] (''we'' or ''our'') have opened or will open with [Name of Bank, Trust Company, Derivatives Clearing Organization or Futures Commission Merchant] (''you'' or ''your'') entitled:

[Name of Futures Commission Merchant or Derivatives Clearing Organization] [if applicable, add ''FCM Customer Omnibus Account''] CFTC Regulation 1.20 Customer Segregated Account

Account Number(s): [ ]

You acknowledge and agree that we have opened or will open the above-referenced Account(s) for the purpose of depositing, as applicable, money, securities and other property (collectively the ''Funds'') of our customers who trade commodities, options, swaps, other cleared OTC derivatives products and other products, as required by Commodity Futures Trading Commission (''CFTC'') Regulations, including Regulation 1.20, as amended; that the Funds held by you, hereafter deposited in the Account(s) or accruing to the credit of the Accounts, will be separately accounted for and segregated on your books from our own funds and all other accounts maintained by us in accordance with the provisions of the Commodity Exchange Act, as amended (the ''Act''), and Part 1 of the CFTC's regulations, as amended; and that the Funds must otherwise be treated in accordance with the provisions of the Act and CFTC regulations.

Furthermore, you acknowledge and agree that such Funds may not be used by you or by us to secure or guarantee any obligations that we might owe to you, nor may they be used by us to secure credit from you. You further acknowledge and agree that the Funds in the Account(s) shall not be subject to any right of offset or lien for or on account of any indebtedness, obligations or liabilities we may now or in the future have owing to you. This prohibition does not affect your right to recover funds advanced in the form of cash transfers you make in lieu of liquidating non-cash assets held in the Account(s) for purposes of variation settlement or posting initial (original) margin.

In addition, you agree that the Account(s) may be examined at any reasonable time by an appropriate officer, agent or employee of the CFTC or a self-regulatory organization of which we are a member, and this letter constitutes the authorization and direction of the undersigned to permit any such examination or audit to take place. You agree to respond promptly and directly to requests for confirmation of account balances and other account information from an appropriate officer, agent, or employee of the CFTC or a self-regulatory organization of which we are a member, without further notice to or consent from the futures

commission merchant or derivatives clearing organization, as applicable. You also agree that, immediately upon instruction by the director of the Division of Swap Dealer and Intermediary Oversight of the CFTC or the director of the Division of Clearing and Risk of the CFTC, or any successor divisions, or such directors' designees, or any appropriate official of a self-regulatory organization of which we are a member, you will provide any and all information regarding or related to the Funds or the Accounts as shall be specified in such instruction and as directed in such instruction. You further agree that you will provide the CFTC and our designated self-regulatory organization with the necessary software, a user log-in, and password that will allow the CFTC and our designated self-regulatory organization to have read-only access to the accounts listed above on your Web site or via an alternative electronic medium on a 24-hour a day basis.

You acknowledge and agree that the Funds in the Account(s) shall be released immediately, subject to the requirements of U.S. or non-U.S. law as applicable, upon proper notice and instruction from an appropriate officer or employee of us or from the director of the Division of Clearing and Risk of the CFTC, the director of the Division of Swap Dealer and Intermediary Oversight of the CFTC, or any successor divisions, or such directors' designees.

We will not hold you responsible for acting pursuant to any instruction from the CFTC or the self-regulatory organization upon which you have relied after having taken reasonable measures to assure that such instruction was provided to you by the director of the Division of Clearing and Risk of the CFTC, the director of the Division of Swap Dealer and Intermediary Oversight of the CFTC, or any successor divisions, or such directors' designees, or any appropriate official of a self-regulatory organization of which we are a member.

In the event that we become subject to either a voluntary or involuntary petition for relief under the U.S. Bankruptcy Code, we acknowledge that you will have no obligation to release the Funds held in the Account(s), except upon instruction of the Trustee in Bankruptcy or pursuant to the Order of the respective U.S. Bankruptcy Court. Notwithstanding anything in the foregoing to the contrary, nothing contained herein shall be construed as limiting your right to assert any right of set off against or lien on assets other than assets maintained in the Account(s), nor to impose such charges against us or any proprietary account maintained by us with you. Further, it is understood that amounts represented by checks, drafts or other items shall not be considered to be part of the Account(s) until finally collected. Accordingly, checks, drafts and other items credited to the Account(s) and subsequently dishonored or otherwise returned to you, or reversed, for any reason and any claims relating thereto, including but not limited to claims of alteration or forgery, may be charged back to the Account(s), and we shall be responsible to you as a general endorser of all such items whether or not actually so endorsed. You may conclusively presume that any withdrawal from the Account(s) and the balances maintained therein are in conformity with the Act and CFTC regulations without any further inquiry, provided that you have no notice of or actual knowledge of, or could not reasonably know of, a violation of the Act or other provision of law by us; and you shall not in any manner not expressly agreed to herein be responsible for ensuring compliance by us with the provisions of the Act and CFTC regulations. You may, and are hereby authorized to, obey the order, judgment, decree or levy of any court of competent jurisdiction or any governmental agency with jurisdiction, which order, judgment, decree or levy relates in whole or in part to the Account(s). In any event, you shall not be liable by reason of any such action or omission to act, to us or to any other person, firm, association or corporation even if thereafter any such order, decree, judgment or levy shall be reversed, modified, set aside or vacated.

The terms of this letter agreement shall remain binding upon the parties, their successors and assigns, including for the avoidance of doubt, regardless of the change in name of any party. This letter agreement supersedes and replaces any prior agreement between the parties in connection with the Account(s), including but not limited to any prior acknowledgment letter, to the extent that such prior agreement is inconsistent with the terms hereof. In the event of any conflict between this letter agreement and any other agreement between the parties in connection with the Account(s), this letter agreement shall govern with respect to matters specific to Section 4d of the Act and the CFTC's regulations, as amended.

This letter agreement shall be governed by and construed in accordance with the laws of [Insert governing law] without regard to the principles of choice of law.

Please acknowledge that you agree to abide by the requirements and conditions set forth above by signing and returning the enclosed copy of this letter. You further acknowledge and agree to provide a copy of this fully executed letter directly to the CFTC (via electronic mail to acknowledgmentletters@cftc.gov) and our designated self-regulatory organization.

[Name of Futures Commission Merchant or Derivatives Clearing Organization]

By:

Print Name:

Title:

ACKNOWLEDGED AND AGREED:

[Name of Bank, Trust Company, Derivatives Clearing Organization or Futures Commission Merchant]

By:

Print Name:

Title:

Contact Information: [Insert phone number and email address]

DATE:

10. Revise § 1.22 to read as follows:

§ 1.22 Use of futures customer funds restricted.

(a) No futures commission merchant shall use, or permit the use of, the futures customer funds of one futures 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 futures customer. The prohibition on the use of one futures customer's funds to extend credit to, or to purchase, margin, or settle the contracts of another person applies at all times. For this purpose, a futures commission merchant which operationally commingles the funds of its futures customers must ensure that at all times its residual interest in futures customer funds exceeds the sum of the margin deficits of all of its futures customers.

(b) Futures customer funds shall not be used to carry trades or positions of the same futures customer other than in contracts for the purchase of sale of any commodity for future delivery or for options thereon traded through the facilities of a designated contract market.

11. Revise § 1.23 to read as follows:

§ 1.23 Interest of futures commission merchant in segregated futures customer funds; additions and withdrawals.

(a)(1) The provision in sections 4d(a)(2) and 4d(b) of the Act and the provision in § 1.20 of this part that prohibit the commingling of futures customer funds with the funds of a futures commission merchant, shall not be construed to prevent a futures commission merchant from having a residual financial interest in the futures customer funds segregated as required by the Act and the regulations in this part and set apart for the benefit of futures customers; nor shall such provisions be construed to prevent a futures commission merchant from adding to such segregated futures customer funds such amount or amounts of money, from its own funds or unencumbered securities from its own inventory, of the type set forth in § 1.25 of this part, as it may deem necessary to ensure any and all futures customers' accounts from becoming undersegregated at any time.

(2) If a futures commission merchant discovers at any time that it is holding insufficient funds in segregated accounts to meet its obligations under §§ 1.20 and 1.22 of this part, the futures commission merchant shall immediately deposit sufficient funds into segregation to bring the account into compliance.

(b) A futures commission merchant may not withdraw funds on any business day for its own proprietary use from an account or accounts holding futures customer funds unless the futures commission merchant has prepared the daily segregation

calculation required by § 1.32 of this part as of the close of business on the previous business day. A futures commission merchant that has completed its daily segregation calculation may make withdrawals for its own use, to the extent of its actual residual financial interest in funds held in segregated futures accounts, adjusted to reflect market activity and other events that may have decreased the amount of the firm's residual financial interest since the close of business on the previous business day, including the withdrawal of securities held in segregated safekeeping accounts held by a bank, trust company, derivatives clearing organization or other futures commission merchant. Such withdrawal(s), *however,* shall not result in the funds of one futures customer being used to purchase, margin or carry the trades, contracts or commodity options, or extend the credit of any other futures customer or other person.

(c) Notwithstanding paragraphs (a) and (b) of this section, each futures commission merchant shall establish a targeted residual interest (*i.e.,* excess funds) that is in an amount that, when maintained as its residual interest in the segregated funds accounts, reasonably ensures that the futures commission merchant shall remain in compliance with the segregated funds requirements at all times. Each futures commission merchant shall establish policies and procedures designed to reasonably ensure that the futures commission merchant maintains the targeted residual amounts in segregated funds at all times. The futures commission merchant shall maintain sufficient capital and liquidity, and take such other appropriate steps as are necessary or appropriate, to reasonably ensure that such amount of targeted residual interest is maintained as the futures commission merchant's residual interest in the segregated funds accounts at all times. In determining the amount of the targeted residual interest, the futures commission merchant shall analyze all relevant factors affecting the amounts in segregated funds from time to time, including without limitation various factors, as applicable, relating to the nature of the futures commission merchant's business including, but not limited to, the composition of the futures commission merchant's customer base, the general creditworthiness of the customer base, the general trading activity of the customers, the types of markets and products traded by the customers, the proprietary trading of the futures commission merchant, the general volatility and liquidity of the markets and products traded by customers, the futures commission merchant's own liquidity and capital needs, and the historical trends in Customer segregated fund balances and debit balances in Customers' and undermargined accounts. The analysis and calculation of the targeted amount of the future commission merchant's residual interest must be described in writing with the specificity necessary to allow the Commission and the futures commission merchant's designated self-regulatory organization to duplicate the analysis and calculation and test the assumptions made by the futures commission merchant. The adequacy of the targeted residual interest and the process for establishing the targeted residual interest must be reassessed periodically by the futures commission merchant and revised as necessary. Notwithstanding any other provision of this section, a futures commission merchant must at all times maintain an amount of residual interest in segregated accounts that exceeds the sum of all margin deficits of its futures customers under § 1.20 of this part, and such residual interest may not be withdrawn by the futures commission merchant.

(d) Notwithstanding any other paragraph of this section, a futures commission merchant may not withdraw funds for its own proprietary use, in a single transaction or a series of transactions on a given business day, from futures accounts if such withdrawal(s) would exceed 25 percent of the futures commission merchant's residual interest in such accounts as reported on the daily segregation calculation required by § 1.32 of this part and computed as of the close of business on the previous business day, unless:

(1) The futures commission merchant's Chief Executive Officer, Chief Finance Officer or other senior official that is listed as a principal of the futures commission merchant on its Form 7–R and is knowledgeable about the futures commission merchant's financial requirements and financial position pre-approves in writing the withdrawal, or series of withdrawals;

(2) The futures commission merchant files written notice of the withdrawal or series of withdrawals, with the Commission and with its designated self-regulatory organization immediately after the Chief Executive Officer, Chief Finance Officer or other senior official as described in paragraph (c)(1) of this section pre-approves the withdrawal or series of withdrawals. The written notice must:

(i) Be signed by the Chief Executive Officer, Chief Finance Officer or other senior official as described in paragraph (c)(1) of this section that pre-approved the withdrawal, and give notice that the futures commission merchant has withdrawn or intends to withdraw more than 25 percent of its residual interest in segregated accounts holding futures customer funds;

(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 futures commission merchant's residual interest in the futures accounts after the withdrawal;

(v) Contain a representation by the Chief Executive Officer, Chief Finance Officer or other senior official as described in paragraph (c)(1) of this section that pre-approved the withdrawal, or series of withdrawals, that, after due diligence, to such person's knowledge and reasonable belief, the futures commission merchant remains in compliance with the segregation requirements after the withdrawal. The Chief Executive Officer, Chief Finance Officer or other senior official as described in paragraph (c)(1) of this section must consider the daily segregation calculation as of the close of business on the previous business day and any other factors that may cause a material change in the futures commission merchant's residual interest since the close of business the previous business day, including known unsecured futures customer debits or deficits, current day market activity and any other withdrawals made from the futures accounts; and

(vi) Any such written notice filed with the Commission must be filed via electronic transmission using a form of user authentication assigned in accordance with procedures established by or approved by the Commission, and otherwise in accordance with instruction issued by or approved by the Commission. Any such electronic submission must clearly indicate the registrant on whose behalf such filing is made and the use of such user authentication in submitting such filing will constitute and become a substitute for the manual signature of the authorized signer. Any written notice filed must be followed up with direct communication to the Regional office of the Commission that has supervisory authority over the futures commission merchant whereby the Commission acknowledges receipt of the notice; and

(3) After making a withdrawal requiring the approval and notice required in paragraphs (c)(1) and (2) of this section, and before the completion of its next daily segregated funds calculation, no futures commission merchant may make any further withdrawals from accounts holding futures customer funds, except to or for the benefit of commodity and option customers, without, for each withdrawal, obtaining the approval required under paragraph (c)(1) of this section and filing a written notice in the manner specified under paragraph (c)(2) of this section with the Commission and its designated self-regulatory organization signed by the Chief Executive Officer, Chief Finance Officer, or other senior official. The written notice must:

(i) List the amount of funds provided to each recipient and each recipient's name;

(ii) Disclose the reason for each withdrawal;

(iii) Confirm that the Chief Executive Officer, Chief Finance Officer, or other senior official (and identify of the person if different from the person who signed the notice) pre-approved the withdrawal in writing;

(iv) Disclose the current estimate of the futures commission merchant's remaining total residual interest in the segregated accounts holding futures customer funds after the withdrawal; and

(v) Include a representation that, after due diligence, to the best of the notice signatory's knowledge and reasonable belief the futures commission merchant remains in compliance with the segregation requirements after the withdrawal.

(e) If a futures commission merchant withdraws funds from futures accounts for its own proprietary use, and the withdrawal causes the futures commission merchant to not hold sufficient funds in the futures accounts to meet its targeted residual interest, as required to be computed under § 1.11 of this part, the futures commission merchant should deposit its own funds into the futures accounts to restore the account balance to the targeted residual interest amount by the close of business on the next business day, or, if appropriate, revise the futures commission merchant's targeted amount of residual interest pursuant to the policies and procedures required by § 1.11 of this part. Notwithstanding the foregoing, if at any time the futures commission merchant's residual interest in customer accounts is less than the sum of its futures customers' margin deficits as set forth in § 1.20(i) of this part, the futures commission merchant must immediately restore the residual interest to exceed the sum of such margin deficits. Any proprietary funds deposited in the futures accounts must be unencumbered and otherwise compliant with § 1.25 of this part, as applicable.

12. Amend § 1.25 by removing paragraph (b)(6) and by revising paragraphs (b)(3)(v), (c)(3), (d)(7), (d)(11), and (e) to read as follows:

§ 1.25 Investment of customer funds.

* * * * *

(b) * * *

(3) * * *

(v) *Counterparty concentration limits.* Securities purchased by a futures commission merchant or derivatives clearing organization from a single counterparty, or from one or more counterparties under common ownership or control, subject to an agreement to resell the securities to the counterparty or counterparties, shall not exceed 25 percent of total assets held in segregation or under § 30.7 of this chapter by the futures commission merchant or derivatives clearing organization.

* * * * *

(c) * * *

(3) A futures commission merchant or derivatives clearing organization shall maintain the confirmation relating to the purchase in its records in accordance with § 1.31 of this part and note the ownership of fund shares (by book-entry or otherwise) in a custody account of the futures commission merchant or derivatives clearing organization in accordance with § 1.26 of this part. The futures commission merchant or the derivatives clearing organization shall obtain the acknowledgment letter required by § 1.26 of this part from an entity that has substantial control over the fund shares purchased with customer funds and has the knowledge and authority to facilitate redemption and payment or transfer of the customer funds. Such entity may include the fund sponsor or depository acting as custodian for fund shares.

* * * * *

(d) * * *

(7) Securities transferred to the futures commission merchant or derivatives clearing organization under the agreement are held in a safekeeping account with a bank as referred to in paragraph (d)(2) of this section, a Federal Reserve Bank, a derivatives clearing organization, or the Depository Trust Company in an account that complies with the requirements of § 1.26 of this part.

* * * * *

(11) The transactions effecting the agreement are recorded in the record required to be maintained under § 1.27 of this part of investments of customer funds, and the securities subject to such transactions are specifically identified in such record as described in paragraph (d)(1) of this section and further identified in such record as being subject to repurchase and reverse repurchase agreements.

* * * * *

(e) *Deposit of firm-owned securities into segregation.* A futures commission merchant may deposit unencumbered securities of the type specified in this section, which it owns for its own account, into a customer account. A futures commission merchant must include such securities, transfers of securities, and disposition of proceeds from the sale or maturity of such securities in the record of investments required to be maintained by § 1.27 of this part. All such securities may be segregated in safekeeping only with a bank, trust company, derivatives clearing organization, or other registered futures commission merchant in accordance with the provisions of § 1.20 of this part. For purposes of this section and §§ 1.27, 1.28, 1.29, and 1.32 of this part, securities of the type specified by this section that are owned by the futures commission merchant and deposited into a customer account shall be considered customer funds until such investments are withdrawn from segregation in accordance with the provisions of § 1.23 of this part. Investments permitted by § 1.25 that are owned by the futures commission merchant and deposited into a futures customer account pursuant to § 1.26 of the part shall be considered futures customer funds until such investments are withdrawn from segregation in accordance with § 1.23 of this part. Investments permitted by § 1.25 that are owned by the futures commission merchant and deposited into a Cleared Swaps Customer Account, as defined in § 22.1 of this chapter, shall be considered Cleared Swaps Customer Collateral, as defined in § 22.1 of this chapter, until such investments are withdrawn from segregation in accordance with § 22.17 of this chapter.

