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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; Final 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: Final rule.

SUMMARY: The Commodity Futures Trading Commission (''Commission'' or ''CFTC'') is adopting new regulations and amending 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 regulations also address certain related issues concerning derivatives clearing organizations (''DCOs'') and chief compliance officers (''CCOs''). The final rules will afford greater assurances to market participants that: Customer segregated funds, secured amount funds, and cleared swaps funds 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: *Effective date:* January 13, 2014.

Compliance date: The applicable compliance dates are discussed in the section of the release titled ''III. Compliance Dates.''

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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) [1] of the Commodity Exchange Act (''the Act'' or ''the CEA'') [2] 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.[3] 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 (''Dodd-Frank Act''),[4] requires each FCM to segregate from its own assets all money, securities, and other property deposited by Cleared Swaps Customers to margin Cleared Swaps.[5] Section 4d(f) also provides that an FCM shall treat and deal with all money, securities, and property of any swaps customer received to margin, guarantee, or secure a swap cleared by or through a DCO (including money, securities, or property accruing to the swaps customer as the result of such a swap) as belonging to the swaps customer. Section 4d(f) further provides that an FCM shall separately account for and not commingle with its own funds any money, securities, and property of a swaps customer, and shall not use such swaps customer's funds to margin, secure, or guarantee any trades or contracts of any swaps customer or person other than the person for whom the same are held.

The Commission 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. In addition, all futures customer funds must be separately accounted for, and may not be commingled with the money, securities or property of an FCM or of any other person, or be used to secure or guarantee the trades, contracts or commodity options, or to secure or extend the credit, of any person other than the one for whom the same are held. Regulation 1.20 also provides that an FCM or DCO may deposit futures customer funds only with a bank or trust company, and for FCMs only, a DCO or another FCM. The funds must be deposited under an account 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 the 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. Regulation 1.22 prohibits an FCM from using, or permitting the use of, the

[1] 7 U.S.C. 6d(a)(2).

[2] 7 U.S.C. 1 et seq.

[3] The term ''futures customer'' is defined in § 1.3(iiii) of the Commission's regulations to include any person who uses an FCM 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*. Commission regulations can be found at 17 CFR Ch. 1.

[4] 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/DoddFrankAct/index.htm.*

[5] The term ''Cleared Swap'' is defined in section 1a(7) of the Act as any swap that is, directly or indirectly, submitted to and cleared by a DCO registered with the Commission. 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.

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. In addition, § 1.22 provides that futures customer funds may not be used to carry trades or positions of the same futures customer other than in commodities or commodity options traded through the facilities of a contract market. Under § 1.20, an FCM or DCO may, however, 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, implements section 4d(f) of the Act and parallels many of the provisions in part 1 that address the manner in which, and the responsibilities imposed upon, an FCM may hold funds for futures customers trading on designated contract markets.[6] For example, § 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.[7] 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 Swaps 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 Cleared Swaps Customer Collateral of one Cleared Swaps Customer to purchase, margin, or settle the Cleared Swaps or any other trade or contract, or to secure or extend credit, of any person other than such Cleared Swaps Customer. 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 accordance with § 1.25.

In addition to holding funds for futures customers transacting on designated contract markets and for Cleared Swaps Customers engaging in Cleared Swaps, 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 (''U.S.'') 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 U.S. 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 Swaps.[8] 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 U.S.; a bank or trust company located outside of the U.S. 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 (except for certain qualifying subordinated debt) 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

[6] 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 was 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).

[7] The term ''Cleared Swaps Customer Collateral'' is defined in § 22.2 to mean all money, securities, or other property (including accruals) received by an FCM or DCO from, for, or on behalf of a Cleared Swaps Customer to margin, guarantee, or secure a Cleared Swap.

[8] The term ''foreign futures or foreign options customer'' is defined in § 30.1 to mean any person located in the U.S., its territories or possessions who trades in foreign futures or foreign options, with the exception of accounts that are proprietary accounts under § 1.3. The term ''foreign futures or foreign option'' is defined in § 30.1 to generally mean any futures and/or options transactions executed on a foreign board of trade.

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 designated self-regulatory organization (''DSRO'') monthly unaudited financial statements and an annual audited financial report.[9] 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 last two years. Those events, which are discussed in greater detail below, demonstrate that the risks of misfeasance and malfeasance, and the risks of an FCM 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 such excess funds makes the funds unavailable when they 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 were proposed by the Commission, 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 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. The Commission recently has moved to conducting continuous reviews of the SROs' FCM examination program that includes a process whereby 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 ''for cause'' situations 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 generally accepted auditing standards as adopted in the U.S. (''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 capital, 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

The recent insolvencies of two FCMs demonstrate the need for revisions to the Commission's customer protection regime. 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 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.[10] The shortfall in customer segregated accounts was attributed by the MFGI Trustee to significant transfers of funds

[9] 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 that is a member of two or more SROs under a joint audit agreement submitted to and approved by the Commission under § 1.52.

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

out of the customer accounts that were used by MFGI for various purposes other than to meet obligations to or on behalf of customers.

In addition, the Commission filed a civil injunctive complaint in federal district court on July 10, 2012, against Peregrine Financial Group, Inc. (''PFGI''), a registered FCM and its Chief Executive Officer (''CEO'') and sole owner, Russell R. Wasendorf, Sr., alleging that PFGI 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 PFGI falsely represented that it held in excess of $220 million of customer funds when in fact it held approximately $5.1 million.[11]

Recent incidents also have demonstrated the value of establishing robust risk management systems within FCMs and enhanced early warning systems to detect and address financial and regulatory 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 financial condition, raising questions as to whether the FCM will be able to protect customer funds [12] and maintain the minimum financial requirements mandated by the Act and Commission regulations.[13]

These recent incidents 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 futures 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 funds and secured amount balances, and detect fraud.

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 were 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.[14] 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 U.S. Government; (2) foreign sovereign debt; and (3) in-house and affiliate transactions.

In adopting 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.[15] 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 is posted by FCMs to the DCOs.

The Commission also approved regulations that impose requirements on FCMs and DCOs regarding the treatment of Cleared Swaps and Cleared Swaps Customer Collateral.[16] Under the traditional futures model, DCOs hold an FCM's futures customers' funds on an omnibus basis in a futures customer account. In the event of a double default, which is a situation where a futures customer defaults on its obligation to its clearing FCM and the loss is so great that the clearing FCM defaults on its obligation to the DCO, the DCO is permitted to use the funds held in the futures customers' omnibus account to cover the loss of the defaulting futures customer before applying its own capital or the guaranty fund contributions of non-defaulting FCM members.

The Commission approved an alternative model for Cleared Swaps. Under the ''LSOC'' (legal segregation with operational comingling) model, DCOs may hold Cleared Swaps Customer Collateral on an omnibus basis in a Cleared Swaps Customer Account.[17] However, unlike with the futures model, following a double default the DCO would only be permitted to access the collateral of the defaulting Cleared Swaps Customers; it would not be permitted to use the collateral of non-defaulting Cleared Swaps Customers to cover a defaulting Cleared Swaps Customer's losses.

Pursuant to section 724(c) of the Dodd-Frank Act, the final rule on segregation for uncleared swaps, approved by the Commission on October 30, 2013, implements the

[11] 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.

[12] The Commission notes that the definition of ''customer funds'' in § 1.3(gg) includes funds held for customers trading on designated contract markets and customers engaging in cleared swap transactions. However, as used in this notice, unless otherwise specified, the term ''customer funds'' also includes funds held for customers trading on foreign markets pursuant to part 30 of the Commission's regulations.

[13] *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).

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

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

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

[17] The term ''Cleared Swaps Customer Account'' is defined in § 22.1 and generally refers to an account that an FCM or a DCO maintains at a permitted depository for the Cleared Swaps (and related collateral) of Cleared Swaps Customers.

requirements of section 4s(l) of the CEA that Swap Dealers (''SDs'') and Major Swap Participants (''MSPs'') notify their counterparties that such counterparties have a right to require that any initial margin which they post to guarantee uncleared swaps be segregated at an independent custodian. Where the counterparty elects segregation for its initial margin, the account must be held at a custodian that is independent of both the counterparty and the SD or MSP.

The Commission also included customer protection enhancements in a final rulemaking for designated contract markets issued in June 2012. These enhancements codify into regulations staff guidance on minimum requirements for SROs regarding their financial surveillance of FCMs.[18] The regulations require a DCM to have arrangements and resources for effective 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 regulations 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 **Federal Register** 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.'' [19] 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 sought additional information through a series of roundtables and other meetings. On February 29 and March 1, 2012, the Commission solicited comments and held public roundtables 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.[20] 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.[21] Panelists and TAC members discussed potential technological solutions directed at enhancing the protection of customer 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.

The Commission also considered industry initiatives to enhance customer protections. 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.[22] 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.[23] 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'').[24] 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

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

[19] *Id.* at 36646.

[20] 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).*

[21] 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.*

[22] 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.*

[23] 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.*

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

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 Liquidating Equity Method may result in NFA initiating a Membership Responsibility Action 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 and CME Group Inc. (''CME'') also adopted rules requiring FCMs to instruct each depository holding futures customer funds to report such balances on a daily basis to the NFA or CME, respectively.[25] Initially, the NFA and CME retained the services of a third-party vendor which received account balance information directly from certain banks, custodians of securities, and money market funds, and passed such information on to the NFA and CME. The CME, however, took over the role of the third-party vendor effective October 29, 2013 and receives account information directly from all depositories holding futures customer funds. The CME also provides NFA with daily account balance information for the FCMs that NFA is the DSRO. The same process applies to the FCM's customer secured account(s) held for customers trading on foreign futures exchanges, and for the FCM's Cleared Swaps Customers engaging in Cleared Swaps.

In addition, NFA and CME expanded their oversight of FCMs under the amended rules, by developing programs that compare the daily balances reported by the depositories with the balances reported by the FCMs in their daily segregation reports. An immediate alert is generated for any material discrepancies.

E. The Proposed Amendments

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. To address these needs, the Commission issued a Notice of Proposed Rulemaking (''NPRM'') on November 14, 2012 (''the Proposal'') containing a series of amendments to enhance customer protections.[26]

The Proposal addressed six main issues. First, recognizing problems surrounding the treatment of customer segregated funds and foreign futures or foreign options secured amounts, the Commission proposed to amend several components of parts 1, 22, and 30 of the Commission's regulations to 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 proposed a new § 1.11 that establishes 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. 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 proposed 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 proposed 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 proposed amendments to § 1.55 that enhance the disclosures provided by FCMs.

II. Comments on the Notice of Proposed Rulemaking

The Proposal, aimed at: (1) Amending and enhancing its current customer protection regime; (2) imposing risk management requirements on FCMs; (3) requiring additional ''early warning'' notices from FCMs regarding material changes in their operations or financial condition; (4) imposing additional liquidity requirements for FCMs; (5) revising the examination process of FCMs by both the SROs and public accountants; and (6) requiring additional disclosures to customers concerning the risks of futures trading and the FCMs that hold customer funds. The Commission extended the initial 60-day comment period for approximately 30 additional days at the request of various commenters and in order to provide interested parties with an additional opportunity to comment on the proposal.[27] The comment period closed on February 15, 2013.

During the comment period the Commission held two public roundtables to solicit input on issues related to the proposal from a cross-section of the futures industry, including market participants, FCMs, DCOs, SROs, securities regulators, foreign clearing organizations, and academics. The Commission received more than 120 written submissions on the proposing release from a range of commenters.[28] Commission staff also met with representatives from at least eight of the commenters and other

[25] *See* NFA Financial Requirements Rules, Section 4. Financial Requirements and Treatment of Customer Property, and CME Rule 971, Segregation, Secured, and Cleared Swaps Customer Account Requirements.

[26] 77 FR 67866 (Nov. 14, 2012).

[27] 78 FR 4093 (Jan. 18, 2013).

[28] The written submissions from the public are available in the comment file on *www.cftc.gov*. They include, but are not limited to, those listed in the table in Appendix 1 to this release. In citing to the comments received during the discussion of the comments in this Section, the Commission used the abbreviations set forth in the table in Appendix 1.

members of the public. Commenters represented a broad spectrum of industry participants, trade organizations, law firms, accounting firms and self-regulatory organizations. The majority of commenters supported the overall principles proposed by the Commission although many raised concerns or offered suggestions regarding certain proposal specifics.

The Commission also held a meeting of the Agricultural Advisory Committee on July 25, 2013, and included in the agenda a discussion of the Proposal. The transcript of the Agricultural Advisory Committee meeting is included in the comment file to the Proposal, and the Commission has considered those comments in finalizing the regulations.

The Commission has carefully considered the comments received and is adopting the Proposal herein subject to various amendments that address certain concerns raised or suggestions made by commenters. Each section of the final rules, including any relevant revisions to the corresponding section of the Proposal, is discussed in greater detail in the following sections.

A. § 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 that is dually-registered as a BD, however, 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 with the Commission and with its DSRO an annual financial report certified by an independent public accountant.

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 reports 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.

1. Amendments to the Segregation and Secured Amount Schedules With Respect to the Reporting of Residual Interest

The Segregation Schedule and the Secured Amount Schedule generally indicate, respectively, (1) The total amount of funds held by the FCM in segregated or secured accounts; (2) 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 (3) whether the firm holds excess segregated or secured funds in the segregated or secured accounts as of the reporting date. FCMs also deposit proprietary funds into customer segregated and secured accounts to protect against becoming undersegregated or undersecured by failing to hold a sufficient amount of funds in such accounts to meet the regulatory requirements. This cushion of proprietary funds is referred to as the FCM's ''residual interest'' in the customer segregated and secured accounts.

The Commission proposed to amend § 1.10 to require each FCM to also disclose in the Segregation Schedule and in the Secured Amount Schedule its targeted amount of ''residual interest'' that the FCM seeks to maintain in customer segregated accounts and secured accounts as computed under § 1.11.[29] As more fully discussed in section II.B. below, new § 1.11(e)(3)(i)(D) requires the senior management of each FCM that carries customer funds to perform appropriate due diligence in setting the amount of the residual interest. Such due diligence 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 by the FCM, the FCM's own liquidity and capital needs, historical trends in customer segregation and secured account funds balances, and historical trends in customer debits and margin deficits (*i.e.,* undermargined amounts).[30] The FCM also is required to maintain policies and procedures establishing the targeted amount of residual interest that the FCM seeks to maintain as its residual interest in the segregated and secured accounts. The FCM's due diligence and policies and procedures must be designed to reasonably ensure that the FCM maintains the targeted residual interest amount and remains in compliance with its segregation requirements at all times.[31]

The disclosure of the targeted amount of the FCM's residual interest in segregated or secured accounts will allow the Commission and the FCM's DSRO to determine whether the FCM actually maintains funds in segregated and secured accounts in amounts sufficient to cover the respective targeted residual interest amounts. If a firm does not maintain sufficient funds to cover the targeted residual interest amounts, the Commission and/or DSRO will take appropriate steps to assess whether the FCM is experiencing financial issues that may indicate potential threats to the overall safety of customer funds. The disclosure of the amounts of the FCM's targeted residual interest also will enhance the Commission's and DSROs' surveillance of FCMs by providing information that will allow for the assessment of the size of the targeted residual interest relative to both the total funds held in segregation or secured accounts and to

[29] The Commission also proposed 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. No comments were received regarding the revisions to the title of the ''Secured Amount Schedule,'' and the Commission is adopting the revisions as proposed.

[30] The NPRM explained that a margin deficit occurs when the value of the customer funds for a customer's account is less than the total amount of collateral required by DCOs for that account's contracts. As explained further in the discussion in sections II.G.9., II.Q., and II.R., the term ''undermargined amount,'' as defined in §§ 1.22(c)(1), 22.2(f)(6)(i), and 30.7(f)(1)(ii)(A), is used in place of the term ''margin deficit'' in the final rule.

[31] The NFA adopted a similar amendment to its rules, mandating that 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*.

the size of the targeted residual interest maintained by other comparable FCMs. This information will assist the Commission and DSROs in the overall risk assessment of the FCMs, including the assessment of the potential risk that a firm may become undersegregated or undersecured. This additional information will further enhance the Commission's and DSROs' overall ability to protect customer funds.

The Commission also proposed to amend the Segregation Schedule and the Secured Amount Schedule to require each FCM filing such schedules to disclose the sum of the outstanding margin deficits (*i.e.,* undermargined amounts) as of the reporting date. The purpose of this disclosure was to demonstrate that the FCM's residual interest in the segregated and secured account exceeded the respective customer margin deficits (*i.e.,* undermargined amounts) as proposed in §§ 1.22 and 1.23.

The Commission has considered the proposal and has determined not to amend the Segregation Schedule and Secured Amount Schedule to require the disclosure of the undermargined amounts. As further discussed in sections II.G.9. and II.R. below, the Commission is revising the proposed amendments to § 1.22 that would have required an FCM to maintain at all times a residual interest in segregated or secured accounts in excess of its undermargined amounts. The final regulations being adopted in § 1.22, § 22.2, and § 30.7 will require computations as of different points in time than that of the computations reflected on the Segregation Schedule and the Secured Amount Schedule, which are prepared as of the close of business each day. The reporting of the undermargined amount information on the Segregation and Secured Amount Schedules would not be accurate as the firm's customers may not be undermargined, or may be less undermargined, at the time the undermargined amount calculations are required to be performed due, for example, to customers meeting margin calls.[32]

The Commission has considered the comments and is adopting the amendments to § 1.10 as proposed, with the above revisions to the Segregation Schedule and the Secured Amount Schedule.

2. New Cleared Swaps Segregation Schedules

The Commission proposed to amend § 1.10(d) and to revise the 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'').[33] The Commission proposed the Cleared Swaps Segregation Schedule to further implement section 724(a) of the Dodd-Frank Act. Section 724(a) of the Dodd-Frank Act amended section 4d of the Act by adding a new paragraph (f) to require an FCM to separately account for and segregate from its own assets Cleared Swaps Customers Collateral deposited by Cleared Swaps Customers. Section 4d(f) of the Act also requires FCMs to treat and deal with all the Cleared Swaps Customer Collateral deposited by a Cleared Swaps Customer as belonging to such customer, and prohibits an FCM from, with certain exceptions, using the Cleared Swaps Customer Collateral to margin, secure or guarantee the Cleared Swaps of any person other than the Cleared Swaps Customer who deposited the Cleared Swaps Customer Collateral. FCMs currently prepare a schedule comparable to the Cleared Swaps Segregation Schedule for Cleared Swaps under applicable contract market or NFA rules, and the Commission's proposal would codify existing practices.

The Commission received one comment on the proposed Cleared Swaps Segregation Schedule. The Students at the SUNY Buffalo Law School supported the development of the Cleared Swaps Segregation Schedule.[34] The Commission has considered the comment and has determined to adopt the Cleared Swaps Segregation Schedule as proposed.[35]

In addition, § 1.10 currently provides that the Commission will treat the monthly Form 1–FR–FCM reports, and monthly FOCUS Reports filed in lieu of the Forms 1–FR–FCM, as exempt from mandatory public disclosure for purposes of the Freedom of Information Act and the Government in the Sunshine Act.[36] Regulation 1.10(g)(2) provides, however, that the following information in Forms 1–FR–FCM, and the same or equivalent information in FOCUS Reports filed in lieu of Forms 1–FR–FCM, are publicly available: The amount of the FCM's adjusted net capital; the amount of the FCM's minimum net capital requirement under § 1.17; and the amount of its adjusted net capital in excess of its minimum net capital requirement. In addition, § 1.10(g)(2) further provides that the FCM's Statement of Financial Condition in the certified annual financial report and the Segregation Schedule and Secured Amount Schedule are public documents.

The Commission proposed to amend § 1.10(g)(2)(ii) to add the Cleared Swaps Segregation Schedule to the list of documents that are publicly available. The only comment that the Commission received regarding making the Cleared Swaps Segregation Schedule public was received from students at the SUNY Buffalo Law School. The students at the SUNY Buffalo Law School supported the development and implementation of the Cleared Swaps Segregation Schedule as a regulatory tool for the Commission to receive additional information and to provide greater protection to customer funds.[37] The students, however, also stated that the public disclosure of the Cleared Swaps Segregation Schedule and other financial information could

[32] The Commission notes, however, that it will receive notice under § 1.12 from an FCM if the firm maintains residual interest in the segregated or secured amount accounts that is less than the sum of the firm's undermargined amount at the point in time the FCM is required to maintain such undermargined amounts under § 1.22, § 22.2, and § 30.7. The notice provision will alert the Commission and the FCM's DSRO to the fact that the undermargined amounts exceed the firm's residual interest in the accounts, and the Commission and DSRO can monitor the firm's actions to restore its residual interest to a level that is above the undermargined amounts, or take other actions as appropriate. *See* section II.C. below.

[33] 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. *See* Capital Requirements of Swap Dealers and Major Swap Participants, 76 FR 27802 (May 12, 2011). The Commission re-proposed the schedule as part of the Proposal in light of the Commission's decision to revise the schedule by requiring FCMs to separately disclose their targeted residual interest in Cleared Swaps Customer Accounts and the sum of margin deficits (*i.e.,* undermargined amounts) for such accounts. The Commission also has adopted new regulations requiring FCMs to hold in segregated accounts funds received from customers engaging in Cleared Swaps to margin, secure or guarantee their Cleared Swaps in accordance with section 4d(f) of the Act. *See* 77 FR 6336 (Feb. 7, 2012).

[34] SUNY Buffalo Comment Letter at 7 (Mar. 19, 2013).

[35] The Commission will revise the Cleared Swaps Segregation Schedule consistent with the revisions to the Segregation Schedule and Secured Amount Schedule discussed in section II.A.1. to remove the requirement for the firm to disclose the amount of the margin deficits as of the close of business on the previous business day. In addition, § 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. Dual-registrant FCM/BDs that have Cleared Swaps Customers will also have to include a Cleared Swaps Segregation Schedule to their Focus Report filings.

[36] 5 U.S.C. 552.

[37] SUNY Buffalo Comment Letter at 8 (Mar. 19, 2013).

cause public panic in certain situations.[38] They cited MFGI and Bear Stearns as examples of how public panic can rapidly accelerate a company's collapse by exacerbating the effects of financial injuries that might otherwise be manageable.[39]

The Commission notes that the monthly Segregation Schedules and Secured Amount Schedules have been available to the public for many years and provide important information that allows customers to monitor the financial condition of FCMs. As noted in the Proposal, the Commission believes that making the Cleared Swaps Segregation Schedule publicly available will benefit customers and potential customers by providing greater transparency on the status of the Cleared Swaps Customer Collateral held by FCMs. This disclosure allows customers and other members of the public to review an FCM's compliance with its regulatory obligations to safeguard customer funds. The disclosure of the Cleared Swaps Segregation Schedule also will provide a certain amount of detail as to how the FCM holds Cleared Swaps Customer Collateral, which customers and potential customers will be able to assess as part of their risk management process.

The disclosure of the status of an FCM's compliance with its obligation to segregate customer funds, coupled with the additional firm risk disclosures that the Commission proposed in § 1.55 (and is adopting in relevant part herein as 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. The Commission believes that these benefits to customers outweigh any potential adverse market impact which, in any event, has not been shown to be an issue based on the Commission's experience in making FCMs' Segregation Schedules and Secured Amount Schedules publicly available. The Commission has, therefore, determined to adopt the amendments to § 1.10(g)(2) as proposed.

3. Amendments to Form 1–FR–FCM

The Commission proposed to amend several statements in the Form 1–FR–FCM. The Commission proposed to amend the Statement of Financial Condition by adding a new line item 1.D. Line 1 currently separately details: (1) The amount of funds that the FCM holds in segregated accounts for customers trading on designated contract markets (Line 1.A.); (2) the amount of funds held in segregation for dealer options (Line 1.B.); and (3) the amount of funds held in secured accounts for foreign futures and foreign option customers (Line 1.C.).

Proposed line item 1.D. would 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 requires 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.[40]

The Commission also proposed to amend the Statement of Financial Condition by adding a new line item 22.F., which would require the separate disclosure of the FCM's liability to Cleared Swaps Customers. The proposed amendments to disclosure the total amount of funds held by the FCM for Cleared Swaps Customers, and the FCM's total obligation to Cleared Swaps Customers, is consistent with the reporting required on the Form 1–FR–FCM for customers trading on designated contract markets.

The Commission also proposed to revise line item 27.J. of the Statement of Financial Condition to require an FCM to disclose separately 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 when conducted by an FCM under section 2(c) of the Act.[41]

NFA filed the only comment addressing the proposed amendments to the Statement of Financial Condition. NFA noted its full support of the proposed amendments to line item 27.J of the Statement of Financial Condition contained in Form 1–FR–FCM, and further requested that the Commission consider amending the asset section of the Statement of Financial Condition of Form 1–FR–FCM to require an FCM or Retail Foreign Exchange Dealer (''RFED'') to report the total funds on deposit to cover its obligations to retail forex customers as required by Commission Regulation 5.8.[42] NFA stated that this revision would result in more accurate reporting and is consistent with the reporting for customer segregated funds.[43]

The Commission has considered the comment and has determined to adopt the amendments as proposed. The Commission also is revising the Statement of Financial Condition in the Form 1–FR–FCM in response to the NFA's comment to include a new line item to require FCMs and RFEDs to separately disclose the assets held in qualifying accounts in excess of the firms' obligations to retail forex customers as required by Commission Regulation 5.8.

Regulation 5.8 requires each FCM and RFED offering or engaging in retail forex transactions to hold, at all times, assets of the type permissible in § 1.25 in an amount that exceeds the FCM's or RFED's total obligation to its retail forex customers at qualifying institutions set forth in the Regulation. The requirement of Regulation 5.8 is to ensure the RFED or FCM holds liquid assets in relation to the amount of liability to retail forex customers.[44] However, such retail forex customer funds are not held in ''segregated accounts'' in manner comparable to section 4d of the Act, which are provided with explicit protections in the event of the bankruptcy of the FCM. The Commission is revising the Statement of Financial Condition of the Form 1–FR–FCM to require each FCM or RFED to report on line 19.B. the aggregate amount of funds held in qualifying accounts to meet its total obligation to retail forex customers as required by § 5.8. Such disclosure will provide greater transparency as to the firm's compliance with Commission regulations.