* * * * *

13. Revise § 1.26 to read as follows:

§ 1.26 Deposit of instruments purchased with futures customer funds.

(a) Each futures commission merchant who invests futures customer funds in instruments described in § 1.25 of this part, except for investments in money market mutual funds, shall separately account for such instruments as futures

customer funds and segregate such instruments as funds belonging to such futures customers in accordance with the requirements of § 1.20 of this part. Each derivatives clearing organization which invests money belonging or accruing to futures customers of its clearing members in instruments described in § 1.25 of this part, except for investments in money market mutual funds, shall separately account for such instruments as customer funds and segregate such instruments as customer funds belonging to such futures customers in accordance with § 1.20 of this part.

(b) Each futures commission merchant or derivatives clearing organization which invests futures customer funds in money market mutual funds, as permitted by § 1.25 of this part, shall separately account for such funds and segregate such funds as belonging to such futures customers. Such funds shall be deposited under an account name which clearly shows that they belong to futures customers and are segregated as required by sections 4d(a) and 4d(b) of the Act and this part. Each futures commission merchant or derivatives clearing organization, upon opening such an account, shall obtain and maintain readily accessible in its files in accordance with § 1.31 of this part, for as long as the account remains open, and thereafter for the period provided in § 1.31 of this part, a written acknowledgment and shall file such acknowledgment in accordance with the requirements of § 1.20 of this part. In the event such funds are held directly with the money market mutual fund or its affiliate, the written acknowledgment letter shall be in the form as set out in Appendix A to this section. In the event such funds are held with a depository the written acknowledgment letter shall be in the form as set out in Appendix A to § 1.20 of this part. In either case, the written acknowledgment letter shall be obtained, provided to the Commission and designated self-regulatory organizations, and retained as required under § 1.20 of this part.

Appendix to § 1.26—Acknowledgment Letter for CFTC Regulation 1.26 Customer Segregated Money Market Mutual Fund Account

[Date]

[Name and Address of Money Market Mutual Fund]

We propose to invest funds held by [Name of Futures Commission Merchant or Derivatives Clearing Organization] (''we'' or ''our'') on behalf of our customers in shares of [Name of Money Market Mutual Fund] (''you'' or ''your'') under account(s) entitled (or shares issued to):

[Name of Futures Commission Merchant or Derivatives Clearing Organization] [if applicable, add ''FCM Customer Omnibus Account''] CFTC Regulation 1.26 Customer Segregated Money Market Mutual Fund Account

[If applicable, include any abbreviated name of the Account(s) as reflected in the Depository's electronic systems (provided any such abbreviated name must reflect that the Account(s) is a CFTC regulated customer segregated account)]

Account Number(s): [_____]

(collectively, the ''Account(s)'').

You acknowledge and agree that we are holding these funds, including any shares issued and amounts accruing in connection therewith (collectively, the ''Shares''), for the benefit of our customers who trade commodities, options, cleared OTC derivatives products and other products (''Commodity Customers''), as required by Commodity Futures Trading Commission (''CFTC'') Regulation 1.26, as amended; that the Shares held by you, hereafter deposited in the Account(s) or accruing to the credit of the Accounts, will be separately accounted for and segregated on your books from our own funds and from any other funds or accounts held by us in accordance with the provisions of the Commodity Exchange Act, as amended (the ''Act''), and Part 1 of the CFTC's regulations, as amended; and that the Shares must otherwise be treated in accordance with the provisions of the Act and CFTC regulations.

Furthermore, you acknowledge and agree that such Shares may not be used by you or by us to secure or guarantee any obligations that we might owe to you, nor may they be used by us to secure credit from you. You further acknowledge and agree that the Shares in the Account(s) shall not be subject to any right of offset or lien for or on account of any indebtedness, obligations or liabilities we may now or in the future have owing to you.

In addition, you agree that the Account(s) may be examined at any reasonable time by an appropriate officer, agent or employee of the CFTC or a self-regulatory organization, and this letter constitutes the authorization and direction of the undersigned to permit any such examination or audit to take place. You agree to respond promptly and directly to requests for confirmation of account balances and other account information from an appropriate officer, agent, or employee of the CFTC or a self-regulatory organization of which we are a member, without further notice to or consent from the futures commission merchant or the derivatives clearing organization, as applicable. You also agree that, immediately upon instruction by the director of the Division of Swap Dealer and Intermediary Oversight of the CFTC or the director of the Division of Clearing and Risk of the CFTC, or any successor divisions, or such directors' designees, or any appropriate official of a self-regulatory organization of which we are a member, you will provide any and all information regarding or related to the Shares or the Accounts as shall be specified in such instruction and as directed in such instruction. You further agree that you will provide the CFTC and our designated self-regulatory organization with the necessary software, a user log-in, and password that will allow the CFTC and our designated self-regulatory organization to have read-only access to the accounts listed above on your Web site on a 24-hour a day basis.

You acknowledge and agree that the Shares in the Account(s) shall be released immediately, subject to the requirements of U.S. or non-U.S. law as applicable, upon proper notice and instruction from an appropriate officer or employee of us or from the director of the Division of Clearing and Risk of the CFTC, or from the director of the Division of Swap Dealer and Intermediary Oversight, or any successor divisions, or such directors' designees. We will not hold you responsible for acting pursuant to any instruction from the CFTC or from the self-regulatory organization upon which you have relied after having taken reasonable measures to assure that such instruction was provided to you by the director of the Division of Clearing and Risk of the CFTC, or the director of the Division of Swap Dealer and Intermediary Oversight, or any successor divisions, or such directors' designees, or any appropriate official of a self-regulatory organization of which we are a member. You further acknowledge that we will provide to the CFTC a copy of this acknowledgment. In the event we become subject to either a voluntary or involuntary petition for relief under the U.S. Bankruptcy Code, we acknowledge that you will have no obligation to release the Shares held in the Account(s), except upon instruction of the Trustee in Bankruptcy or pursuant to the Order of the respective U.S. Bankruptcy Court.

Notwithstanding anything in the foregoing to the contrary, nothing contained herein shall be construed as limiting your right to assert any right of set off against or lien on assets other than assets maintained in the Account(s), nor to impose such charges against us or any proprietary account maintained by us with you. Further, it is understood that amounts represented by checks, drafts or other items shall not be considered to be part of the Account(s) until finally collected. Accordingly, checks, drafts and other items credited to the Account(s) and subsequently dishonored or otherwise returned to you, or reversed, for any reason and any claims relating thereto, including but not limited to claims of alteration or forgery, may be charged back to the Account(s), and we shall be responsible to you as a general endorser of all such items whether or not actually so endorsed. You may conclusively presume that any withdrawal from the Account(s) and the balances maintained therein are in conformity with the Act and CFTC regulations without any further inquiry, provided that you have no notice of or actual knowledge of, or could not reasonably know of, a violation of the Act or other provision of law by us; and you shall not in any manner not expressly agreed to herein be responsible for ensuring compliance by us with the provisions of the Act and CFTC regulations.

You may, and are hereby authorized to, obey the order, judgment, decree or levy of any court of competent jurisdiction or any

governmental agency with jurisdiction, which order, judgment, decree or levy relates in whole or in part to the Account(s). In any event, you shall not be liable by reason of any such action or omission to act, to us or to any other person, firm, association or corporation even if thereafter any such order, decree, judgment or levy shall be reversed, modified, set aside or vacated.

We are permitted to invest our Commodity Customers' funds in money market mutual funds pursuant to CFTC Regulation 1.25. That rule sets forth the following conditions, among others, with respect to any investment in a money market mutual fund:

(1) The net asset value of the fund must be computed by 9:00 a.m. of the business day following each business day and be made available to us by that time;

(2) The fund must be legally obligated to redeem an interest in the fund and make payment in satisfaction thereof by the close of the business day following the day on which we make a redemption request except as otherwise specified in CFTC Regulation 1.25(c)(5)(ii); and,

(3) The agreement under which we invest our Commodity Customers' funds must not contain any provision that would prevent us from pledging or transferring fund shares.

The terms of this letter agreement shall remain binding upon the parties, their successors and assigns, including for the avoidance of doubt, regardless of the change in name of any party. This letter agreement supersedes and replaces any prior agreement between the parties in connection with the Account(s), including but not limited to any prior acknowledgment letter, to the extent that such prior agreement is inconsistent with the terms hereof. In the event of any conflict between this letter agreement and any other agreement between the parties in connection with the Account(s), this letter agreement shall govern with respect to matters specific to Section 4d of the Act and the CFTC's regulations, as amended.

This letter agreement shall be governed by and construed in accordance with the laws of [Insert governing law] without regard to the principles of choice of law.

Please acknowledge that you agree to abide by the requirements and conditions set forth above by signing and returning the enclosed copy of this letter. You further acknowledge and agree to provide a copy of this fully executed letter directly to the CFTC (via electronic mail to acknowledgmentletters@cftc.gov) and our designated self-regulatory organization in accordance with CFTC Regulation 1.20.

[Name of Futures Commission Merchant or Derivatives Clearing Organization]

By:

Print Name:

Title:

ACKNOWLEDGED AND AGREED:

[Name of Money Market Mutual Fund]

By:

Print Name:

Title:

Contact Information: [Insert phone number and email address]

Date:

14. Revise § 1.29 to read as follows:

§ 1.29 Gains and losses resulting from investment of customer funds.

(a) The investment of customer funds in instruments described in § 1.25 of this part shall not prevent the futures commission merchant or derivatives clearing organization so investing such funds from receiving and retaining as its own any incremental income or interest income resulting therefrom.

(b) The futures commission merchant or derivatives clearing organization, as applicable, shall bear sole responsibility for any losses resulting from the investment of customer funds in instruments described in § 1.25 of this part. No investment losses shall be borne or otherwise allocated to the customers of the futures commission merchant and, if customer funds are invested by a derivatives clearing organization in its discretion, to the futures commission merchant.

15. Revise § 1.30 to read as follows:

§ 1.30 Loans by futures commission merchants; treatment of proceeds.

Nothing in these regulations shall prevent a futures commission merchant from lending its own funds to customers on securities and property pledged by such customers, or from repledging or selling such securities and property pursuant to specific written agreement with such customers. The proceeds of such loans used to purchase, margin, guarantee, or secure the trades, contracts, or commodity options of customers shall be treated and dealt with by a futures commission merchant as belonging to such customers, in accordance with and subject to the provisions of the Act and these regulations. A futures commission merchant may not loan funds on an unsecured basis to finance customers' trading, nor may a futures commission merchant loan funds to customers secured by the customer accounts of such customers.

16. Amend § 1.32 by revising the section heading and paragraphs (b) and (c) and by adding paragraphs (d), (e), (f), (g), (h), (i), (j), and (k), to read as follows:

§ 1.32 Reporting of segregated account computation and details regarding the holding of futures customer funds

* * * * *

(b) In computing the amount of futures customer funds required to be in segregated accounts, a futures commission merchant may offset any net deficit in a particular futures customer's account against the current market value of readily marketable securities, less applicable 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 futures customer's account. Futures commission merchants that establish and enforce written policies and procedures to assess the credit risk of commercial paper, convertible debt instruments, or nonconvertible debt instruments in accordance with Rule 240.15c3–1(c)(2)(vi) of the Securities and Exchange Commission (17 CFR 240.15c3–1(c)(2)(vi)) may apply the lower haircut percentages specified in Rule 240.15c3–1(c)(2)(vi) for such commercial paper, convertible debt instruments and nonconvertible debt instruments. The futures commission merchant must maintain a security interest in the securities, including a 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, derivatives clearing organization, 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) Each futures commission merchant is required to document its segregation computation required by paragraph (a) of this section by preparing a Statement of Segregation Requirements and Funds in Segregation for Customers Trading on U.S. Commodity Exchanges contained in the Form 1–FR–FCM as of the close of each business day. Nothing in this paragraph shall affect the requirement that a futures commission merchant at all times maintain sufficient money, securities and property to cover its total obligations to all futures customers, in accordance with § 1.20 of this part.

(d) Each futures commission merchant is required to submit to the Commission and to the firm's designated self-regulatory organization the daily Statement of Segregation Requirements and Funds in Segregation for Customers Trading on U.S. Commodity Exchanges required by paragraph (c) of this section by noon the following business day.

(e) Each futures commission merchant shall file the Statement of Segregation Requirements and Funds in Segregation for Customers Trading on U.S. Commodity Exchanges required by paragraph (c) of this section in an electronic format using a form of user authentication assigned in accordance with procedures established or approved by the Commission.

(f) Each futures commission merchant is required to submit to the Commission

and to the firm's designated self-regulatory organization a report listing the names of all banks, trust companies, futures commission merchants, derivatives clearing organizations, or any other depository or custodian holding futures customer funds as of the fifteenth day of the month, or the first business day thereafter, and the last business day of each month. This report must include:

(1) The name and location of each entity holding futures customer funds;

(2) The total amount of futures customer funds held by each entity listed in paragraph (f)(1) of this section; and

(3) The total amount of cash and investments that each entity listed in paragraph (f)(1) of this section holds for the futures commission merchant. The futures commission merchant must report the following investments:

(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 of a State (municipal securities);

(iii) General obligation issued by any enterprise sponsored by the United States (government sponsored enterprise securities);

(iv) Certificates of deposit issued by a bank;

(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;

(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; and

(vii) Interests in money market mutual funds.

(g) Each futures commission merchant must report the total amount of futures customer-owned securities held by the futures commission merchant as margin collateral and must list the names and locations of the depositories holding such margin collateral.

(h) Each futures commission merchant must report the total amount of futures customer funds that have been used to purchase securities under agreements to resell the securities (reverse repurchase transactions).

(i) Each futures commission merchant must report which, if any, of the depositories holding futures customer funds under paragraph (f)(1) of this section are affiliated with the futures commission merchant.

(j) Each futures commission merchant shall file the detailed list of depositories required by paragraph (f) of this section by 11:59 p.m. the next business day in an electronic format using a form of user authentication assigned in accordance with procedures established or approved by the Commission.

(k) Each futures commission merchant shall retain its daily segregation computation and the Statement of Segregation Requirements and Funds in Segregation for Customers Trading on U.S. Commodity Exchanges required by paragraph (c) of this section, and its detailed list of depositories required by paragraph (f) of this section, together with all supporting documentation, in accordance with the requirements of § 1.31 of this part.

17. Revise § 1.52 to read as follows:

§ 1.52 Self-regulatory organization adoption and surveillance of minimum financial requirements.

(a) For purposes of this section, the following terms are defined as follows:

(1) ''Examinations expert'' is defined as a Nationally recognized accounting and auditing firm with substantial expertise in audits of futures commission merchants, risk assessment and internal control reviews, and is an accounting and auditing firm that is acceptable to the Commission;

(2) ''Generally accepted auditing standards'' is defined as U.S. generally accepted auditing standards, developed by the Auditing Standards Board of the American Institute of Certified Public Accountants; and

(3) ''Material weakness'' is defined as a deficiency, or a combination of deficiencies, in internal control over financial reporting such that there is a reasonable possibility that a material misstating of the entities financial statements and regulatory computations will not be prevented or detected on a timely basis by the entity's internal controls;

(b)(1) Each self-regulatory organization must adopt rules prescribing minimum financial and related reporting requirements for members who are registered futures commission merchants, registered retail foreign exchange dealers, or registered introducing brokers. The self-regulatory organization's minimum financial and related reporting requirements must be the same as, or more stringent than, the requirements contained in §§ 1.10 and 1.17 of this part, for futures commission merchants and introducing brokers, and §§ 5.7 and 5.12 of this chapter for retail foreign exchange dealers; *provided, however,* that a self-regulatory organization may permit its member registrants that are registered with the Securities and Exchange Commission as securities brokers or dealers to file (in accordance with § 1.10(h) of this part) a copy of their Financial and Operational Combined Uniform Single Report under the Securities Exchange Act of 1934 (''FOCUS Report''), Part II, Part IIA, or Part II CSE, as applicable, in lieu of Form 1–FR; *provided, further,* that such self-regulatory organization must require such member registrants to provide all information in Form 1–FR that is not included in the FOCUS Report Part provided by such member registrant. The definition of adjusted net capital must be the same as that prescribed in § 1.17(c) of this chapter for futures commission merchants and introducing brokers, and § 5.7(b)(2) of this chapter for futures commission merchants offering or engaging in retail forex transactions and for retail foreign exchange dealers.

(2) In addition to the requirements set forth in paragraph (b)(1) of this section, each self-regulatory organization that has a futures commission merchant member registrant must adopt rules prescribing risk management requirements for futures commission merchant member registrants that shall be the same as, or more stringent than, the requirements contained in § 1.11 of this part.

(c)(1) Each self-regulatory organization must establish and operate a supervisory program that includes written policies and procedures concerning the application of such supervisory program in the examination of its member registrants for the purpose of assessing whether each member registrant is in compliance with the applicable self-regulatory organization and Commission regulations governing minimum net capital and related financial requirements, the obligation to segregate customer funds, risk management requirements, financial reporting requirements, recordkeeping requirements, and sales practice and other compliance requirements. The supervisory program also must address the following elements:

(i) *Adequate levels and independence of examination staff.* A self-regulatory organization must maintain staff of an adequate size, training, and experience to effectively implement a supervisory program. Staff of the self-regulatory organization, including officers, directors, and supervising committee members, must maintain independent judgment and its actions must not impair its independence nor appear to impair its independence in matters related to the supervisory program. The self-regulatory organization must

provide annual ethics training to all staff with responsibilities for the supervisory program.

(ii) *Ongoing surveillance.* A self-regulatory organization's ongoing surveillance of member registrants must include the review and analysis of financial reports and regulatory notices filed by member registrants with the designated self-regulatory organization.

(iii) *High-risk firms.* A self-regulatory organization's supervisory program must include procedures for identifying member registrants that are determined to pose a high degree of potential financial risk, including the potential risk of loss of customer funds. High-risk member registrants must include firms experiencing financial or operational difficulties, failing to meet segregation or net capital requirements, failing to maintain current books and records, or experiencing material inadequacies in internal controls. Enhanced monitoring for high risk firms should include, as appropriate, daily review of net capital, segregation, and secured calculations, to assess compliance with self-regulatory organization and Commission requirements.

(iv) *On-site examinations.* (A) A self-regulatory organization must conduct routine periodic on-site examinations of member registrants. Member futures commission merchants and retail foreign exchange dealers must be subject to on-site examinations no less frequently than once every eighteen months. A self-regulatory organization shall establish a risk-based method of establishing the scope of each on-site examination; *provided, however,* that the scope of each on-site examination of a futures commission merchant or retail foreign exchange dealer must include an assessment of whether the registrant is in compliance with applicable Commission and self-regulatory organization minimum capital, customer fund protection, recordkeeping, and reporting requirements.

(B) A self-regulatory organization must establish the frequency of on-site examinations of member introducing brokers that do not operate pursuant to guarantee agreements with futures commission merchants or retail foreign exchange dealers using a risk-based approach; *provided, however,* that each introducing broker is subject to an on-site examination no less frequently than once every three years.

(C) A self-regulatory organization must conduct on-site examinations of member registrants in accordance with uniform examination programs and procedures that have been submitted to the Commission.

(v) *Adequate documentation.* A self-regulatory organization must adequately document all aspects of the operation of the supervisory program, including the conduct of risk-based scope setting and the risk-based surveillance of high-risk member registrants, and the imposition of remedial and punitive action(s) for material violations.

(2) In addition to the requirements set forth in paragraph (c)(1) of this section, the supervisory program of a self-regulatory organization that has a registered futures commission merchant member must satisfy the following requirements:

(i) The supervisory program must set forth in writing the examination standards that the self-regulatory organization must apply in its examination of its registered futures commission merchant member. The supervisory program must be based on controls testing as well as substantive testing and must address all areas of risk to which futures commission merchants can reasonably be foreseen to be subject. The determination as to which elements of the supervisory program are to be performed on any examination must be based on the risk profile of each registered futures commission merchant member as well as any additional areas of risk to be addressed in such examination.

(ii) All aspects of the supervisory program, including the standards pursuant to paragraph (c)(2)(iii) of this section, must, at minimum, conform to generally accepted auditing standards after giving full consideration to those auditing standards as prescribed by the Public Company Accounting Oversight Board.

(iii) The supervisory program must, at a minimum, have standards addressing the following:

(A) The ethics of an examiner;

(B) The independence of an examiner;

(C) The supervision, review, and quality control of an examiner's work product;

(D) The evidence and documentation to be reviewed and retained in connection with an examination;

(E) The sampling size and techniques used in an examination;

(F) The examination risk assessment process;

(G) The examination planning process;

(H) Materiality assessment;

(I) Quality control procedures to ensure that the examinations maintain the level of quality expected;

(J) Communications between an examiner and the regulatory oversight committee of the self-regulatory organization of which the registered futures commission merchant is a member;

(K) Communications between an examiner and a futures commission merchant's audit committee of the board of directors or other similar governing body;

(L) Analytical review procedures;

(M) Record retention; and

(N) Required items for inclusion in the examination report, such as repeat violations, material items, and high risk issues.

(iv) A self-regulatory organization must cause an examinations expert to evaluate the supervisory program and such self-regulatory organization's application of the supervisory program at least once every two years.

(A) The self-regulatory organization must obtain from such examinations expert a written report that includes the following:

(*1*) An affirmation that the examinations expert has evaluated the supervisory program, including the sufficiency of the risk-based approach and the internal controls testing thereof, and comments and recommendations in connection with such evaluation from such examinations expert;

(*2*) An affirmation that the examinations expert has evaluated the application of the supervisory program by the self-regulatory organization, and comments and recommendations in connection with such evaluation from such examinations expert;

(*3*) The examinations expert's opinion as to whether the supervisory program is reasonably likely to identify a material weakness in internal controls over financial and/or regulatory reporting and in any of the other items that are the subject of an examination conducted in accordance with the supervisory program; and

(*4*) A discussion and recommendation of any new or best practices as prescribed by industry sources, including, but not limited to, those from the American Institute of Certified Public Accountants, the Institute of Internal Auditors, and The Risk Management Association.

(B) The self-regulatory organization must provide the written report to the Commission no later than fifteen days following the receipt thereof. Upon resolution of any questions or comments raised by the Commission, and upon notice from the Commission that it has no further comments or questions on the supervisory program as amended (by reason of the examinations expert's proposals, considerations of the Commission's questions or comments, or otherwise), the self-regulatory organization shall commence applying

such supervisory program as the standard for examining its registered futures commission merchant members.

(v) The supervisory program must require the self-regulatory organization to report to its risk and/or audit committee of the board of directors with timely reports of the activities and findings of the supervisory program to assist the risk and/or audit committee of the board of directors to fulfill its responsibility of overseeing the examination function.

(vi) The initial supervisory program shall be established as follows. Within 120 days following the effective date of this section, or such other time as the Commission may approve, the self-regulatory organization shall submit a proposed supervisory program to the Commission for its review and comment, together with a written report that includes the elements found in paragraphs (c)(2)(iv)(A)(*1*) and (*3*) of this section from an examinations expert who has evaluated the supervisory program. Upon resolution of any questions or comments raised by the Commission, and upon notice from the Commission that it has no further comments or questions on the proposed supervisory program as amended (by reason of the considerations of the Commission's questions or comments or otherwise), the self-regulatory organizations shall commence applying such supervisory program as the standard for examining its members that are registered as futures commission merchants.

(d)(1) Any two or more self-regulatory organizations may file with the Commission a plan for delegating to a designated self-regulatory organization, for any registered futures commission merchant, retail foreign exchange dealer, or introducing broker that is a member of more than one such self-regulatory organization, the function of:

(i) Monitoring and examining for compliance with the minimum financial and related reporting requirements and risk management requirements, including policies and procedures relating to the receipt, holding, investing and disbursement of customer funds, adopted by such self-regulatory organizations and the Commission in accordance with paragraphs (b) and (c) of this section; and

(ii) Receiving the financial reports and notices necessitated by such minimum financial and related reporting requirements; *provided, however,* that the self-regulatory organization that delegates the functions set forth in this paragraph (d)(1) shall remain responsible for its member registrants' compliance with the regulatory obligations, and if such self-regulatory organization becomes aware that a delegated function is not being performed as required under this section, the self-regulatory organization shall promptly take any necessary steps to address any noncompliance.

(2) If a plan established pursuant to paragraph (d)(1) of this section applies to any registered futures commission merchant, then such plan must include the following elements:

(i) *The Joint Audit Committee.* The self-regulatory organizations that choose to participate in the plan shall form a Joint Audit Committee, consisting of all self-regulatory organizations in the plan as members. The members of the Joint Audit Committee shall establish, operate and maintain a Joint Audit Program in accordance with the requirements of this section to ensure an effective and a high quality program for examining futures commission merchants, to designate the designated self-regulatory organizations that will be responsible for the examinations of futures commission merchants pursuant to the Joint Audit Program, and to satisfy such additional obligations set forth in this section in order to facilitate the examinations of futures commission merchants by their respective designated self-regulatory organizations.

(ii) *The Joint Audit Program.* The Joint Audit Program must, at minimum, satisfy the following requirements.

(A) The purpose of the Joint Audit Program must be to assess whether each registered futures commission merchant member of the Joint Audit Committee members is in compliance with the Joint Audit Program and Commission regulations governing minimum net capital and related financial requirements, the obligation to segregate customer funds, risk management requirements, including policies and procedures relating to the receipt, holding, investment, and disbursement of customer funds, financial reporting requirements, recordkeeping requirements, and sales practice and other compliance requirements.

(B) The Joint Audit Program must include written policies and procedures concerning the application of the Joint Audit Program in the examination of the registered futures commission merchant members of the Joint Audit Committee members.

(C)(*1*) *Adequate levels and independence of examination staff.* A designated self-regulatory organization must maintain staff of an adequate size, training, and experience to effectively implement the Joint Audit Program. Staff of the designated self-regulatory organization, including officers, directors, and supervising committee members, must maintain independent judgment and its actions must not impair its independence nor appear to impair its independence in matters related to the Joint Audit Program. The designated self-regulatory organization must provide annual ethics training to all staff with responsibilities for the Joint Audit Program.

(*2*) *Ongoing surveillance.* A designated self-regulatory organization's ongoing surveillance of futures commission merchant member registrants over which it has oversight responsibilities must include the review and analysis of financial reports and regulatory notices filed by such member registrants with the designated self-regulatory organization.

(*3*) *High-risk firms.* The Joint Audit Program must include procedures for identifying futures commission merchant member registrants over which it has oversight responsibilities that are determined to pose a high degree of potential financial risk, including the potential risk of loss of customer funds. High-risk member registrants must include firms experiencing financial or operational difficulties, failing to meet segregation or net capital requirements, failing to maintain current books and records, or experiencing material inadequacies in internal controls. Enhanced monitoring for high risk firms should include, as appropriate, daily review of net capital, segregation, and secured calculations, to assess compliance with self-regulatory and Commission requirements.

(*4*) *On-site examinations.* A designated self-regulatory organization must conduct routine periodic on-site examinations of futures commission merchant member registrants over which it has oversight responsibilities. Such member registrants must be subject to on-site examinations no less frequently than once every eighteen months. A designated self-regulatory organization shall establish a risk-based method of establishing the scope of each on-site examination, *provided, however,* that the scope of each on-site examination of a futures commission merchant must include an assessment of whether the registrant is in compliance with applicable Commission and self-regulatory organization minimum capital, customer fund protection, recordkeeping, and reporting requirements. A designated self-regulatory organization must conduct on-site examinations of futures commission merchant registrants in accordance with the Joint Audit Program.

(D) The Joint Audit Committee members must adequately document all aspects of the operation of the Joint Audit Program, including the conduct of risk-based scope setting and the risk-based surveillance of high-risk member registrants, and the imposition of remedial and punitive action(s) for material violations.

(E) The Joint Audit Program must set forth in writing the examination standards that a designated self-regulatory organization must apply in its examination of a registered futures commission merchant. The Joint Audit Program must be based on controls testing as well as substantive testing and must address all areas of risk to which registered futures commission merchants can reasonably be foreseen to be subject. The determination as to which elements of the Joint Audit Program are to be performed on any examination must be based on the risk profile of each registered futures commission merchant as well as any additional areas of risk to be addressed in such examination.

(F) All aspects of the Joint Audit Program, including the standards required pursuant to paragraph (d)(2)(ii)(G) of this section, must, at minimum, conform to generally accepted auditing standards after full consideration to those auditing standards as prescribed by the Public Company Accounting Oversight Board.

(G) The Joint Audit Program must have standards addressing those items listed in paragraph (c)(2)(iii) of this section.

(H) The initial Joint Audit Program shall be established as follows. Within 120 days following the effective date of this section, or such other time as the Commission may approve, the Joint Audit Committee members shall submit a proposed initial Joint Audit Program to the Commission for its review and comment, together with a written report that includes the elements found in paragraphs (d)(2)(ii)(I)(*1*) and (*3*) of this section from an examinations expert who has evaluated the Joint Audit Program. Upon resolution of any questions or comments raised by the Commission, and upon notice from the Commission that it has no further comments or questions on the proposed Joint Audit Program as amended (by reason of the considerations of the Commission's questions or comments or otherwise), the designated self-regulatory organizations shall commence applying such Joint Audit Program as the standard for examining their respective registered futures commission merchants.

(I) Following the establishment of the Joint Audit Program, no less frequently than once every two years, the Joint Audit Committee members must cause an examinations expert to evaluate the Joint Audit Program and each designated self-regulatory organization's application of the Joint Audit Program. The Joint Audit Committee members must obtain from such examinations expert a written report, and must provide the written report to the Commission no later than forty-five days prior to the annual meeting of the members of the Joint Audit Committee to be held in that year pursuant to paragraph (d)(2)(iii)(A) of this section. The written report must include the following:

(*1*) An affirmation that the examinations expert has evaluated the Joint Audit Program, including the sufficiency of the risk-based approach and the internal controls testing thereof, and comments and recommendations in connection with such evaluation from such examinations expert;

(*2*) An affirmation that the examinations expert has evaluated the application of the Joint Audit Program by each designated self-regulatory organization, and comments and recommendations in connection with such evaluation from such examinations expert;

(*3*) The examinations expert's opinion as to whether the Joint Audit Program is reasonably likely to identify a material deficiency in internal controls over financial and/or regulatory reporting and in any of the other items that are the subject of an examination conducted in accordance with the Joint Audit Program; and

(*4*) A discussion and recommendation of any new or best practices as prescribed by industry sources, including, but not limited to, those from the American Institute of Certified Public Accountants, the Internal Audit Association and The Risk Management Association.

(J) The Joint Audit Program must require each Joint Audit Committee member to report to its risk and/or audit committee of the board of directors with timely reports of the activities and findings of the Joint Audit Program to assist the risk and/or audit committee of the board of directors to fulfill its responsibility of overseeing the examination function.

(iii) *Meetings of the Joint Audit Committee.* (A) No less frequently than once every year, the Joint Audit Committee members must meet to consider whether changes to the Joint Audit Program are appropriate, and in considering such, in meetings corresponding to the biennial written report obtained from an examinations expert pursuant to paragraph (d)(2)(ii)(I) of this section, the Joint Audit Committee members must consider such written report, including the results of the examinations expert's assessment of the Joint Audit Program and any additional recommendations. The Commission's questions, comments and proposals must also be considered. Upon notice from the Commission that it has no further comments or questions on the Joint Audit Program as amended (by reason of the examinations expert's proposals, considerations of the Commission's questions, comments and proposals, or otherwise), the designated self-regulatory organizations shall commence applying such Joint Audit Program as the standard for examining their respective registered futures commission merchants.

(B) In addition to the items considered in paragraph (d)(2)(iii)(A) of this section, the Joint Audit Committee members must consider the following items during the annual meeting:

(*1*) The role of the Joint Audit Committee and its members as it relates to self-regulatory organization responsibilities;

(*2*) Developing and maintaining the Joint Audit Program for all designated self-regulatory organizations to follow with no exceptions;

(*3*) Coordinating self-regulatory organization responsibilities with those of independent certified public accountants, the Commission and other regulators and self-regulatory organizations (*e.g.,* the Securities and Exchange Commission, the Financial Industry Regulatory Authority, and others, as the case may be for futures commission merchants subject to regulation by multiple regulators and self-regulatory organizations);

(*4*) Coordinating and sharing information between the Joint Audit Committee members, including issues and industry concerns in connection with examinations of futures commission merchants;

(*5*) Identifying industry financial and regulatory reporting issues and financial and operational internal control issues and modifying the Joint Audit Program accordingly;

(*6*) Issuing an annual risk alert for futures commission merchants;

(*7*) Issuing an annual examination alert for certified public accountants and designated self-regulatory organization examiners;

(*8*) Responding to industry issues;

(*9*) Providing industry feedback to Commission proposals; and

(*10*) Developing and maintaining a standard of ethics and independence with which all examination units of the Joint Audit Committee members must comply.

(C) Minutes must be taken of all meetings and distributed to all members on a timely basis.

(D) The Commission must receive timely prior notice of each meeting, have to right to attend and participate in each meeting and receive written copies of the reports and minutes required pursuant to paragraphs (d)(2)(ii)(J) and (d)(2)(iii)(C) of this section, respectively.

(3) The plan referenced in paragraph (d)(1) of this section shall not be effective without Commission approval pursuant to paragraph (h) of this section.

(e) Any plan filed under this section may contain provisions for the allocation of expenses reasonably incurred by designated self-regulatory organizations among the self-regulatory organizations participating in such a plan.

(f) A plan's designated self-regulatory organizations must report to:

(1) That plan's other self-regulatory organizations any violation of such other self-regulatory organizations' rules and regulations for which the responsibility to monitor or examine has been delegated to such designated self-regulatory organization under this section; and

(2) The Director of the Division of Swap Dealer and Intermediary Oversight of the Commission any violation of a self-regulatory organization's rules and regulations or any violation of the Commission's regulations for which the responsibility to monitor, audit, or examine has been delegated to such designated self-regulatory organization under this section.

(g) The Joint Audit Committee members may, among themselves, establish programs to provide access to any necessary financial or related information.

(h) After appropriate notice and opportunity for comment, the Commission may, by written notice, approve such a plan, or any part of the plan, if it finds that the plan, or any part of it:

(1) Is necessary or appropriate to serve the public interest;

(2) Is for the protection and in the interest of customers;

(3) Reduces multiple monitoring and multiple examining for compliance with the minimum financial rules of the Commission and of the self-regulatory organizations submitting the plan of any futures commission merchant, retail foreign exchange dealer, or introducing broker that is a member of more than one self-regulatory organization;

(4) Reduces multiple reporting of the financial information necessitated by such minimum financial and related reporting requirements by any futures commission merchant, retail foreign exchange dealer, or introducing broker that is a member of more than one self-regulatory organization;

(5) Fosters cooperation and coordination among the self-regulatory organizations; and

(6) Does not hinder the development of a registered futures association under section 17 of the Act.

(i) After the Commission has approved a plan, or part thereof, under paragraph (h) of this section, a self-regulatory organization delegating the functions described in paragraph (d)(1) of this section must notify each of its members that are subject to such a plan:

(1) Of the limited scope of the delegating self-regulatory organization's responsibility for such a member's compliance with the Commission's and self-regulatory organization's minimum financial and related reporting requirements; and

(2) Of the identity of the designated self-regulatory organization that has been delegated responsibility for such a member; *provided, however,* that the self-regulatory organization that delegates, pursuant to paragraph (d) of this section, the functions set forth in paragraphs (b) and (c) of this section shall remain responsible for its member registrants' compliance with the regulatory obligations, and if such self-regulatory organization becomes aware that a delegated function is not being performed as required under this section, the self-regulatory organization shall promptly take any necessary steps to address any noncompliance.