4. FCM Certified Annual Report Deadline

The Commission proposed to amend § 1.10(b)(1)(ii) to require an FCM to submit its certified annual report to the Commission and to the firm's 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 its year-end date, except for FCMs that also are registered with the SEC as 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 would impact only FCMs that are not

[38] *Id.* at 8–9.

[39] *Id.*

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

[41] 7 U.S.C. 2(c).

[42] NFA Comment Letter at 9 (Feb. 15, 2013).

[43] *Id.*

[44] *See* 75 FR 3282, 3290 (Jan. 20, 2010).

dually-registered as BDs and would align the filing deadlines for both FCMs and dual registrant FCMs/BDs.

The Commission received one comment on the proposal. NFA supported the proposal noting that the amendment will provide both the Commission and DSROs with more timely information for monitoring the financial condition of an FCM.[45] The Commission considered the comment received and is adopting the amendments to § 1.10(b)(1)(ii) as proposed. The Commission also is cognizant of the fact that public accountants are currently engaged in the audit of FCMs for the year ending December 31, 2013 and possible for other year-end dates in 2014. Accordingly, in order to ensure that the amendments do not impede examinations that are currently in process, the Commission is establishing a compliance date for FCM annual audits for years ending June 1, 2014 or later. This compliance date also will align the revised reporting deadline with the auditing amendments to the auditing standards that public accountants use in the audit of FCMs and discussed in section II.E. below. Compliance dates are discussed further in section III below.

5. Leverage Ratio Calculation

The Commission proposed 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. Proposed § 1.10(b)(5) defined the term ''leverage'' as an FCM's 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 repurchase agreement) divided by the FCM's total capital (*i.e.,* the sum of the FCM's stockholders' equity and subordinated debt). FCMs currently file the same leverage information with NFA on a monthly basis using the same definition of the term ''leverage.'' The leverage ratio would provide information regarding the amount of assets supported by the FCM's capital base, and would allow the Commission to enhance its oversight of FCMs that are highly leveraged relative to their peers or based upon the Commission's understanding of the firm's business model.

The Commission received three comments with respect to this proposal. Commenters were concerned that the leverage metrics proposed might not provide meaningful information and/or that the Commission's leverage definition was not consistent with those of other regulatory authorities. NFA noted that while the leverage definition proposed by the Commission is the same definition as that set forth in NFA Financial Requirement Section 16, it may not be the most appropriate measure.[46] NFA noted that it has been studying an alternative calculation method and encouraged the Commission to defer codifying a single definition until it has the opportunity to examine NFA's calculation results.[47] NFA also suggested the Commission consider adopting a requirement that FCMs report a leverage ratio as defined by a registered futures association rather than including a specific definition in the Commission's regulations.[48]

FIA indicated that it supported the proposed amendment, but stated that it is essential that the definition of the term ''leverage'' be consistent among regulatory authorities with supervision over FCMs and encouraged the Commission to coordinate with the SEC and the relevant SROs to ensure consistent treatment across the industry.[49]

RJ O'Brien objected to the proposal on the grounds that the definition of ''leverage'' in the proposal ''penalizes'' FCMs that are not dually-registered as BDs.[50] RJ O'Brien stated that an FCM-only entity's balance sheet is primarily composed of funds deposited by customers for trading commodity interests, and that the leverage ratio computed under the proposed regulation does not properly reflect the risk of the firm's business.[51] RJ O'Brien recommended that the Commission work with NFA to develop a more meaningful metric and further recommended that the Commission not permit or require public disclosure of FCM leverage ratios under the current methodology because RJ O'Brien believes it could provide the public with misleading information.[52]

The Commission has considered the comments and has determined to adopt a final regulation requiring FCMs to submit to the Commission monthly balance sheet leverage information. As noted above, such information will enhance the Commission's ability to conduct financial surveillance of FCMs. The final regulation, however, will define the term ''leverage'' by referencing to the rules of a registered futures association as suggested by NFA. This revision to the final regulation will align the Commission's definition of leverage with the current NFA definition of leverage.[53]

As stated above, in proposing the requirement for FCMs to report their monthly leverage ratios, the Commission intended for FCMs to file the same leverage information that they currently file with the NFA. In this regard, the Commission proposed a definition of leverage that is identical to the current NFA definition contained in its Financial Requirement Section 16. Such an approach will enhance the consistency in how the Commission and the SROs impose leverage reporting requirements on FCMs and in how leverage is monitored by the regulators. Furthermore, in response to RJ O'Brien's comment, the Commission intends to work with NFA and other regulators going forward on any revisions to the definition of ''leverage'' to maintain as consistent a definition as practicable.

6. Procedural Filing Requirements

The Commission proposed to amend § 1.10(c)(2)(i) to require FCMs to electronically file with the Commission their monthly unaudited Forms 1–FR–FCM or FOCUS Reports and their certified annual financial reports. FCMs currently file their monthly unaudited financial statements with the Commission electronically using the WinJammer Online Filing System (''WinJammer'') and the proposed amendments merely codify current practices.[54]

FCM annual financial reports are filed in paper form with the Commission. Under the Commission's proposal, an FCM would use the WinJammer system to electronically file its certified financial report as a ''PDF'' document.

No comments were received on the proposed amendments to § 1.10(c)(2)(i). The Commission is adopting the amendments as proposed.

The Commission also is adopting a proposed technical amendment to § 1.10(c)(1) on which no comments were received. 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

[45] NFA Comment Letter at 9 (Feb. 15, 2013).

[46] NFA Comment Letter at 7–8 (Feb. 15, 2013).

[47] *Id.* at 7.

[48] *Id.* at 8.

[49] FIA Comment Letter at 12 (Feb. 15, 2013).

[50] RJ O'Brien Comment Letter at 8–9 (Feb. 15, 2013)

[51] *Id.*

[52] *Id.*

[53] NFA is currently the only registered futures association.

[54] WinJammer is a web-based application developed and maintained jointly by the Chicago Mercantile Exchange and the NFA. The WinJammer system is provided at no cost to FCMs. 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.

when received by the Commission Regional office with jurisdiction over the state in which the FCM has its principal place of business. The amendments to § 1.10(c)(1) sets forth the jurisdiction of each of the Commission's three Regional offices under § 140.02, and is intended to ensure that FCM's financial reports are filed expeditiously with the correct Commission Regional office.

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

The Commission proposed new § 1.11 to require each FCM that carries customer accounts to establish a ''Risk Management Program,'' as defined in § 1.11(c), designed to monitor and manage the risks associated with the FCM's activities as an FCM. Under the Commission's proposal, the Risk Management Program must: (1) consist of written policies and procedures that have been approved by the ''governing body'' (defined below) of the FCM and furnished to the Commission; and (2) establish a risk management unit that is independent from an FCM's ''business unit'' (defined below) to administer the Risk Management Program.

NFA, FIA, ICI, CFA, Chris Barnard, and Paul/Weiss generally supported proposed § 1.11.[55] Advantage stated ''that most aspects of proposed § 1.11 are appropriate and unlikely to be burdensome as FCMs typically have most (if not all) of these requirements in place.'' [56] Several other commenters raised issues with specific components of the proposed regulation, which are discussed in the sections below. The Commission has considered the comments received and is adopting § 1.11 as proposed, with the following observations and clarifications.

1. Applicability

Proposed paragraph (a) of § 1.11 provides that the regulation would only apply to FCMs that accept 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. FCMs that do not accept or hold customer funds to margin, guarantee or secure commodity interests are generally not operating as FCMs, and are not subject to § 1.11. To clarify, the Commission notes that it would expect registered FCMs that do not accept customer funds to establish a Risk Management Program that complies with § 1.11 and file such program with the Commission and with the FCMs' DSROs prior to changing their business model to begin accepting customer funds.

The Commission also requested comment on whether different risk management requirements for FCMs should be based upon some measurable criteria, such as size of the firm, and whether different elements of § 1.11 should apply to smaller FCMs versus larger FCMs. Advantage stated that a one-size fits all approach is less than optimal, and that the Commission could establish minimum risk management standards for specific business lines/customer type, and then require that FCMs engaging in those lines of business/clearing that type of customer have those programs in place.[57]

The Commission has considered the comment and has determined that § 1.11 provides sufficient flexibility for FCMs to establish a risk management program that is appropriate to its business operations. To develop specific requirements for different business activities would not be appropriate in that each FCM may operate in a different manner. The Commission believes that each FCM can develop its own program to meet its business activities using the general framework established by § 1.11.

The Commission received no additional comments on proposed § 1.11(a) and is adopting the provision as proposed.

2. Definitions

The Commission proposed definitions of the terms ''customer,'' ''business unit,'' ''governing body,'' ''segregated funds,'' and ''senior management'' in paragraph (b) of § 1.11. These definitions are designed to ensure that there is accountability at the highest levels for the FCM's key internal controls and processes regarding the FCM's responsibility to meet its obligations as a futures market participant, including acting as an intermediary for customer transactions, and its obligation to safeguard customer funds.

The term ''business unit'' was proposed to include generally any department, division, group or personnel of an FCM or any affiliate involved in soliciting orders and handling customer money, including segregation functions, and personnel exercising direct supervisory authority over the performance of such activities. The definition was intended to delineate clearly the separation of the risk management unit required by the regulation from the other personnel of an FCM from whom the risk management must be independent.

The term ''customer'' was proposed 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 contracts or options on futures contracts listed on foreign contract markets, and Cleared Swaps Customers (as defined in § 22.1) engaging in Cleared Swaps.

The term ''governing body'' was proposed to be 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 liability partnership. The term ''senior management'' was proposed to mean any officer or officers specifically granted the authority and responsibility to fulfill the requirements of senior management under proposed § 1.11 by the governing body.

The term ''segregated funds'' was proposed to mean money, securities, or other property held by an FCM in separate accounts pursuant to § 1.20 for futures customers, pursuant to § 22.2 for Cleared Swaps Customers, and pursuant to § 30.7 for 30.7 customers. The proposed definition of ''segregated funds'' makes clear that the requirements of § 1.11 apply to all customer funds that may be held by an FCM. The Act and Commission regulations currently require FCMs to hold each type of segregated funds in separate accounts and to segregate such segregated funds from the FCM's own funds and to segregate each class of segregated funds from each other type, except if otherwise permitted by Commission rule, regulation or order.[58]

The Commission did not receive any comments regarding the proposed definitions in § 1.11(b) and is adopting the amendments as proposed.

3. Approval of Policies and Procedures and Submission to the Commission

The Commission proposed § 1.11(c) to require each FCM to establish, maintain, and enforce a system of risk management policies and procedures

[55] NFA Comment Letter at 10 (Feb. 15, 2013); FIA Comment Letter at 52 (Feb. 15, 2013); ICI Comment Letter at 7 (Jan. 14, 2013); CFA Comment Letter at 4 (Feb. 13, 2013); Chris Barnard Comment Letter at 2 (Dec. 18, 2012); Paul/Weiss Comment Letter at 2 (Feb. 15, 2013).

[56] Advantage Comment Letter at 2 (Feb. 15, 2013).

[57] Advantage Comment Letter at 2 (Feb. 15, 2013).

[58] *See* 7 U.S.C. 6d(a)(2) and 7 U.S.C. 6d(f).

designed to monitor and manage the risks associated with the activities of the FCM as an FCM.[59] The policies and procedures are collectively referred to as the FCM's Risk Management Program.

Under proposed § 1.11, the FCM's governing body is required to approve in writing the FCM's Risk Management Program and any material changes to the Risk Management Program. The FCM also is required to provide a copy of the Risk Management Program to the Commission and to the FCM's DSRO upon application for registration or upon request by the Commission or by the FCM's DSRO. The filing of the Risk Management Program is intended to allow the Commission and the FCM's DSRO to monitor the status of risk management practices among FCMs.

Several commenters expressed general support for the requirement that an FCM implement a risk management program.[60] The Commission received no other comments on proposed § 1.11(c) and is adopting the amendments as proposed.

4. Organizational Requirements of the Risk Management Program

a. Separation of Risk Management Unit from Business Unit

The Commission proposed § 1.11(d), requiring an FCM to establish a risk management unit that is independent from the FCM's business unit to administer the Risk Management Program. As part of the Risk Management Program, each FCM must 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. The risk management unit is required to report directly to senior management.

Several commenters opposed the separation of the risk management unit from the business unit. RCG stated that requiring FCMs to separate the risk management function from the ''business unit'' is unnecessary, counterproductive, and will likely result in increased risk to the FCM and its customers.[61] RCG argued that the proposed requirement removes a valuable, mature talent pool from participating in risk management, and the proposal is counterproductive in that it has the potential of blocking the flow of historical and financial information about a customer from the business side of the FCM to the risk management side of the FCM, information that is crucial to evaluating risk.[62]

Phillip Futures Inc. stated that the proposed separation of the business unit from the risk management unit will lead to a decrease in the timeliness of decision making as decisions will have to be filtered through new supervisory employees that the proposal will ultimately create, which will hinder each FCM's ability to assess risk.[63] Phillip Futures Inc. stated that so long as internal controls, senior leadership, and training programs of a firm are created with the proper checks and balances which ensure proper supervision of activities conducted by the business unit and the risk management unit, the respective units need not be independent from each other.[64] Phillip Futures Inc. also asserted that the separation of duties required by the regulation would require it to hire multiple employees who would have limited job responsibilities.[65]

CHS Hedging stated that it would not be realistic or cost effective for smaller FCMs to establish an entirely separate risk management unit, and argued that if supervisory risk management personnel report to senior management separately from the business side to avoid a conflict of interest, a standalone unit should not be required.[66]

RJ O'Brien also argued that requiring FCMs to create a separate risk management unit is not operationally or financially practical for all FCMs, particularly small to midsized FCMs, and needlessly increases the costs of compliance for most firms without producing significant benefits.[67] RJ O'Brien stated that supervisors at many small to mid-sized FCMs have the knowledge and expertise that can be essential to maintaining a strong risk management program at their firm, however, such supervisors also may have a role in the business unit activities.[68] They proposed that the Commission revise the proposed regulation such that supervisors of business unit personnel are permitted to be part of the risk management unit provided that such supervisors are not compensated in connection with soliciting or accepting orders for the purchase or sale of any commodity interest.[69]

The Commission notes that, as stated above, only employees involved in soliciting orders and handling customer money (including the segregation functions), and employees directly supervising such activities would fall within the definition of ''business unit'' under § 1.11(b)(1). Therefore, the Commission does not agree with the assertion that a large pool of employees will be barred from participating in the risk management unit. Further, the Commission observes that the independence of the risk management unit required by proposed § 1.11 does not require FCMs to establish information partitions between the risk management unit and members of the business unit, and disagrees with commenters that such independence requirement would block the flow of historical and financial information about a customer from the business side of the FCM to the risk management side of the FCM. In any event, the Commission believes that the freedom from conflicts of interests that the independence of the risk management unit provides is critically important to the protection of customer funds in the custody of the FCM.

The FIA commented that in adopting the rules governing risk management programs for SDs and MSPs, the Commission clarified the interpretation of certain provisions, and asked that the Commission confirm that such clarifications apply equally to the provisions of § 1.11.[70] In general, the FIA requested the Commission to confirm, subject to certain exceptions or requirements, that the requirements of § 1.11:

(1) Do not prescribe rigid organization structures;

(2) do not require an FCM's risk management unit to be a formal division in the FCM's organizational structure, provided that the FCM will be able to identify all personnel responsible for required risk management activities

[59] Because § 1.11 applies to all FCMs that accept money, securities, or property (or extend credit in lieu thereof) from customers, it necessarily applies to any risks generated by the FCMs customers' trading activities. *See, e.g., In re FCStone LLC,* CFTC Docket 13–24, (May 29, 2013), where a customer's trading activities and the FCM's inadequate risk management practices caused the firm to lose over $127,000,000.

[60] *See* Franklin Comment Letter at 2 (Feb. 15, 2013); AIMA Comment Letter at 1 and 4 (Feb. 15, 2013); TIAA–CREF Comment Letter at 3 (Feb. 15, 2013).

[61] RCG Comment Letter at 5 (Feb. 12, 2013). *See also* Phillip Futures Inc. Comment Letter at 2 (Feb. 14, 2013).

[62] RCG Comment Letter at 5 (Feb. 12, 2013). *See also* Phillip Futures Inc. Comment Letter at 2 (Feb. 14, 2013).

[63] Phillip Futures Inc. Comment Letter at 2 (Feb. 14, 2013).

[64] *Id.*

[65] *Id.*

[66] CHS Hedging Comment Letter at 3 (Feb. 15, 2013).

[67] RJ O'Brien Comment Letter at 9 (Feb. 15, 2013).

[68] *Id.*

[69] *Id.*

[70] *See* 77 FR 20128 (April 3, 2012).

even if such personnel fulfill other functions; and

(3) Allow FCMs to establish dual reporting lines for risk management personnel performing functions in addition to their risk management duties, provided that § 1.11 would not permit a member of the risk management unit to report to any officer in the business unit for any non-risk management activity.[71]

The FIA further commented that the ''policies and procedures'' approach provides an adequate amount of flexibility that will allow the FCMs to rely upon any existing compliance or risk management capabilities to meet the requirements of the rule.[72]

The Commission generally agrees with the FIA in that, while the requirements of § 1.11 represent prudent risk management practices, they do not prescribe rigid organizational structures. The Commission also believes that the ''policies and procedures'' approach provides an adequate amount of flexibility that will allow FCMs to rely upon any existing compliance or risk management capabilities to meet the requirements of the final rule. The Commission further believes that nothing in § 1.11 would prevent FCMs from relying upon existing compliance and risk management programs to a significant degree.

As the Commission confirmed in its final rulemaking discussing § 23.600(b) regarding the risk management program for SDs and MSPs, the Commission also confirms that § 1.11(d) does not require a registrant's risk management unit to be a formal division in the registrant's organizational structure, provided that the FCM will be able to identify all personnel responsible for required risk management activities as its ''risk management unit'' even if such personnel fulfill other functions in addition to their risk management activities; and permits FCMs to establish dual reporting lines for risk management personnel performing functions in addition to their risk management duties, but this rule would not permit a member of the risk management unit to report to any officer in the business unit for any non-risk management activity.[73] Such dual reporting invites conflicts of interest and would violate § 1.11's risk management unit independence requirement.

The Commission notes that the formal independence of the risk management unit from the business unit does not relieve an FCM from the duty to resolve other conflicts of interest that may have an adverse effect on the effectiveness of the FCM's risk management program. An FCM's CCO is required under § 3.3(d)(2) to resolve any conflicts of interest that may arise, in consultation with the FCM's board of directors or its senior officer. Thus, the Commission would expect an FCM to recognize and eliminate or appropriately mitigate any conflict of interest between the FCM's business interests and its duty to establish and maintain an effective risk management program.

Having considered the comments regarding § 1.11(d), the Commission is adopting the provision as proposed.

5. Components of the Risk Management Program

The Commission's 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. Those elements 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.

Proposed § 1.11(e)(1)(ii) requires the Risk Management Program to take into account risks posed by affiliates, all lines of business of the FCM, and all other trading activity engaged in by the FCM. The FIA asked the Commission to confirm its position that, to the extent that many FCMs are part of a larger holding company structure that may include affiliates that are engaged in a wide array of business activities, the Commission understands that, in some instances, the top level company in the holding company structure, which has the benefit of an organization-wide view, is in the best position to evaluate the risks that an affiliate of an FCM may pose to the FCM.[74] Therefore, to the extent an FCM is part of a holding company within an integrated risk management program, the FCM may address affiliate risks and comply with § 1.11 through its participation in a consolidated entity risk management program provided that such program does in fact assess the risks posed to the FCM by its affiliated entities.[75]

The Commission recognizes that some FCMs will be part of a larger holding company structure that may include affiliates that are engaged in a wide array of business activities. The Commission understands with respect to these entities, that in some instances, the top level company in the holding company structure is in the best position to evaluate the risks that an affiliate of an FCM may pose to the enterprise, as it has the benefit of an organization-wide view and because an affiliate's business may be wholly unrelated to an FCM's activities. Therefore, to the extent an FCM is part of a holding company with an integrated risk management program, the Commission would allow an FCM to address affiliate risks and comply with § 1.11(e)(1)(ii) through its participation in a consolidated entity risk management program.

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 commodity interests. 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, § 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;[76] (2) 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;[77] (3) establishing

[71] FIA Comment Letter at 54–55 (Feb. 15, 2013).

[72] *Id.* at 52.

[73] 77 FR 20128 (April 3, 2012).

[74] FIA Comment Letter at 55 (Feb. 15, 2013).

[75] *Id.*

[76] The evaluation process must include documented criteria that any depository will be assessed against in order to qualify to hold funds belonging to customers. The criteria must address a depository's capitalization, creditworthiness, operational reliability, and 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.

[77] As required by § 1.20, such account opening documentation is necessary to ensure that the

Continued

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 the 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;[78] (5) procedures for assessing the appropriateness of investing customer funds in accordance with § 1.25;[79] (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;[80] (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 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 final rule, the 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 (*i.e.,* undermargined amounts). 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 the 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.[81] 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.

Proposed § 1.11(e)(3)(i)(G) requires 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. Phillip Futures Inc. stated that such a separation of duties would require it to hire multiple employees that would have limited job responsibilities, and suggested that as long as internal controls are adequate and supervisory personnel are properly registered with the Commission and NFA, the separation of duties is not necessary.[82]

Regulation 1.11(e)(3)(i)(I) requires that the written policies and procedures include procedures for the reporting of suspected breaches of the policies and procedures to the CCO, without fear of retaliation, and the consequences of failing to comply with the segregation requirements of the Act and regulations. Chris Barnard recommended that the procedures for reporting breaches should allow and stress the complete anonymity of the reporting party (whistleblower).[83] The Commission takes note of Mr. Barnard's comments related to whistleblowers as sound practices. The Commission notes, however, that such additional requirements were not proposed and, in any event, are outside the scope of this rulemaking.[84]

Also, 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.

The Commission has considered the comments received on the proposal and, for the reasons stated above, is adopting § 1.11(e) as proposed.

6. Annual Review, Distribution of Policies and Procedures and Recordkeeping

The Commission's proposal also includes: (1) § 1.11(f) which 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; (2) § 1.11(g) which requires the timely distribution of written risk management policies and procedures to relevant supervisory personnel; and (3) § 1.11(h) which discusses recordkeeping and availability of records. The Commission received no comments on paragraphs (f), (g), and (h) of § 1.11 and is adopting the paragraphs as proposed.

7. CCO or CEO Certification

Regulation 3.3 requires the CCO or CEO 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

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.

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

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

[80] 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.

[81] 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.9., II.H., and II.I. for §§ 1.20, 1.22, and 1.23, respectively, that residual interest exceed the sum of outstanding undermargined amounts 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.

[82] Phillip Futures Inc. Comment Letter at 2 (Feb. 14, 2013).

[83] Chris Barnard Comment Letter at 2 (Dec. 18, 2012).

[84] The Commission further notes that it maintains a whistleblower program that provides for the anonymous reporting of violations of the Act and Commission regulations. *See* part 165 of the Commission's regulations.

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.[85] The annual report also must include a certification by the CCO or CEO 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 requested comment on whether the standard for the CCO's or CEO's certification in the annual report (*i.e.,* based on the CCO's or CEO's knowledge and reasonable belief) required under § 3.3 is adequate for a certification of the FCM's compliance with policies and procedures for the safeguarding of customer funds. Specifically, the Commission requested comment on whether § 1.11 should contain a separate CCO or CEO certification requirement that would impose a higher duty of strict liability or some other higher obligation on a CCO or CEO.

The Commission received three comments in this regard. NFA and FIA believed that the ''knowledge and reasonable belief'' standard in § 3.3 remains appropriate for a CCO's/CEO's certification regarding an FCM's customer funds safeguards.[86] That is, the CCO or CEO should not be liable for matters that are beyond the CCO's/CEO's knowledge and reasonable belief. Further, NFA stated that the Commission should reconsider whether the CCO's/CEO's annual report should contain a separate certification (with the ''knowledge and reasonable belief language'') executed by the FCM's CEO or CFO regarding the adequacy of the FCM's customer funds safeguards.[87] Newedge opposed the imposition of a strict liability standard on a CCO/CEO for the annual certifications because the CCO/CEO is relying on internal representations from other FCM employees that are far more expert regarding these matters.[88] Newedge stated that such a standard would make it difficult to recruit qualified persons to serve as a CCO/CEO.[89]

In response to these comments, the Commission is not requiring a separate CCO/CEO certification requirement imposing a higher duty of strict liability or other standard for the segregation of customer funds. The Commission also is not imposing a separate certification by the FCM's CEO or CFO at this time. Commission staff will monitor the role of the CCO/CEO as the regulation is implemented and propose to the Commission any amendments to the CCO's/CEO's standard for certifying compliance as deemed appropriate based upon staff's experiences.

C. § 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 that may indicate a possible threat to the financial condition of the firm or to the safety of customer funds held by the FCM. Regulation 1.12 currently obligates FCMs 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)). As discussed further below, the Commission proposed to amend § 1.12 to include several additional reportable events and to revise the process for submitting reportable events to the Commission and DSROs.

1. Timing of Notices

The proposed new reportable events, discussed individually below, will require immediate notice to the Commission and the firm's DSRO upon the occurrence of the relevant event. FIA commented that while it is not opposed to a requirement for FCMs to provide prompt notice of a reportable event, it questioned the need for ''immediate'' notice as proposed by the Commission.[90] FIA recommended that if the Commission determined to adopt the proposed early warning notices that it allow 24 hours if the event is financial in nature and 48 hours for business-related events in order to afford FCMs time to determine the cause of the event and take an appropriate corrective action.[91]

The purpose of the ''early warning'' notice system established under § 1.12 is to provide the Commission and an FCM's DSRO with adequate and prompt notice of a reportable event in order to allow Commission staff to assess the situation and to consult with the registrant and the SROs to determine if further action is necessary in order to protect customer funds or to determine if the FCM can continue to meet its obligations to the marketplace and clearing process. The filing of a notice is often the first step where the Commission staff is alerted to a potential issue at a firm. The Commission also initiates a dialogue with the firm and the firm's DSRO, as necessary, upon receipt of a § 1.12 notice.