(j) The Commission may at any time, after appropriate notice and opportunity for hearing, withdraw its approval of any plan, or part thereof, established under this section, if such plan, or part thereof, ceases to adequately effectuate the purposes of section 4f(b) of the Act or of this section.

(k) Whenever a registered futures commission merchant, a registered retail foreign exchange dealer, or a registered introducing broker holding membership in a self-regulatory organization ceases to be a member in good standing of that self-regulatory organization, such self-regulatory organization must, on the same day that event takes place, give electronic notice of that event to the Commission at its Washington, DC, headquarters and send a copy of that notification to such futures commission merchant, retail foreign exchange dealer, or introducing broker.

(l) Nothing in this section shall preclude the Commission from examining any futures commission merchant, retail foreign exchange dealer, or introducing broker for compliance with the minimum financial and related reporting requirements, and the risk management requirements, as applicable, to which such futures commission merchant, retail foreign exchange dealer, or introducing broker is subject.

(m) In the event a plan is not filed and/or approved for each registered futures commission merchant, retail foreign exchange dealer, or introducing broker that is a member of more than one self-regulatory organization, the Commission may design and, after notice and opportunity for comment, approve a plan for those futures commission merchants, retail foreign exchange dealers, or introducing brokers that are not the subject of an approved plan (under paragraph (h) of this section), delegating to a designated self-regulatory organization the responsibilities described in paragraph (d) of this section.

18. Amend § 1.55 by revising paragraphs (b)(2) through (8) and by adding paragraphs (b)(9) through (14), (i), (j), (k), (l), (m), (n), and (o), to read as follows:

§ 1.55 Public disclosures by futures commission merchants

* * * * *

(b) * * *

(2) The funds you deposit with a futures commission merchant for trading futures positions are not protected by insurance in the event of the bankruptcy or insolvency of the futures commission merchant, or in the event your funds are misappropriated due to fraud.

(3) The funds you deposit with a futures commission merchant for trading futures positions are not protected by the Securities Investor Protection Corporation even if the futures commission merchant is registered with the Securities and Exchange Commission as a broker or dealer.

(4) The funds you deposit with a futures commission merchant are not guaranteed or insured by a derivatives clearing organization in the event of the bankruptcy or insolvency of the futures commission merchant, or if the futures commission merchant is otherwise unable to refund your funds.

(5) The funds you deposit with a futures commission merchant are not held by the futures commission

merchant in a separate account for your individual benefit. Futures commission merchants commingle the funds received from customers in one or more accounts and you may be exposed to losses incurred by other customers if the futures commission merchant does not have sufficient capital to cover such other customers' trading losses.

(6) The funds you deposit with a futures commission merchant may be invested by the futures commission merchant in certain types of financial instruments that have been approved by the Commission for the purpose of such investments. Permitted investments are listed in Commission Regulation 1.25 and include: U.S. government securities; municipal securities; money market mutual funds; and certain corporate notes and bonds. The futures commission merchant may retain the interest and other earnings realized from its investment of customer funds. You should be familiar with the types of financial instruments that a futures commission merchant may invest customer funds in.

(7) Futures commission merchants are permitted to deposit customer funds with affiliated entities, such as affiliated banks, securities brokers or dealers, or foreign brokers. You should inquire as to whether your futures commission merchant deposits funds with affiliates and assess whether such deposits by the futures commission merchant with its affiliates increases the risks to your funds.

(8) You should consult your futures commission merchant concerning the nature of the protections available to safeguard funds or property deposited for your account.

(9) Under certain market conditions, you may find it difficult or impossible to liquidate a position. This can occur, for example, when the market reaches a daily price fluctuation limit (''limit move'').

(10) All futures positions involve risk, and a ''spread'' position may not be less risky than an outright ''long'' or ''short'' position.

(11) The high degree of leverage (gearing) that is often obtainable in futures trading because of the small margin requirements can work against you as well as for you. Leverage (gearing) can lead to large losses as well as gains.

(12) In addition to the risks noted in the paragraphs enumerated above, you should be familiar with the futures commission merchant you select to entrust your funds for trading futures positions. The Commodity Futures Trading Commission requires each futures commission merchant to make publicly available on its Web site firm specific disclosures and financial information to assist you with your assessment and selection of a futures commission merchant. Information regarding this futures commission merchant may be obtained by visiting our Web site, *www.[Web site address].*

ALL OF THE POINTS NOTED ABOVE APPLY TO ALL FUTURES TRADING WHETHER FOREIGN OR DOMESTIC. IN ADDITION, IF YOU ARE CONTEMPLATING TRADING FOREIGN FUTURES OR OPTIONS CONTRACTS, YOU SHOULD BE AWARE OF THE FOLLOWING ADDITIONAL RISKS:

(13) Foreign futures transactions involve executing and clearing trades on a foreign exchange. This is the case even if the foreign exchange is formally ''linked'' to a domestic exchange, whereby a trade executed on one exchange liquidates or establishes a position on the other exchange. No domestic organization regulates the activities of a foreign exchange, including the execution, delivery, and clearing of transactions on such an exchange, and no domestic regulator has the power to compel enforcement of the rules of the foreign exchange or the laws of the foreign country. Moreover, such laws or regulations will vary depending on the foreign country in which the transaction occurs. For these reasons, customers who trade on foreign exchanges may not be afforded certain of the protections which apply to domestic transactions, including the right to use domestic alternative dispute resolution procedures. In particular, funds received from customers to margin foreign futures transactions may not be provided the same protections as funds received to margin futures transactions on domestic exchanges. Before you trade, you should familiarize yourself with the foreign rules which will apply to your particular transaction.

(14) Finally, you should be aware that the price of any foreign futures or option contract and, therefore, the potential profit and loss resulting therefrom, may be affected by any fluctuation in the foreign exchange rate between the time the order is placed and the foreign futures contract is liquidated or the foreign option contract is liquidated or exercised.

THIS BRIEF STATEMENT CANNOT, OF COURSE, DISCLOSE ALL THE RISKS AND OTHER ASPECTS OF THE COMMODITY MARKETS

I hereby acknowledge that I have received and understood this risk disclosure statement.

_____

Date

_____

Signature of Customer

* * * * *

(i) Notwithstanding any other provision of this section, no futures commission merchant may enter into a customer account agreement or first accept funds from a customer, unless the futures commission merchant discloses to the customer all information about the futures commission merchant, including its business, operations, risk profile, and affiliates, that would be material to the customer's decision to entrust such funds to and otherwise do business with the futures commission merchant and that is otherwise necessary for full and fair disclosure. In connection with the disclosure of such information, the futures commission merchant shall provide material information about the topics described in paragraph (k) of this section, expanding upon such information as necessary to keep such disclosure from being misleading, whether through omission or otherwise. The futures commission merchant shall also disclose the same information required by this paragraph to all customers existing on the effective date of this paragraph even if the futures commission merchant and such existing customers have previously entered into a customer account agreement or the futures commission merchant has already accepted funds from such existing customers. The futures commission merchant shall update the information required by this section as and when necessary, but at least annually, to keep such information accurate and complete and shall promptly disclose such updated information to all of its customers. In connection with such obligation to update information, the futures commission merchant shall take into account any material change to its business operation, financial condition and other factors material to the customer's decision to entrust the customer's funds and otherwise do business with the futures commission merchant since its most recent disclosure pursuant to this paragraph, and for this purpose shall without limitation consider events that require periodic reporting required to be filed pursuant to § 1.12 of this part. For purposes of this section, the disclosures required pursuant to this paragraph (i) will be referred to as the ''Disclosure Documents.'' The Disclosure Documents shall provide a detailed table of contents referencing and describing the Disclosure Documents.

(j)(1) Each futures commission merchant shall make the Disclosure Documents available to each customer to whom disclosure is required pursuant to paragraph (i) of this section (for purposes of this section, its ''FCM Customers'') and to the general public.

(2) A futures commission merchant shall make the Disclosure Documents available to FCM Customers and to the general public by posting a copy of the Disclosure Documents on the futures commission merchant's Web site. A futures commission merchant, *however,* may use an electronic means other than its Web site to make the Disclosure Documents available to its FCM Customers; *provided* that:

(i) The electronic version of the Disclosure Documents shall be presented in a format that is readily communicated to the FCM Customers. Information is readily communicated to the FCM Customers if it is accessible to the ordinary computer user by means of commonly available hardware and software and if the electronically delivered document is organized in substantially the same manner as would be required for a paper document with respect to the order of presentation and the relative prominence of information; and

(ii) A complete paper copy of the Disclosure Documents shall be provided to an FCM Customer upon request.

(k) *Specific Topics.* The futures commission merchant shall provide material information about the following specific topics:

(1) The futures commission merchant's name, address of its principal place of business, phone number, fax number, and email address;

(2) The names and business addresses of the futures commission merchant's directors and senior management, including titles, business background, areas of responsibility, and the nature of duties of each;

(3) The significant types of business activities and product lines engaged in by the futures commission merchant, and the approximate percentage of the futures commission merchant's assets and capital that are used in each type of activity;

(4) The futures commission merchant's business on behalf of its customers, including types of accounts, markets traded, international businesses, and clearinghouses and carrying brokers used, and the futures commission merchant's policies and procedures concerning the choice of bank depositories, custodians, and other counterparties;

(5) The material risks, accompanied by an explanation of how such risks may be material to its customers, of entrusting funds to the futures commission merchant, including, without limitation, the nature of investments made by the futures commission merchant (including credit quality, weighted average maturity, and weighted average coupon); the futures commission merchant's creditworthiness, leverage, capital, liquidity, principal liabilities, balance sheet leverage and other lines of business; risks to the futures commission merchant created by its affiliates and their activities, including investment of customer funds in an affiliated entity; and any significant liabilities, contingent or otherwise, and material commitments;

(6) The name of the futures commission merchant's designated self-regulatory organization and its Web site address and the location where the annual audited financial statements of the futures commission merchant is made available;

(7) Any material administrative, civil, enforcement, or criminal action then pending, and any enforcement actions taken in last three years;

(8) A basic overview of customer fund segregation, futures commission merchant collateral management and investments, futures commission merchants, and joint futures commission merchant/broker dealers;

(9) Information on how a customer may obtain information regarding filing a complaint about the futures commission merchant with the Commission or with the firm's designated self-regulatory organization: and

(10) The following financial data as of the most recent month-end when the Disclosure Document is prepared:

(i) The futures commission merchant's total equity, regulatory capital, and net worth, all computed in accordance with U.S. Generally Accepted Accounting Principles and § 1.17 of this part, as applicable;

(ii) The dollar value of the futures commission merchant's proprietary margin requirements as a percentage of the aggregate margin requirement for futures customers, Cleared Swaps Customers, and 30.7 Customers;

(iii) The number of futures customers, Cleared Swaps Customers, and 30.7 Customers that comprise 50 percent of the futures commission merchant's total funds held for futures customers, Cleared Swaps Customers, and 30.7 Customers, respectively;

(iv) The aggregate notional value, by asset class, of all non-hedged, principal over-the-counter transactions into which the futures commission merchant has entered;

(v) The amount, generic source and purpose of any unsecured lines of credit (or similar short-term funding) the futures commission merchant has obtained but not yet drawn upon;

(vi) The aggregated amount of financing the futures commission merchant provides for customer transactions involving illiquid financial products for which it is difficult to obtain timely and accurate prices; and

(vii) The percentage of futures customer, Cleared Swaps Customer, and 30.7 Customer receivable balances that the futures commission merchant had to write-off as uncollectable during the past 12-month period, as compared to the current balance of funds held for futures customers, Cleared Swaps Customers, and 30.7 Customers; and

(11) A summary of the futures commission merchant's current risk practices, controls and procedures.

(l) In addition to the foregoing, each futures commission merchant shall adopt policies and procedures reasonably designed to ensure that advertising and solicitation activities by each such futures commission merchant and any introducing brokers associated with such futures commission merchant are not misleading to its FCM Customers in connection with their decision to entrust funds to and otherwise do business with such futures commission merchant.

(m) The Disclosure Document required by paragraph (i) of this section is in addition to the Risk Disclosure Statement required under paragraph (a) of this section.

(n) All Disclosure Documents, with each Disclosure Document dated the date of first use, shall be maintained in accordance with § 1.31 and shall be made available promptly upon request to representatives of its designated self-regulatory organization, representatives of the Commission, and representatives of applicable prudential regulators.

(o)(1) Each futures commission merchant shall make the following financial information publicly available on its Web site:

(i) The daily Statement of Segregation Requirements and Funds in Segregation for Customers Trading on U.S. Exchanges for the most current 12-month period;

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

(iii) The daily Statement of Cleared Swaps Customer Segregation Requirements and Funds in Cleared

Swaps Customer Accounts Under Section 4d(f) of the Act for the most current 12-month period;

(iv) A summary schedule of the futures commission merchant's adjusted net capital, net capital, and excess net capital, all computed in accordance with § 1.17 of this part and reflecting balances as of the month-end for the 12 most recent months; and

(v) The Statement of Financial Condition, the Statement of Segregation Requirements and Funds in Segregation for Customers Trading on U.S. Exchanges, the Statement of Secured Amounts and Funds Held in Separate Accounts for 30.7 Customers Pursuant to Commission Regulation 30.7, the Statement of Cleared Swaps Customer Segregation Requirements and Funds in Cleared Swaps Customer Accounts Under Section 4d(f) of the Act, an all related footnotes to the above schedules that are part of the futures commission merchant's most current certified annual report pursuant to § 1.16 of this part.

(2) Each futures commission merchant must include a statement on its Web site that is available to the public that financial information regarding the futures commission merchant, including how the futures commission merchant invests and holds customer funds, may be obtained from the National Futures Association and include a link to the Web site of the National Futures Association's Basic System where information regarding the futures commission merchant's investment of customer funds is maintained.

(3) Each futures commission merchant must include a statement on its Web site that is available to the public that additional financial information on all futures commission merchants is available from the Commodity Futures Trading Commission, and include a link to the Commodity Futures Trading Commission's web page for financial data for futures commission merchants.

PART 3—REGISTRATION

19. The authority citation for part 3 continues to read as follows:

Authority: 5 U.S.C. 552, 552b; 7 U.S.C. 1a, 2, 6a, 6b, 6b–1, 6c, 6d, 6e, 6f, 6g, 6h, 6i, 6k, 6m, 6n, 6o, 6p, 6s, 8, 9, 9a, 12, 12a, 13b, 13c, 16a, 18, 19, 21, and 23, as amended by Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. 111–203, 124 Stat. 1376 (Jul. 21, 2010).

20. Amend § 3.3 by revising paragraph (f)(2) to read as follows:

§ 3.3 Chief compliance officer.

* * * * *

(f) * * *

(2) The annual report shall be furnished electronically to the Commission not more than 60 days after the end of the fiscal year of the futures commission merchant, swap dealer, or major swap participant, simultaneously with the submission of Form 1–FR–FCM, as required under § 1.10(b)(2)(ii) of this chapter, simultaneously with the Financial and Operational Combined Uniform Single Report, as required under § 1.10(h) of this chapter, or simultaneously with the financial condition report, as required under section 4s(f) of the Act, as applicable.

* * * * *

PART 22—CLEARED SWAPS

21. The authority citation for part 22 continues to read as follows:

Authority: 7 U.S.C. 1a, 6d, 7a–1 as amended by Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. 111–203, 124 Stat. 1376 (Jul. 21, 2010).

22. Amend § 22.2 by revising paragraphs (d)(1), (e)(1), (f)(2), (f)(4), (f)(5)(iii)(B), and (g)(2), and by adding paragraphs (f)(6) and (g)(3) through (10) to read as follows:

§ 22.2 Futures Commission Merchants: Treatment of Cleared Swaps and Associated Cleared Swap Customer Collateral.

* * * * *

(d) *Limitations on use.* (1) No futures commission merchant shall use, or permit the use of, the Cleared Swaps Customer Collateral of one Cleared Swaps Customer to purchase, margin, or settle the Cleared Swaps or any other trade or contract of, or to secure or extend the credit of, any person other than such Cleared Swaps Customer. Cleared Swaps Customer Collateral shall not be used to margin, guarantee, or secure trades or contracts of the entity constituting a Cleared Swaps Customer other than in Cleared Swaps, except to the extent permitted by a Commission rule, regulation or order. For this purpose, a futures commission merchant which operationally commingles the funds of its Cleared Swaps Customers must ensure that at all times its residual interest in Cleared Swaps Customer Accounts exceeds the sum of the margin deficits of all of its Cleared Swaps Customers.

* * * * *

(e) * * *

(1) *Permitted investments.* A futures commission merchant may invest money, securities, or other property constituting Cleared Swaps Customer Collateral in accordance with § 1.25 of this chapter, which shall apply to such money, securities, or other property as if they comprised customer funds or customer money subject to segregation pursuant to section 4d(a) of the Act and the regulations thereunder; *Provided, however,* that the futures commission merchant shall bear sole responsibility for any losses resulting from the investment of customer funds in instruments described in § 1.25 of this chapter. No investment losses shall be borne or otherwise allocated to Cleared Swaps Customers of the futures commission merchant.

* * * * *

(f) * * *

(2) The futures commission merchant must reflect in the account that it maintains for each Cleared Swaps Customer the market value of any Cleared Swaps Customer Collateral that it receives from such customer, as adjusted by:

(i) Any uses permitted under § 22.2(d) of this part;

(ii) Any accruals on permitted investments of such collateral under § 22.2(e) of this part that, pursuant to the futures commission merchant's customer agreement with that customer, are creditable to such customer;

(iii) Any gains and losses with respect to Cleared Swaps;

(iv) Any charges lawfully accruing to the Cleared Swaps Customer, including any commission, brokerage fee, interest, tax, or storage fee; and

(v) Any appropriately authorized distribution or transfer of such collateral.

* * * * *

(4) The futures commission merchant must, at all times, maintain in segregation, in its FCM Physical Locations and/or its Cleared Swaps Customer Accounts at Permitted Depositories, an amount equal to the sum of any credit balances that the Cleared Swaps Customers of the futures commission merchant have in their accounts, excluding from such sum any debit balances that the Cleared Swaps Customers of the futures commission merchant have in their accounts.

(5) * * *

(iii) * * *

(B) Reduce such market value by applicable percentage deductions (*i.e.,* ''securities haircuts'') as set forth in Rule 15c3–1(c)(2)(vi) of the Securities and Exchange Commission (§ 240.15c3–1(c)(2)(vi) of this title). Futures commission merchants that establish and enforce written policies and procedures to assess the credit risk of commercial paper, convertible debt instruments, or nonconvertible debt instruments in accordance with Rule

240.15c3–1(c)(2)(vi) of the Securities and Exchange Commission (17 CFR 240.15c3–1(c)(2)(vi)) may apply the lower haircut percentages specified in Rule 240.15c3–1(c)(2)(vi) for such commercial paper, convertible debt instruments and nonconvertible debt instruments. The portion of the debit balance, not exceeding 100 percent, that is secured by the reduced market value of such readily marketable securities shall be included in calculating the sum referred to in paragraph (f)(4) of this section.

(6) The FCM must reflect in the account it maintains for each Cleared Swaps Customer the amount of collateral required for the Cleared Swaps Customer's Cleared Swaps at each derivatives clearing organization on which the futures commission merchant is a member, or by each other futures commission merchant through which the futures commission merchant clears Cleared Swaps, and the total of such required collateral amounts. If the value of the Cleared Swaps Customer Collateral, as calculated in this section, for a Cleared Swaps Customer is less than the total amount of collateral required for that Cleared Swaps Customer's Cleared Swaps at such derivatives clearing organizations and such other futures commission merchants, the difference is a margin deficit. The futures commission merchant must at all times maintain a residual interest in Cleared Swaps Customer Accounts sufficient to exceed the sum of all margin deficits that Cleared Swaps Customers of the futures commission merchant have in their accounts. Such residual interest may not be withdrawn pursuant to any provision of this chapter.

(g) * * *

(2) Each futures commission merchant is required to document its segregation computation required by paragraph (g)(1) of this section by preparing a Statement of Cleared Swaps Customer Segregation Requirements and Funds in Cleared Swaps Customer Accounts Under 4d(f) of the CEA contained in the Form 1–FR–FCM as of the close of business each business day.

(3) Each futures commission merchant is required to submit to the Commission and to the firm's designated self-regulatory organization the daily Statement of Cleared Swaps Customer Segregation Requirements and Funds in Cleared Swaps Customer Accounts Under 4d(f) of the CEA required by paragraph (g)(2) of this section by noon the following business day.

(4) Each futures commission merchant shall file the Statement of Cleared Swaps Customer Segregation Requirements and Funds in Cleared Swaps Customer Accounts Under 4d(f) of the CEA required by paragraph (g)(2) of this section in an electronic format using a form of user authentication assigned in accordance with procedures established or approved by the Commission.

(5) Each futures commission merchant is required to submit to the Commission and to the firm's designated self-regulatory organization a report listing of the names of all banks, trust companies, futures commission merchants, derivatives clearing organizations, or any other depository or custodian holding Cleared Swaps Customer Collateral as of the fifteenth day of the month, or the first business day thereafter, and the last business day of each month. This report must include:

(i) The name and location of each entity holding Cleared Swaps Customer Collateral;

(ii) The total amount of Cleared Swaps Customer Collateral held by each entity listed in this paragraph (g)(5); and

(iii) The total amount of cash and investments that each entity listed in this paragraph (g)(5) holds for the futures commission merchant. The futures commission merchant must report the following investments:

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

(B) General obligations of any State or of any political subdivision of a State (municipal securities);

(C) General obligation issued by any enterprise sponsored by the United States (government sponsored enterprise securities);

(D) Certificates of deposit issued by a bank;

(E) 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;

(F) 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; and

(G) Interests in money market mutual funds.

(6) Each futures commission merchant must report the total amount of customer owned securities held by the futures commission merchant as Cleared Swaps Customer Collateral and must list the names and locations of the depositories holding customer owned securities.

(7) Each futures commission merchant must report the total amount of Cleared Swaps Customer Collateral that has been used to purchase securities under agreements to resell the securities (reverse repurchase transactions).

(8) Each futures commission merchant must report which, if any, of the depositories holding Cleared Swaps Customer Collateral under paragraph (g)(5) of this section are affiliated with the futures commission merchant.

(9) Each futures commission merchant shall file the detailed list of depositories required by paragraph (g)(5) of this section by 11:59 p.m. the next business day in an electronic format using a form of user authentication assigned in accordance with procedures established or approved by the Commission.

(10) Each futures commission merchant shall retain its daily segregation computation and the Statement of Cleared Swaps Customer Segregation Requirements and Funds in Cleared Swaps Customer Accounts under section 4d(f) of the CEA required by paragraph (g)(2) of this section and the detailed listing of depositories required by paragraph (g)(5) of this section, together with all supporting documentation, in accordance with § 1.31 of this chapter.

23. Add § 22.17 to read as follows:

§ 22.17 Policies and procedures governing disbursements of Cleared Swaps Customer Collateral from Cleared Swaps Customer Accounts.

(a) The provision in section 4d(f)(2) of the Act that prohibits the commingling of Cleared Swaps Customer Collateral with the funds of a futures commission merchant, shall not be construed to prevent a futures commission merchant from having a residual financial interest in the funds segregated as required by the Act and the regulations in this part and set apart for the benefit of Cleared Swaps Customers; nor shall such provisions be construed to prevent a futures commission merchant from adding to such segregated funds such amount or amounts of money, from its own funds or unencumbered securities from its own inventory, of the type set forth in § 1.25 of this chapter, as it may deem necessary to ensure any and all Cleared Swaps Customer Accounts are not undersegregated at any time.

(b) A futures commission merchant may not withdraw funds on any business day for its own proprietary use from a Cleared Swaps Customer Account unless the futures commission merchant has prepared the daily segregation calculation required by § 22.2 of this part as of the close of business on the previous business day.

A futures commission merchant that has completed its daily segregation calculation may make withdrawals for its own use, to the extent of its actual residual financial interest in funds held in segregated accounts, including the withdrawal of securities held in segregated safekeeping accounts held by a bank, trust company, derivatives clearing organization or other futures commission merchant. Such withdrawal(s) shall not result in the funds of one Cleared Swaps Customer being used to purchase, margin or carry the trades, contracts or swaps positions, or extend the credit of any other Cleared Swaps Customer or other person. Notwithstanding any other provision of this chapter, a futures commission merchant must at all times maintain an amount of residual interest in Cleared Swaps Customer Accounts for the benefit of Cleared Swaps Customers that exceeds the sum of all Cleared Swaps Customers' margin deficits and such residual interest may not be withdrawn by the futures commission merchant.

(c) A futures commission merchant may not withdraw funds for its own proprietary use, in a single transaction or a series of transactions on a given business day, from Cleared Swaps Customer Accounts if such withdrawal(s) would exceed 25 percent of the futures commission merchant's residual interest in such accounts as reported on the daily segregation calculation required by § 22.2 of this part and computed as of the close of business on the previous business day, unless:

(1) The futures commission merchant's Chief Executive Officer, Chief Finance Officer or other senior official that is listed as a principal of the futures commission merchant on its Form 7–R and is knowledgeable about the futures commission merchant's financial requirements and financial position pre-approves in writing the withdrawal, or series of withdrawals;

(2) The futures commission merchant files written notice of the withdrawal or series of withdrawals, with the Commission and with its designated self-regulatory organization immediately after the Chief Executive Officer, Chief Finance Officer or other senior official pre-approves the withdrawal or series of withdrawals. The written notice must:

(i) Be signed by the Chief Executive Officer, Chief Finance Officer or other senior official that pre-approved the withdrawal, and give notice that the futures commission merchant has withdrawn or intends to withdraw more than 25 percent of its residual interest in such accounts holding Cleared Swaps Customer Accounts funds;

(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 the name of each recipient;

(iv) Include the current estimate of the amount of the futures commission merchant's residual interest in the swaps customer funds after the withdrawal;

(v) Contain a representation by the Chief Executive Officer, Chief Finance Officer or other senior official that pre-approved the withdrawal, or series of withdrawals, that, after due diligence, to such person's knowledge and reasonable belief, the futures commission merchant remains in compliance with the segregation requirements after the withdrawal. The Chief Executive Officer, Chief Finance Officer or other senior official must consider the daily segregation calculation as of the close of business on the previous business day and any other factors that may cause a material change in the futures commission's residual interest since the close of business the previous business day, including known unsecured customer debits or deficits, current day market activity and any other withdrawals made from the Cleared Swaps Customer Accounts; and

(vi) Any such written notice filed with the Commission must be filed via electronic transmission using a form of user authentication assigned in accordance with procedures established by or approved by the Commission, and otherwise in accordance with instruction issued by or approved by the Commission. Any such electronic submission must clearly indicate the registrant on whose behalf such filing is made and the use of such user authentication in submitting such filing will constitute and become a substitute for the manual signature of the authorized signer. Any written notice filed must be followed up with direct communication to the Regional office of Commission which has supervisory authority over the futures commission merchant whereby the Commission acknowledges receipt of the notice; and

(3) After making a withdrawal requiring the approval and notice required in paragraphs (c)(1) and (2) of this section, and before the next daily segregated funds calculation, no futures commission merchant may make any further withdrawals from accounts holding Cleared Swaps Customer Account funds, except to or for the benefit of Cleared Swaps Customers, without complying with paragraph (c)(1) of this section and filing a written notice with the Commission under (c)(2)(vi) of this section and its designated self-regulatory organization signed by the Chief Executive Officer, Chief Finance Officer, or other senior official. The written notice must:

(i) List the amount of funds provided to each recipient and each recipient's name;

(ii) Disclose the reason for each withdrawal;

(iii) Confirm that the Chief Executive Officer, Chief Finance Officer, or other senior official (and identify of the person if different from the person who signed the notice) pre-approved the withdrawal in writing;

(iv) Disclose the current estimate of the futures commission merchant's remaining total residual interest in the segregated accounts holding Cleared Swaps Customer Account funds after the withdrawal; and

(v) Include a representation that to the best of the notice signatory's knowledge and reasonable belief the futures commission merchant remains in compliance with the segregation requirements after the withdrawal.

(d) If a futures commission merchant withdraws funds from Cleared Swaps Customer Accounts for its own proprietary use, and the withdrawal causes the futures commission merchant to not hold sufficient funds in Cleared Swaps Customer Accounts to meet its targeted residual interest, as required to be computed under § 1.11 of this chapter, the futures commission merchant must deposit its own funds into the Cleared Swaps Customer Accounts to restore the targeted amount of residual interest on the next business day, or, if appropriate, revise the futures commission merchant's targeted amount of residual interest pursuant to the policies and procedures required by § 1.11 of this chapter. Notwithstanding the foregoing, if at any time the futures commission merchant's residual interest in Cleared Swaps Customer Accounts is less than the sum of its Cleared Swaps Customers' margin deficits, the futures commission merchant must immediately restore the residual interest to exceed the sum of such margin deficits. Any proprietary funds deposited in Cleared Swaps Customer Accounts must be unencumbered and otherwise compliant with § 1.25 of this chapter, as applicable.

(e) Notwithstanding any other provision of this part, a futures commission merchant may not withdraw funds for its own proprietary use from a Cleared Swaps Customer Account unless the futures commission merchant follows its policies and procedures required by § 1.11 of this chapter.

PART 30—FOREIGN FUTURES AND FOREIGN OPTIONS TRANSACTIONS

24. The authority citation for part 30 continues to read as follows:

Authority: 7 U.S.C. 1a, 2, 4, 6, 6c, and 12a, as amended by Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. 111–203, 124 Stat. 1376 (Jul. 21, 2010).

25. Amend § 30.1 by adding paragraphs (f), (g), and (h) to read as follows:

§ 30.1 Definitions.

* * * * *

(f) *30.7 Customer* means any foreign futures or foreign options customer as defined in paragraph (c) of this section as well as any foreign-domiciled person who trades in foreign futures or foreign options through a futures commission merchant; *Provided, however,* that an owner or holder of a proprietary account as defined in paragraph (y) of § 1.3 of this chapter shall not be deemed to be a 30.7 customer.

(g) *30.7 Account* means any account maintained by a futures commission merchant 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.

(h) *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.

26. Revise § 30.7 to read as follows:

§ 30.7 Treatment of foreign futures or foreign options secured amount.

(a) *General.* Except as provided in this section, a futures commission merchant must at all times maintain in a separate account or accounts money, securities and property in an amount at least sufficient to cover or satisfy all of its obligations to 30.7 Customers denominated as the foreign futures or foreign options secured amount. In computing the foreign futures or foreign options secured amount, a futures commission merchant may offset any net deficit in a particular 30.7 Customer's Account against the current market value of readily marketable securities held for the same particular 30.7 Customer's Account as provided for in paragraph (l) of this section. The amount that must be deposited in such separate account or accounts for 30.7 Customers must be no less than the amount required to be held in a separate account or accounts for or on behalf of 30.7 Customers pursuant to any law, or rule, regulation or order thereunder, or any rule of any self-regulatory organization authorized thereunder, in the jurisdiction in which the depository or the 30.7 Customer, as appropriate, is located. In addition, the futures commission merchant must at all times maintain residual interest in separate accounts for 30.7 Customers sufficient to exceed the sum of all margin deficits that the 30.7 Customers of the futures commission merchant have in their 30.7 Accounts. Such residual interest may not be withdrawn pursuant to any provision of this section. If the value of a 30.7 Customer's Funds for a 30.7 Account is less than the total amount of collateral required for that 30.7 Customer's 30.7 Account for foreign futures or foreign options, the difference is a margin deficit.

(b) *Location of 30.7 Customer Funds.* A futures commission merchant shall deposit the foreign futures or foreign options secured amount under an account name that clearly identifies the funds as belonging to 30.7 Customers and shows that the foreign futures or foreign options secured amount is set aside as required by this part. A futures commission merchant may deposit funds set aside as the foreign futures or foreign options secured amount with the following depositories:

(1) A bank or trust company located in the United States;

(2) A bank or trust company located outside the United States that has in excess of $1 billion of regulatory capital;

(3) A futures commission merchant registered as such with the Commission;

(4) A derivatives clearing organization;

(5) The clearing organization of any foreign board of trade;

(6) A member of any foreign board of trade; or

(7) Such member's or clearing organization's designated depositories.

(c) *Limitation on holding foreign futures or foreign options secured amount outside of the United States.* A futures commission merchant may not deposit or hold the foreign futures or foreign options secured amount in accounts maintained outside of the United States with any of the depositories listed in paragraph (b) of this section except to meet margin requirements, including prefunding margin requirements, established by rule, regulation, or order of foreign boards of trade or foreign clearing organizations, or to meet margin calls issued by foreign brokers carrying the 30.7 Customers' foreign futures and foreign option positions; *Provided, however,* that a futures commission merchant may deposit an additional amount of up to 10 percent of the total amount of funds necessary to meet margin and prefunding margin requirements to avoid daily transfers of funds between the futures commission merchant's 30.7 Accounts maintained in the United States and those maintained outside of the United States. 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.

(d) *Written acknowledgment from depositories.* (1) Each futures commission merchant must obtain a written acknowledgment from each depository as set out in Appendix E to this part in accordance with the requirements of this part; *Provided, however,* that an acknowledgment need not be obtained from a derivatives clearing organization that has adopted and submitted to the Commission rules that provide for the separate holding of the foreign futures or foreign options secured amount, in accordance with all relevant provisions of the Act, this part and the regulations and orders promulgated thereunder, of all funds held on behalf of 30.7 Customers and all instruments purchased with funds set aside as the foreign futures or foreign options secured amount as provided for under paragraph (i) of this section.

(2) The written acknowledgment must be in the form as set out in Appendix E to this part: *Provided, however,* that if the futures commission merchant invests funds set aside as the foreign futures or foreign options secured amount in money market mutual funds as a permitted investment under paragraph (i) of this section and in accordance with the terms and conditions of § 1.25(c) of this chapter, the written acknowledgment with respect to such investment must be in the form as set out in Appendix F to this part.

(3) A futures commission merchant may deposit 30.7 Customer Funds only with a depository that provides the Commission and the futures commission merchant's designated self-regulatory organization with direct, read-only access to account information on 24-hour a day basis. The Commission and the futures commission merchant's designated self-regulatory organization must receive the direct access when the account is opened. The written acknowledgment must contain the

futures commission merchant's authorization to the depository to provide direct and immediate account access to the Commission and the futures commission merchant's designated self-regulatory organization.

(4) A futures commission merchant may deposit 30.7 Customer Funds only with a depository that agrees to provide the Commission and the futures commission merchant's designated self-regulatory organization with a copy of the executed written acknowledgment within three business days of the opening of the account. The Commission must receive the written acknowledgment from the depository via electronic mail at *acknowledgmentletters@cftc.gov.* The written acknowledgment must contain the futures commission merchant's authorization to the depository to provide the written acknowledgment to the Commission and to the futures commission merchant's designated self-regulatory organization without further notice to or consent from the futures commission merchant.

(5) A futures commission merchant may deposit 30.7 Customer Funds only with a depository that agrees to reply promptly and directly to the Commission's or to the futures commission merchant's designated self-regulatory organization's requests for confirmation of account balances or other account information without further notice to or consent from the futures commission merchant. The written acknowledgment must contain the futures commission merchant's authorization to the depository to respond directly and immediately to requests from the Commission or the futures commission merchant's designated self-regulatory organization for confirmation of account balances and other account information without further notice to or consent from the futures commission merchant.

(6) The futures commission merchant shall promptly file a copy of the written acknowledgment with the Commission in the manner specified by the Commission and in no event later than the later of:

(i) The effective date of this rule; or

(ii) Three business days after the account is opened.

(7) The futures commission merchant shall amend the written acknowledgment and promptly file the amended written acknowledgment with the Commission within 120 days of any changes in the following:

(i) The name or business address of the futures commission merchant;

(ii) The name or business address of the depository; or

(iii) The account number(s) under which the foreign futures or foreign options secured amount are held.