Given the critical role that notices play in the Commission's and DSRO's surveillance of FCMs, the Commission believes that immediate notice is necessary when a reportable event is financial in nature (*e.g.,* the FCM is not in compliance with the Commission's capital or segregation requirements). In such situations, the firm should file immediate notice with the Commission. If a firm needs additional time to assess the cause of the reportable event, or if additional time is needed to document what steps the FCM will take to remedy the situation causing the reportable event, it may file an amendment to its initial notice with the Commission. In addition, in a situation where the registrant is reporting that it is undercapitalized or undersegregated, the Commission and DSRO will have initiated an ongoing dialogue whereby the Commission and the DSRO will be in frequent communication with the registrant and will receive updated information as the registrant becomes aware of the facts.

Reportable events that are not related to an FCM's ability to meet its financial obligations or not directly related to the protection of customer funds may not be subject to the same sense of immediacy and the Commission is revising its proposed regulations accordingly. The revisions to the proposed amendments are discussed in the appropriate sections below with the comments received on the proposed new notice provisions.

2. Undercapitalized FCMs and IBs

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

[85] 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).

[86] FIA Comment Letter at 11 (Feb. 15, 2013); NFA Comment Letter at 10 (Feb. 15, 2013).

[87] NFA Comment Letter at 10 (Feb. 15, 2013).

[88] Newedge Comment Letter at 3 (Feb. 15, 2013).

[89] *Id.*

[90] FIA Comment Letter at 37–38 (Feb. 15, 2013).

[91] *Id.*

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 proposed to amend § 1.12(a) to clarify 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 may not delay filing the notice until it has adequate information to compute its actual level of adjusted net capital.

NFA commented in support of the Commission's proposal noting that in situations where an FCM is in potential distress, it may be even more important for the Commission and the firm's DSRO to become immediately aware of the situation so that the Commission and DSRO staff can assist in determining the firm's current, accurate financial condition.[92] The Commission agrees that it is imperative that an FCM or IB provide immediate notice if the firm is undercapitalized and, accordingly is adopting the amendment as proposed.

3. Insufficient Segregation of Funds of Cleared Swaps Customers

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 proposed 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.[93] The amendment will ensure immediate notification of a failure to hold sufficient funds in segregation for Cleared Swaps Customers so that the Commission and the firm's DSRO can promptly assess the financial condition of an FCM and determine if there are threats to the safety of the Cleared Swaps Customers Collateral held by the FCM. The amendment also harmonizes the notice requirements whenever an FCM fails to hold in proper segregated or secured accounts sufficient funds to meet its total obligations to futures customers, 30.7 customers, and Cleared Swaps Customers.

The Commission did not receive any comments on proposed § 1.12(h). The Commission is adopting the amendments to paragraph (h) as proposed.

4. Investment of Customer Funds in Contravention of Regulation 1.25

The Commission also proposed to amend § 1.12 by adding new paragraph (i) to require an FCM to provide immediate 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 limitations contained in § 1.25(b)(3). The proposal applies to funds held for futures customers, 30.7 customers, and Cleared Swaps Customers.

The Commission received no comments on the proposed amendments to § 1.12(i). The Commission is adopting paragraph (i) as proposed.

5. Notice of Residual Interest Falling Below Targeted Level or Undermargined Amounts

The Commission proposed to amend § 1.12 to provide a new paragraph (j) to 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 secured accounts for 30.7 customers, sufficient to meet the firm's targeted residual interest in one or more of these accounts as computed under proposed § 1.11, which is being adopted herein, or if its residual interest in one or more of these accounts is less than the sum of outstanding margin deficits (*i.e.,* undermargined amounts) for such accounts. Regulation 1.11, as adopted herein, also requires 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 possibility of the FCM being undersegregated or undersecured due to a withdrawal of proprietary funds from a segregated or secured account.

FIA questioned the necessity of the proposed provision noting that under the proposed amendments to § 1.32 each FCM holding customer funds is required to file a report with the Commission on a daily basis that will disclose if the FCM's residual interest has fallen below the FCM's targeted amount or if the residual amount is less than the sum of the customers' margin deficits.[94] FIA also noted that under current regulations an FCM's residual interest will frequently fall below its targeted amount and that if the Commission adopts its proposed amendments to §§ 1.20, 22.2 and 30.7 to require an FCM to use proprietary funds to cover margin deficits, withdrawals in excess of 25 percent of the firm's residual interest will likely be a daily event requiring daily notices to be filed with the Commission and with the FCM's DSRO.[95]

One of the primary objectives of the proposed amendments to § 1.12 is to ensure that the Commission and DSROs receive notice of potential financial or operational issues at an FCM, or of rule violations by an FCM, in as timely a manner as possible such that the Commission and the FCM's DSRO will be in a position to assess the issues and the potential impact on the FCM's ability to meet its regulatory obligations and its ability to safeguard customer funds. While the proposed amendments to § 1.32 do require each FCM holding customer funds to file on a daily basis a Segregation Schedule, Secured Amount Schedule, and Cleared Swaps Segregation Schedule (as appropriate) that includes information concerning the amount of the firm's actual and targeted residual interests, the notice required by § 1.12(j) requires the firm to include a discussion of the cause of the event, and what steps the firm will take to increase the residual interest. The notice will assist the Commission and the DSROs in determining what, if any, additional steps may be necessary in order to mitigate potential market disruptions if the FCM cannot meet its regulatory obligations, and will enhance the overall safety of customer funds. In addition, the Commission believes that the filing of a notice by an FCM will focus greater attention by management at the firm on the fact that the firm's

[92] NFA Comment Letter at 10 (Feb. 15, 2013).

[93] Commencing November 13, 2012, the compliance date for certain Commission part 22 regulations, FCMs are 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. 77 FR 6336 (Feb. 7, 2012).

[94] FIA Comment Letter at 38 (Feb. 15, 2013). The Commission is proposing to require each FCM to file with the Commission and with the firm's DSRO a daily: (1) Segregation Schedule (§ 1.32); (2) Secured Amount Schedule (§ 30.7); and, (3) Cleared Swaps Segregation Schedule (§ 22.2)). The Commission proposed to include information disclosing the FCM's targeted residual interest and whether the amount of the actual residual interest exceeds the targeted residual interest and the total amount of the FCM's margin deficiencies in the Segregation Schedule, Secured Amount Schedule, and the Cleared Swaps Segregation Schedule.

[95] *Id.*

actual residual interest is below its targeted residual interest, which should result in further reflection by management on the adequacy of the target amount and/or any changes in operations that may be appropriate, including increasing the firm's residual interest or using other sources of liquidity.

The Commission also notes that an FCM's obligation under § 1.12(j) to file a notice when the firm's residual interest is less than the sum of the undermargined amounts in its customer accounts is determined at the point in time that the firm is required to maintain as residual interest the undermargined amounts under § 1.22, § 22.2, and § 30.7. In addition, the Commission further notes that the obligation to file a notice under § 1.12(j) when the firm's residual interest is less than the sum of the undermargined amounts in its customer accounts commences as of the respective compliance dates for § 1.22, § 22.2, and § 30.7 established by the Commission and discussed further in section III below.

The Commission has considered the comments and has determined to adopt new paragraph 1.12(j) as proposed and as clarified above.

6. Events Causing Material Adverse Financial Impact or Material Change in Operations

The Commission proposed new paragraphs (k) and (l) to § 1.12. Proposed 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.

Two comments were received on the proposal. FIA stated that the proposed amendments do not provide an FCM sufficient guidance on the circumstances that would require notice and requested that the Commission define more precisely the events that would require notice.[96] RJ O'Brien similarly stated its concern that the term ''creditworthiness'' as used in proposed Regulation 1.12(k) is ambiguous and subjective and requires a clearer definition to afford FCMs the ability to reasonably ascertain their reporting duties and obligations.[97]

FIA also recommended that the Commission coordinate with the SEC and the banking regulators to establish a uniform standard identifying ''material adverse'' changes or impacts.[98] Finally, FIA noted that it does not believe that a change in senior management at an FCM should require an early warning notice of any kind because such notice is already provided to NFA in the ordinary course.[99]

The Commission has considered the comments and has determined to adopt the amendments to § 1.12(k) and (l) as proposed, with the revision that the notices required by § 1.12(l) must be filed promptly, but not later than 24 hours after the event, instead of immediately. By adopting this revision, the Commission acknowledges that immediate notice is not necessary in all situations.

An FCM should report § 1.12(l) notices in a punctual or prompt manner, but may do so without the expediency required by an immediate notice provision that is required, for example, when a firm is undercapitalized or undersegregated, which may indicate that immediate Commission or DSRO action is required to assess the financial condition of the FCM or the safety of customer funds. This revision provides the appropriate balance between the receipt of timely notices and the ability of the FCM to document an explanation of the events that trigger the notice.

As noted above, the Commission proposed additional notice provisions under § 1.12 in order to ensure that the Commission and DSROs receive timely information regarding certain events that should be assessed by the Commission and the DSROs as part of the overall oversight and risk assessment of FCMs. Regulation 1.12(k) will require an FCM to provide notice if the FCM or its parent or material affiliate experiences a material adverse impact to its creditworthiness or its ability to fund its obligations. Regulation 1.12(l) will require an FCM to provide notice if there is a material change in the firm's operations, senior management, clearing arrangements, or a material line of business.[100] The purpose of paragraphs (k) and (l) is to provide the Commission and the relevant DSRO with an opportunity to initiate a dialogue with the firm regarding any potential adverse impact that such a material change may have on the ability of the FCM to meet its obligations as a market intermediary and on the protection of the customer funds held by the FCM.

The Commission is cognizant of the commenters' desire for more precise guidance on when notices must be filed under § 1.12(k) and (l). However, FCMs represent a broad range of entities, with diverse business models. In this regard, some FCMs are small operations with a minimum level of capital, and others are highly capitalized entities with more sophisticated operations. Some FCMs focus on retail and/or agricultural clients, and others focus exclusively on institutional clients. Some FCMs are standalone entities that do not engage in proprietary or securities trading, and others are dually-registered with the SEC as BDs and engage in a significant amount of securities transactions for both their proprietary and customer accounts.

With FCMs covering such a broad and diverse spectrum of business organizations and models, the Commission does not believe that it would be appropriate to define by regulation the scenarios that are material to an FCM and would automatically require the filing of a regulatory notice. Instead, the regulation has been developed to allow each FCM to assess whether any particular or unique event is material to the specific firm. In making this determination, each FCM should assess the potential impact that an event may have on the FCM. This would include whether new lines of business would result in a significant increase in the firm's capital requirement or otherwise result in a significant additional financial or operational risk to the FCM's existing business, or whether the change in credit terms will significantly impact

[96] *Id.*

[97] RJ O'Brien Comment Letter at 10 (Feb. 15, 2013).

[98] FIA Comment Letter at 38 (Feb. 15, 2013).

[99] *Id.*

[100] Regulation 1.12(k) and (l) both require an FCM to report a material change in the firm's creditworthiness or its ability to fund its obligations. Accordingly, the Commission is removing the reference to the FCM's credit arrangements in § 1.12(l).

the liquidity resources available to the FCM.

The Commission also considered the comment that FCMs should not be required to report to the Commission changes in senior management as such information is reported to NFA. The Commission does not agree with this comment. As previously noted, the § 1.12 notice provisions are intended to provide the Commission and DSROs with prompt notice of material events at FCMs that will allow the Commission and DSROs to monitor the impact of such material events on FCMs and to factor such events into the risk assessment of the firm as part of their respective surveillance programs. The resignation or appointment of a new chief executive officer or chief risk officer at an FCM is a material change at an FCM and is information that should be reported to enhance the Commission's and DSRO's understanding of the firm's operations and the assessment of risk at the FCM.

7. Notice of Correspondence From Other Regulatory Authorities

The Commission proposed to add a new paragraph (m) to § 1.12 to require an FCM that receives a notice, examination report, or any other correspondence from a DSRO, the SEC, or a securities self-regulatory organization to immediately file a copy of such notice, examination report, or correspondence with the Commission. The Commission stated in proposing § 1.12(m) that the receipt of such notices, examination reports, or correspondence is necessary for the Commission to conduct appropriate oversight of FCMs.

The Commission received several comments that expressed a general concern that the language of the proposal is overbroad.[101] FIA noted that FCMs receive regular, and often routine, correspondence from their DSROs and that the amount of correspondence is multiplied for FCMs that are also registered as BDs and receive similar correspondence from their securities SROs and the SEC.[102] NFA agreed with the Commission that notices of material regulatory actions would provide the Commission and the DSROs with important information to carry out their oversight responsibilities, but also encouraged the Commission to reconsider the breadth of the proposal.[103] NFA noted that with respect to futures examinations reports, it already files such reports with the Commission's Division of Swap Dealer and Intermediary Oversight.[104] NFA also requested that the Commission clarify that FCMs would not have to file notices of public regulatory actions taken by futures SROs against an FCM because NFA already provides the complaint associated with these actions to the Commission and makes the action available on NFA's BASIC system.[105] TD Ameritrade recommended that the Commission limit notification to items that pertain to financial responsibility rules.[106]

The Commission notes that it was not its intention to require an FCM to file with the Commission routine or non-material correspondence from regulators or SROs. Regulation 1.12 in general is intended to provide the Commission with information regarding an FCM's interaction with its other regulators regarding the regulators' examinations and other material communications with FCMs. The Commission would use such information to enhance its understanding of the firm and its compliance with regulatory requirements to assess the operations of the firm and learn of events that may present a potential adverse impact on the firm, including its ability to properly operate in a regulated environment or otherwise safeguard customer funds.

The Commission is revising final § 1.12(m) to require an FCM to file notice with the Commission: (1) if the FCM is informed by the SEC or a SRO that it is the subject of a formal investigation; (2) if the FCM is provided with an examination report issued by the SEC or a SRO, and the FCM is required to file a copy of such examination report with the Commission; and (3) if the FCM receives notice of any correspondence from the SEC or a securities SRO that raises issues with the adequacy of the FCM's capital position, liquidity to meet its obligations or otherwise operate its business, or internal controls. The Commission believes that the revised regulation will provide the Commission with information necessary for the effective oversight of FCMs and will minimize the notices that dual-registrant FCMs/BDs will have to file with the Commission.

8. Filing Process and Content

The Commission proposed 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 proposed 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.[107] Each FCM currently uses WinJammer to file regulatory notices with the Commission and with the firm's DSRO. The proposed 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's Regional office with jurisdiction over the firm and make arrangements for the filing of the regulatory notices with the Commission via electronic mail at a specially designated email address established by the Commission; *fcmnotices@cftc.gov*. The Commission also proposed to amend § 1.12(n) to require that each notice filed by an FCM, IB, or SRO under § 1.12 include a discussion of what caused the reportable event, and what steps have been, or are being taken, to address the reportable event. Additional amendments to § 1.12(b), (d), (e), (f) and (g) were proposed that were necessary and technical in nature, and primarily revise internal cross-references to the filing requirements in § 1.12(n).

The Commission received one comment on the proposed amendments to Regulation 1.12(n), specifically with respect to the requirement that notices under the regulation include a discussion of what caused the reportable event and what steps have been or will be taken to address the event.[108] CHS Hedging stated its concern that requiring such a discussion in the notice is at odds with the requirement that notices be filed immediately.[109]

The Commission has determined to adopt the amendments to § 1.12(n) and the technical and related amendments

[101] FIA Comment Letter at 39 (Feb. 15, 2013); TD Ameritrade Comment Letter at 3 (Feb. 15, 2013); RCG Comment Letter at 7 (Feb. 12, 2013); CHS Hedging Comment Letter at 3 (Feb. 15, 2013).

[102] FIA Comment Letter at 39 (Feb. 15, 2013).

[103] NFA Comment Letter at 10 (Feb. 15, 2013).

[104] *Id.* at 11.

[105] *Id.*

[106] TD Ameritrade Comment Letter at 3 (Feb. 15, 2013).

[107] 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.

[108] CHS Hedging Comment Letter at 3 (Feb. 15, 2013).

[109] *Id.*

in § 1.12(b), (d), (e), (f) and (g) as proposed. In the Commission's experience, in many cases an FCM has sufficient information to provide a notice of reportable event and the remedial steps that can be taken to mitigate future issues upon learning of the reportable event or very shortly thereafter. The Commission does not believe that the requirement to provide such information is at odds with the need to provide the information immediately. In the event that an FCM 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, it may revise its notice at a later date when it has more complete or accurate information. It is essential, however, that the Commission receives timely notice of early warning events, and compliance with the relevant notice time period should be an FCM's first priority. Accordingly, as noted in the Proposal, even if such information is not immediately readily available, the reporting entity may not delay the reporting of a reportable event.

9. Public Disclosure of Early Warning Notices

The Commission requested comment as to whether reportable events should be made public by the Commission, SROs, or FCMs and what the benefits and/or negative impact from public disclosure of such events would be. The Commission received several comments regarding the public disclosure of reportable events. Several commenters, including FHLB, the ICI, ACLI, BlackRock, and SIFMA believed that the Commission should mandate public disclosure of such information.[110] Two commenters, FIA and NFA, believed that such events should not be made public.[111] NFA did not believe any of the filings should be public, but emphasized that those events that are not subject to a formal public action particularly should not be subject to public disclosure.[112] FIA was concerned that without context, public disclosure of the notices would be subject to misinterpretation and could create an adverse market event.[113]

The Commission has considered the comments and has determined that regulatory notices filed under § 1.12 should not be made publicly available. The notices required under § 1.12 provide a mechanism whereby Commission and SRO staff are alerted to potential issues at an FCM. In order to fully assess the potential impact of a reportable event, Commission and SRO staff generally must contact the firm to obtain additional information, including up to date information on how the firm is addressing the matter that caused the reportable event to develop. If reportable events were disclosed to the public, they may not provide complete or current information. For example, an FCM may be required to file immediate notice that it was undersegregated at a point in time, but the notice may not contain information that the FCM has taken corrective action and is no longer in violation of the segregation requirements. The Commission also recognizes that many of the § 1.12 notices are required to be filed as a result of one-off processing errors or timing differences that trigger a reportable event but are immediately rectified by the FCM and do not indicate a failure of the FCM's control system nor the firm's ability to effectively operate as an FCM.

In addition, under § 1.12 FCMs that are dually registered BDs with the SEC are required to file with the Commission copies of certain regulatory notices that they are required to file with the SEC. The SEC, however, does not make such notices public. The Commission believes it is important to ensure consistency such that information that a firm must file with the SEC and that is otherwise not publicly disclosed is not made public by the Commission as a result of the firm also being required to file a notice with the Commission under § 1.12.

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

Regulation 1.15 currently requires each FCM subject to the risk assessment reporting requirements to file certain financial reports with the Commission within 120 days of the firm's year end. The risk assessment filings include FCM organizational charts; financial, operational, and risk management policies, procedures, 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 proposed to amend § 1.15 to require the financial information to be filed in electronic format. The Commission received no comments on the proposed amendments to § 1.15. The Commission is adopting the amendments as proposed. The Commission also has revised the final regulation to provide that the risk assessment filings should be filed via 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. The Commission will provide direction regarding how FCMs should file the risk assessment reports in a secure manner with the Commission prior to the effective date of the regulation.

E. § 1.16: Qualifications and Reports of Accountants

Regulation 1.16 addresses the minimum requirements a public accountant must meet in order to be recognized by the Commission as qualified to conduct an examination for the purpose of expressing an opinion on the financial statements of an FCM. Regulation 1.16(b) currently provides that the Commission will recognize a person as qualified if such person is duly registered and in good standing as a public accountant under the laws of the place of the accountant's principal office or principal residence.

The Commission proposed several amendments to enhance the qualifications that a public accountant must meet in order to conduct an examination of an FCM. Specifically, the Commission proposed to require that the public accountant must: (1) Be registered with the Public Company Accounting Oversight Board (''PCAOB''); (2) have undergone an examination by the PCAOB; and, (3) have remediated to the satisfaction of the PCAOB any deficiencies identified during the examination within three years of the PCAOB issuing its report.

The Commission also sought to enhance the quality of the public accountant's examination of an FCM by proposing to require that the examination be conducted in accordance with U.S. GAAS after full consideration of the auditing standards issued by the PCAOB. The Commission further sought to ensure that the FCM's governing body took an active role in the assessment and appointment of the public accountant by imposing an obligation on the governing body to evaluate, among other things, the accountant's experience auditing FCMs; the adequacy of the accountant's knowledge of the Act and Commission regulations; the depth of the accountant's staff; and, the independence of the accountant.

Additionally, the Commission proposed technical amendments to

[110] FHLB Comment Letter at 10 (Feb. 15, 2013); ICI Comment Letter at 7–8 (Jan. 14, 2013); ACLI Comment Letter at 4 (Feb. 15, 2013); BlackRock Letter at 3 (Feb. 15, 2013); and SIFMA Comment Letter at 2 (Feb. 21, 2013).

[111] NFA Comment Letter at 11 (Feb. 15, 2013); FIA Comment Letter at 38 (Feb. 15, 2013).

[112] NFA Comment Letter at 11 (Feb. 15, 2013).

[113] FIA Comment Letter at 38 (Feb. 15, 2013).

§ 1.16. The Commission proposed to amend § 1.16(f)(1)(i)(C) to require each FCM to submit its certified annual report to the Commission in an electronic format. The Commission also proposed to amend § 1.16(c)(2) to remove the requirement that the accountant manually sign the accountant's report, which would facilitate the electronic filing of the FCM's certified annual report with the Commission.

The proposed amendments to § 1.16, including a discussion of the comments received, are discussed below.

1. Mandatory PCAOB Registration Requirement

Regulation 1.16(b)(1) would continue to require a public accountant to be registered and in good standing under the laws of the place of the accountant's principal office or principal residence in order to be qualified to conduct examinations of FCMs. The Commission proposed to enhance the qualifications of public accountants by further requiring the public accountant to be registered with the PCAOB.

The PCAOB is a nonprofit corporation established by Congress under the Sarbanes-Oxley Act of 2002 (''SOX'') to oversee the audits of public companies and BDs of securities registered with the SEC in order to protect investors and the public interest by promoting informative, accurate, and independent audit reports.[114] The SEC has oversight authority over the PCAOB, including the approval of the PCAOB's rules, auditing and other standards, and budget.[115]

The Commission received several comments on the proposed amendments to Regulation 1.16, which are discussed below. The commenters, however, did not oppose the proposed PCAOB registration requirement. In addition, the Commission does not anticipate that the PCAOB registration requirement will present a significant issue to FCMs or public accountants. In this regard, only one public accountant that currently conducts examinations of FCMs is not registered with the PCAOB. PCAOB-registered public accountants conducted the examinations of 103 of the 104 registered FCMs based upon a review of the most current annual reports submitted by FCMs to the Commission. Accordingly, after considering the comments, the Commission is adopting the PCAOB registration requirement as proposed.

2. PCAOB Inspection Requirement

The Commission proposed to amend § 1.16(b)(1) to require that a public accountant must have undergone a PCAOB examination in order to be qualified to conduct examinations of FCMs. Section 104 of SOX requires the PCAOB to conduct an annual inspection of each registered public accountant that regularly provides audit reports for more than 100 public issuers each year.[116] Section 104 further requires public accountants that provide audit reports for 100 or fewer issuers to be inspected by the PCAOB no less frequently than once every three years.[117]

In addition, the Dodd-Frank Act amended SOX and vested the PCAOB with new oversight authority over the audits of BDs registered with the SEC.[118] The PCAOB was provided with the authority, subject to SEC approval, to determine the scope and frequency of the inspection of public accountants of BDs. The SEC also approved a PCAOB temporary rule implementing an inspection program for BDs.[119]

Several commenters raised issues with, or objected to, the proposal. Ernst & Young requested clarification that the term ''examination'' in proposed § 1.16(b)(1) referred to the ''inspections'' that are required under section 104 of SOX.[120] The Commission confirms that the term ''examination'' in proposed § 1.16 was intended to refer to the ''inspections'' required under section 104 of the SOX, and has revised the regulation accordingly.

Several commenters stated that the proposed inspection requirement would disqualify public accountants that were registered with the PCAOB, but had not yet undergone an inspection.[121] These commenters stated that the proposal would disqualify accounting firms that recently registered with the PCAOB, but due to the triennial inspections schedule may not be subject to a PCAOB inspection for almost three years.[122] Commenters also noted that certain PCAOB registered accounting firms may audit non-issuer BDs and may be subject to inspection under the PCAOB's temporary or permanent inspection program, but may not have been selected yet for inspection by the PCAOB.[123] The AICPA stated that, while any public accounting firm can register with the PCAOB, by law only accountants that audit public issuers or audit certain non-issuer BDs may be inspected by the PCAOB.[124] KPMG also stated that the requirement that accounting firms auditing an FCM must have undergone an inspection makes the rules governing the audits of FCMs more restrictive than the SEC rules governing the audits of BDs.[125] KPMG suggests that the Commission align the standards required of auditors of FCMs and BDs.[126]

The AICPA also stated that the Commission should permit a practice monitoring program (such as the AICPA peer review program) that evaluates and opines on an accounting firm's system of quality control relevant to the firm's non-issuer accounting and auditing practice as an alternative to the PCAOB inspection requirement.[127] The AICPA also stated that a robust process, such as the AICPA's peer review program, whereby a team of certified public accountants conducts a comprehensive evaluation of a public accountant's system of quality control and whose work is subject to the oversight and approval by a separate group of certified public accountants should be required rather than having one certified public accountant review another.[128]

The NFA also supported a temporary alternative to the PCAOB inspection requirement in order to ensure that public accountants that are unable to obtain a PCAOB inspection within the time period required by the Commission will not automatically be prohibited from conducting FCM examinations.[129] NFA recommended that the Commission specifically designate the AICPA's peer review program as the only peer review program that will be acceptable to alleviate any uncertainty as to whether a certified public

[114] Public Law 107–204, 116 Stat. 745 (July 30, 2002). *See also* section 101 of SOX.

[115] Sections 107 and 109 of SOX.

[116] Section 104(b)(1)(A) of SOX.

[117] Section 104(b)(1)(B) of SOX.

[118] Section 982 of the Dodd-Frank Act.

[119] *See* Public Company Oversight Board; Order Approving Proposed Temporary Rule for an Interim Program of Inspection Related to Audits of Brokers and Dealers, 76 FR 52996 (Aug. 24, 2011).

[120] Section 104 of SOX requires the PCAOB to conduct a continuing program of inspections to assess the degree of compliance of each registered public accounting firm and associated persons of that firm with the provisions of the SOX, the rules of the PCAOB, the rules of the SEC, or professional standards, in connection with its performance of audits, issuance of audit reports, and related matters involving public issuers.

[121] Center for Audit Quality Comment Letter at 2 (Jan. 14, 2013); Deloitte Comment Letter at 2 (Jan. 14, 2013); Ernst & Young Comment Letter at 2 (Jan. 14, 2013).

[122] *Id.*

[123] Center for Audit Quality Comment Letter at 2 (Jan. 14, 2013); Deloitte Comment Letter at 2 (Jan 14, 2013).

[124] AICPA Comment Letter at 2 (Feb. 11, 2013).

[125] KPMG Comment Letter at 2 (Jan. 11, 2013).

[126] *Id.*

[127] AICPA Comment Letter at 3 (Feb 11, 2013).

[128] *Id.*

[129] NFA Comment Letter at 11 (Feb. 15, 2013).

accountant is ''qualified'' to conduct the peer review.[130]

As noted in the proposal, FCMs are sophisticated financial market participants that are entrusted with more than $182 billion of customers' funds.[131] FCMs intermediate futures customers activities and guarantee customers' financial performance to DCOs, other FCMs, and foreign brokers. In addition, FCMs are anticipated to hold significant amounts of Cleared Swaps Customer Collateral deposited to margin, secure or guarantee Cleared Swaps as more provisions of the Dodd-Frank Act are implemented. FCMs also may conduct proprietary futures and securities transactions, and handle business for securities customers in addition to futures customers. The sophistication of the futures markets and the Commission's regulations, coupled with the critical role played by FCMs in the futures market (and in the case of many of the largest FCMs, the securities markets) necessitates the engagement of competent and experienced accountants to conduct the examinations of FCMs.

The Commission believes that registration with the PCAOB and being subject to the PCAOB inspection program will help to ensure that accounting firms engaged to conduct audits of FCMs remain competent and qualified. The PCAOB inspection program involves the review of the accounting firm's compliance with PCAOB issued audit, quality control, independence and ethics standards.

In addition, the purpose of the PCAOB registration and inspection requirement in the final rule is not to ensure that the accounting firm's audits of FCMs are subject to inspection by the PCAOB. The Commission acknowledges that the PCAOB's primary jurisdiction and inspections are directed toward the audits of public issuers and BDs. However, the Commission's objective is to reasonably ensure the quality and competence of the public accountants engaged in the audits of FCMs. The Commission believes that such quality and competence may be assessed by the PCAOB inspecting the accounting firms' audit process for issuers and BDs, and is not dependent solely upon the inspection of the accounting firms' audits of FCMs.

The Commission further believes that its proposed PCAOB inspection requirement is consistent with the SEC's audit requirements for BDs. Any auditor of an SEC-registered BD must register with the PCAOB and will be subject to the PCAOB inspection program.

Moreover, the Commission believes that the imposition of a PCAOB inspection requirement provides several benefits over a peer review program. The PCAOB is an entity that was created by Congress and charged with improving audit quality, reducing the risks of audit failures in the U.S. public securities markets and promoting public trust. As previously noted, the PCAOB is subject to oversight by the SEC, which approves the PCAOB's rules, auditing and other standards, and budget. A peer review program, while providing many benefits in the oversight of the accounting profession, is overseen by the accounting industry and is not subject to oversight by a federal regulator, which the Commission believes is a key advantage of the PCAOB in the furtherance of the protection of customer funds.

The Commission also does not anticipate a significant impact on existing FCMs from the imposition of the PCAOB inspection requirement on public accountants. As noted above, 103 of the 104 FCMs currently are subject to examination by public accountants that are registered with the PCAOB. In addition, only six of the PCAOB-registered public accountants that conduct examinations of fourteen FCMs have not been subject to a PCAOB inspection at this time. However, all six of these firms have indicated in their PCAOB filings that they conduct audits of BDs and, therefore, will be subject at a future date to the PCAOB inspection program for the inspection of accountants that conduct audits of BDs.

The Commission, based upon the analysis above and further consideration of the comments, has determined to adopt the regulation as proposed. The Commission recognizes, however, that the audits of many FCMs with a year-end date of December 31, 2013 or later have already been initiated. Accordingly, the Commission has determined that the PCAOB registration requirement will apply for audit reports issued for the year ending June 1, 2014 or later so as not to unnecessarily interrupt the examinations that currently are in progress. The Commission also is adopting a December 31, 2015 compliance date for a PCAOB inspection. The deferred compliance date will provide public accountants with additional time to register with, and to be inspected by, the PCAOB. The compliance dates are discussed further in section III below.

3. Remediation of PCAOB Inspection Findings by the Public Accountant

The Commission proposed in § 1.16(b)(1) that any deficiencies noted during a PCAOB inspection must be successfully remediated to the satisfaction of the PCAOB within three years.

KPMG, the Center for Audit Quality, Deloitte, the AICPA, and PWC generally argued that it is not clear how the requirement that any deficiencies noted during the PCAOB exam must have been remediated to the satisfaction of the PCAOB would work or what it means.[132] The commenters also noted that the Commission's proposed requirement that the public accountant remediate any deficiencies noted in a PCAOB inspection report is more stringent than the SEC's requirements for auditors of BDs and public issuers. KPMG also asked who would make a determination of remediation as there is no procedure for the PCAOB to communicate such determinations to the public accountant or the public.[133] PWC also stated that reliance on the PCAOB inspection results was misplaced and that the PCAOB inspection comments are issued in the context of a constructive dialogue to encourage Certified Public Account (''CPA'') firms to improve their practices and procedures.[134] PWC further noted that disciplinary sanctions such as revocation of the firm's right to audit a public company or BD can only be made in the context of an adjudicative process in which the firm is afforded procedural rights.[135] Lastly, PWC asserted that the Commission's proposal would disqualify a firm without providing any of the procedural rights or safeguards established by SOX.[136]

The Commission has considered the comments and recognizes that the PCAOB inspection process does not involve a formal process for communicating that a public accountant has adequately remediated deficiencies identified during the PCAOB's last inspection. In addition, the Commission understands that the PCAOB may not always issue a report at the conclusion of an inspection, or that the report may contain both public and non-public sections.

In light of these comments, the Commission has determined to revise

[130] *Id.*

[131] The customer funds information is based upon the 1–FR–FCM reports and FOCUS Reports filed by FCMs for the month ending April 30, 2013.

[132] KPMG Comment Letter at 2–3 (Jan. 11, 2013); Center for Audit Quality Comment Letter at 2–3 (Jan. 14, 2013); Deloitte Comment Letter at 2–3 (Jan. 14, 2013); AICPA Comment Letter at 2 (Feb. 11, 2013); PWC Comment Letter at 2 (Jan. 15, 2013).

[133] KPMG Comment Letter at 2 (Jan. 11, 2013).

[134] *See* PWC Comment Letter at 2 (Jan. 15, 2013).

[135] *Id.*

[136] *Id.*

the final regulation by removing the requirement that a public accountant must remediate any deficiencies identified during a PCAOB inspection to the satisfaction of the PCAOB within three years of the inspection. The Commission is further revising § 1.16(b)(1) to provide that a public accountant that, as a result of the PCAOB disciplinary process, is subject to a sanction that would permanently or temporarily bar the public accountant from engaging in the examination of a public issuer or BD may not conduct the examination of an FCM. The Commission notes that the PCAOB has the authority to initiate a disciplinary action against a firm and its associated persons for failing to adequately address inspection findings or for other transgressions.

The Commission also is revising § 1.16(b)(4) to require the governing body of the FCM to review and consider the PCAOB's inspection reports of the public accountant as part of the governing body's assessment of the qualifications of the public accountant to perform an audit of the FCM. The governing body is in a position to request information from the public accountant regarding the PCAOB inspections and general oversight of the public accountant and should use such information in assessing the competency of the accountant to conduct an examination of the FCM. An FCM's governing body should be concerned if the PCAOB inspection reports indicate that the public accountant has significant deficiencies and should take such information into consideration in assessing the qualifications of the public accountant.

4. Auditing Standards

The Commission proposed to amend § 1.16(c)(2) to require that the public accountant's report of its examination of an FCM must state whether the examination was done in accordance with generally accepted auditing standards promulgated by the Auditing Standards Board of the AICPA (*i.e.,* U.S. GAAS), after giving full consideration to the auditing standards issued by the PCAOB. Commenters raised issues with the proposal noting that there is no existing reporting framework that requires the application of one set of auditing standards and the consideration of another set of auditing standards.[137] Deloitte noted that public accountants may be specifically engaged to conduct an audit of an entity under both PCAOB auditing standards and U.S. GAAS, but that there is no reporting framework for an audit under one set of auditing standards, after giving ''full consideration'' to a separate set of auditing standards.[138]

The Commission has reviewed the comments and has determined to revise the final regulation to provide that the accountant's report must state whether the examination of the FCM was conducted in accordance with the auditing standards issued by the PCAOB. The Commission acknowledges the fact that there is no reporting framework for public accountants to report on one set of auditing standards after giving full consideration to another set of auditing standards. Also, the Commission recognizes that the SEC has recently adopted final regulations to its Rule 17a–5 to require public accountants to use PCAOB standards in the examination of the financial statements of BDs.[139] Therefore, the Commission's amendments to § 1.16(c)(2) to require public accountants to use PCAOB standards in conducting the examination of the financial statements of an FCM is consistent with the SEC's revisions to its Rule 17a–5. The Commission also is setting a compliance date for public accountants to use PCAOB auditing standards for all FCM examinations with a year-end date of June 1, 2014 or later. The extended compliance date allows FCMs currently subject to an examination by a public accountant to complete the examination cycle without having the public accountant adjust the examination for the new PCAOB standards requirement. The June 1, 2014 compliance date also is consistent with the SEC's compliance date for revisions to Rule 17a-5 and, therefore, will allow FCMs that are dually-registered as FCMs/BDs to be subject to uniform CFTC and SEC requirements.[140] Compliance dates are discussed further in section III below.

5. Review of Public Accountant's Qualifications by the FCM's Governing Body

The Commission proposed to amend § 1.16(b) by adding new paragraph (4) which would require the FCM's governing body to ensure that a public accountant engaged to conduct an examination of the FCM is duly qualified to perform the audit. The proposed new paragraph further provided that the evaluation should include, among other things, the public accountant's experience in auditing FCMs, the public accountant's knowledge of the Act and Commission regulations, the depth of the public accountant's staff, and the public accountant's size and geographical location. The proposed requirements are intended to ensure that the FCM's governing body takes an active role in the assessment and appointment of the public accountant.

PWC requested clarification of the Commission's expectations for the criteria that would be expected to be used by the FCM's governing body for determining qualification. PWC stated that such clarification may be helpful so that a consistent framework for determining the qualifications is used across the industry and FCM governing bodies.[141]

The Commission has considered the comments and has determined to adopt the amendments as proposed. FCMs represent a diverse group of entities and business models. Some FCMs focus primarily on institutional clients and engage in securities transactions as their primary business. Other FCMs focus on retail customers and engage in no proprietary or securities transactions.

With such a wide range of business models, the Commission believes that it is not practical to provide a uniform set of criteria that each governing body of each FCM should use to assess the qualifications of a public accountant. In fact, such a standard list would go against the Commission's objective of ensuring that the governing body is actively reviewing the qualifications of the public accountant relative to the FCM's particular business model. The requirement is not intended to exclude regional or smaller public accountants from being qualified to conduct examinations, provided that the governing body is satisfied that the public accountant has the appropriate skill, knowledge, and other resources to effectively conduct an examination, and is otherwise in compliance with the qualification requirements in § 1.16.

The Commission also is revising final § 1.16(b)(4) in response to the comments received on proposed § 1.16(b)(1) that would have required that a public accountant remediate any findings issued by the PCAOB in its inspection report within 3 years of the issuance of the inspection report. As stated above, commenters noted that there is no formal mechanism to assess whether a public accountant has remediated any inspection findings to the satisfaction of

[137] Ernst & Young Comment Letter at 3 (Jan. 14, 2013); Deloitte Comment Letter at 1 (Jan. 14, 2013); PWC Comment Letter at 3 (Jan. 15, 2013); AICPA Comment Letter at 2 (Feb. 11, 2013); and KPMG Comment Letter at 3 (Jan. 11, 2013).

[138] Deloitte Comment Letter at 1 (Jan. 14, 2013).

[139] *Broker Dealer Reports,* 78 FR 51910 (Aug. 21, 2013).

[140] *Id.*

[141] PWC Comment Letter at 3 (Jan. 15, 2013).

the PCAOB. Accordingly, the Commission is revising § 1.16(b)(4) to provide that the governing body of the FCM should review the inspection report of the public accountant and discuss inspection findings as appropriate with the public accountant. Such reviews and discussions will provide additional information to the governing body that will allow it to better assess the qualifications of the public accountant to conduct an audit of the FCM.

6. Electronic Filing of Certified Annual Reports

The Commission proposed to amend § 1.16(f)(1)(i)(C) to require each FCM to submit its certified annual report to the Commission in an electronic format. The Commission also proposed to amend § 1.16(c)(2) to remove the requirement that the accountant manually sign the account's report, which will facilitate the electronic filing of the FCM's certified annual report with the Commission. The Commission received no comments on the above amendments and is adopting the amendments as proposed.

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

1. FCM Cessation of Business and Transfer of Customer Accounts if Unable To Demonstrate Adequate Liquidity

Section 4f(b) of the Act provides that no person may be registered as an FCM unless it meets the minimum financial requirements that the Commission has established as necessary to ensure that the FCM meets its obligations as a registrant at all times, which would include its obligations to customers and to market participants, including DCOs. The Commission's minimum capital requirements for FCMs are set forth in § 1.17 which, among other things, 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 or is not able to demonstrate its compliance with the minimum capital requirements.

The proposed amendments to § 1.17 authorize the Commission to request certification in writing from an FCM that it has sufficient liquidity to continue operating as a going concern. If an FCM is not able to immediately provide the written certification, or is not able to demonstrate adequate access to liquidity with verifiable evidence, the FCM must transfer all customer accounts and immediately cease doing business as an FCM.

The FIA stated that it agreed with the regulatory purpose underlying this proposed amendment, but stated that the Commission should not adopt the rule before it clearly articulates the objective standards by which it will determine that an FCM has ''sufficient liquidity.'' [142] Similarly, FCStone requested clarity with respect to the exigent circumstances that would give the Commission authority to require an FCM to cease operating.[143]

The Commission understands the concerns of commenters regarding the process by which the Commission, or the Director of the Division of Swap Dealer and Intermediary Oversight acting pursuant to delegated authority under § 140.91(6), could require immediate cessation of business as an FCM and the transfer of customer accounts; however, that same authority currently exists should a firm fail to meet its minimum capital requirement. The Commission believes the ability to certify, and if requested, demonstrate with verifiable evidence, access to 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 section 4f(b) of the Act. Further, the Commission notes that the ''going concern'' standard is well defined in accounting literature and practice, and generally means an ability to continue operating in the near term.

The proposed liquidity provision is intended to cover circumstances that require immediate attention and would 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 purpose of the provision is to address situations where an FCM may currently be in compliance with minimum financial requirements, but lacks liquidity to meet pending, non-discretionary obligations such that the firm's ability to continue operating in the near term is in serious jeopardy. In such a situation, it is expected that the Commission and the FCM's DSRO and applicable DCOs would be in frequent communication with the firm to review the FCM's options and plans to continue operating as a going concern and to assess what actions were necessary to ensure the firm continues to meet its obligations as a market intermediary and to protect customer funds. If an FCM's management cannot in good faith certify that the FCM has sufficient liquidity to permit it to operate throughout the following week, then the FCM has failed to meet its minimum financial requirements necessary to ensure that the firm will continue to meet its obligations as a registrant and the Commission would have to determine how to minimize the impact of a potential FCM insolvency or default.

The Commission has considered the comments and has determined to adopt the amendments as proposed.

2. Reducing Time Period for FCMs To Incur a Capital Charge for Undermargined Accounts to One Day After Margin Calls Are Issued

Regulation 1.17 requires an FCM to incur a charge to capital for customer and noncustomer accounts that are undermargined beyond a specified period of time.[144] Regulation 1.17(c)(5)(viii) currently requires an FCM to reduce its capital (*i.e.,* take a capital charge) if a customer account is undermargined for three business days after the margin call is issued.[145] 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 Commission proposed to amend § 1.17(c)(5)(viii) and (ix) to require an FCM to take capital charges for undermargined customer, noncustomer, and omnibus accounts that are undermargined for more than one business day after a margin call is issued. Thus, for example, under the proposal, if an account carried by an FCM became undermargined on Monday, the operation of the regulation assumes that the FCM would issue a margin call on Tuesday, and the FCM would have to incur a capital charge at the close of business on Wednesday if the margin call was still outstanding.

Vanguard commented that it supported the Commission's proposal, stating that the accelerated timetable makes sense given modern trading and asset transfer timing.[146] Vanguard further stated that each customer must stand up for its trades and promptly post margin, and it further stated that it believes the overall market may be weakened to the extent an FCM is

[142] FIA Comment Letter at 8 (Feb. 15, 2013).

[143] FCStone Comment Letter at 4 (Feb. 15, 2013).

[144] Noncustomers are defined in § 1.17(b)(4) as accounts carried by the FCM that are not customer accounts or proprietary accounts. Noncustomer accounts are generally accounts carried by an FCM for affiliates and certain employees of the FCM.

[145] For purposes of these Commission regulations, a margin call is presumed to be issued by the FCM the day after an account becomes undermargined.

[146] Vanguard Comment Letter at 7 (Feb. 22, 2013).

extending significant amounts of credit over an extended period to cover a customer's margin deficit.[147]

MFA objected to the proposal noting that, while in the ordinary course of business, few margin calls remain outstanding for more than two business days, the proposal does recognize the practical reasons why a margin call may be outstanding more than 2 business days after the call issued.[148] MFA cited disputes between an FCM and its customer as to the appropriate level of margin, and good faith errors that may cause a delay beyond 2 days for a margin call to be met.[149] MFA also stated that an increase in costs resulting from the regulation will ultimately be passed on the customers.

The NCBA stated that the proposal may require market participants to use wire transfers in lieu of checks, which will increase the costs and impose a significant financial burden to the cattle industry.[150] The NCBA also stated that the proposal will cause customers to prefund their accounts for anticipated margin requirements, which will reduce customers' capital and impede their other business operations.[151] The NCBA further noted that the proposal is not related to the MFGI and PFGI failures, which were not caused by customers failing to meet margin calls.[152]

JSA stated that an effective increase in a capital charge for undermargined customer accounts could cause an increase in requirements for customers to prefund their accounts, which would be punitive in a highly competitive environment that already places midsized FCMs and FCMs that are not affiliated with a banking institution at a disadvantage to larger, more highly capitalized firms, or FCMs that are affiliated with banking institutions.[153] JSA also stated that if smaller FCMs are forced out of the market, larger FCMs or FCMs affiliated with banks may not be willing to service customers that are farmers, ranchers, retail, or introduced brokerage accounts, for which they have historically shown little interest.[154]

FIA stated that while institutional and many commercial market participants generally meet margin calls by means of wire transfers, the proposal, creates operational problems because it does not consider delays arising from accounts located in other time zones that cannot settle same day, or ACH settlements, or the requirement to settle or convert certain non-U.S. dollar currencies.[155] FIA also stated that a substantial number of customers that do not have the resources of large institutional customers (in particular members of the agricultural community) depend on financing from banks to fund margin requirements, which may require more than one day to obtain.[156]

RJ O'Brien stated that it recognized that the collection of margin is a critical component of an FCM's risk management program, however, it objected to the proposed amendment.[157] RJ O'Brien stated that as the largest independent FCM serving a client base that includes a great number of farmers and ranchers, it is well aware that many customers that use the markets to hedge commercial risk still meet margin calls by check or ACH because of the impracticality and costliness of wire transfers in their circumstances.[158] RJ O'Brien stated that in many cases, the costs of a wire transfer would exceed the transaction costs paid by the client to its FCMs, and additionally, that some customers in the farming and ranching community finance their margin calls, which can require additional time to arrange for delivery of margin call funds due to routine banking procedures.[159]

RJ O'Brien also stated that if the proposal is adopted, FCMs that service non-institutional clients will struggle to remain competitive and the proposal may result in fewer clearing FCMs and greater systemic risk to the marketplace.[160] RJ O'Brien further stated that many of the larger FCM/BDs likely have little interest in servicing smaller rancher and farmer clients, as was evidenced in the wake of MFGI's failure, and that a loss of such smaller FCMs will result in fewer options available to these ranchers, farmers and other commercial market participants that wish to hedge their commercial risks.[161]

TD Ameritrade stated that it did not support the proposed amendments to § 1.17(c)(5)(viii) and (ix) as it would impose financial hardships on customers that the Proposal was intended to protect.[162] TD Ameritrade stated that a large number of retail customers do not currently use wire transfers to meet a margin requirement in one business day.[163] TD Ameritrade also noted that non-U.S. customer accounts are faced with time zone differences and inherent delays in meeting margin calls.[164]

Other commenters expressed the general concern that the proposal will harm the customers it is meant to protect by requiring more capital to be kept in customer accounts, possibly forcing users to hold funds at FCMs well in excess of their margin requirements, or resulting in certain segments of the market to forego the futures markets to hedge their commercial operations.[165] Those commenters argued that such pre-funding could add significant financial burdens to trading as customers find themselves having to provide excess funds to their brokers which could increase their risk with regard to the magnitude of funds potentially at risk in the event of future FCM insolvencies.[166] The commenters general expressed significant concerns that reducing margin calls to one day will harm many customers as: (1) Many small businesses, farmers, cattle producers and feedlot operators routinely pay by check and forcing them to use wire transfers increases their cost of doing business; (2) clients who make margin calls by ACH payments instead of wire transfers because ACH is cheaper, would no longer be able to do so because there is a one-day lag in availability of funds; and (3) foreign customers would not be able to make margin calls due to time zone differences, the time required to convert certain non-USD currencies, and for

[147] *Id.*

[148] MFA Comment Letter at 7 (Feb. 15, 2013).

[149] *Id.*

[150] NCBA Comment Letter at 2 (Feb. 15, 2013).

[151] *Id.*

[152] *Id. See also* JSA Comment Letter at 2 (Feb. 15, 2013) and ICA Comment Letter at 1–2 (Feb. 15, 2013).

[153] JSA Comment Letter at 2 (Feb. 15, 2013). *See also* Frontier Futures Comment Letter at 2–3 (Feb. 14, 2013).

[154] *Id.*

[155] FIA Comment Letter at 26 (Feb. 15, 2013).

[156] *Id.*

[157] RJ O'Brien Comment Letter at 3–4 (Feb. 15, 2013).

[158] *Id. See also* RCG Comment Letter at 5 (Feb. 12, 2013). RCG also recommended that the Commission implement a pilot program that requires FCMs to provide the Commission with daily undermargined reports. The Commission does not believe that a pilot program is necessary for gathering additional information.

[159] *Id.*

[160] *Id.*

[161] *Id.*

[162] TD Ameritrade Comment Letter at 3–4 (Feb. 15, 2013).

[163] *Id.*

[164] *Id.*

[165] NPPC Comment Letter at 2 (Feb. 14, 2013); RCG Comment Letter at 4–5 (Feb. 12, 2013); NGFA Comment Letter at 3 (Feb. 15, 2013); NEFI/PMAA Comment Letter at 3 (Jan. 14, 2013); AIM Comment Letter at 15 (Jan. 24, 2013); Amarillo Comment Letter at 1 (Feb. 14, 2013); NCFC Comment Letter at 1 (Feb. 15,2013); NFA Comment Letter at 12–13 (Feb. 15, 2013); FCStone Comment Letter at 3 (Feb. 15, 2013); Advantage Comment Letter at 1–2 (Feb. 15, 2013); AFBF Comment Letter at 2 (Feb. 15, 2013); CCC Comment Letter at 2 (Feb. 15, 2013); Steve Jones Comment Letter at 1 (Feb. 14, 2013); ICA Comment letter at 1–2 (Feb. 15, 2013);TCFA Comment Letter at 1–2 (Feb. 15, 2013); CME Comment Letter at 5 (Feb. 15, 2013). AIM resubmitted the comment letters of Premier Metal Services, NEFI/PMAA, and the ISRI and indicated its support for the recommendations therein (Jan. 14, 2013).

[166] *Id.*

whom banking holidays fall on different days.[167]

The CCC stated that the proposed amendment to the capital rule places an undue burden on the FCMs, which will likely result in FCMs demanding that customers prefund trades to prevent market calls and potential capital charges.[168] The CCC also stated that the proposal could result in forced liquidations of customer positions to ensure that the FCM does not incur a capital charge.[169]

FIA and RJ O'Brien provided alternatives to the Commission's proposal. Both FIA and RJ O'Brien offered that an FCM be required to take a capital charge for any customer margin deficit exceeding $500,000 that is outstanding for more than one business day.[170] FIA further suggested that if the customer's margin deficit is $500,000 or less, the FCM should take a capital charge if the margin call is outstanding two business days or more after the margin call is issued.[171] RJ O'Brien's comment letter does not address the timing of the capital charge for accounts with a margin deficit of $500,000 or less.