(8) Each futures commission merchant must maintain each written acknowledgment readily accessible in its files in accordance with § 1.31 of this chapter, for as long as the account remains open, and thereafter for the period provided in § 1.31 of this chapter.

(e) *Commingling.* (1) A futures commission merchant may commingle the funds set aside as the foreign futures or foreign options secured amount that it receives from, or on behalf of, multiple 30.7 Customers in a single account or multiple accounts with one or more of the depositories listed in paragraph (b) of this section.

(2) A futures commission merchant may not commingle the funds set aside as the foreign futures or foreign options secured amount held for 30.7 Customers with the money, securities or property of such futures commission merchant, with any proprietary account of such futures commission merchant, or use such funds to secure or guarantee the obligations of, or extend credit to, such futures commission merchant or any proprietary account of such futures commission merchant; *Provided, however,* a futures commission merchant may deposit proprietary funds into 30.7 Customer Accounts as permitted under paragraph (g) of this section.

(3) A futures commission merchant may not commingle funds held for 30.7 Customers with funds deposited by futures customers as defined in § 1.3 of this chapter and held in account segregated pursuant to Section 4d(a) and 4d(b) of the Act or with funds deposited by Cleared Swap Customers as defined under § 22.1 of this chapter and held in segregated accounts pursuant to Section 4d(f) of the Act, or with funds of any account holders of the futures commission merchant unrelated to trading foreign futures or foreign options; *Provided, however,* that a futures commission merchant may commingle 30.7 Customer funds with funds deposited by futures customers or Cleared Swaps Customers pursuant to the terms of a Commission regulation or order authorizing such commingling.

(f) *Limitations on use of 30.7 Customer Funds.* (1) A futures commission merchant shall not use, or permit the use of, the funds of one 30.7 Customer to purchase, margin or settle the trades, contracts, or commodity options of, or to secure or extend credit to, any person other than such 30.7 Customer. This prohibition on the use of the funds of one 30.7 customer to extend credit to, or to purchase, margin or settle the trades, contracts, or commodity options of another 30.7 Customer applies at all times. For this purpose, a futures commission merchant which operationally commingles the funds of its 30.7 Customers must ensure that at all times its residual interest in funds set aside as the foreign futures or foreign options secured amount exceeds the sum of all its 30.7 Customers' margin deficits.

(2) A futures commission merchant may not impose or permit the imposition of a lien on any funds set aside as the foreign futures or foreign options secured amount, including any residual financial interest of the futures commission merchant in such funds.

(3) A futures commission merchant may not include in funds set aside as the foreign futures or foreign options secured amount any money invested in securities, memberships, or obligations of any clearing organization or board of trade. A futures commission merchant may not include in funds set aside as the foreign futures or foreign options secured amount any other money, securities, or property held by a member of a foreign board of trade, board of trade, or clearing organization, except if the funds are deposited to margin, secure, or guarantee 30.7 Customers' foreign futures or foreign options positions and the futures commission merchant obtains the written acknowledgment from the member of the foreign board of trade, board of trade, or clearing organization as required by paragraph (d) of this section.

(g) *Futures commission merchant's residual financial interest and withdrawal of funds.* (1) The provision in paragraph (e) of this section, which prohibits the commingling of funds set aside as the foreign futures or foreign options secured amount with the funds of a futures commission merchant, shall not be construed to prevent a futures commission merchant from having a residual financial interest in the funds set aside as required by the regulations in this part for the benefit of 30.7 Customers; nor shall such provisions be construed to prevent a futures commission merchant from adding to such set aside funds such amount or amounts of money, from its own funds or unencumbered securities from its own inventory, of the type set forth in § 1.25 of this chapter, as it may deem necessary to ensure any and all 30.7 Accounts from becoming undersecured at any time.

(2) A futures commission merchant may not withdraw funds on any business day for its own proprietary use

from an account or accounts holding the foreign futures and foreign options secured amount unless the futures commission merchant has prepared the daily 30.7 calculation required by paragraph (l) of this section as of the close of business on the previous business day. A futures commission merchant that has completed its daily 30.7 calculation may make withdrawals to its own order, to the extent of its actual residual financial interest in funds held in 30.7 Accounts, including the withdrawal of securities held in secured amount safekeeping accounts held by a bank, trust company, contract market, clearing organization, member of a foreign board of trade, or other futures commission merchant. Such withdrawal(s) shall not result in the funds of one 30.7 Customer being used to purchase, margin or carry the foreign futures or foreign options positions, or extend the credit of any other 30.7 Customer or other person. Notwithstanding any other provision of this section, a futures commission merchant must at all times maintain an amount of residual interest in separate accounts for the benefit of 30.7 Customers that exceeds the sum of all 30.7 Customers' margin deficits and such residual interest may not be withdrawn by the futures commission merchant.

(3) A futures commission merchant may not withdraw funds for its own proprietary use, in a single transaction or a series of transactions on a given business day, from an account or accounts holding 30.7 Customer Funds if such withdrawal(s) would exceed 25 percent of the futures commission merchant's residual interest in such accounts as reported on the daily secured amount calculation required by paragraph (l) of this section and computed as of the close of business on the previous business day, unless the futures commission merchant's Chief Executive Officer, Chief Finance Officer or other senior official that is listed as a principal of the futures commission merchant on its Form 7–R and is knowledgeable about the futures commission merchant's financial requirements and financial position pre-approves in writing the withdrawal, or series of withdrawals.

(4) A futures commission merchant must file written notice of the withdrawal or series of withdrawals that exceed 25 percent of the futures commission merchant's residual interest in 30.7 Customer Funds as computed under paragraph (h)(2) of this section with the Commission and with its designated self-regulatory organization immediately after the Chief Executive Officer, Chief Finance Officer or other senior official as described in paragraph (g)(2) of this section pre-approves the withdrawal or series of withdrawals. The written notice must:

(i) Be signed by the Chief Executive Officer, Chief Finance Officer or other senior official that pre-approved the withdrawal, and give notice that the futures commission merchant has withdrawn or intends to withdraw more than 25 percent of its residual interest in accounts holding 30.7 Customer Funds;

(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 the name of each recipient;

(iv) Include the current estimate of the amount of the futures commission merchant's residual interest in the 30.7 Customer Funds after the withdrawal;

(v) Contain a representation by the Chief Executive Officer, Chief Finance Officer or other senior official as described in paragraph (g)(3) of this section that pre-approved the withdrawal, or series of withdrawals, that to such person's knowledge and reasonable belief, the futures commission merchant remains in compliance with the secured amount requirements after the withdrawal. The Chief Executive Officer, Chief Finance Officer or other appropriate senior official as described in paragraph (g)(2) of this section must consider the daily 30.7 calculation as of the close of business on the previous business day and any other factors that may cause a material change in the futures commission's residual interest since the close of business the previous business day, including known unsecured customer debits or deficits, current day market activity and any other withdrawals made from the 30.7 Customer Accounts; and

(vi) Any such written notice filed with the Commission must be filed via electronic transmission using a form of user authentication assigned in accordance with procedures established by or approved by the Commission, and otherwise in accordance with instruction issued by or approved by the Commission. Any such electronic submission must clearly indicate the registrant on whose behalf such filing is made and the use of such user authentication in submitting such filing will constitute and become a substitute for the manual signature of the authorized signer. Any written notice filed must be followed up with direct communication to the Regional office of Commission which has supervisory authority over the futures commission merchant whereby the Commission acknowledges receipt of the notice.

(5) After making a withdrawal requiring the approval and notice required in paragraphs (c)(1) and (2) of this section, and before the next daily secured amount calculation, no futures commission merchant may make any further withdrawals from accounts holding 30.7 Customer Funds, except to or for the benefit of 30.7 Customers, without, for each withdrawal, obtaining the approval required under paragraph (c)(1) of this section and filing a written notice with the Commission under paragraph (g)(4)(vi) of this section and its designated self-regulatory organization signed by the Chief Executive Officer, Chief Finance Officer, or other senior official. The written notice must:

(i) List the amount of funds provided to each recipient and each recipient's name;

(ii) Disclose the reason for each withdrawal;

(iii) Confirm that the Chief Executive Officer, Chief Finance Officer, or other senior official (and identify of the person if different from the person who signed the notice) pre-approved the withdrawal in writing;

(iv) Disclose the current estimate of the futures commission merchant's remaining total residual interest in the secured accounts holding 30.7 Customer Funds after the withdrawal; and

(v) Include a representation that to the best of the notice signatory's knowledge and reasonable belief the futures commission merchant remains in compliance with the secured amount requirements after the withdrawal.

(6) If a futures commission merchant withdraws funds from the separate accounts holding 30.7 Customer Funds for its own proprietary use, and the withdrawal causes the futures commission merchant to not hold sufficient funds in the separate accounts for the benefit of the 30.7 Customers to meet its targeted residual interest, as required to be computed under § 1.11 of this chapter, the futures commission merchant must deposit its own funds into the separate accounts for the benefit of 30.7 Customers to restore the account balance to the targeted residual interest amount on the next business day, or, if appropriate, revise the futures commission merchant's targeted amount of residual interest pursuant to the policies and procedures required by § 1.11 of this chapter. Notwithstanding the foregoing, if at any time the futures commission merchant's residual interest in separate accounts for the benefit of 30.7 Customers is less than the sum of

its 30.7 Customer's margin deficits, the futures commission merchant must immediately restore the residual interest to exceed the sum of such margin deficits. Any proprietary funds deposited in the 30.7 Customer Accounts must be unencumbered and otherwise compliant with § 1.25 of this section, as applicable.

(7) Notwithstanding any other provision of this part, a futures commission merchant may not withdraw funds for its own proprietary use from 30.7 Accounts unless the futures commission merchant follows its policies and procedures required by § 1.11 of this chapter.

(h) *Permitted investments and deposits of 30.7 Customer Funds.* (1) A futures commission merchant may invest 30.7 Customer Funds subject to, and in compliance with, the terms and conditions of § 1.25 of this chapter. Regulation 1.25 of this chapter shall apply to the investment of 30.7 Customer Funds as if such funds comprised customer funds or customer money subject to segregation pursuant to section 4d of the Act and the regulations thereunder.

(2) Each futures commission merchant that invests money, securities or property on behalf of 30.7 Customers must keep a record showing the following:

(i) The date on which such investments were made;

(ii) The name of the person through whom such investments were made;

(iii) The amount of money or current market value of securities so invested;

(iv) A description of the obligations in which such investments were made, including CUSIP or ISIN numbers;

(v) The identity of the depositories or other places where such investments are maintained;

(vi) The date on which such investments were liquidated or otherwise disposed of and the amount of money received or current market value of securities received as a result of such disposition;

(vii) The name of the person to or through whom such investments were disposed of; and

(viii) A daily valuation for each instrument and readily available documentation supporting the daily valuation for each instrument. Such supporting documentation must be sufficient to enable third parties to verify the valuations and the accuracy of any information from external sources used in those valuations.

(3) Any 30.7 Customer Funds deposited in a bank or trust company located in the United States or in a foreign jurisdiction must be available for immediate withdrawal upon the demand of the futures commission merchant.

(4) Futures commission merchants that invest 30.7 Customer Funds in instruments described in § 1.25 of this chapter shall include such instruments in the computation of its secured amount requirements, required under paragraph (l) of this section, at values that at no time exceed current market value, determined as of the close of the market on the date for which such computation is made.

(i) *Responsibility for § 1.25 investment losses.* A futures commission merchant shall bear sole financial responsibility for any losses resulting from the investment of 30.7 Customer Funds in instruments described in § 1.25 of this chapter. No investment losses shall be borne or otherwise allocated to the 30.7 Customers of the futures commission merchant.

(j) *Loans by futures commission merchants; Treatment of proceeds.* A futures commission merchant may lend its own funds to 30.7 Customers on securities and property pledged, or from repledging or selling such securities and property pursuant to specific written agreement with such 30.7 Customers. The proceeds of such loans used to purchase, margin, guarantee, or secure the trades, contracts, or commodity options of 30.7 Customers shall be treated and dealt with by a futures commission merchant as belonging to such 30.7 Customers. A futures commission merchant may not loan funds on an unsecured basis to finance a 30.7 Customer's foreign futures and foreign options trading, nor may a futures commission merchant loan funds to a 30.7 Customer secured by the 30.7 Customer's trading account.

(k) *Permitted withdrawals.* A futures commission merchant may withdraw funds from 30.7 Customer Accounts in an amount necessary in the normal course of business to margin, guarantee, secure, transfer, or settle 30.7 Customers' foreign futures or foreign option positions with a foreign broker or clearing organization. A futures commission merchant also may withdraw funds from 30.7 Customer Accounts to pay commissions, brokerage, interest, taxes, storage, and other charges lawfully accruing in connection with the 30.7 Customers' foreign futures and foreign options positions.

(l) *Daily computation of 30.7 Customer secured amount requirement and details regarding the holding and investing of 30.7 Customer Funds.* (1) Each futures commission merchant is required to prepare a Statement of Secured Amounts and Funds Held in Separate Accounts for 30.7 Customers pursuant to Commission Regulation 30.7 contained in the Form 1–FR–FCM as of the close of each business day. Futures commission merchants that invest funds set aside as the foreign futures or foreign options secured amount in instruments described in § 1.25 of this chapter shall include such instruments in the computation of its secured amount requirements at values that at no time exceed current market value, determined as of the close of the market on the date for which such computation is made. Nothing in this paragraph shall affect the requirement that a futures commission merchant at all times maintain sufficient money, securities and property to cover its total obligations to all 30.7 Customers, in accordance with paragraph (a) of this section.

(2) A futures commission merchant may offset any net deficit in a particular 30.7 Customer's Account against the current market value of readily marketable securities, less deductions (*i.e.* ''securities haircuts'') as set forth in Rule 15c3–1(c)(2)(vi) of the Securities and Exchange Commission (17 CFR 240.15c3–1(c)(2)(vi)), held for the same particular 30.7 Customer's Account in computing the daily Foreign Futures and Foreign Options Secured Amount. Futures commission merchants that establish and enforce written policies and procedures to assess the credit risk of commercial paper, convertible debt instruments, or nonconvertible debt instruments in accordance with Rule 240.15c3–1(c)(2)(vi) of the Securities and Exchange Commission (17 CFR 240.15c3–1(c)(2)(vi)) may apply the lower haircut percentages specified in Rule 240.15c3–1(c)(2)(vi) for such commercial paper, convertible debt instruments and nonconvertible debt instruments. The futures commission merchant must maintain a security interest in the securities, including a written authorization to liquidate the securities at the futures commission merchant's discretion, and must set aside the securities in a safekeeping account compliant with paragraph (c) of this section. 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)).

(3) Each futures commission merchant is required to submit to the Commission and to the firm's designated self-regulatory organization the daily Statement of Secured Amounts and Funds Held in Separate Accounts for

30.7 Customers pursuant to Commission Regulation 30.7 required by paragraph (l)(1) of this section by noon the following business day.

(4) Each futures commission merchant shall file the Statement of Secured Amounts and Funds Held in Separate Accounts for 30.7 Customers pursuant to Commission Regulation 30.7 required by paragraph (l)(1) of this section in an electronic format using a form of user authentication assigned in accordance with procedures established or approved by the Commission.

(5) Each futures commission merchant is required to submit to the Commission and to the firm's designated self-regulatory organization a report listing of the names of all banks, trust companies, futures commission merchants, derivatives clearing organizations, foreign brokers, foreign clearing organizations, or any other depository or custodian holding 30.7 Customer Funds as of the fifteenth day of the month, or the first business day thereafter, and the last business day of each month. This report must include:

(i) The name and location of each depository holding 30.7 Customer Funds;

(ii) The total amount of 30.7 Customer Funds held by each depository listed in paragraph (l)(5) of this section; and

(iii) The total amount of cash and investments that each depository listed in paragraph (l)(5) of this section holds for the futures commission merchant. The futures commission merchant must report the following investments:

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

(B) General obligations of any State or of any political subdivision of a State (municipal securities);

(C) General obligation issued by any enterprise sponsored by the United States (government sponsored enterprise securities);

(D) Certificates of deposit issued by a bank;

(E) 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;

(F) 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; and

(G) Interests in money market mutual funds.

(6) Each futures commission merchant must report the total amount of customer owned securities held by the futures commission merchant as 30.7 Customer Funds and must list the names and locations of the depositories holding customer owned securities.

(7) Each futures commission merchant must report the total amount of 30.7 Customer Funds that have been used to purchase securities under agreements to resell the securities (reverse repurchase transactions).

(8) Each futures commission merchant must report which, if any, of the depositories holding 30.7 Customer Funds under paragraph (l)(5) of this section are affiliated with the futures commission merchant.

(9) Each futures commission merchant shall file the detailed list of depositories required by paragraph (l)(5) of this section by 11:59 p.m. the next business day in an electronic format using a form of user authentication assigned in accordance with procedures established or approved by the Commission.

(10) Each futures commission merchant shall retain its daily secured amount computation, the Statement of Secured Amounts and Funds Held in Separate Accounts for 30.7 Customers pursuant to Commission Regulation 30.7 required by paragraph (l)(1) of this section, and the detailed list of depositories required by paragraph (l)(5) of this section, together with all supporting documentation, in accordance with the requirements of § 1.31 of this part.

27. Add Appendix E and Appendix F to part 30 to read as follows:

Appendix E to Part 30—Acknowledgment Letter for CFTC Regulation 30.7 Customer Secured Account

[Date]

[Name and Address of Depository]

We refer to the *Secured Amount Account(s)* which [Name of Futures Commission Merchant] (''we'' or ''our'') have opened or will open with [Name of Depository] (''you'' or ''your'') entitled:

[Name of Futures Commission Merchant] [if applicable, add ''FCM Customer Omnibus Account''] CFTC Regulation 30.7 Customer Secured Account [If applicable, include any abbreviated name of the Account(s) as reflected in the Depository's electronic systems (provided any such abbreviated name must reflect that the Account(s) is a CFTC regulated customer secured account)]

Account Number(s):

(collectively, the ''Account(s)'').