NFA, FIA, MFA and AIMA stated that if the Commission adopts the amendments regarding residual interest as proposed, then the Commission should consider whether a capital charge for undermargined accounts remains necessary at all because the FCM will have already accounted for an undermargined account by maintaining a residual interest sufficient at all times to exceed the sum of all margin deficits; hence the capital charges related to an undermargined account appear to impose an additional financial burden without any necessary financial protection.[172]

RJ O'Brien also stated that the Commission should provide at least a one-year period of time for any changes to the timeframe for taking a capital charge for undermargined accounts to be effective.[173] RJ O'Brien stated that FCMs will need to educate and develop systems to assist their clients in meeting margin calls in an expedited timeframe.[174] Lastly, RJ O'Brien stated that the Commission should require futures exchanges to increase their margin requirements to 135% of maintenance margin to reduce the number and frequency of margin calls.[175]

With respect to the reduction of the timeframe in § 1.17(c)(5)(viii) for an FCM to incur a capital charge for undermargined customer accounts, the Commission has considered the comments and has determined to adopt the amendments as proposed. 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 customers to meet their potential obligations to a DCO. As guarantor of the financial performance of the customer 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) was established in the 1970s when the use of checks and the mail system were more prevalent for depositing margin with an FCM. However, 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, the Commission believes that the timeframe for taking a capital charge should be reduced both to give an incentive to FCMs to exercise prudent risk management and to strengthen the financial protections of FCMs, and to enhance the safety of the clearing systems and other customers by requiring FCMs to reserve capital for undermargined customer accounts that fail to meet a margin call on a timely basis.

Several commenters have stated that the proposal would harm customers by increasing costs to customers or by exposing more of the customers' funds to the FCM.[176] The Commission notes that the final regulation provides for at least two full days from the point in time that a customer's account is undermargined to the time the FCM is required to incur a capital charge for the undermargined account. Under the regulation, if a customer's account becomes undermargined at some point before close of business on Monday, the FCM will have until the close of business on Wednesday before it is required to take a capital charge. Customers are responsible for monitoring the activity in their account and should have information that would allow them to determine that their trading account is undermargined prior to the close of business on Monday.

The alternative proposed by FIA and RJ O'Brien is premised on their belief that the regulation would not provide an adequate amount of time for a customer to meet a margin call before the FCM would have to take a capital charge for an undermargined account. As noted above, the Commission believes that the regulation, which provides at least two full business days for a customer to fund its undermargined account, does provide an adequate period of time for margin calls to be met. In situations involving customers located in foreign jurisdictions and the associated issues of time zone differences and differences in banking holidays, the Commission believes that the FCM should include such factors in its risk management program and operating procedures with such customers in an effort to ensure compliance with the regulations.

The Commission believes that the time period provided in § 1.17(c)(5)(viii) is adequate in most situations for a customer to receive and fund a margin call. The intent of margin is to ensure that a customer maintains a sufficient amount of funds in its account to cover 99 percent of the observed market moves of its portfolio of positions over a specified period of time. Customers that maintain fully margined accounts are exposed to greater risk to the safety of their funds if other customer accounts carried by the FCM are undermargined. In order to provide greater protection to the customers that are fully margined or maintain excess margin on deposit, and to provide greater assurance that the FCM can continue to meet its financial obligations to DCOs, the Commission believes that the FCM should maintain a sufficient amount of capital to cover the potential shortfall in undermargined customers' accounts.

The Commission also has considered the comments on the proposed amendments to § 1.17(c)(5)(ix), which reduce the timeframe for an FCM to incur a capital charge on an undermargined noncustomer or omnibus account from two days after the call was issued to one day after the call was issued. The Commission notes that the majority of the comments addressed the undermargined charge on customer accounts, but considered the comments generally in reviewing the proposed amendments to § 1.17(c)(5)(ix).

The Commission has considered the proposal and is adopting the amendments to § 1.17(c)(5)(ix) as

[167] *Id.*

[168] CCC Comment Letter at 2–3 (Feb. 15, 2013).

[169] *Id.*

[170] FIA Comment Letter at 27 (Feb. 27, 2013); RJ O'Brien Comment Letter at 4 (Feb. 15, 2013).

[171] FIA Comment Letter at 27 (Feb. 15, 2013).

[172] NFA Comment Letter at 13 (Feb. 15, 2013); FIA Comment Letter at 26 (Feb. 15, 2013); MFA Comment Letter at 6–7 (Feb. 15, 2013); and AIMA Comment Letter at 3 (Feb. 15, 2013).

[173] RJ O'Brien Comment Letter at 4 (Feb. 15, 2013).

[174] *Id.*

[175] *Id.*

[176] *See, e.g.,* NCBA Comment Letter at 2 (Feb. 15, 2013); NGFA Comment Letter at 3–4 (Feb. 15, 2013).

proposed. As noted above, § 1.17(c)(5)(ix) applies to noncustomers and omnibus accounts carried by an FCM. Many of the concerns raised by the comments regarding the ability to fund a margin call under § 1.17(c)(5)(viii) do not apply to accounts held by an affiliate or an omnibus accounts. Such accounts should pay margin calls promptly and by wire transfer to reduce the potential exposure to the FCM resulting from undermargined accounts.

The Commission also believes that the amendments to § 1.17(c)(5)(viii) and (ix) are appropriate even if the Commission amends its regulations to require an FCM to maintain residual interest in segregated accounts in excess of the undermargined amount of customer accounts. The purpose of the capital rule is to ensure that an FCM maintains sufficient liquid assets to meet its obligations as a going concern. Proprietary funds held in segregated accounts that exceed the total obligation to customers are included in an FCM's capital computation. However, in situations where the FCM's residual interest in segregated accounts is covering an undermargined customer account, a capital charge is appropriate because the FCM's residual interest is necessary to cover potential market losses on the undermargined accounts.

3. Permit an FCM That Is Not a BD To Develop Policies and Procedures To Determine Creditworthiness

The Commissions proposed to amend § 1.17(c)(v) to permit an FCM that is not a BD to develop a framework to establish, maintain and enforce written policies and procedures for determining creditworthiness of commercial paper, convertible debt, and nonconvertible debt instruments that are readily marketable. In recommending the proposal, the Commission noted that the SEC proposed to permit a BD to establish written policies and procedures to assess the credit risk of commercial paper, convertible debt, and nonconvertible debt instruments that are readily marketable.[177]

Under both the Commission's proposal and the SEC's proposal, an FCM or BD would assess the security's credit risk using the following factors, to the extent appropriate:

- 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 FCM or BD);
- Internal or external credit risk assessments (*i.e.,* whether credit assessments developed internally by the FCM or BD 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 FCM or BD 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).

An FCM that maintains written policies and procedures and determines that the credit risk of a security is minimal is permitted under the 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).

The CFA does not believe it is appropriate for FCMs to use internal models to determine minimum required capital.[178] The CFA believes that capital models should be established by the relevant regulatory agencies for use by FCMs or BDs.[179] It has serious concerns that internal models used for calculating minimum capital requirements are prone to failure in a crisis.[180] The CFA states that the regulatory agency should provide an objective and clear minimum risk-based capital baseline.[181]

As noted above, the SEC has proposed amendments to its net capital rule to allow BDs to take a lower net capital charge on certain securities based on the BDs' own determinations that certain securities have minimal credit risk, pursuant to the BDs having protocols for assessing the credit risk and maintaining appropriate documentations. If the SEC approves the proposal, the SEC capital charges would apply to an FCM that is dually-registered as an FCM/BD. In the absence of the Commission adopting a similar provision, certificates of deposit, bankers acceptances, commercial paper and nonconvertible debt securities held by standalone FCMs that have very low credit and market risk securities would be subject to the minimum default securities haircut of 15 percent.

The Commission proposed that standalone FCMs be permitted the same flexibility as FCM/BDs with respect to taking a lower capital charges for certain securities that may be determined to have minimal credit risk. The Commission also notes that based upon a review of Forms 1–FR–FCM filed with the Commission, standalone FCMs generally have limited investments in the types of securities that would be subject to the internal models, and such haircuts are not material to most standalone FCM's adjusted net capital.

The Commission has considered the proposal and is adopting the amendments as proposed.

4. Revisions to Definitions in Regulation 1.17(b)

The Commission proposed technical amendments to certain definitions in § 1.17(b)(2) and (7) to reflect proposed changes the term ''30.7 customer'' and to remove surplus language due to other revisions to the regulations. No comments were received on these proposed changes and the Commission is adopting the proposal as final.

Regulation 1.17(a) requires each FCM, in computing its minimum capital requirement, to include 8 percent of the risk margin required on futures and over the counter derivative instruments that the FCM carries in customer and non-

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

[178] CFA Comment Letter at 4–5 (Feb. 13, 2013).

[179] *Id.*

[180] *Id.*

[181] *Id.*

customer accounts. Regulation 1.17(b)(9) defines the term ''over the counter derivative instruments'' as those instruments set forth in 12 U.S.C. 4421. Section 740 of the Dodd-Frank Act, however, repealed 12 U.S.C. 4421.

The Commission, however, has not revised its capital requirements and continues to require FCMs to include over the counter derivative instruments that it carries in customer and non-customer accounts in their minimum capital computations. The Commission interprets § 1.17(b)(9) to require an FCM to include the types of derivative transactions or instruments that were previously set forth in 12 U.S.C. 4421 in its computation of its minimum capital requirement. The Commission also has directed staff to develop a rulemaking to amend Regulation 1.17(b)(9) to account for the repeal of 12 U.S.C. 4421.

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

Regulation 1.20 imposes obligations on FCMs, DCOs, and other depositories regarding the holding, and accounting for, customer funds. The Commission proposed to reorganize the structure of § 1.20 by providing additional subparagraphs to the existing specific requirements, and by applying headings to the regulation to assist in the reading and understanding of the regulation. The Commission also proposed new provisions discussed below to enhance the protection of customer funds.

1. Identification of Customer Funds and Due Diligence

The Commission proposed to amend § 1.20(a) to more clearly define the requirements regarding how FCMs must hold customer funds. Proposed paragraph (a) of § 1.20 requires an FCM to separately account for all futures customer funds and to segregate futures customer funds from its own funds. The proposed amendments further provide that an FCM shall deposit customer funds with a depository under an account name that clearly identifies the funds as futures customer funds and shows that the funds are segregated as required by the Act and Commission regulations. Proposed paragraph (a) also provides that an FCM must perform due diligence of each depository holding customer segregated funds (including depositories affiliated with the FCM), as required by new § 1.11, and to update its due diligence on at least an annual basis.

Proposed paragraph (a) also provides that an FCM must maintain at all times in the separate account or accounts funds in an amount at least sufficient in the aggregate to cover its total obligations to all futures customers. Proposed paragraph (a) further provides that an FCM computes its ''total obligations'' to futures customers as the aggregate amount of funds necessary to cover the Net Liquidating Equities of all futures customers as set forth in paragraph § 1.20(i).

The Commission stated in the Proposal that it is not sufficient for an FCM to be in compliance with its segregation requirement at the end of a business day, but fail to hold sufficient funds in segregation to meet the Net Liquidating Equities of each of its customers on an intra-day basis. This provision explicitly clarifies the Commission's long-standing interpretation of existing statutory and regulatory requirements on how FCMs must hold customer funds. Section 4d(a)(2) of the Act requires an FCM to treat and deal with all money, securities, and property received by the FCM to margin, guarantee, or secure the trades or contracts of any customer of the FCM, or accruing to such customer as the result of such trades or contracts, as belonging to such customer. Section 4d(a)(2) further provides that funds belonging to a customer must be separately accounted for by the FCM and may not be commingled with the funds of the FCM or be used to margin or guarantee the trades or contracts, or extend the credit, of any customer or person other than the customer for whom the FCM holds the funds. The separate treatment of customer funds is further set forth in § 1.22 which provides that no FCM shall use, or permit the use of, the funds of one customer to purchase, margin, or settle the trades, contracts, or commodity options of, or to secure or extend the credit of, any person other than such customer. Therefore, the current statutory and regulatory regime requires an FCM to maintain at all times a sufficient amount of funds in segregation to cover the full amount of the firm's obligations to its customers (*i.e.,* the aggregate Net Liquidating Equity of each customer) to prevent the FCM from using the funds of one customer to margin or guarantee the commodity interests of other customers, or to extend credit to other customers.

In its letter, the FIA stated that ''[t]he Commission has stated, and [FIA] agrees, that FCMs are required to comply with the segregation provisions of the Act at all times.'' [182] FIA further cited to a Commission 1998 rulemaking where the Commission stated the segregation rules require compliance at all times.[183] If an FCM is not in compliance with its obligation to maintain a sufficient amount of funds in segregation to meet the Net Liquidating Equities of all of its customer on an intra-day basis, the FCM would be using the funds of one customer to margin positions of another customer, or to cover the losses of another customer in violation of section 4d of the Act and Commission regulations.

The Commission did not receive any comments on revised paragraph (a) and is adopting the amendments as proposed.

2. Permitted Depositories

Proposed paragraph (b) of § 1.20 lists the permitted depositories for futures customer funds as any bank, trust company, DCO, or another FCM, subject to compliance with the FCM's risk management policies and procedures required in new § 1.11. The Commission did not propose changes to the list of permitted depositories for FCMs. The Commission did not receive any comments on paragraph (b) and is adopting the amendments as proposed.

3. Limitation on the Holding of Futures Customer Funds Outside of the United States

Proposed paragraph (c) of § 1.20 provides that an FCM may hold futures customer funds in depositories outside of the U.S. only in accordance with the current provisions of § 1.49. The Commission received no comments on paragraph (c) and is adopting the amendments as proposed.

4. Acknowledgment Letters

a. Background

Proposed paragraph (d) of § 1.20 would require an FCM to obtain a written acknowledgment from each bank, trust company, DCO, or FCM with which the FCM opens an account to hold futures customer funds, with the exception of a DCO that has Commission-approved rules providing for the segregation of such funds. Similarly, proposed § 1.20(g)(4) would require a DCO to obtain a written acknowledgment from each depository prior to or contemporaneously with the opening of a futures customer funds account. Paragraphs (d) and (g) further enumerate requirements for acknowledgment letters, expanding upon the requirements set forth in current § 1.20. Proposed § 1.26, which would require an FCM or DCO that

[182] FIA Comment Letter at 2 (Jun 20, 2013). In addition, FIA expressed its agreement with the existing requirement for an FCM to maintain sufficient funds in segregation at all times to cover its total obligation to its customers.

[183] *Id.* (citing 63 FR 2188, 2190 (Jan. 14, 1998)).

invests customer funds in instruments described in § 1.25 to obtain an acknowledgment letter from the depository holding such instruments,[184] and proposed § 30.7(c)(2), which would require an FCM to obtain an acknowledgment letter from each depository with which it opens an account to hold funds on behalf of its foreign futures and foreign options customers, are consistent with proposed § 1.20(a) and (g)(4). The Commission proposed to repeal and replace § 30.7(c)(2), but retain the requirement to obtain an acknowledgment letter in proposed § 30.7(d).

The Commission has proposed amendments to the acknowledgment letter requirements in §§ 1.20, 1.26, and 30.7 in three separate notices of proposed rulemaking, the first being published on February 20, 2009 (the ''Original Proposal'').[185] 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.

In light of the comments on the Original Proposal, in 2010 the Commission re-proposed the amendments with several changes made in response to comments (the ''First Revised Proposal'').[186] As part of the First 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'').

The Commission received nine comment letters on the First Revised Proposal. In general, the commenters were supportive of the First 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 letter would simplify the process of obtaining an acknowledgment letter. In addition, commenters were in agreement that uniformity of acknowledgment letters would provide consistency and greater legal certainty across the commodities and banking industries.

The Commission proposed further refinements to the acknowledgment letter requirements in 2012 to address several issues that had arisen in the context of the MFGI and PFGI failures and their adverse impact on customers of those FCMs (''Second Revised Proposal'').[187] In the Second Revised Proposal, the Commission also addressed comments it had received in response to the First Revised Proposal and incorporated related changes to the Template Letters.

The Commission received 15 comment letters related to the Template Letters in response to the Second Revised Proposal.[188] Again, the commenters were generally supportive of the Commission's proposal and, in particular, were supportive of the mandatory use of Template Letters. The Depository Bank Group commented that the Template Letters will help ''facilitate a more efficient process for the establishment and maintenance of customer segregated accounts'' and clarify the rights and responsibilities of depositories.[189] Eurex noted that it appreciated the ''potential convenience'' and increased certainty and transparency afforded by the Template Letters.[190] CME supported the Commission's efforts to ''strengthen and standardize'' the Template Letters.[191]

While many of the comments were supportive of the Template Letters, FCStone expressed the view that ''prescriptive rules'' could drive participants out of the futures industry.[192] MGEX commented that the required use of a Template Letter appeared to be a ''dramatic shift'' from the current requirements and questioned whether depositories would be willing to sign the Template Letter due to the ''access and timing information requirements.''[193] RCG stated that early indications were that many depositories ''with extensive experience servicing FCMs'' are unwilling to sign the Template Letter and expressed concern that if such depositories refuse to sign, customer funds will become concentrated with depositories ''less experienced in carrying FCM accounts.''[194]

Regulation 1.20 in its current form already requires FCMs and DCOs to obtain acknowledgment letters, and the Commission believes that use of a standardized Template Letter will reduce negotiation costs, create efficiencies for Commission registrants as well as non-registrant depositories, provide greater legal certainty as to the rights and obligations of parties under the Act and CFTC regulations, and facilitate consistent treatment of customer funds across FCMs, DCOs, and depositories. In addition, the use of a standardized letter is the approach that has been proposed by the Financial Conduct Authority (''FCA'') in the United Kingdom (''U.K.'').[195]

The Commission has taken into consideration the comments and recommendations provided by FCMs, DCOs, and depositories, and it believes the final rules and Template Letters largely address the concerns they have expressed. The Commission's response to comments on the major issues raised by commenters is discussed by subject matter, below.

b. Technical Changes to the Template Letters

Proposed paragraphs (d)(2) and (g)(4)(ii) of § 1.20 would require FCMs and DCOs, respectively, to use the Template Letter set forth in Appendix A to § 1.20 when opening a customer segregated account with a depository. In response to the comments, and in recognition of the different functions FCMs and DCOs perform in relation to customer funds, the Commission has determined to finalize different versions of the Template Letters for FCMs and DCOs. The Template Letter specific to FCMs is being adopted as Appendix A to § 1.20, and the Template Letter for DCOs is being adopted as Appendix B to § 1.20. Paragraph (g)(4)(ii) has been revised to require DCOs to use the Template Letter in Appendix B.

Another change concerns the full account name as it appears in the Template Letter. Proposed § 1.20(a) and (g)(1) provides in part that customer funds shall be deposited ''under an account name that 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 [part 1 of the Commission's regulations].'' Schwartz & Ballen noted that operational constraints limit the number of characters available for account names, and requested additional flexibility with regard to account titles ''so long as the accounts are clearly identified as custodial

[184] Section 22.5 applies the written acknowledgment requirements of §§ 1.20 and 1.26 to FCMs and DCOs in connection with depositing Cleared Swaps Customer Collateral in an account at a permitted depository.

[185] 74 FR 7838 (Feb. 20, 2009).

[186] 75 FR 47738 (Aug. 9, 2010).

[187] 77 FR 67866 (Nov. 14, 2012).

[188] Letters were submitted by Schwartz & Ballen, FIA, LCH.Clearnet, MGEX, the Federal Reserve Banks, NYPC, CME, the Depository Bank Group, Eurex, RJ O'Brien, RCG, NFA, FCStone, ICI, and Katten-FIA.

[189] Depository Bank Group Comment Letter at 2 (Feb. 15, 2013).

[190] Eurex Comment Letter at 1 (Aug. 1, 2013).

[191] CME Comment Letter at 7 (Feb. 15, 2013).

[192] FCStone Comment Letter at 5 (Feb. 15, 2013).

[193] MGEX Comment Letter at 3 (Feb. 18, 2013).

[194] RCG Comment Letter at 7 (Feb. 12, 2013).

[195] *See* Financial Conduct Authority, ''Review of the client assets regime for investment business,'' Consultation Paper CP13/5 (July 2013).

accounts held for the benefit of the FCM's customers.'' [196]

The Commission has modified the Template Letters to accommodate a depository's account titling conventions. The Commission will permit a depository to abbreviate the account name when the full name as set forth in the Template Letter is too long for a depository's operational system to include all characters, provided that (i) the Template Letter includes both the full and abbreviated account name(s) and (ii) the abbreviated account name clearly identifies the account as a Commission-regulated segregated/secured account that holds customer funds (*e.g.,* ''segregated'' may be shortened to ''seg;'' ''customer'' may be shortened to ''cust;'' ''account'' to ''acct;'' etc.).

FIA recommended several modifications to the Template Letters, including the addition of a clause to address banking practices used to provide third-party access to account information. As a result, the Commission has added the following language to the FCM Template Letter (and similar language to the other Template Letters): ''The parties agree that all actions on your part to respond to the above information and access requests will be made in accordance with, and subject to, such usual and customary authorization verification and authentication policies and procedures as may be employed by you to verify the authority of, and authenticate the identity of, the individual making any such information or access request, in order to provide for the secure transmission and delivery of the requested information or access to the appropriate recipient(s).''

In addition, the proposed Template Letters, as well as proposed §§ 1.20(d)(4) and (g)(4)(iv) and 30.7(d)(4), would require the depository to agree to provide a copy of the executed acknowledgment letter to the Commission at a specific email address. The email address has been deleted from the Template Letters, and the depository is now required to provide a copy to the Commission via electronic means in a format and manner determined by the Commission. The rule text has been revised accordingly (and § 1.20(g)(4)(iv) has been renumbered as § 1.20(g)(4)(iii)).

Finally, the Commission has made minor technical revisions to the Template Letters in the form of grammatical and stylistic changes to clarify meaning and provide consistency among the letters.

c. Federal Reserve Banks as Depositories

Pursuant to § 806(a) of the Dodd-Frank Act, the Board of Governors of the Federal Reserve System (the ''Board'') may authorize a Federal Reserve Bank to establish and maintain an account for systemically important DCOs (''SIDCOs'') that have been designated by the Financial Stability Oversight Council (''FSOC'') as systemically important financial market utilities (''Designated FMUs'').[197] In their comment letter, the Federal Reserve Banks stated: ''Absent clarification, the [Federal] Reserve Banks must assume that we would be treated as depository institutions under the proposed rules if we were to hold Designated FMU customer funds.'' The Federal Reserve Banks commented that they do not believe that they can accept all of the terms of the Template Letters given the ''unique nature of the [Federal] Reserve Banks and of Designated FMUs.'' [198]

The Federal Reserve Banks raised specific concerns with two terms of the Template Letters: (1) The provision authorizing the Commission to order the immediate release of customer funds; and (2) the provision that allows a depository to presume legality for any withdrawal of customer funds, provided the depository has no knowledge of, or could not reasonably know of, any violation of the law. The Federal Reserve Banks suggested that under ''exceptional circumstances, such as a prospective insolvency of the SIDCO that threatens customer funds,'' a Commission-authorized withdrawal would need to be considered in the context of a larger coordinated effort, which would include FSOC.[199] The Federal Reserve Banks further asserted that, due to their dual roles as both supervisory bodies and providers of financial services, coupled with the Board prohibition on sharing supervisory information with personnel performing financial services, the standard of liability leaves them in the ''untenable position of not being able to rely on the presumption of legality.'' [200]

The Commission is adopting, as proposed, § 1.20(g)(2), which confirms that the Federal Reserve Banks are depositories for purposes of section 4d of the Act and Commission regulations thereunder. Accordingly, a Federal Reserve Bank would be required to execute a written acknowledgment when it accepts customer funds from a SIDCO or other DCO for which it holds customer funds. However, the Commission recognizes the unique role of the Federal Reserve Bank and is therefore modifying proposed § 1.20(g)(4)(ii) to provide an exception for Federal Reserve Banks from the requirement that depositories accepting customer funds from DCOs execute the Template Letter in Appendix B to § 1.20. Rather, a Federal Reserve Bank will be required only to execute a written acknowledgment that: (1) It was informed that the customer funds deposited therein are those of customers who trade commodities, options, swaps, and other products and are being held in accordance with the provisions of section 4d of the Act and Commission regulations thereunder; and (2) it agrees to reply promptly and directly to any request from the director of the Division of Clearing and Risk or the director of the Division of Swap Dealer and Intermediary Oversight, or any successor divisions, or such directors' designees, for confirmation of account balances or provision of any other information regarding or related to an account.

The Commission is modifying proposed § 1.20(g)(2) from ''A [DCO] 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 [DCO]'' to ''A [DCO] may deposit futures customer funds with a bank or trust company, which may include a Federal Reserve Bank with respect to deposits of a [DCO] that is designated by the Financial Stability Oversight Council to be systemically important.'' Changing the phrase ''which shall include a Federal Reserve Bank'' to ''which may include a Federal Reserve Bank,'' avoids possible ambiguity as to whether the DCO is required to deposit futures customer funds with a Federal Reserve Bank. By revising the description of the DCO, the Commission has effectively captured any DCO, such as one that is also registered with the SEC as a clearing agency and has been designated to be systemically important in that capacity, which could hold customer funds at a Federal Reserve Bank.[201]

[196] Schwartz & Ballen Comment Letter at 8 (Feb. 15, 2013).

[197] Section 806(a) of the Dodd-Frank Act; *see also* Federal Reserve Banks Comment Letter at 1 (Feb. 22, 2013).

[198] Federal Reserve Banks Comment Letter at 2 (Feb. 22, 2013).

[199] *Id.* at 1.

[200] *Id.* at 2.