You acknowledge and agree that we have opened or will open the above-referenced Account(s) for the purpose of depositing, as applicable, money, securities and other property (collectively ''Funds'') for or on behalf of our customers who are entering into foreign futures and/or foreign options transactions (as such terms are defined in U.S. Commodity Futures Trading Commission (''CFTC'') Regulation 30.1, as amended). The Funds deposited in the Account(s) or accruing to the credit of the Accounts will be kept separate and apart and separately accounted for on your books from our own funds and all other accounts maintained by us in accordance with the provisions of the Commodity Exchange Act, as amended (the ''Act''), and Part 30 of the CFTC's regulations, as amended, and may not be commingled with our own funds in any proprietary account we maintain with you and the Funds must otherwise be treated in accordance with the provisions of the Act and CFTC Regulations.

Furthermore, you acknowledge and agree that such Funds may not be used by you or by us to secure or guarantee any obligations that we might owe to you, nor may they be used by us to secure credit from you. You further acknowledge and agree that the Funds in the Account(s) shall not be subject to any right of offset or lien for or on account of any indebtedness, obligations or liabilities we may now or in the future have owing to you, and that you understand the nature of the Funds held or hereafter deposited in the Account(s) and that you will treat and maintain such Funds in accordance with the provisions of the Act and CFTC regulations. This prohibition does not affect your right to recover funds advanced in the form of cash transfers you make in lieu of liquidating non-cash assets held in the Account(s) for purposes of variation settlement or posting initial (original) margin.

In addition, you agree that the Account(s) may be examined at any reasonable time by an appropriate officer, agent or employee of the CFTC or a self-regulatory organization, and this letter constitutes the authorization and direction of the undersigned to permit any such examination or audit to take place. You agree to respond promptly and directly to requests for confirmation of account balances and other account information from an appropriate officer, agent, or employee of the CFTC or a self-regulatory organization of which we are a member, without further notice to or consent from the futures commission merchant. You also agree that, immediately upon instruction by the director of the Division of Swap Dealer and Intermediary Oversight of the CFTC or the director of the Division of Clearing and Risk of the CFTC, or any successor divisions, or such directors' designees, or any appropriate official of a self-regulatory organization of which we are a member, you will provide any and all information regarding or related to the Funds or the Accounts as shall be specified in such instruction and as directed in such instruction. You further agree that you will provide the CFTC and our designated self-regulatory organization with the necessary software, a user log-in, and password that will allow the CFTC and our designated self-regulatory organization to have read-only access to the accounts listed above on your Web site on a 24-hour a day basis. This letter further constitutes the consent and authorization of the undersigned for you to respond immediately to requests from appropriate officers, agents, or employees of the CFTC or a self-regulatory

organization for information and/or confirmation of current and historical account balances of the Account(s).

You acknowledge and agree that you meet the requirements detailed for depositories in CFTC Regulation 30.7, as amended. You further acknowledge and agree that the Funds in the Account(s) shall be released immediately, subject to the requirements of US or non-U.S. law as applicable, upon proper notice and instruction from an appropriate officer or employee of us or from the director of the Division of Clearing and Risk of the CFTC, the director of the Division of Swap Dealer and Intermediary Oversight, or any successor divisions, or such directors' designees. We will not hold you responsible for acting pursuant to any instruction from the CFTC upon which you have relied after having taken reasonable measures to assure that such instruction was provided to you by the director of the Division of Clearing and Risk or the director of the Division of Swap Dealer and Intermediary Oversight of the CFTC, or any successor divisions, or such directors' designees.

In the event we become subject to either a voluntary or involuntary petition for relief under the U.S. Bankruptcy Code, we acknowledge that you will have no obligation to release the Funds held in the Account(s), except upon instruction of the Trustee in Bankruptcy or pursuant to the Order of the respective U.S. Bankruptcy Court.

Notwithstanding anything in the foregoing to the contrary, nothing contained herein shall be construed as limiting your right to assert any right of set off against or lien on assets other than assets maintained in the Account(s), nor to impose such charges against us or any proprietary account maintained by us with you. Further, it is understood that amounts represented by checks, drafts or other items shall not be considered to be part of the Account(s) until finally collected. Accordingly, checks, drafts and other items credited to the Account(s) and subsequently dishonored or otherwise returned to you, or reversed, for any reason and any claims relating thereto, including but not limited to claims of alteration or forgery, may be charged back to the Account(s), and we shall be responsible to you as a general endorser of all such items whether or not actually so endorsed.

You may conclusively presume that any withdrawal from the Account(s) and the balances maintained therein are in conformity with the Act and CFTC regulations without any further inquiry, provided that you have no notice of or actual knowledge of, or could not reasonably know of, a violation of the Act or other provision of law by us; and you shall not in any manner not expressly agreed to herein be responsible for ensuring compliance by us with the provisions of the Act and CFTC regulations.

You may, and are hereby authorized to, obey the order, judgment, decree or levy of any court of competent jurisdiction or any governmental agency with jurisdiction, which order, judgment, decree or levy relates in whole or in part to the Account(s). In any event, you shall not be liable by reason of any such action or omission to act, to us or to any other person, firm, association or corporation even if thereafter any such order, decree, judgment or levy shall be reversed, modified, set aside or vacated.

The terms of this letter agreement shall remain binding upon the parties, their successors and assigns, including for the avoidance of doubt, regardless of the change in name of any party. This letter agreement supersedes and replaces any prior agreement between the parties in connection with the Account(s), including but not limited to any prior acknowledgment letter, to the extent that such prior agreement is inconsistent with the terms hereof. In the event of any conflict between this letter agreement and any other agreement between the parties in connection with the Account(s), this letter agreement shall govern with respect to matters specific to the Act and the CFTC's regulations, as amended.

This letter agreement shall be governed by and construed in accordance with the laws of [Insert governing law] without regard to the principles of choice of law.

Please acknowledge that you agree to abide by the requirements and conditions set forth above by signing and returning the enclosed copy of this letter. You further acknowledge and agree to provide a copy of this fully executed letter directly to the CFTC (via electronic mail to *acknowledgmentletters@cftc.gov*) and our designated self-regulatory organization.

[Name of Futures Commission Merchant]
By:
Print Name:
Title:
ACKNOWLEDGED AND AGREED:
[Name of Depository]
By:
Print Name:
Title:
Contact Information: [Insert phone number and email address]
DATE:

Appendix F to Part 30:

CFTC Regulation 30.7—Acknowledgment Letter for CFTC Regulation 30.7 Customer Secured Money Market Mutual Fund Account [All of this was not proposed]

[Date]

[Name and Address of Money Market Mutual Fund]

We propose to invest funds held by [Name of Futures Commission Merchant or Derivatives Clearing Organization] (''we'' or ''our'') on behalf of our customers in shares of [Name of Money Market Mutual Fund] (''you'' or ''your'') under account(s) entitled (or shares issued to):

[Name of Futures Commission Merchant or Derivatives Clearing Organization] [if applicable, add ''FCM Customer Omnibus Account''] CFTC Regulation 30.7 Customer Secured Money Market Mutual Fund Account

[If applicable, include any abbreviated name of the Account(s) as reflected in the Depository's electronic systems (provided any such abbreviated name must reflect that the Account(s) is a CFTC regulated customer segregated account)]

Account Number(s): [ ]
(collectively, the ''Account(s)'').

You acknowledge and agree that we are holding these funds, including any shares issued and amounts accruing in connection therewith (collectively, the ''Shares''), for the benefit of our customers who are entering into foreign futures and/or foreign options transactions (as such terms are defined in U.S. Commodity Futures Trading Commission (''CFTC'') Regulation 30.1, as amended); that the Shares held by you, hereafter deposited in the Account(s) or accruing to the credit of the Accounts, will be kept separate and apart and separately accounted for on your books from our own funds and from any other funds or accounts held by us in accordance with the provisions of the Commodity Exchange Act, as amended (the ''Act''), and Part 30 of the CFTC's regulations, as amended; and that the Shares must otherwise be treated in accordance with the provisions of the Act and CFTC regulations.

Furthermore, you acknowledge and agree that such Shares may not be used by you or by us to secure or guarantee any obligations that we might owe to you, nor may they be used by us to secure credit from you. You further acknowledge and agree that the Shares in the Account(s) shall not be subject to any right of offset or lien for or on account of any indebtedness, obligations or liabilities we may now or in the future have owing to you.

In addition, you agree that the Account(s) may be examined at any reasonable time by an appropriate officer, agent or employee of the CFTC or a self-regulatory organization, and this letter constitutes the authorization and direction of the undersigned to permit any such examination or audit to take place. You agree to respond promptly and directly to requests for confirmation of account balances and other account information from an appropriate officer, agent, or employee of the CFTC or a self-regulatory organization of which we are a member, without further notice to or consent from the futures commission merchant. You also agree that, immediately upon instruction by the director of the Division of Swap Dealer and Intermediary Oversight of the CFTC or the director of the Division of Clearing and Risk of the CFTC, or any successor divisions, or such directors' designees, or any appropriate official of a self-regulatory organization of which we are a member, you will provide any and all information regarding or related to the Funds or the Accounts as shall be specified in such instruction and as directed in such instruction. You further agree that you will provide the CFTC and our designated self-regulatory organization with the necessary software, a user log-in, and password that will allow the CFTC and our designated self-regulatory organization to have read-only access to the accounts listed above on your Web site on a 24-hour a day basis. This letter further constitutes the consent and authorization of the undersigned for you to respond immediately to requests from appropriate officers, agents, or employees of the CFTC or a self-regulatory organization for information and/or confirmation of current and historical account balances of the Account(s).

You acknowledge and agree that the Shares in the Account(s) shall be released immediately, subject to the requirements of U.S. or non-U.S. law as applicable, upon proper notice and instruction from an appropriate officer or employee of us or from the director of the Division of Clearing and Risk or the director of the Division of Swap Dealers and Intermediary Oversight of the CFTC, or any successor divisions, or such directors' designees. We will not hold you responsible for acting pursuant to any instruction from the CFTC upon which you have relied after having taken reasonable measures to assure that such instruction was provided to you by the director of the Division of Clearing and Risk of the CFTC, or any successor division, or such director's designee. You further acknowledge that you will provide to the CFTC a copy of this fully executed acknowledgment (via electronic mail to *acknowledgmentletters@cftc.gov*).

In the event we become subject to either a voluntary or involuntary petition for relief under the U.S. Bankruptcy Code, we acknowledge that you will have no obligation to release the Shares held in the Account(s), except upon instruction of the Trustee in Bankruptcy or pursuant to the Order of the respective U.S. Bankruptcy Court.

Notwithstanding anything in the foregoing to the contrary, nothing contained herein shall be construed as limiting your right to assert any right of set off against or lien on assets other than assets maintained in the Account(s), nor to impose such charges against us or any proprietary account maintained by us with you. Further, it is understood that amounts represented by checks, drafts or other items shall not be considered to be part of the Account(s) until finally collected. Accordingly, checks, drafts and other items credited to the Account(s) and subsequently dishonored or otherwise returned to you, or reversed, for any reason and any claims relating thereto, including but not limited to claims of alteration or forgery, may be charged back to the Account(s), and we shall be responsible to you as a general endorser of all such items whether or not actually so endorsed.

You may conclusively presume that any withdrawal from the Account(s) and the balances maintained therein are in conformity with the Act and CFTC regulations without any further inquiry, provided that you have no notice of or actual knowledge of, or could not reasonably know of, a violation of the Act or other provision of law by us; and you shall not in any manner not expressly agreed to herein be responsible for ensuring compliance by us with the provisions of the Act and CFTC regulations.

You may, and are hereby authorized to, obey the order, judgment, decree or levy of any court of competent jurisdiction or any governmental agency with jurisdiction, which order, judgment, decree or levy relates in whole or in part to the Account(s). In any event, you shall not be liable by reason of any such action or omission to act, to us or to any other person, firm, association or corporation even if thereafter any such order, decree, judgment or levy shall be reversed, modified, set aside or vacated.

We are permitted to invest our Commodity Customers' funds in money market mutual funds pursuant to CFTC Regulation 1.25. That rule sets forth the following conditions, among others, with respect to any investment in a money market mutual fund:

(1) The net asset value of the fund must be computed by 9:00 a.m. of the business day following each business day and be made available to us by that time;

(2) The fund must be legally obligated to redeem an interest in the fund and make payment in satisfaction thereof by the close of the business day following the day on which we make a redemption request except as otherwise specified in CFTC Regulation 1.25(c)(5)(ii); and

(3) The agreement under which we invest our Commodity Customers' funds must not contain any provision that would prevent us from pledging or transferring fund shares.

The terms of this letter agreement shall remain binding upon the parties, their successors and assigns, including for the avoidance of doubt, regardless of the change in name of any party. This letter agreement supersedes and replaces any prior agreement between the parties in connection with the Account(s), including but not limited to any prior acknowledgment letter, to the extent that such prior agreement is inconsistent with the terms hereof. In the event of any conflict between this letter agreement and any other agreement between the parties in connection with the Account(s), this letter agreement shall govern with respect to matters specific to Section 4d of the Act and the CFTC's regulations, as amended.

This letter agreement shall be governed by and construed in accordance with the laws of [Insert governing law] without regard to the principles of choice of law.

Please acknowledge that you agree to abide by the requirements and conditions set forth above by signing and returning the enclosed copy of this letter. You further acknowledge and agree to provide a copy of this fully executed letter directly to the CFTC and our designated self-regulatory organization.

[Name of Futures Commission Merchant or Derivatives Clearing Organization]

By:

Print Name:

Title:

ACKNOWLEDGED AND AGREED:

[Name of Money Market Mutual Fund]

By:

Print Name:

Title:

Contact Information: [Insert phone number and email address]

DATE:

PART 140—ORGANIZATION, FUNCTIONS, AND PROCEDURES OF THE COMMISSION

28. The authority citation for part 140 continues to read as follows:

Authority: 7 U.S.C. 2 and 12a.

29. In § 140.91, redesignate paragraph (a)(8) as paragraph (a)(12) and paragraph (a)(7) as paragraph (a)(8), add new paragraphs (a)(7), (a)(9), (a)(10), and (a)(11), and revise paragraph (b) to read as follows:

§ 140.91 Delegation of authority to the Director of the Division of Clearing and Risk and to the Director of the Division of Swap Dealer and Intermediary Oversight.

(a) * * *

(7) All functions reserved to the Commission in § 1.20 of this chapter.

* * * * *

(9) All functions reserved to the Commission in § 1.26 of this chapter.

(10) All functions reserved to the Commission in § 1.52 of this chapter.

(11) All functions reserved to the Commission in § 30.7 of this chapter.

* * * * *

(b) The Director of the Division of Clearing and Risk and the Director of the Division of Swap Dealer and Intermediary Oversight may submit any matter which has been delegated to him or her under paragraph (a) of this section to the Commission for its consideration.

* * * * *

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Name of Company: Employer ID No: NFA ID No:

CFTC FORM 1-FR-FCM
STATEMENT OF FINANCIAL CONDITION
AS OF __/__/____

Assets

	Current		Non-Current		Total	
1. Funds segregated or in separate accounts pursuant to the CEAct and the Regulations						
A. U.S. exchanges (page 11, line 13)	$ 0	1000			$ 0	1005
B. Dealer options (page 12, line 2.C.)	0	1010			0	1015
C. Foreign exchanges (page 14, line 8)	0	1020	$ 0	1025	0	1030
D. Cleared Swaps (page XX, line X)	0	XXX	0	XXX	0	XXX
(Do not Duplicate line 1. assets below)						
2. Cash	0	1040	0	1045	0	1050
3. Securities, at market value						
A. Firm owned	0	1055	0	1060	0	1065
B. Noncustomer-owned	0	1070			0	1075
C. Individual partners' and members' security accounts	0	1090			0	1095
D. Stock in clearing organizations	0	1100	0	1105	0	1110
4. Securities purchased under resale agreements	0	1115	0	1120	0	1125
5. Receivables from and deposits with U.S. derivatives clearing organizations						
A. Margins	0	1130			0	1135
B. Settlement receivable	0	1140			0	1145
C. Guarantee deposits	0	1150			0	1155
D. Net long options value	0	1157			0	1158
6. Receivables from and deposits with foreign commodity clearing organizations						
A. Margins	0	1160	0	1165	0	1170
B. Settlement receivable	0	1175			0	1180
C. Guarantee deposits	0	1182	0	1185	0	1190
D. Net long options value	0	1191	0	1192	0	1193
7. Receivables from registered FCMs						
A. Net liquidating equity	0	1195	0	1200	0	1205
B. Security deposits			0	1210	0	1215
C. Other	0	1220	0	1225	0	1230
8. Receivables from foreign commodity brokers						
A. Net liquidating equity	0	1235	0	1240	0	1245
B. Security deposits			0	1250	0	1255
C. Other	0	1260	0	1265	0	1270

Name of Company: Employer ID No: NFA ID No:

CFTC FORM 1-FR-FCM
STATEMENT OF FINANCIAL CONDITION
AS OF __/__/____

Liabilities & Ownership Equity

Liabilities

21. Payables to banks		
A. Secured loans		2000
B. Unsecured loans		2010
C. Overdrafts		2020
22. Equities in commodity accounts and cleared swaps accounts		
A. Customers trading on U.S. commodity exchanges		2030
B. Customers trading on foreign exchanges		2040
C. Customers' dealer option accounts		2050
D. Noncustomers' accounts		2060
E. General partners' and members' trading accounts (not included in capital)		2070
F. Customers trading cleared swaps		XXXX
23. Payable to U.S. derivatives clearing organizations		2080
Including short option value $ 0		
24. Payable to foreign commodity clearing organizations		2090
Including short option value $ 0		
25. Payable to registered futures commission merchants		2100
26. Payable to foreign commodity brokers		2110
27. Accounts payable, accrued expenses and other payables		
A. Accounts payable and accrued expenses		2120
B. Salaries, wages, commissions and bonuses payable		2130
C. Taxes payable		2140
D. Deferred income taxes		2150
E. Security deposits held		2160
F. Advances against commodities		2170
G. Unrealized losses on forward contracts and commitments		2180
H. Due to subsidiaries and affiliates		2190
I. Notes, mortgages and other payables due within twelve months		2200
J. Obligation to Retail FX Customers		XXXXX
K. Other (itemize on a separate page)		2210
28. Notes, mortgages and other payables not due within twelve months of the date of this statement		
A. Unsecured		2220
B. Secured		2230