[201] For example, The Options Clearing Corporation is a registered DCO that has been designated as ''systemically important'' but is not a SIDCO as defined in § 39.2 of the Commission's regulations. A Federal Reserve Bank would be required to segregate customer funds and provide an acknowledgment letter under § 1.20 with respect

Continued

d. Foreign Depositories

In its comment letter, Eurex questioned whether foreign depositories could fully comply with the proposed regulations and execute the Template Letters, noting the probability of ''strong resistance'' by foreign depositories to providing the Commission with read-only electronic access to account information.[202] Eurex pointed to the ''detailed nature of the representations'' in the Template Letters and further expressed its belief that foreign depositories would not be permitted to legally execute the Template Letters.[203] Eurex recommended that the Commission consider alternative methods for achieving the goal of the Template Letters, such as authorizing Commission staff to ''accept alternate language'' from foreign depositories.[204] FIA commented that it had not discussed the Template Letters with foreign depositories and thus did not know whether the Template Letters would ''cause concern'' under a foreign jurisdiction's laws.[205]

The Commission appreciates these perspectives related to foreign depositories, but notes that the comments are of a general nature and do not provide any specific examples to support the commenters' assertions. The Commission did not receive a comment letter from any foreign depository holding customer funds.

As noted above, the FCA recently proposed the use of template acknowledgment letters for purposes of satisfying FCA acknowledgment letter requirements. The proposed letters are similar in many respects to the Template Letters the Commission is adopting herein, and FCA regulations would require both U.K. and non-U.K. depositories to execute the template acknowledgment letters.

The Commission recognizes that there may be valid reasons why some foreign depositories would require modifications to the Template Letters. In such circumstances, the Commission would consider alternative approaches, including no-action relief, on a case-by-case basis.

e. Release of Funds Upon Commission Instruction

As proposed, the Template Letters would require a depository to release funds immediately upon instruction from the director of the Division of Clearing and Risk, the director of the Division of Swap Dealer and Intermediary Oversight, or any successor divisions, or such directors' designees. The purpose of this provision was to enable the Commission to expeditiously carry out measures to protect customer funds in exceptional circumstances, such as the imminent bankruptcy of an FCM. Commenters expressed concerns about this requirement, citing liability that might arise from a depository acting or failing to act ''immediately,''[206] and the need for the depository to implement proper security and authorization procedures in connection with acting upon instructions from the Commission rather than the account holder.[207]

With respect to DCOs in particular, NYPC pointed out that a DCO normally holds customer funds in a segregated account without further subdivision by customer or clearing member and, as a result, a DCO would effectuate a transfer of customer funds from a defaulting clearing member to a non-defaulting clearing member by book entry on the DCO's books and records.[208] NYPC noted that no transfer of funds may be required if the DCO holds the funds at the same depository.

The Depository Bank Group commented that the term ''immediately'' may subject a depository to potential claims by FCMs, DCOs or the Commission in the event of a delay in the transfer of customer funds, even if such delay is the result of reasonable actions or events beyond the control of the depository.[209] As previously noted, the Federal Reserve Banks commented that during such ''exceptional circumstances'' in which instructions to transfer funds from a SIDCO's account would likely be made, the FSOC would be involved.[210] The Depository Bank Group, FIA, and Schwartz & Ballen all commented that the proposal is ''inconsistent'' with a depository's security policies and procedures.[211] CME requested that the Commission clarify the exceptional circumstances that would give rise to the Commission's request for an immediate release of customer funds and the impact such an instruction could have on the timely payment of obligations to a DCO.[212]

After considering the concerns raised by the commenters, the Commission has determined not to require depositories to agree to release or transfer customer funds upon its instruction. The Commission notes that in exceptional circumstances such as the imminent bankruptcy of an FCM, Commission staff would be in regular communication with the FCM, its DSRO, DCOs, and depositories in an effort to protect customer funds.

f. Read-Only Access and Information Requests

Proposed paragraphs (d)(3) and (g)(4)(iii) of § 1.20, proposed § 30.7(d)(3), and the proposed Template Letters, including the Template Letters for § 1.26 investments in money market mutual funds, would require depositories to provide the Commission with 24-hour, read-only electronic access to accounts holding customer funds. The Commission received eight comment letters on this requirement.

As a preliminary matter, FIA noted that significant time for development would be necessary to implement such a requirement.[213] Schwartz & Ballen observed that the read-only access approach conflicts with bank procedures used to provide account information to third parties, which typically involve allowing the customer to grant access to a third party, rather than the bank doing so.[214] The Depository Bank Group and FIA also pointed out that Commission staff would be required to comply with the depository's security policies and procedures.[215] The Depository Bank Group recommended that the Template Letters expressly authorize the depository to provide access to the Commission and suggested language that could be incorporated into the Template Letters.[216] RJ O'Brien agreed with the Depository Bank Group's position on read-only access.[217]

FCStone noted that time differences and geographic locations may make it difficult for foreign commodity brokers to satisfy the 24-hour-a-day requirement and respond promptly to requests made

to any customer account subject to section 4d of the Act and opened by The Options Clearing Corporation in its capacity as a DCO.

[202] Eurex Comment Letter at 1 (Aug. 1, 2013).

[203] *Id.* at 2.

[204] *Id.*

[205] FIA Comment Letter at 40 (Feb. 15, 2013).

[206] Depository Bank Group Comment Letter at 10.

[207] *Id.* at 11; Schwartz & Ballen Comment Letter at 2 (Feb. 15, 2013); Katten-FIA Comment Letter at 2 (Aug. 2, 2013).

[208] NYPC Comment Letter at 2 (Feb. 15, 2013).

[209] Depository Bank Group Comment Letter at 10 (Feb. 15, 2013).

[210] Federal Reserve Banks Comment Letter at 1 (Feb. 22, 2013).

[211] *Id.* at 11; Katten-FIA Comment Letter at 2 (Aug. 2, 2013); and Schwartz & Ballen Comment Letter at 5 (Feb. 15, 2013).

[212] CME Comment Letter at 7 (Feb. 15, 2013).

[213] FIA Comment Letter at 40 (Feb. 15, 2013).

[214] Schwartz & Ballen Comment Letter at 4 (Feb. 15, 2013).

[215] Depository Bank Group Comment Letter at 13 (Feb. 15, 2013); Katten-FIA Comment Letter at 2 (Aug. 2, 2013).

[216] Depository Bank Group Comment Letter at 13 (Feb. 15, 2013).

[217] RJ O'Brien Comment Letter at 11 (Feb. 15, 2013).

by the Commission.[218] The Depository Bank Group commented that often a bank denies access during routine maintenance to technology systems, and asked that the Commission remove the ''24-hour'' requirement.[219]

NYPC commented that, because DCOs hold customer funds on behalf of all their clearing members in omnibus accounts that are not further subdivided by each customer, the account information to which the Commission would have access at a DCO's depository ''would not provide the level of detail that would permit reconciliation between either the DCO's FCM clearing members or those clearing members' underlying customers.'' [220] In addition, Schwartz & Ballen contended that the requirement would not achieve the Commission's goal of quickly identifying discrepancies between FCM-reported balances and balances at a depository because the depository typically posts all credits and debits after the close of business.[221]

LCH.Clearnet recommended that the Commission consider ''alternative approaches'' for routine access to account balance information at depositories holding customer funds. For central banks, LCH.Clearnet suggested that the Commission should accept confirmation of balance information directly from the central bank in a form acceptable to the central bank, but it did not explain why central banks should be treated differently than other depositories. For other depositories, LCH.Clearnet believes the Commission should consider ''following the lead of the [NFA].'' [222]

NFA pointed out that its board of directors had adopted a financial requirements rule in August 2012.[223] NFA explained that instead of adopting a read-only access provision of its own in this rule, it instead chose to use, in conjunction with CME, an automated daily segregation confirmation system to monitor customer segregated and secured amount accounts and their balances.[224] NFA requested that the Commission rescind its proposed read-only access requirement.[225]

With the goal of achieving the highest degree of customer protection, the Commission has determined to adopt, with certain modifications, the requirement that a depository agree to provide the Commission with read-only access to accounts maintained by an FCM. Regulations 1.20(d)(3) and 30.7(d)(3) require the depository to agree to provide the Commission with ''the technological connectivity, which may include provision of hardware, software, and related technology and protocol support, to facilitate direct, read-only electronic access to transaction and account balance information.'' In the Template Letters, the parties further acknowledge and agree that the connectivity has either been provided (in the case of a new letter that covers existing accounts) or will be provided promptly following the opening of the account(s) (with respect to new accounts). However, the Commission is not requiring read-only electronic access for an FCM's DSRO, as proposed. The Commission was advised by the DSROs that they intend to rely on the NFA and CME automated daily segregation confirmation system.

The Commission does not anticipate that its staff would access FCM accounts on a regular basis to monitor account activity; rather, staff would make use of the read-only access only when necessary to obtain account balances and other information that staff could not obtain via the NFA and CME automated daily segregation confirmation system, or otherwise directly from the depositories, as discussed below. In this regard, the CME and NFA will provide the Commission on a daily basis with the account balances reported to them by each depository holding customer funds, under the CME and NFA's daily confirmation process. In addition, as discussed in section N below, each FCM that completes a daily Segregation Schedule, Secured Amount Schedule, and/or Cleared Swaps Segregation Schedule will be required to file such schedules with the Commission on a daily basis. The Commission anticipates that the combination of receipt of daily account balances reported by depositories and the Commission's ability to confirm account balances and transactions directly with depositories will diminish the need to rely upon direct electronic access to account information at depositories.

With respect to depositories holding customer funds in accounts maintained by a DCO, the Commission has decided not to adopt the electronic access requirement. Given that DCOs hold omnibus customer accounts that are not subdivided by clearing member or individual customer, read-only access to a DCO's customer account would not provide the kind of information that would identify inaccuracies in FCM reporting. Accordingly, proposed § 1.20(g)(4)(iii), which would require a DCO to deposit futures customer funds only with a depository that provides read-only access to the Commission, is not being adopted, and the remaining subparagraphs of § 1.20(g)(4) are renumbered accordingly.

The Commission also is adopting §§ 1.20(d)(6), 1.20(g)(4)(iv), and 30.7(d)(6), which require an FCM or DCO to deposit customer funds only with a depository that agrees to reply promptly and directly to any request from the director of the Division of Swap Dealer and Intermediary Oversight, the director of the Division of Clearing and Risk, or any successor divisions, or such directors' designees,[226] (or, in the case of an FCM, an appropriate officer, agent or employee of the FCM's DSRO), for confirmation of account balances or provision of any other information regarding or related to an account, without further notice to or consent from the FCM or DCO.[227] For DCOs, the Commission believes that this ability, in addition to the daily reporting of various accounts by customer origin pursuant to § 39.19(c)(1), will enable it to verify DCO account balances with a depository as necessary.

[218] FCStone Comment Letter at 5 (Feb. 15, 2013).

[219] Depository Bank Group Comment Letter at 13 (Feb. 15, 2013).

[220] NYPC Comment Letter at 2 (Feb. 15, 2013).

[221] Schwartz & Ballen Comment Letter at 4 (Feb. 15, 2013).

[222] LCH.Clearnet Comment Letter at 3 (Jan. 25, 2013).

[223] NFA Comment Letter at 6 (Feb. 15, 2013).

[224] *Id.*

[225] *Id.* at 7.

[226] Proposed §§ 1.20(d)(5) and (g)(4)(v) and 30.7(d)(5) would require the depository to reply promptly and directly to ''the Commission's'' requests, and the authority to make such requests was delegated to the director of the Division of Swap Dealer and Intermediary Oversight and the director of the Division of Clearing and Risk under proposed § 140.91(a)(7) and (11). The proposed Template Letters would require the depository to 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'' and ''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 . . . 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.'' The Commission is revising the rule text and the Template Letters so that all such requests will come from the director of the Division of Swap Dealer and Intermediary Oversight or the director of the Division of Clearing and Risk, or any successor divisions, or such directors' designees.

[227] To assist a depository in verifying authority and authenticating identity in connection with a request for information or electronic access, the Commission intends to post on its Web site an up-to-date list of names (including title and contact information) of the directors of the Division of Swap Dealer and Intermediary Oversight and the Division of Clearing and Risk, or any successor divisions, and the directors' designees, if any, for the relevant purpose.

g. Requirement To File New Acknowledgment Letters

Proposed paragraphs (d)(7) and (g)(4)(vii) of § 1.20 and proposed § 30.7(d)(7) would require FCMs and DCOs to file amended acknowledgment letters with the Commission upon a change to a depository's name or other information specified in the regulation. The Commission received three comments on this requirement. Schwartz & Ballen recommended that the Commission remove this requirement from the Template Letters and instead include ''binding effect'' language to ensure that the counterparties remain subject to the terms of the acknowledgment letter even if a party's name has changed.[228] LCH.Clearnet recommended a six-month timeframe after the publication of these rules by which DCOs and FCMs must obtain acknowledgment letters.[229] NYPC commented that the proposed requirements impose ''an onerous periodic validation process with depositories'' and, given this, it suggested that depositories provide written notice to a DCO of a name or address change no later than 30 days after any such change in order to permit a DCO to execute a new Template Letter.[230]

The Commission believes that acknowledgment letters should be as current and up-to-date as possible in order to maintain the clear legal status of the customer account, which will better protect customers in the event of an FCM failure. Accordingly, the Commission is adopting (renumbered) §§ 1.20(d)(8) and (g)(4)(vi) and 30.7(d)(8) as proposed, except that instead of providing for an ''amended'' letter, the regulation requires that a ''new'' letter be executed. The purpose of this technical change is to avoid problems in locating the accounts covered by a single letter that has been amended multiple times to reflect various changes. The Commission expects that a depository would notify account holders of a name change as a matter of practice and does not believe that it is too burdensome to expect a DCO or FCM to be aware of such changes. Any new acknowledgment letter reflecting a change enumerated in the regulation must be executed within 120 days of such changes, and then filed with the Commission within three business days of executing the new letter.

The Commission also is adopting (renumbered) §§ 1.20(d)(7) and (g)(4)(v) and 30.7(d)(7), which require an FCM or DCO to submit a copy of the acknowledgment letter to the Commission within three business days of the opening of an account or obtaining a new acknowledgment letter for an existing account; and §§ 1.20(d)(4) and (g)(4)(iii) and 30.7(d)(4), which require an FCM or DCO to deposit customer funds only with a depository that agrees to provide a copy of the acknowledgment letter to the Commission (and, in the case of an FCM, the FCM's DSRO) within the same time frame.[231] The Commission is, however, giving FCMs, DCOs, and depositories 180 days from the effective date of the final rules to replace existing acknowledgment letters with new ones that conform to the Template Letters.

As an additional matter, the Commission advises that it expects an FCM or DCO to follow customary authorization verification and signature authentication policies and procedures to ensure that an acknowledgment letter is executed by an individual authorized to bind the depository to the terms of the letter, and that the signature that appears on the letter is authentic. For example, an FCM or DCO may request from the depository a list of authorized signatories, a duly executed power of attorney, or other such documentation.

h. Standard of Liability

The proposed Template Letters would provide that a depository ''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 [the depository has] no notice of or actual knowledge of, or could not reasonably know of, a violation of the Act or other provision of law by [the FCM or DCO]; and [the depository] shall not in any manner not expressly agreed to [in the letter] be responsible for ensuring compliance by [the FCM or DCO] with the provisions of the Act and CFTC regulations.''

The Depository Bank Group commented that this ''standard of liability'' provision would impose a burden beyond that currently expected of depository institutions.[232] In this regard, the Depository Bank Group asserted that the phrase ''violation of the Act or other provision of law'' encompasses much more than section 4d of the Act and would effectively require that the depository monitor and ensure the FCM's or DCO's compliance with *all* other laws, even those unrelated to the deposit of customer funds.[233] The Depository Bank Group further contended that the proposed standard, ''could not reasonably know of a violation'' would likely be read to require depositories to ''perform some undefined level of diligence'' which would be highly problematic.[234] The Depository Bank Group also stated that this requirement would likely delay transfers or withdrawals, and result in depositories passing on related costs to FCMs and DCOs and, in turn, to their clients, although the Depository Bank Group did not quantify the costs.[235] FIA similarly expressed concern that the requirement could cause delays and increased costs, again, without providing specific details and quantifying costs.[236]

Schwartz & Ballen asserted that banks have no ability to determine what uses an FCM is making of funds it withdraws from the account.[237] As noted above, the Federal Reserve Banks, which may act as depositories for Designated FMUs, commented that the ''actual knowledge'' standard, which typically imputes knowledge to a legal person as a whole, is not feasible for them because of the Board policy to not share supervisory information with Federal Reserve Bank personnel performing financial services.

In response to concerns expressed by commenters, the Commission clarifies that it does not intend to use the Template Letters as means to expand the scope of a depository's liability to FCM or DCO account holders, or to alter the responsibility that an FCM or DCO bears for its own compliance with the customer funds segregation requirements under the Act and Commission regulations. The use of standardized acknowledgment letters is intended to promote a uniform understanding among FCMs, DCOs, and depositories as to their obligations under the Act and Commission regulations with respect to the proper treatment of customer funds. In light of the public comments, the Commission is revising the language in the Template

[228] Schwartz & Ballen Comment Letter at 7 (Feb. 15, 2013).

[229] LCH.Clearnet Comment Letter at 4 (Jan. 25, 2013).

[230] NYPC Comment Letter at 4 (Feb. 15, 2013).

[231] The acknowledgment letter must be executed upon the opening of the account, regardless of when customer funds are deposited in the account.

[232] Depository Bank Group Comment Letter at 3 (Feb. 15, 2013). *See also* RJ O'Brien Comment Letter at 11 (Feb. 15, 2013).

[233] Depository Bank Group Comment Letter at 5 (Feb. 15, 2013). *See also* Katten-FIA Comment Letter at 2 (Aug. 2, 2013); Schwartz & Ballen Comment Letter at 6 (Feb. 15, 2013); and CME Comment Letter at 7 (Feb. 15, 2013).

[234] Depository Bank Group Comment Letter at 3 (Feb. 15, 2013).

[235] *Id.* at 5.

[236] FIA Comment Letter at 40 (Feb. 15, 2013).

[237] Schwartz & Ballen Comment Letter at 6 (Feb. 15, 2013).

Letters to more precisely articulate the intended scope of the depository's responsibility.

The provision, as adopted, reads as follows: ''You [the depository] 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, in the ordinary course of your business as a depository, you have no notice of or actual knowledge of a potential violation by us of any provision of the Act or CFTC regulations that relates to the segregation of customer funds; and you shall not in any manner not expressly agreed to [in the letter] be responsible to us [the FCM or DCO] for ensuring compliance by us with the provisions of the Act and CFTC regulations; however, the aforementioned presumption does not affect any obligation you may otherwise have under the Act or CFTC regulations.'' Changes from the proposed language are discussed below.

The Depository Bank Group recommended inserting the phrase ''in the ordinary course of your business as a depository,'' and the Commission has accepted this recommendation to clarify the context in which the presumption of the FCM's or DCO's compliance is effective. As proposed, the presumption would be effective so long as the depository has ''no notice of or actual knowledge of, or could not reasonably know of, a violation.'' Given the concerns expressed by commenters as to the implications of the ''reasonably know'' standard, the Commission has determined to eliminate that clause in the final Template Letters.

In considering the various circumstances in which the conclusive presumptions would no longer be effective, the Commission has determined that the proposed reference to notice or actual knowledge of a ''violation,'' does not adequately capture all of the relevant circumstances. This is because the depository might receive information that calls into question the conduct of the FCM or DCO account holder, but it might not be apparent whether or not the activity rises to the level of being an actual violation of the law. Indeed, some actions will not be deemed to be ''violations'' until a judicial decision is rendered. As a result, the Commission has revised the language to refer to a ''potential violation'' so as not to inadvertently exclude circumstances which would warrant further inquiry by a depository.

The Commission agrees that the broad reference to ''the Act and CFTC regulations'' should be narrowed with respect to the description of the potential violation. Therefore, the Commission is adopting the Depository Bank Group's suggestions that the reference to the violation specify that it is limited to ''any provision of the Act or the CFTC regulations that relates to the segregation of customer funds.'' The Commission has made a similar change in the 30.7 Template Letters, referring to ''any provision of the Act or Part 30 of the CFTC regulations that relates to the holding of customer funds.'' This more precisely identifies the legal requirements that are the subject of the parties' obligations and the acknowledgment letter as a whole.

As an additional matter, the Commission has added to the standard of liability provision the following proviso: ''however, the aforementioned presumption does not affect any obligation you may otherwise have under the Act or CFTC regulations.'' This statement affirms the depository's understanding that its statutory and regulatory obligations with respect to the customer funds on deposit are not limited by the presumption upon which it relies in its dealings with FCM or DCO account holders.

The Commission notes that a depository's obligation to comply with the segregation requirements under section 4d of the Act is explicitly imposed upon depositories by section 4d(b) of the Act,[238] and legal precedent has established a standard of liability to which the Commission holds depositories and which is not dependent upon affirmation in the Template Letters. The Commission reaffirms its long-held position that the depository will be held liable for the improper transfers of customer funds by an FCM or DCO if it knew or should have known that the transfer was improper.[239]

The Commission recognizes that a depository's treatment of customer funds may be limited in particular circumstances on the basis of what it knows or reasonably should know of a violation of the Act that would preclude it from obtaining rights to such funds superior to those of one or more customers of the defaulting FCM.[240] Such a violation could occur, for example, in circumstances in which the depository received particular margin funds with actual knowledge, or in circumstances in which it is reasonable to conclude that the depository should have known, that the depositing FCM or DCO has breached its duty under section 4d. The depository's participation in such use of customer funds could subject it to liability for violating section 4d or aiding and abetting a violation of the Act under section 13(a) of the Act (7 U.S.C. 13c).[241]

The Commission emphasizes that while the depository has no affirmative obligation to police or monitor an FCM or DCO account holder's compliance with the Act or Commission regulations, the depository *cannot* ignore signs of wrongdoing. Should a depository know or suspect that funds held in a customer account have been improperly withdrawn or otherwise improperly used in violation of section 4d of the Act or the Commission's regulations related to segregation of customer funds, the Commission expects the depository to immediately report its concern to the Division of Swap Dealer and Intermediary Oversight, the Division of Clearing and Risk, the Division of Enforcement, or the Commission's Whistleblower Office.[242]

i. Liens

The proposed Template Letters would include the following language: ''Furthermore, [the depository]

[238] Section 4d(b) of the Act explicitly provides that it is unlawful for any clearing agency of a contract market and any depository that has received customer funds to hold, dispose of, or use any such funds as belonging to the depositing FCM or any person other than the customers of such FCM. *See also* section 4d(f)(6) of the Act (applying the same requirement to Cleared Swaps Customer Collateral).

[239] *See, e.g.,* CFTC Interpretative Ltr. No. 79–1, [1977–1980 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶20,835 (May 29, 1979) at page 2. As long ago as 1979, the Commission found that ''if a bank, with prior notice, permits or acquiesces in the withdraw [sic] or use of customers' funds by a futures commission merchant for an unlawful purpose, the bank would violate or be aiding and abetting a violation of the Act.''

[240] *See* CFTC Interpretative Ltr. No. 86–9, [1986–1987 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶23,015 (April 21, 1986) (limiting a bank's treatment of customer margin funds ''in particular circumstances by reason of what it knows or reasonably should know of a violation of the Act or other provision of law that would preclude it from obtaining rights to such funds superior to those of one or more customers of the defaulting FCM.'').

[241] *Id. See also* CFTC Interpretative Statement. No. 85–3 [1984–1986 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶22,703 (Aug. 12, 1985). A DCO's rights with respect to the use of customer margin funds may be limited in particular circumstances by reason of the clearing organization's knowledge of or participation in a violation of the Act or other provision of law that precludes it from obtaining rights to such funds superior to those of one or more customers of the defaulting clearing member. The letter provides that a DCO could be subject to aiding and abetting liability under section 13(a) of the Act if the DCO knowingly participates in a violation of the Act.

[242] *See* CFTC Interpretative Ltr. No. 79–1 (stating ''if a bank subsequently becomes aware of an unauthorized withdrawal or use of customers' funds by an FCM, we would expect the bank to notify the Commission immediately'').

acknowledge[s] and agree[s] that such Funds may not be used by [the depository] or by [the FCM or DCO] to secure or guarantee any obligations that [the FCM or DCO] might owe to [the depository], nor may they be used by [the FCM or DCO] to secure credit from [the depository]. [The depository] further acknowledge[s] and agree[s] 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 [the FCM or DCO] may now or in the future have owing to [the depository]. This prohibition does not affect [the depository's] right to recover funds advanced in the form of cash transfers [the depository] make[s] in lieu of liquidating non-cash assets held in the Account(s) for purposes of variation settlement or posting initial (original) margin.'' This language is consistent with section 4d(b) of the Act, which states: ''It shall be unlawful for any person, including but not limited to . . . any depository, that has received any money, securities, or property for deposit in a separate account as provided in [section 4d(a)(2) of the Act], to hold, dispose of, or use any such money, securities, or property as belonging to the depositing [FCM] or any person other than the customers of such [FCM].''

Schwartz & Ballen asserted that because many FCMs hold only cash assets in the accounts, the language in the letter should be expanded to permit banks to recover funds they advance that result in overdrafts in the accounts.[243] Schwartz & Ballen further stated that the failure to permit banks to recover such advances whether or not there are non-cash assets in the account will likely lead to banks incurring losses.[244] FCStone elaborated on this issue, explaining that a customer receives a margin call through an account statement, which is transmitted overnight, and the customer wires funds the following day.[245] The DCO, however, automatically drafts the funds from the FCM's account at 9:00 a.m. on the basis of a depository's intraday daylight overdraft.[246] Without granting a depository a lien on customer funds, FCStone stated that an FCM would be required to ''front'' all funds for customers until the customer has wired funds to the FCM.[247] FCStone contended that a change of this sort could ''threaten the continued operations of small to mid-sized FCMs not affiliated with banks'' and cause a substantial liquidity strain.[248] The Depository Bank Group additionally warned that a depository may not be willing to provide intraday advances to the customer segregated account without the right to take a lien on the account or the right to set off between multiple customer segregated accounts and would, therefore, not be in a position to provide liquidity.[249] As a result, an FCM or DCO would likely need to maintain a buffer of its own funds in the segregated customer accounts to fully pre-fund transactions related to such accounts.[250] The Depository Bank Group contended that the impact on small- to mid-sized FCMs would be that of a lesser ability to enter into ''everyday transactions'' for the customer segregated account, which could result in exclusion from the industry.[251] The Depository Bank Group cited as support a comment letter that staff of the Federal Reserve Bank of Chicago submitted in 2010.[252]

The Commission recognizes that a depository may not want to provide unsecured overdraft coverage. However, a depository taking a lien on a customer account to facilitate intraday payments presents a serious problem if an FCM's customer does not satisfy a margin call and the FCM, in turn, cannot cover the call and becomes insolvent before the depository can be repaid.