Name of Company: Employer ID No: NFA ID No:

CFTC FORM 1-FR-FCM
STATEMENT OF SEGREGATION REQUIREMENTS AND FUNDS IN SEGREGATION
FOR CUSTOMERS TRADING ON U.S. COMMODITY EXCHANGES
AS OF xx/xx/xxxx

SEGREGATION REQUIREMENTS (Section 4d(2) of the CEAct)

1. Net ledger balance				
A. Cash			$ 0	5000
B. Securities (at market)			0	5010
2. Net unrealized profit (loss) in open futures contracts traded on a contract market			0	5020
3. Exchange traded options				
A. Market value of open option contracts purchased on a contract market			0	5030
B. Market value of open option contracts granted (sold) on a contract market			0	5040
4. Net equity (deficit) (add lines 1, 2, and 3)			$ 0	5050
5. Accounts liquidating to a deficit and accounts with debit balances - gross amount	$ 0	5060		
Less: amount offset by customer owned securities	0	5070	0	5080
6. Amount required to be segregated (add lines 4 and 5)			$ 0	5090

FUNDS IN SEGREGATED ACCOUNTS

7. Deposited in segregated funds bank accounts				
A. Cash			$ 0	5100
B. Securities representing investment of customers' funds (at market)			0	5110
C. Securities held for particular customers or option customers in lieu of cash (at market)			0	5120
8. Margins on deposit with derivatives clearing organizations of contract markets				
A. Cash			0	5130
B. Securities representing investments of customers' funds (at market)			0	5140
C. Securities held for particular customers or option customers in lieu of cash (at market)			0	5150
9. Net settlement from (to) derivatives clearing organizations of contract markets			0	5160
1				
A. Value of open long option contracts			0	5170
B. Value of open short option contracts			0	5180
11. Net equities with other FCMs				
A. Net liquidating equity			0	5190
B. Securities representing investments of customers' funds (at market)			0	5200
C. Securities held for particular customers or option customers in lieu of cash (at market)			0	5210
12. Segregated funds on hand (describe:)			0	5215
13. Total amount in segregation (add lines 7 through 12)			$ 0	5220
14. Excess (deficiency) funds in segregation (subtract line 6 from line 13)			$ 0	5230
15. Management Target Amount for Excess funds in segregation			$ 0	5240
16. Excess (deficiency) funds in segregation over (under) Management Target Amount Excess			$ 0	5250
17. Sum of Margin Deficits for futures customers			$ 0	
18. Excess (Deficiency) of Residual Interest (Line 14) over Sum of Margin Deficits (Line 17)			$ 0	

Name of Company: Employer ID No: NFA ID No:

CFTC FORM 1-FR-FCM
STATEMENT OF SECURED AMOUNTS AND FUNDS HELD IN SEPARATE ACCOUNTS
PURSUANT TO COMMISSION REGULATION 30.7
AS OF xx/xx/xxxx

FOREIGN FUTURES AND FOREIGN OPTIONS SECURED AMOUNTS

☐ Amount required to be set aside pursuant to law, rule or regulation of a foreign government or a rule of a self-regulatory organization authorized thereunder

1. Net ledger balance - Foreign Futures and Foreign Options Trading - All Customers				
A. Cash			$ 0	
B. Securities (at market)			0	
2. Net unrealized profit (loss) in open futures contracts traded on a foreign board of trade			0	
3. Exchange traded options				
A. Market value of open option contracts purchased on a foreign board of trade			0	
B. Market value of open option contracts granted (sold) on a foreign board of trade			0	
4. Net equity (deficit) (add lines 1, 2, and 3)			$ 0	
5. Accounts liquidating to a deficit and accounts with debit balances - gross amount	$ 0			
Less: amount offset by customer owned securities	0		0	
6. Amount required to be set aside as the secured amount - Net Liquidating Equity Method (add lines 4 and 5)			$ 0	
7. Greater of amount required to be set aside pursuant to foreign jurisdiction (above) or line 6.			$ 0	

Name of Company: Employer ID No: NFA ID No:

CFTC FORM 1-FR-FCM
STATEMENT OF SECURED AMOUNTS AND FUNDS HELD IN SEPARATE ACCOUNTS
PURSUANT TO COMMISSION REGULATION 30.7
AS OF xx/xx/xxxx

FUNDS DEPOSITED IN SEPARATE REGULATION 30.7 ACCOUNTS

1. Cash in Banks					
A. Banks located in the United States		$ 0	5700		
B. Other Banks qualified under Regulation 30.7					
Name(s):	5710	0	5720	$ 0	5730
2. Securities					
A. In safekeeping with banks located in the United States		$ 0	5740		
B. In safekeeping with other banks qualified under Regulation 30.7					
Name(s):	5750	0	5760	0	5770
3. Equities with registered futures commission merchants					
A. Cash		$ 0	5780		
B. Securities		0	5790		
C. Unrealized gain (loss) on open futures contracts		0	5800		
D. Value of long option contracts		0	5810		
E. Value of short option contracts		0	5815	0	5820
4. Amounts held by clearing organizations of foreign boards of trade					
Name(s):	5830				
A. Cash		$ 0	5840		
B Securities		0	5850		
C. Amount due to (from) clearing organization - daily variation		0	5860		
D. Value of long option contracts		0	5870		
E. Value of short option contracts		0	5875	0	5880
5. Amounts held by members of foreign boards of trade					
Name(s):	5890				
A. Cash		$ 0	5900		
B. Securities		0	5910		
C. Unrealized gain (loss) on open futures contracts		0	5920		
D. Value of long option contracts		0	5930		
E. Value of short option contracts		0	5935	0	5940
6. Amounts with other depositories designated by a foreign board of trade					
Name(s):	5950			0	5960
7. Segregated funds on hand (describe:)				0	5965
8. Total funds in separate section 30.7 accounts (to page 13, line 2)				$ 0	5970
9. Excess (deficiency) Set Aside Funds for Secured Amount (subtract line 7 Secured Statement Page 1 from Line 8)				$ 0	
10. Management Target Amount for Excess funds in separate section 30.7 accounts				$ 0	
11. Excess (defiency) funds in separate section 30.7 accounts over (under) Management Target Excess				$ 0	
12. Sum of Margin Deficits for 30.7 customers				$ 0	
13. Excess (Deficiency) of Residual Interest (Line 9) over Sum of Margin Deficits (Line 12)				$ 0	

Name of Company: Employer ID No: NFA ID No:

CFTC FORM 1-FR-FCM --- SEC FOCUS II --- SEC FOCUS II CSE

STATEMENT OF CLEARED SWAPS CUSTOMER SEGREGATION REQUIREMENTS AND FUNDS IN CLEARED SWAPS CUSTOMER ACCOUNTS UNDER 4D(F) OF THE CEA

Cleared Swaps Customer Requirements				
1. Net ledger balance				
A. Cash			$ 0	X500
B. Securities (at market)			$ 0	X510
2. Net unrealized profit (loss) in open cleared swaps			$ 0	X520
3. Cleared swaps options				
A. Market value of open cleared swaps option contracts purchased			$ 0	X530
B. Market value of open cleared swaps option contracts granted (sold)			$ 0	X540
4. Net equity (deficit) (add lines 1, 2, and 3)			$ 0	X550
5. Accounts liquidating to a deficit and accounts with debit balances - gross amount	$ 0	X560		
Less: amount offset by customer owned securities	$ 0	X570	$ 0	X580
6. Amount required to be segregated for cleared swaps customers (add lines 4 and 5)			$ 0	X590
Funds in Cleared Swaps Customer Segregated Accounts				
7. Deposited in cleared swaps customer segregated accounts at banks				
A. Cash			$ 0	X600
C. Securities representing investments of cleared swaps customers' funds (at market)			$ 0	X610
E. Securities held for particular cleared swaps customers in lieu of cash (at market)			$ 0	X620
8. Margins on deposit with derivatives clearing organizations in cleared swaps customer segregated accounts				
A. Cash			$ 0	X630
B. Securities representing investments of cleared swaps customers' funds (at market)			$ 0	X640
C. Securities held for particular cleared swaps customers in lieu of cash (at market)			$ 0	X650
9. Net settlement from (to) derivatives clearing organizations			$ 0	X660
10. Cleared swaps options				
A. Value of open cleared swaps long option contracts			$ 0	X670
B. Value of open cleared swaps short option contracts			$ 0	8680
11. Net equities with other FCMs				
A. Net liquidating equity			$ 0	X690
B. Securities representing investments of cleared swaps customers' funds (at market)			$ 0	X700
C. Securities held for particular cleared swaps customers in lieu of cash (at market)			$ 0	X710
12. Cleared swaps customer funds on hand (describe:)			$ 0	X715
13. Total amount in cleared swaps customer segregation (add lines 7 through 12)			$ 0	X720
14. Excess (deficiency) funds in cleared swaps customer segregation (subtract line 6 from line 13)			$ 0	X730
15. Management Target Amount for Excess funds in cleared swaps segregated accounts			$ 0	
16. Excess (Deficiency) funds in cleared swaps customer segregated accounts over (under) Management Target Excess			$ 0	
17. Sum of Margin Deficits for Cleared Swaps Customers			$ 0	
18. Excess (Deficiency) of Residual Interest (Line 14) over Sum of Margin Deficits (Line 17)			$ 0	

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Issued in Washington, DC, on October 23, 2012 by the Commission.

Stacy Yochum,

Counsel.

Appendices to Enhancing Protections Afforded Customers and Customer Funds Held by Futures Commission Merchants and Derivatives Clearing Organizations—Commission Voting Summary and Statements of Commissioners

Note: The following appendices will not appear in the Code of Federal Regulations.

Appendix 1—Commission Voting Summary

On this matter, Chairman Gensler and Commissioners Sommers, Chilton, O'Malia and Wetjen voted in the affirmative; no Commissioner voted in the negative.

Appendix 2— Statement of Chairman Gary Gensler

I support the proposed rules to enhance the protections afforded customers that participate in the futures and swaps markets, including the protection of customer funds held by futures commission merchants (FCMs) and derivatives clearing organizations.

The CFTC's mission is to ensure the integrity of the futures and swaps markets. As part of this, we must do everything within our authorities and resources to strengthen oversight programs and the protection of customers and their funds. And that's the goal of this proposal. It's about ensuring customers have confidence that the funds they post as margin or collateral are fully segregated and protected.

CFTC Commissioners and staff have reached out broadly on ways to enhance customer protections. We hosted two roundtables this year on issues ranging from the segregation of customer funds to examining the CFTC's oversight of self-regulatory organizations (SROs).

In July, the CFTC approved a National Futures Association (NFA) proposal that stemmed from a coordinated effort by the CFTC, the SROs, other financial regulators, and market participants, including from the CFTC's roundtable earlier this year.

This customer protection proposal incorporates these NFA rules into the Commission's regulations so that the CFTC

can directly enforce these important rules. Under this proposal, FCMs would be required to:

• Hold sufficient funds in Part 30 secured accounts (funds held for U.S. foreign futures and options customers trading on foreign contract markets) to meet their total obligations to customers trading on foreign markets computed under the net liquidating equity method. FCMs would no longer be allowed to use the alternative method, which had allowed them to hold a lower amount of funds representing the margin on their foreign futures;

• Maintain written policies and procedures governing the maintenance of excess funds in customer segregated and Part 30 secured accounts. Withdrawals of 25 percent or more would necessitate pre-approval in writing by senior management and must be reported to the designated SRO and the CFTC; and

• Make additional reports available to the SRO and the CFTC, including daily computations of segregated and Part 30 secured amounts.

Beyond the NFA rules, additional reforms in this proposal benefited from the CFTC's broad outreach and consultation with the SROs and market participants, as well as substantial feedback from CFTC Commissioners. They include:

• First, bringing the regulators' view of customer accounts into the 21st century by giving the SROs and the CFTC direct electronic access to FCMs' bank and custodial accounts for customer funds, without asking the FCMs' permission. Further, acknowledgement letters and confirmation letters must come directly to regulators from banks and custodians.

• Second, increasing disclosures to customers regarding the risks associated with futures trading and using FCMs to invest their funds. Futures customers, if they wish, should have access to information about how their assets are held, similar to that which is available to mutual fund and securities customers. FCMs would be required to provide current and potential customers with specific information about the FCM's risks.

• Third, enhancing controls at FCMs regarding how customer accounts are handled, including policies and procedures on supervision and risk management of customer funds.

• Fourth, setting standards for the SROs' examinations and the annual certified financial statement audits, including raising minimum standards for independent public accountants who audit FCMs.

• Fifth, requiring FCMs to ensure they back up segregated customer accounts with funds to cover potential margin deficits.

• Sixth, implementing a more effective early warning system for the Commission and the SROs that alerts them to certain problems, including a) when an FCM's funds are insufficient to meet the targeted residual interest in customer accounts b) when there is a material adverse impact to the FCM's creditworthiness and c) when there is a material change to the FCM's clearing or financial arrangements.

• And seventh, instituting a liquidity requirement for FCMs, in addition to the existing capital requirement, to better detect FCMs that have become distressed and may put customer funds at risk.

Prior to this proposal, the Commission already made some important improvements to protections for customer funds. They include:

• The completed amendments to rule 1.25 regarding the investment of funds that bring customers back to protections they had prior to exemptions the Commission granted between 2000 and 2005. Importantly, this prevents use of customer funds for in-house lending through repurchase agreements;

• Clearinghouses will have to collect margin on a gross basis and FCMs will no longer be able to offset one customer's collateral against another and then send only the net to the clearinghouse;

• The so-called ''LSOC rule'' (legal segregation with operational comingling) for swaps ensures customer money is protected individually all the way to the clearinghouse; and

• The Commission included customer protection enhancements in the final rule for designated contract markets. These provisions codify into rules staff guidance on minimum requirements for SROs regarding their financial surveillance of FCMs.

It is crucial that the CFTC, working with SROs and market participants, continues its efforts to enhance protections for the funds of both futures and swaps customers. We look forward to reviewing the public input on this proposal.

Appendix 3—Statement of Commissioner Jill E. Sommers

Today the Commission has proposed a new set of rules to, among other things, increase customer protections and disclosures, strengthen risk management programs, and enhance auditing and examination procedures for futures commission merchants (FCMs). In light of the recent events surrounding MF Global and Peregrine, I am, of course, supportive of such steps to the extent that they lead to greater customer protection and increased customer awareness of the risks associated with their futures and swaps accounts.

As always, I am sensitive to the fact that some regulation, while well intended, may not further its stated goals or may be so burdensome that the benefits do not justify the costs. I encourage members of the public to comment, both to support the aspects of this proposed rule that take appropriate steps towards achieving the Commission's objectives and to highlight the areas of the proposal that they believe may be unnecessary or that could be accomplished through more efficient means. In particular, I welcome comment on the Commission's proposal requiring an FCM to maintain residual interest in segregated accounts in an amount that exceeds the sum of all futures customers' margin deficits. Additionally, it would be helpful to hear from self-regulatory organizations (SROs) regarding whether reviews by an examinations expert would assist the SROs in the application of their respective supervisory programs.

I am hopeful that, with the help of thoughtful recommendations from market participants, the Commission will finalize an effective and streamlined rule improving protections for futures and swaps customers.

Appendix 4—Statement of Commissioner Scott O'Malia

In response to the Peregrine and MF Global failures, the Commission has proposed a new set of rules to enhance the level of protection afforded customers of the futures markets. In particular, the proposal calls for FCMs to maintain adequate capital in their customer accounts to ensure customers are not bearing the credit risk of their fellow customers, implement controls around the risks specific to a particular FCM's business, increase the level of disclosures provided to customers, and create an independent segregation account balance verification system. While these measures are a good start, I believe that it is essential to focus on a comprehensive technological solution that goes beyond what the Commission has proposed in this release. Technology can be a cost effective oversight tool for both customers and the Commission to enhance transparency and improve risk management. Improving our capacity to monitor money flows can serve as a significant deterrent against fraudulent behavior.

I encourage industry participants to voice their opinion as to how the proposals put forth today can be improved upon. Specifically, what technological solutions can be employed to facilitate the dissemination of information about FCMs to their customers so that they may ''know their FCM''? How can firms implement the new capital requirements in the most cost effective manner? What is the best method for an FCM to monitor its level of risk? I look forward to hearing from market participants on the most effective ways to implement the customer protection rules proposed by the Commission today.

I would also like to highlight one of today's proposals that will require additional development in order to fulfill the goal of customer protection. Today's proposal calls for the creation of an electronic balance confirmation process that would allow the Commission and Self-Regulatory Organizations (''SROs'') to independently check the balance of each segregated account held on behalf of customers. While this can be used to aid in the surveillance of account balances, the Commission proposal only works on an individual basis and requires significant human involvement to log in and monitor individual accounts. What the industry needs is a fully automated system that allows the Commission and SROs to download the account balances for each segregated account held for a customer and compare that balance to the figures on record at each FCM. In response to the Peregrine and MF Global failures, industry participants discussed the implementation of such a system in July of this year during the Commission's Technology Advisory Committee (TAC) meeting. During the meeting, the TAC members present were virtually unanimous in their belief that an automated customer fund verification system was needed. Certain TAC members also made presentations discussing the technological

hurdles that must be overcome in order to put such a system in place.

On October 30th we will have another TAC meeting during which SROs will update us on the status of this system's implementation and their estimates for when it will be fully operational. Only when this system is up and running can customers of the futures industry feel secure that their investments are in safe hands and properly monitored by both the Commission and SROs. This is an issue of utmost importance and requires collaboration on the part of the Commission, SROs and each and every Commission registrant. The end result of this process will provide customers with the assurance they need to continue investing in the derivatives markets.

I hope market participants will provide thoughtful recommendations to improve customer protections and deploy technology that is cost-effective to create and maintain. I also encourage market participants to provide specific data that the Commission can use to develop a robust cost benefit analysis.

[FR Doc. 2012–26435 Filed 11–13–12; 8:45 am]

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