The Commission interprets the requirements of section 4d of the Act to prohibit a lien on customer funds to satisfy an intraday extension of credit to an FCM to meet margin requirements at a DCO. As an alternative to taking a lien on the customer account, the depository could take a lien on a proprietary account held by the FCM at the depository, or the FCM could add its own funds to the segregated account or collect more margin from its customers in order to provide a more substantial financial cushion. It is not the Commission's intention to disadvantage mid-size and smaller FCMs in applying this standard across all FCMs, regardless of size.

The Commission notes that no commenter has proffered information or data that would indicate intraday advances are a commonplace, routine occurrence. Indeed, it may be cause for concern if a large number of FCMs cannot meet intraday margin calls for customer accounts on a regular basis.

Without expressing a view of the Commission's position concerning section 4d of the Act, FIA recommended expanding the circumstances in which a depository could impose a lien with respect to customer funds.[253] FIA recommended revising the language to read: ''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 except to recover from the Account(s) (or from any other CFTC Regulation 1.20 Customer Segregated Account(s) we have with you), Funds you may advance from time to time to facilitate transactions by or on behalf of, or on account of, or otherwise for the benefit of, the Account(s) or our customers whose Funds are held in the Account(s).''[254] The Commission confirms that a depository can possess a lien across multiple accounts of the same FCM as long as the accounts are of the same account class (*i.e.,* 4d(a) cash and custodial accounts). However, the Commission believes FIA's suggested modification is overbroad and has the potential to be interpreted to permit a depository's imposition of a lien in a greater number of circumstances than section 4d of the Act allows.

NYPC urged the Commission to clarify that DCOs have the right to transform non-cash customer funds into cash to satisfy liquidity needs related to the customer account of a defaulting FCM clearing member not only through the sale of such assets, but also through the use of liquidity arrangements, such as lines of credit and repurchase agreements.[255] NYPC recommended that the Commission modify the last sentence in the ''lien'' paragraph as follows: ''The prohibitions contained in this paragraph do not affect your right to recover funds advanced by you in the form of cash transfers, lines of credit, repurchase agreements or other similar liquidity arrangements in lieu of the liquidation of non-cash assets held in the Account(s) for purposes of variation settlement or posting initial (original) margin with respect to the Account(s).'' The Commission recognizes that liquidity arrangements are an important aspect of a DCO's default management plan and agrees that the use of lines of

[243] Schwartz & Ballen Comment Letter at 6–7 (Feb. 15, 2013).

[244] *Id.*

[245] FCStone Comment Letter at 4.

[246] *Id.*

[247] *Id.* at 5.

[248] *Id.*

[249] Depository Bank Group Comment Letter at 7 (Feb. 15, 2013).

[250] *Id.*

[251] *Id.*

[252] Comment letter from David A. Marshall, Federal Reserve Bank of Chicago, dated September 8, 2010.

[253] Katten-FIA Comment Letter at 2 (Aug. 2, 2013).

[254] *Id.*

[255] NYPC Comment Letter at 3 (Feb. 15, 2013).

credit or repurchase agreements are acceptable alternatives to the liquidation of non-cash assets held in a customer account. As a result, the Commission has determined to modify the sentence in a manner similar to that recommended by NYPC.

In response to the other comments, the Commission notes that it has always interpreted and applied section 4d of the Act in a manner consistent with the language in the proposed Template Letters. With respect to a depository's right of setoff against a customer account, the Commission has long recognized only one very limited circumstance. CFTC Interpretative Letter No. 86–9 allows, with certain limitations,[256] a bank's right of setoff against a customer cash account that does not have sufficient available balances to meet a margin call, where there exists an affiliated custodial account that contains securities purchased with funds from the customer cash account.[257] In this case, there is no extension of credit because the accounts, when aggregated, have enough assets to support the cash advance.

The Depository Bank Group raised a question about similar circumstances in which a depository might set off amounts owed to a customer segregated account holding U.S. dollars, with amounts held in foreign currency in another customer segregated account.[258] To the extent that a depository advances cash in lieu of exchanging foreign currency held in a related 4d account, the same rationale that serves as the basis for CFTC Interpretative Letter No. 86–9 would apply, *i.e.,* the advancement of funds does not represent an extension of credit secured by customer funds. The Commission confirms that a depository holding customer funds in one segregated account may set off amounts withdrawn from another account in cases where the depository advances funds in lieu of converting cash in one currency to cash in a different currency.

The Template Letters provide for a depository's right of setoff against the customer account consistent with Interpretative Letter No. 86–9. The Commission believes that expanding the scope of a depository's right of setoff to support extensions of credit to an FCM would violate the requirements of section 4d of the Act and notes that none of the commenters provided a legal analysis that would refute this position.

The Commission recognizes, however, that there may be situations similar to those specifically enumerated in the proposed Template Letters for which an advancement of cash and the related imposition of a lien in lieu of liquidating non-cash assets or converting cash in one currency to cash in a different currency may be permissible. To accommodate this, the Commission is revising the language to remove the concluding clause, ''for the purposes of variation settlement or posting initial (original) margin.'' This change preserves the intended meaning and purpose of the provision without unintentionally limiting its application in other similar circumstances.

Accordingly, the Commission is adopting the proposed ''lien'' language of the Template Letters, modified to include a reference to the depository's right to recover funds related to certain liquidity arrangements and to eliminate specific examples of circumstances in which imposition of a lien would be permissible. FCMs, DCOs, and depositories are reminded that any permissible advancement of cash and related imposition of a lien on a customer account must be properly documented and recorded in compliance with all applicable recordkeeping requirements.

j. Examination of Accounts

As proposed, the Template Letters for both FCMs and DCOs would require a depository to agree that accounts holding customer segregated funds could be ''examined at any reasonable time'' by the Commission or, as applicable, an FCM's DSRO, and they further provide that the acknowledgment letter ''constitutes the authorization and direction of the undersigned to permit any such examination or audit to take place.'' Schwartz & Ballen commented that the provision should also provide for the Commission or DSRO to give the depository advance notice before being permitted to examine FCM accounts.[259] The Commission is not including this recommended precondition because an examination of this type is likely to be conducted only in response to exigent circumstances and the ''reasonable time'' provision is sufficient evidence of the Commission's intent to proceed in a commercially reasonable manner under the particular circumstances.

The Commission is retaining the examination provision in the FCM Template Letters but is not including it in the DCO Template Letters. Consistent with the Commission's determination regarding electronic access to DCO account information, the Commission believes that authorization to examine a DCO's customer segregated account at a depository is not necessary because of the Commission's ability to obtain account information directly from the depository upon request, and directly from the DCO through daily reporting under § 39.19(c)(1).

As a technical matter, the Commission is eliminating use of the term ''audit'' to clarify that the examination will be targeted and is not intended to be an audit, as that term is used in the field of accounting.

5. Prohibition against Commingling Customer Funds

The Commission proposed to amend § 1.20(e) to explicitly address the commingling of customer funds. Proposed § 1.20(e)(1) provides that an FCM may, for convenience, commingle the 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 permitted depositories set forth in § 1.20(b).

Proposed § 1.20(e)(2) prohibits an FCM from commingling futures customers funds with any proprietary funds of the FCM, or with any proprietary account of the FCM. Proposed § 1.20(e)(2), however, provides that the prohibition on the commingling of futures customer funds and the FCM's proprietary funds does not prohibit an FCM from depositing proprietary funds into segregated accounts in accordance with proposed § 1.23 as a buffer to prevent the firm from becoming undersegregated due to normal business activities, such as daily margin payments by the FCM to a DCO.

Proposed § 1.20(e)(3) further prohibits an FCM from commingling futures customer funds with funds deposited by 30.7 customers for trading foreign futures or foreign option positions in accordance with part 30 of the Commission's regulations, or with Cleared Swaps Customer Collateral deposited by Cleared Swaps Customers for Cleared Swaps under part 22 of the Commission's regulations. Proposed § 1.20(e)(3) permits, however, the commingling of futures customer funds with 30.7 customer funds and/or Cleared Swaps Customer funds if expressly permitted by a Commission

[256] *See* CFTC Interpretative Ltr. No. 86–9, [1986–1987 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶23,015 (April 21, 1986) (limiting a bank's treatment of customer margin funds ''in particular circumstances by reason of what it knows or reasonably should know of a violation of the Act or other provision of law that would preclude it from obtaining rights to such funds superior to those of one or more customers of the defaulting FCM.'').

[257] *Id.*

[258] *Id.* at 8.

[259] Schwartz & Ballen Comment Letter at 7 (Feb. 15, 2013).

regulation or order, or by a DCO rule approved in accordance with § 39.15(b)(2) of the regulations.[260]

Similarly, a proposed amendment to § 30.7 would prohibit an FCM from commingling funds required to be deposited in a foreign futures and foreign options secured amount account with funds required to be deposited in a customer segregated account or cleared swaps customer account.[261]

The Commission received one comment on the proposed amendments to § 1.20(e). FIA stated that it fully supported the proposed amendments, which implement the segregation provisions of section 4d(a) and 4d(f) of the Act.[262]

FIA further requested that the Commission confirm that the proposed amendments would not prohibit a customer that engages in futures transactions on a designated contract market, foreign futures or options transactions on foreign boards of trade, and Cleared Swaps through a single FCM, from meeting its margin obligations for the three different segregation accounts by making a single payment to the FCM.[263] FIA states that such practice is common in the industry today, reduces the FCM's credit risk, is operationally more efficient for both the FCM and its customers, and indirectly reduces customer settlement risk.[264]

The Commission confirms, subject to the following conditions, that a receipt of funds from a customer that wishes to meet its multiple margin obligations by making a single deposit payment to the FCM is not prohibited by § 1.20. The FCM, however, must initially receive the customer's funds into the customer's section 4d(a)(2) segregation account. The funds may not be directly deposited into the customer's § 30.7 secured account or Cleared Swaps Segregation Account, as such accounts may present different risks than the section 4d(a)(2) account, and the Commission would like to standardize operationally the practice of how customer funds are received by FCMs by authorizing one approach that would be applicable to all customers to minimize the possibility of transactional errors.

In addition, the FCM must simultaneously record the book entry credit to the customer's § 30.7 secured account and the customer's Cleared Swaps Account (as applicable) as directed by the customer upon the receipt and recording of the cash into the customer's 4d(a)(2) segregation account. Also, the FCM must ensure at the time the book entry credit is made to the customer's account, that the credit does not result in the FCM having obligations to 30.7 customers or Cleared Swaps Customers that are in excess of the total assets held in such accounts for such customers. Failure of the FCM to hold a sufficient amount of excess funds in the 30.7 customer accounts and Cleared Swaps Customer Accounts at any time to meet its obligations to such customers would be a violation of the Act and the Commission's regulations.

Furthermore, if the FCM permits customers to use one wire transfer to fund more than one account class, the FCM's policy and procedures for assessing the appropriate amount of targeted residual interest required under § 1.11 must take this practice into consideration and should include appropriate adjustments and estimates to reflect this practice. Finally, the Commission hereby clarifies that all prior guidance concerning the receipt of customer deposits at branch locations or otherwise deposited into the FCM's proprietary accounts, regardless of excess funds held in segregation, is repealed and withdrawn and such practice is not permitted under § 1.20 as adopted.[265]

The Commission adopts the amendment as proposed.

6. Limitations on the Use of Customer Funds

Proposed § 1.20(f) requires FCMs to treat and deal with the funds of a futures customer as belonging to such futures customer. In addition, the Commission proposed to prohibit an FCM from using, or permitting the use of, the funds of futures customer for any person other than for futures customers, subject to certain limited exceptions. Proposed § 1.20(f) also states that an FCM may obligate futures customers' funds to a DCO or another FCM solely to purchase, margin, or guarantee futures and options positions of futures customers, and that no person, including any DCO or any depository, that has received futures customer funds for deposit in a segregated account, may hold, dispose of, or use any such funds as belonging to any person other than the futures customers of the FCM that deposited such funds.

The Commission did not receive any comments regarding proposed § 1.20(f). However, as discussed above, the FIA stated that it agrees that FCMs are required to comply with the segregation provisions of the Act at all times, and expressed general support for the Commissions efforts to implement the Act's segregation provision.[266] The Commission notes that the language in proposed § 1.20(f) largely mirrors the language set forth in current § 1.20, which language was, and continues to be, intended to further implement the segregation provisions of the Act.[267] Thus, the Commission is adopting the provision as proposed.

7. Segregation Requirements for DCOs

Proposed § 1.20(g) provides segregation requirements applicable to DCOs, as opposed to FCMs. 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. The necessity for this proposed amendment is highlighted by 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 by the Financial Stability Oversight Council. Proposed paragraph (g)(3) requires DCOs to comply with the provisions of § 1.49 with respect to holding segregated funds outside the U.S. Regulation 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

[260] Regulation 22.2(c)(2) regarding cleared swaps customer accounts already prohibits commingling.

[261] Proposed § 30.7(e)(3).

[262] FIA Comment Letter at 36 (Feb. 15, 2013).

[263] *Id.*

[264] *Id.*

[265] Previous guidance permitted a branch office of an FCM to deposit customer funds into an unsegregated bank account if the main office of the FCM on the same day deposited the same amount of its funds into a segregated bank account, and kept records fully explaining the transactions. *See* Commodity Exchange Authority Administrative Determination No. 203 (December 1, 1966). *See also* CFTC Interpretative Letter No. 90–7 (Secured Amount Account for Foreign Futures and Options, May 1, 1990). This practice is now prohibited.

[266] FIA Comment Letter at 2 (June 20, 2013). *See also* section II.G.1. above for a further discussion of an FCM's obligation to be in compliance with its segregation obligation at all times.

[267] Accordingly, relevant prior Commission orders and guidance will continue to apply to § 1.20(f). For example, in *In re JPMorgan Chase Bank* CFTC 12–17 (April 4, 2012), the Commission simultaneously initiated and settled an action against a depository for violating § 1.20(a) and (c) because it unlawfully used customer funds as belonging to someone other than the customers of an FCM. Specifically, the Commission found that a depository's intra-day extension of credit to an FCM (Lehman Brothers) based upon customer funds the FCM had deposited with a bank (JPMorgan Chase) violated § 1.20(a) and (c). Regulation 1.20(f) would continue to prohibit such use of customer funds, as well as any other type of disposal, holding or use the Commission has previously identified as unlawful.

Cleared Swaps Customers. DCOs would be permitted to commingle the funds of multiple futures customers in a single account or accounts for operational convenience. The Commission adopts the amendment as proposed.

8. Immediate Availability of Bank and Trust Company Deposits

The Commission proposed a paragraph (h) to § 1.20 to require that all futures customer funds deposited with a bank or trust company must be deposited in accounts that do not impose any restrictions on the ability of the FCM or DCO to withdraw such funds upon demand. An FCM or DCO may not deposit customer funds in any account with a bank or trust company that does not, by the terms of the account or operation of banking law, provide for the immediate availability of such deposits upon the demand of 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.[268] The requirement, as proposed, is a practical necessity to the effective functioning of FCMs and futures markets. In this regard, customer funds deposited with a bank must be maintained in accounts that allow for the immediate availability of the funds in order for the FCM to be assured of meeting its obligation to make any necessary transfers of customer funds to a DCO or to return funds to customers upon their request. The Commission is adopting paragraph (h) as proposed.[269]

9. Segregated Funds Computation Requirement

The Commission proposed to add a new paragraph (i), which mirrored the requirements recently adopted in part 22 for Cleared Swaps Customers. Proposed paragraph (i) was designed to implement, with increased detail, the Net Liquidating Equity Method of calculating segregation requirements. A customer may have positive Net Liquidating Equity (*i.e.,* a credit balance) in his or her account, requiring segregation of his or her funds, but may have insufficient Net Liquidating Equity to cover the margin required for that customer's open positions.

Accordingly, the Commission proposed to require an FCM to record in the accounts of its futures customers the amount of margin required for each customers' open positions, and to calculate margin deficits (*i.e.,* undermargined amounts) for each of its customers. Moreover, the Commission proposed to require that an FCM maintain residual interest in segregated accounts in an amount that exceeds the sum of all futures customers' margin deficits (''the Proposed Residual Interest Requirement'').[270]

In addition, the Commission proposed an amendment to § 1.22.[271] Regulation 1.22 is a longstanding regulation[272] and currently 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.[273] This ''requirement is designed not only to prevent disparate treatment of customers by an FCM, but also to insure that there will be sufficient money in segregation to pay all customer claims if the FCM becomes insolvent.'' [274] 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 DCM.[275]

The Commission proposed an amendment to § 1.22 to clarify that it is not permissible for an FCM to be undersegregated at any point in time during the day. As stated in the Proposal, section 4d(a)(2) expressly 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.[276] Moreover, to review compliance with these proposed requirements, the Commission proposed that the sum of all margin deficits (*i.e.,* undermargined amounts) be reported on the Segregation Schedule (as discussed previously in section II.A. with respect to amendments to § 1.10) and on the daily segregation calculation.[277]

The Commission requested comment on all aspects of the Proposed Residual Interest Requirement, including the costs and benefits of this proposed regulation.[278]

[268] *See* Administrative Determination No. 29 of the Commodity Exchange Authority dated Sept. 28, 1937 stating, ''the deposits, 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 purposes of the Commodity Exchange Act. All funds deposited in a bank should in all cases be subject to withdrawal on demand.''

[269] CIEBA noted it is comment letter that industry groups are involved in various initiatives to provide customers with the option for full physical segregation of margin collateral, and requested confirmation that § 1.20(h) would not prohibit the use of a full segregation model if developed. *See* CIEBA Comment Letter at 4 (Feb. 20, 2013). The Commission encourages industry groups to continue to assess alternatives to the current segregation structure in an effort to provide greater protection of customer funds and to ensure the effective operation of the clearing and settlement functions. Regulation 1.20(h) is intended to prohibit situations where an FCM or DCO deposits customer funds into an account that by law or operation limits or potentially limits the FCM's or DCO's ability to withdraw the funds from the account for the use intended (*i.e.,* as performance bond). The Commission would consider any future amendments to § 1.20(h) based upon the developments of alternative segregation modes.

[270] *See* discussion in note 30 above. Therefore, under the Proposed Residual Interest Requirement an FCM would have to maintain at all times in segregated account a sufficient amount of funds to cover the Net Liquidating Equities of each customer and a sufficient amount of residual interest to cover the undermargined amounts of each customer.

[271] 77 FR 67886.

[272] *See, e.g.,* 13 FR, 7820, 7837 (Dec. 18, 1948).

[273] 17 CFR 1.22.

[274] 46 FR 11668, 11669 (Feb. 10, 1981).

[275] 17 CFR 1.22.

[276] 77 FR 67886.

[277] *Id.*

[278] *See* 77 FR 67882, 67916. The Commission also specifically requested comments on the following: Whether the Proposed Residual Interest Requirement would serve to increase the protections to customer funds in the event of an FCM bankruptcy? To what extent would the Proposed Residual Interest Requirement increase costs to FCMs and/or futures customers? To what extent would the Proposed Residual Interest Requirement benefit futures customers and/or FCMs? To what extent would the Proposed Residual Interest Requirement increase or mitigated market risk? To what extent would the Proposed Residual Interest Requirement lead to FCMs requiring customers to provide margin for their trades before placing them? To what extent is the Proposed Residual Interest Requirement likely to lead to a re-allocation of costs from customers with excess margin to undermargined customers? For purposes of margin deficit calculations, whether the Commission should 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? *See* 77 FR at 67882.

With regards to the costs and benefits, the Commission asked the following questions: Whether FCMs typically maintain residual interest in their customer segregated account 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. How much additional residual interest would FCMs need to hold in their customer segregated accounts in order to comply with the Proposed Residual Interest Requirement? 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. Information regarding the additional amount of capital that FCMs would likely maintain in their customer segregated accounts, if any, to comply with the Proposed Residual Interest Requirement. What is the average cost of capital for an FCM? *See* 77 FR at 67916.

The Commission also specifically requested that commenters provide data and calculations that would allow the Commission to replicate and verify the cost of capital that commenters estimate. *See id.*

The Commission has received and has considered a wide variety of public comments regarding the Proposed Residual Interest Requirement, including comments from panelists made during public roundtables and written submissions from commenters.

Several commenters supported the Commission's Proposed Residual Interest Requirement. CIEBA stated that it strongly supported the Proposed Residual Interest Requirement, arguing that the proposed regulations are consistent with Congressional intent and the Commission's historical interpretations of the Act and sound economic and systemic risk policy. Highlighting section 4d(a)(2) of the Act and its directive that FCMs ''keep collateral and funds of each individual customer distinct from that of customers and the FCM,'' CIEBA argued that ''permitting FCMs to use customer funds to cover margin deficits of a different customer and thereby subsidize the FCM's obligations would'' contravene well established statutory policy.[279] In addition, CIEBA noted that the Dodd-Frank Act was adopted to increase regulatory protections for customers.[280] CIEBA also noted several benefits resulting from the Proposed Residual Interest Requirement, including the reduction of systemic risk, competitive benefits for those FCMs that do not use customer excess to meet the obligations of other clients, and the enhancement of customer protection in the event of an FCM bankruptcy.[281] ICI also stated that it supported the Proposed Residual Interest Requirement on the basis that it would provide additional protections to customer funds.[282] SIFMA asserted that it strongly supported the Proposed Residual Interest Requirement because it preserves the sanctity of each customer's margin account by maintaining segregation between customer margin accounts through the incorporation of appropriate safeguards to protect customer funds.[283] SIFMA stated that the proposal, ''in effect, shifts the costs and burdens of a margin shortfall from customers with excess margin to customers with deficits, where it properly belongs.''[284] Paul/Weiss supported the Proposed Residual Interest Requirement ''[i]n principle.''[285] Vanguard stated that it was ''particularly supportive'' of the Proposed Residual Interest Requirement.[286] Noting that while an FCM would either have to have its customers pre-fund margin requirements for pending trades or ''lend'' such customers margin ahead of a margin transfer, Vanguard argued that the ''proposed changes correctly shift the risk to customers in deficit and away from any excess margin transferred by other customers.''[287] Vanguard also argued that, in its opinion, comments at the public roundtable that ''suggested same-day margin transfers were overly complicated to achieve and the accelerated capital charge would therefore impose significant added costs to an FCM and, by extension, to its customers,'' seem overstated particularly because same-day margin transfer is ''the norm in the OTC swap market.''[288] In fact, Vanguard stated that ''same-day margin transfer is required in Vanguard's futures and options agreements, consistent with the long-standing market practice.''[289] Vanguard encouraged the Commission to avoid weakening customer protection, ''at least a weakening beyond the need to maintain segregation on no less than a once-a-day basis, with the possibility for clearing house initiated intra-day calls (and corresponding segregation maintenance) as needed in periods of market stress.''[290] CFA also supported the Proposed Residual Interest Requirement, asserting its belief ''that no futures customer should be under-segregated at any time during the day for any reason.''[291]

A number of commenters opposed the Proposed Residual Interest Requirement on the basis that the requirement appeared wholly unrelated to the MFGI and PFGI bankruptcies,[292] with other commenters observing that the Proposed Residual Interest Requirement is unnecessary to achieve the regulatory goals, including assuring compliance with section 4d of the Act, in light of other Commission regulations.[293]

In addition, several commenters commented on the lack of feasibility of the proposal, interpreting the ''at all times'' language to require FCMs to continuously calculate the sum of their customers' margin deficits, and to continuously act on those calculations. For example, RCG stated that it would be virtually impossible for FCMs to satisfy the Proposed Residual Interest Requirement because an accurate assessment of aggregate customer margin deficiencies would be difficult given that (1) ''the underlying markets operate on a 24-hour basis and customer fund transfers occur repeatedly throughout each business day,'' and (2) ''omnibus account offsets are not provided to clearing FCMs until the end of the trading day or, in some instances, the next business day.''[294] MGEX also argued that ''at all times'' requirement in the Proposed Residual Interest Requirement may be impracticable as it is a constantly moving target,[295] and TD Ameritrade argued that because the firm calculates margin calls after it receives its nightly downloads, ''it would be difficult, if not impossible, to assess customer margin deficiencies at any moment in time, because the markets have not closed and the margin requirements are not always known.''[296] In addition, CME stated that there does not appear to be a system that currently exists or that could be constructed in the near future that will permit FCMs to accurately calculate customer margin deficiencies, at all times.[297] CMC asserted that the ''at all times'' portion of the Proposed Residual Interest Requirement would ''create liquidity issues and increase costs for FCMs and end users,'' possibly ''limit the number and type of transactions FCMs clear, the number of customers they service and the amount of financing they provide,'' and ''require executing FCMs to collect collateral for give-ups so that customer positions are fully margined in the event a trade is rejected by a clearing

[279] CIEBA Comment Letter at 2 (Feb. 20, 2013).

[280] *Id.*

[281] *Id.* at 3. On this point, CIEBA further noted that allowing an FCM to use customer excess to support other customer's positions could lead to improper or complex recordkeeping, which can, in turn, jeopardize the ability of a trustee to facilitate the return of customer funds and the porting of positions to a solvent FCM.

[282] ICI Comment Letter at 3 (Jan. 14, 2013). *See also* Franklin Comment Letter at 2 (Feb. 15, 2013) (writing in support of the positions taken in the ICI Comment Letter).

[283] SIFMA Comment Letter at 2 (Feb. 21, 2013).

[284] *Id.*

[285] Paul/Weiss Comment Letter at 3 (Feb. 15, 2013).

[286] Vanguard Comment Letter at 7 (Feb. 22, 2013).

[287] *Id.*

[288] *Id.*

[289] *Id.*

[290] *Id.* at 7–8.

[291] CFA Comment Letter at 5–6 (Feb. 13, 2013).

[292] *See, e.g.,* CHS Hedging Comment Letter at 1 (Feb. 15, 2013); NFA Comment Letter at 12 (Feb. 15, 2013); JSA Comment Letter at 2 (Feb. 15, 2013); Paragon Comment Letter at 1 (Feb. 15, 2013); NIBA Comment Letter at 2 (Feb. 15, 2013); ICA Comment Letter at 1 (Feb. 15, 2013).

[293] *See, e.g.,* FIA Comment Letter at 18–21 (Feb. 15, 2013). *See also* FIA Comment Letter at 2–5 (June 20, 2013).

[294] RCG Comment Letter at 3 (Feb. 12, 2013).

[295] *See* MGEX Comment Letter at 2 (Feb. 18, 2013). *See also* NPPC Comment Letter at 2 (Feb. 15, 2013) (stating that the ''at all times'' portion of the Proposed Residual Interest Requirement is ''burdensome'', and that changing margin procedures ''to anticipate future market movements, pre-fund margin calls, [or] make margin call deposits throughout the day based on current market movements is impractical.'').

[296] TD Ameritrade Comment Letter at 4–5 (Feb. 15, 2013).

[297] *See* CME Comment Letter at 5 (Feb. 15, 2013).

FCM,'' [298] which ''may force many end users to decrease or discontinue hedging and risk management practices.'' [299] Advantage opposed the Proposed Residual Interest Requirement asserting that it was ''extremely prejudicial to small and midsize firms and their customers.'' [300] Advantage also stated that the Proposed Residual Interest Requirement would result in FCMs more quickly liquidating customer positions during extreme market moves, which would make markets more volatile.[301] Advantage also maintained that calculations of margin for omnibus accounts cannot be determined prior to the receipt of offsets, which may not be obtained until late in the day, thereby adversely impacting an FCM's ability to assess customer margin deficiencies.[302]

FIA and LCH.Clearnet opposed the Proposed Residual Interest Requirement, and focused particularly on the ''at all times'' portion of the requirement.[303] FIA stated that the Proposed Residual Interest Requirement may force a number of small to mid-sized FCMs out of the market, which will decrease access to the futures markets and increase costs for IBs, hedgers, and small traders.[304] In addition, FIA argued that the Proposed Residual Interest Requirement would significantly impair the price discovery and risk management purposes of the market.[305] Moreover, FIA stated that the Proposed Residual Interest Requirement ''would impose a tremendous operational and financial burden on the industry, requiring the development and implementation of entirely new systems to assure compliance'' with the ''at all times'' portion of the requirement.[306] FIA also averred that the ''provisions of section 4d of the Act prohibiting an FCM from using the fund of one customer 'to margin or guarantee the trades or contracts, or to secure or extend the credit, of any customer or person other than the one for whom the same are held,' has been the lynchpin of customer funds protection since the Commodity Exchange Act was enacted in 1936.'' [307] In addition, FIA stated that they were not aware that the Commission has interpreted the statute to require the real time calculation of margin deficits.[308]

Several commenters requested that the Commission refrain from adopting the Proposed Residual Interest Requirement until it conducted further analysis with the industry regarding the costs and benefits of such proposal,[309] with others stating that the Proposed Residual Interest Requirement would mark a significant departure from current market practice and could have a material adverse impact on the liquidity and smooth functioning of the futures and swaps markets.[310]

In addition, the Commission received several specific comments on the potential costs and benefits of the Proposed Residual Interest Requirement. The Congressional Committees requested that the Commission consider the benefits in light of ''both the costs to America's farmers and ranchers and the potential impact on consolidation in the FCM industry,'' and in particular the ''consequences of changing the manner or frequency in which 'residual interest'—the capital an FCM must hold to cover customer positions—is calculated.'' [311]

FIA noted that FCMs would look to avoid the need to use their own resources by seeking to make sure that their customers would not be undermargined, and that this process would involve the FCM collecting greater amounts of collateral from each customer.[312] FIA averred that collecting greater amounts of collateral from customers would be contrary to the desire of the market to reduce the amount of funds maintained with FCMs following the failures of MFGI and PFGI.[313] Moreover, FIA estimated that compliance with the Proposed Residual Interest Requirement would require FCMs or their customers to contribute significantly in excess of $100 billion into customer funds accounts beyond the sum required to meet initial margin requirements, and that the annual financing costs for these increases will range from $810 million to $8.125 billion.[314]

MFA asserted that applying the Proposed Residual Interest Requirement continuously to FCMs ''could significantly increase the operational burdens and costs on FCMs and their customers,'' and that ''any pre-funding obligation is an unacceptable imposition on customers'' because ''[i]t would create margin inefficiencies by causing customers to reserve assets to pre-fund their obligations . . . , and thus, reduce the amount of assets that customers have to use for investment or other purposes.'' [315] FHLB cautioned that ''[w]hile it cannot be disputed that a residual interest buffer should lower the risk that an FCM will fall out of compliance with its segregation requirements, there will likely be a real economic cost associated with maintaining whatever residual interest buffers is established by an FCM'' and that ''the prospects of funding an additional residual interest buffer may discourage FCMs from appropriately demanding collateral from customers in excess of DCO requirements.'' [316] FHLB further noted that the ''funds maintained by an FCM as residual interest can reasonably be expected to earn less than the FCM's unrestricted funds,'' thus, the proposal ''represents a real cost to FCMs'' that will be passed on to customers.[317] Jefferies stated that the Proposed Residual Interest Requirement will result in more assets being held at FCMs' custodial facilities at a time when ''the Commission has been enacting changes that have been shifting capital away from FCMs towards DCO facilities. . . .'' [318] Newedge also stated that the Proposed Residual Interest Requirement ''will result in many FCMs requiring customers to pre-fund and over-margin their positions, which will increase

[298] CMC Comment Letter at 2 (Feb. 15, 2013).

[299] *Id.*

[300] Advantage Comment Letter at 8 (Feb. 15, 2013).

[301] *See id.* at 7–8.

[302] *See id.* at 7.

[303] *See* FIA Comment Letter at 4–5, 12–26 (Feb. 15, 2013); LCH.Clearnet Comment Letter at 4–5 (Jan. 25, 2013).

[304] *See* FIA Comment Letter at 17 (Feb. 15, 2013).

[305] *See id.* at 4, 17.

[306] *Id.* at 4. *See also id.* at 13.

[307] FIA Comment Letter at 2 (June 20, 2013).

[308] *Id.*

[309] *See, e.g.,* AIMA Comment Letter at 3 (Feb. 15, 2013); CCC Comment Letter at 2–3 (Feb. 15, 2013); CHS Hedging Comment Letter at 2–3 (Feb. 15, 2013); CME Comment at 5–7 (Feb. 15, 2013); AFBF Comment Letter at 2 (Feb. 15, 2013); Jefferies Comment Letter at 9 (Feb. 15, 2013); JSA Comment Letter at 1–2 (Feb. 15, 2013); NCBA Comment Letter at 2 (Feb. 15, 2013); NGFA Comment Letter at 5 (Feb. 15, 2013); NIBA Comment Letter at 1–2 (Feb. 15, 2013); TCFA Comment Letter at 2 (Feb. 15, 2013); AFMP Group Comment Letter at 1–2 (Sept. 18, 2013).

[310] *See, e.g.,* MGEX Comment Letter at 2 (Feb. 18, 2013); AIMA Comment Letter at 2 (Feb. 15, 2013); CMC Comment Letter at 2 (Feb. 15, 2013); AFMP Group Comment Letter at 1–2 (Sept. 18, 2013); Rice Dairy LLC Comment Letter at 1 (Feb. 13, 2013).

[311] Congressional Committees Comment Letter at 1 (Sept. 25, 2013).

[312] FIA Comment Letter at 17 (Feb. 15, 2013).

[313] *Id.* at 17. *See also* AFMP Group Comment Letter at 1 (Sept. 18, 2013) (arguing that ''[m]uch more customer money—maybe twice as much—will be at risk in the event of another FCM insolvency.'').

[314] FIA Comment Letter at 16 (Feb. 15, 2013).

[315] MFA Comment Letter at 8 (Feb. 15, 2013).

[316] FHLB Comment Letter at 3–4 (Feb. 15, 2013).

[317] *Id.* at 4 n.5.

[318] Jefferies Comment Letter at 7 (Feb. 15, 2013). *See also* CCC Comment Letter at 2 (Feb. 15, 2013) (arguing that ''the practical effect'' of the Proposed Residual Interest Requirement ''is that FCMs would require commodity customers to contribute significantly more property to their FCM in order to meet new margin requirements far in excess of exchange margin requirements,'' and expressing concern over any requirement that would require customers ''to contribute even more capital to a system [CCC] believe[s] is flawed.'')

their exposure to FCMs'' and ''have a significant impact on customers' own liquidity.'' [319]

Steve Jones expressed the view that ''[w]ith more funds on deposit, a corrupt FCM CEO (or other staff with access to the funds) will simply be more tempted to 'misappropriate' the funds.[320] In addition, Jefferies stated that requiring an FCM to maintain this level of residual interest ''at all times'' ''would impose tremendous financial and operational difficulties'' on FCMs, which would result in tremendous increases to necessary liquidity, and ''negatively impact competitiveness within the industry. . . .'' [321] Jefferies further stated that the Proposed Residual Interest Requirement would impose heavy costs, and that, under the proposal, Jefferies would be required to increase its residual interest by $15 million (non-peak) or $30 million (peak), respectively.[322] Jefferies also stated that the industry would be required to increase its residual interest by $49 billion (non-peak) or $83 billion (peak) at a cost of approximately $2 billion (non-peak) or $5 billion (peak), respectively.[323]

ISDA asserted that the Proposed Residual Interest Requirement will make customers ''self-guaranteeing'' and diminish reliance on the FCM, and that, while this would diminish overall risk of FCM default, it comes at a very significant cost to market participants, market volumes and liquidity.[324] ISDA estimated the funding needed to comply with ''at all times'' portion of the Proposed Residual Interest Requirement to be $73.2 billion, with a long term impact of $335 billion.[325] CHS Hedging argued that the Proposed Residual Interest Requirement ''would substantially increase the amount of capital an FCM would need on hand at all times.'' [326] Further, CHS Hedging stated that ''[i]n the current economic environment, the difference between the cost of capital and the return an FCM could reasonably expect through investment of funds in a compliant and prudent manner would result in a material effect on the business of all FCMs.'' [327] CHS Hedging also stated that FCMs ''could require that customers pre-fund their accounts in anticipation of adverse market movement,'' which ''would likely result in hardship with regard to working capital and may encourage customers to seek alternative methods to hedge their risk. . . .'' [328] CHS Hedging is also of the view that ''pre-funding accounts concentrates additional funds at FCMs, which seems to contradict the spirit of the'' customer protection rules.[329]

Other commenters argued that the Proposed Residual Interest Requirement would be more burdensome on smaller FCMs and customers. Some commenters stated that forcing FCMs to ask customers to pre-fund positions will cause many futures industry participants, including agricultural producers and other customers to suffer a financial burden by tying up capital that is better used in other areas, such as the operation of the feedlot, stocker operation or cow/calf operation,[330] with two commenters asserting that increased costs associated with the use of wire transfers, rather than checks, would have a similar impact.[331] Moreover, NCFC stated that in addition to increased costs for hedgers, the Proposed Residual Interest Requirement ''would be more burdensome to firms like farmer cooperative-owned FCMs'' because they ''are largely homogenous, with virtually all of their commercial customers going deficit at the same time.'' [332] NCFC also asserted that ''[t]o require all deficits to be covered immediately would be overly stringent on these FCMs given the low-risk profile of their customers as hedgers,'' [333] while NIBA noted that the Proposed Residual Interest Requirement ''will actually limit or deny market access to many customers'' (such as farmers, ranchers and other agricultural organizations) ''who use the markets to hedge their financial and commercial risks'' because the proposal ''could raise the cost of hedging product to prohibitive levels.'' [334] NIBA also stated that if small to mid-sized FCMs are forced out of business, market access ''will become limited and more expensive for IBs and their smaller hedge and speculative clients.'' [335] JSA argued that the Proposed Residual Interest Requirement would be ''punitive in a highly competitive environment that already places the midsize operator at a disadvantage to his better capitalized multinational competitors.'' [336] JSA also asserted that the resulting consolidation would cause ''the loss of competitive forces, [the] loss of significant numbers of jobs, and the loss of transparency and liquidity required for a highly functioning hedging environment.'' [337] Moreover, JSA stated that the cost of the Proposed Residual Interest Requirement would result in a higher cost of hedging, which would be become prohibitive and prompt agricultural users to walk away from the futures market.[338] CME averred that mid-sized and smaller FCMs will not have the capital required by the Proposed Residual Interest Requirement and that customers will be required to pre-fund potential margin obligations.[339] CME asserted that, given this increase in cost, some customers may transfer their accounts to the larger, better-capitalized FCMs to reduce the cost of trading,[340] but that agricultural customers ''likely will not be able to transfer to the larger FCMs because they do not fit their customer profile,'' thereby making these customers bear more of the cost burden.[341] CME also stated that the Proposed Residual Interest Requirement will lead to consolidation among FCMs, which will ''actually *increase*[] systemic risk by concentrating risk among fewer market participants.'' [342] Frontier Futures argued that the Proposed Residual Interest Requirement does not give an FCM time to collect margin from customers if the market moves against a customer's position.[343] Because many small customers, including most farmers, do not watch markets constantly, it would be difficult for them to meet margin calls on a

[319] Newedge Comment Letter at 2 (Feb. 15, 2013).

[320] Steve Jones Comment Letter at 1 (Feb. 15, 2013).

[321] Jefferies Comment Letter at 7 (Feb. 15, 2013).

[322] *Id.* at 8.

[323] *Id.*

[324] ISDA Comment Letter at 3 (Feb. 15, 2013). *See also* ISDA Comment Letter at 2–3 (May 8, 2013).

[325] ISDA Comment Letter at 4–5 (Feb. 15, 2013).

[326] CHS Hedging Comment Letter at 2 (Feb. 15, 2013).

[327] *Id.*

[328] *Id.*

[329] *Id.*

[330] TCFA Comment Letter at 2 (Feb. 15, 2013); NCBA Comment Letter at 2 (Feb. 15, 2013); FCStone Comment Letter at 3 (Feb. 15, 2013); Randy Fritsche Comment Letter at 1 (Feb. 15, 2013); Global Commodity Comment Letter at 1 (Feb. 13, 2013); AFMP Group Comment Letter at 1–2 (Sept. 18, 2013).

[331] TCFA Comment Letter at 1 (Feb. 15, 2013); NCBA Comment Letter at 1 (Feb. 15, 2013).

[332] NCFC Comment Letter at 2 (Feb. 15, 2013).

[333] *Id.*

[334] NIBA Comment Letter at 1 (Feb. 15, 2013).

[335] *Id.* at 1–2. NIBA also asserted that ''[t]ransferring accounts between brokerage houses would become very difficult to accomplish'' because open positions would ''need to be margined at the receiving house as well as the transferring one,'' thereby restraining Brokers ''to remain with one FCM, or completely close customers' positions in order to start up again with a different FCM.'' *Id.* at 2.

[336] JSA Comment Letter at 1 (Feb. 15, 2013).

[337] *Id.* at 1–2.

[338] *Id.* at 2.

[339] CME Comment Letter at 5–6 (Feb. 15, 2013).

[340] *Id.* at 6.

[341] *Id.*

[342] *Id.* (emphasis in original). CME also maintained that ''those customers who qualify as [ECPs] can move to the uncleared and less regulated swaps space and decline to use centralized clearing.'' *Id.* at 6–7.

[343] Frontier Futures Comment Letter at 3 (Feb. 15, 2013).

moment's notice, thereby causing FCMs to require significantly higher margins or to liquidate customer positions where margin calls cannot be immediately met.[344] Frontier Futures also asserted that the proposal ''may force a number of small to mid-sized FCMs out of the market,'' making it more expensive, if not impossible, for IBs and small members to clear their business, removing ''significant capital from the futures industry,'' and ''reducing stability to the markets as a whole.'' [345] RJ O'Brien stated that the Proposed Residual Interest Requirement is impractical because many farmers and agricultural clients still use checks and ACH to meet margin calls.[346]

Several commenters presented alternative proposals for the Commission's consideration. For example, two commenters argued that the Commission should consider less costly alternatives to the current residual interest proposal, such as allowing the FCM ''to count guaranty fund deposits with [DCOs] as part of their residual interest,'' [347] with others stating that the residual interest amount that an FCM must carry should only apply to a limited number of its largest customers.[348]

Moreover, and as discussed more fully below, other commenters urged the Commission to conform the final version of proposed Rules 1.20(i)(4), 22.2(f)(6), and 30.7(a) to the current method of calculating residual interest buffer for Cleared Swaps by dropping the words ''at all times.'' [349] For example, ISDA and FIA further urged consideration of an alternative under which the residual interest calculations would be made once a day and that, by the end of a business day, an FCM would be required to maintain a residual interest in its customer funds accounts at least equal to its customers' aggregate margin deficits for the prior trade date.[350] ISDA stated this alternative ''would rationally reduce'' FCMs cost of compliance[351] and that ''[f]or an FCM with robust credit risk management systems, covering end-of-day customer deficits should not be a significant cost.'' [352] ISDA also noted that at the end of the day ''typically, all customer calls have been met, and all customer gains have been paid out; all achieved without the FCM having recourse to its own funding resources.'' [353] FIA asserted that it would ''achieve the Commission's regulatory goals without imposing the damaging financial and operational burdens on FCMs, and the resulting financial burdens on customers.'' [354] LCH.Clearnet argued that customer collateral can be protected by performing the ''LSOC Compliance Calculation'' once per day, prior to settlement at a DCO, because ''prior to meeting a call for an increased requirement, a customer may be under collateralized, but is not collateralized by another customer.'' [355] ISDA and FIA evaluated the costs associated with requiring FCMs to perform the residual interest calculation once each day at the close of business on the first business day following the trade date.[356] ISDA estimated that ''removing the predictive element of FCM funding requirements'' of the ''at all times'' method in favor of the alternative approach would permit markets to ''reap the efficiencies of end-of-day accounting,'' [357] thereby significantly reducing the overall cost of compliance with the regulation. ISDA estimated that for futures, the costs associated with the would be the cost of covering the out-standing margin deficits of between 2 and 5% of its futures customers, and thus would impose only ''incremental funding requirements'' on FCMs.[358] ISDA estimated that the costs of the alternate proposal would be even smaller for cleared swaps, due to the ''more professional'' nature of the market.[359] FIA estimated the financing costs to FCMs of complying with FIA's proposed alternative and concluded that the costs associated with the Proposed Residual Interest Requirement would be approximately ten times the costs associated with the FIA proposal.[360] FIA also concluded that their proposal would not ''impos[e] damaging financial and operational burdens on FCMs . . . and the resulting financial burdens on customers.''[361]

RJ O'Brien also recommended that the Commission drop the ''at all times'' requirement and that the residual interest calculation be done once each day at the close of business on the first business day following the trade date.[362] RJ O'Brien asserted that ''this alternative will reduce the substantial financial burdens'' on customers ''while further enhancing the protection of customer funds.'' [363]

MFA stated that the Commission should modify the proposed FCM residual interest requirement in § 1.20(i)(4) so that it is a ''point of time'' obligation that requires FCMs to ensure they maintain sufficient residual interest ''as of the close of business EST on the business day after the FCM issues a customer's margin call.'' [364] MFA argued that this alternative would ''reduce the stress on the market'' and ''eliminate[] the need for customer pre-funding or intraday margin calls, while also ensuring that * * * FCMs will hold sufficient funds to protect against customer shortfalls.'' [365]

Paul/Weiss stated that the Commission should clarify that the residual interest amount an FCM is required to maintain must be determined ''at the time of any end-of-day, intra-day or special call payment by an FCM to derivatives clearing organization (or other clearing house or clearing intermediary). . . .''[366] Paul/Weiss argued that these payments are ''the relevant points in time at which

[344] *Id.*

[345] *Id.*

[346] RJ O'Brien Comment Letter at 3 (Feb. 15, 2013). *See also* ICA Comment Letter at 1–2 (Feb. 15, 2013).

[347] Newedge Comment Letter at 3 (Feb. 15, 2013). *See also* RJ O'Brien Comment Letter at 5 (Feb. 15, 2013). *Cf.* Frontier Futures Comment Letter at 3 (Feb. 15, 2013) (suggesting further that firm firewalls be put in place between customer funds and an FCM's proprietary funds in the form of approval by an independent agency for an FCM to transfer customer funds and that FCMs ''do their proprietary trading through another FCM thereby engaging the risk management of a third party.'')

[348] *See, e.g.,* Newedge Comment Letter at 3 (Feb. 15, 2013).

[349] *See, e.g.,* LCH.Clearnet Comment Letter at 5 (Feb. 15, 2013); ISDA Comment Letter at 6 (Feb. 15, 2013); RJ O'Brien Comment Letter at 5 (Feb. 15, 2013).

[350] *See* ISDA Comment Letter at 6 (Feb. 15, 2013); FIA Comment Letter at 23–25 (Feb. 15, 2013).

[351] ISDA Comment Letter at 6 (Feb. 15, 2013).

[352] ISDA Comment Letter at 2 (May 8, 2013).

[353] *Id.* ISDA further recommended that because many FCM customers use custodians across the world, ''many customers cannot assure payment of their morning FCM call before the end of the New York day,'' and therefore recommended that Commission study the feasibility of reducing the time in which customers have to meet margin calls, if that is ''imperative.'' *Id.* at 3.

[354] FIA Comment Letter at 23 (Feb. 15, 2013). *See also* ISDA Comment Letter at 4 (May 8, 2013).

[355] LCH.Clearnet Comment Letter at 5 (Feb. 15, 2013).

[356] ISDA Comment Letter at 1–2 (May 8, 2013); FIA Comment Letter at 8–10 (June 20, 2013).

[357] *Id.* at 3.

[358] ISDA Comment Letter at 3–4 (May 8, 2013).

[359] *Id.* at 4.

[360] *See* FIA Comment Letter at 8–10 (June 20, 2013). While the rates used by FIA in this exercise may be conservative, and thus the Commission does not purport to opine on the precise estimates reached, the exercise is nevertheless illustrative and useful for the purpose of comparing the costs of the Residual Interest Proposal, the alternate proposal, and the final rule.

[361] *Id.* at 9.

[362] RJ O'Brien Comment Letter at 5 (Feb. 15, 2013).

[363] *Id.*

[364] MFA Comment Letter at 8–9 (Feb. 15, 2013).

[365] *Id.*

[366] Paul/Weiss Comment Letter at 4 (Feb. 15, 2013).

the FCM is obligated to transfer'' customer margin.[367]

As a threshold matter, and as noted above, the Commission reiterates that the Act *expressly prohibits* an FCM from using the collateral of one customer to margin, secure, or guarantee the trades or contracts of other customers.[368] Congress specifically added this prohibition in response to concerns that certain customers were carrying the risks and obligations of other favored customers.[369] By this token, any customer that is undermargined is being favored over the customers with excess margin, in contravention of section 4d(a)(2) when other customers' funds are being used to cover the undermargined amounts.[370]

Moreover, there is an inescapable mathematical fact: When an FCM meets the DCO's margin requirements, the property used to meet those requirements can only come from one of three sources: the responsible customer, the FCM, or other customers. If the property does not come from the customer whose positions generated the margin requirement or loss, or the FCM itself (that is, the FCM's residual interest), then it must, of necessity, come from other customers.[371] In reviewing the Commission's customer protection rules in light of MFGI and PFGI, staff identified market practices that were in tension with the plain language of the Act, and, as such, the Commission attempted to clarify acceptable practices with respect to these existing statutory requirements with the Proposed Residual Interest Requirement.

As noted above, several commenters strongly supported the Proposed Residual Interest Requirement, noting it is consistent with Congressional intent and the Commission's historical interpretations of the Act. In general, these commenters argued that the proposal correctly shifts the risk of loss to customers with margin deficiencies and away from customers with excess margin. Some of these commenters questioned market cost estimates and statements regarding the technical challenges associated with same-day margin transfers, and urged the Commission to avoid unnecessarily weakening customer protection.

On the other hand, many commenters expressed concern regarding the costs associated with the Proposed Residual Interest Requirement. In particular, commenters stated that requiring the FCM to be in compliance with residual interest requirements ''at all times'' would disparately impact agricultural producers, small and mid-size FCMs, and hedgers; decrease market liquidity; cause market consolidation; and increase systemic risk. Moreover, the Commission notes that many of the estimates of the amount of additional capital required as a result of the Proposed Residual Interest Requirement seem to result from a particular interpretation of the meaning of the ''at all times'' portion of the proposal, and seemed to range from $49 billion (non-peak) and $83 billion (peak),[372] to $73.2 billion,[373] to upwards of $100 billion.[374] Further, commenters asserted that the ''at all times'' portion of the Proposed Residual Interest Requirement would be operationally unachievable, and argued that the Proposed Residual Interest Requirement would curtail competition, concentrate capital in FCMs at a time when the market would like to reduce the amount of customer collateral held at the FCM, and reduce the number of viable FCMs, thereby negatively impacting overall market risk and market access for smaller customers and agricultural hedgers. Commenters also argued that the Proposed Residual Interest Requirement is unnecessary because in their view, customer funds are not at risk when fellow customer accounts are undermargined.[375]

Many of the commenters interpreted the proposal to require FCMs to continuously calculate and monitor the margin deficits of their customers. In the final rulemaking, the Commission is, in general, following the concept advanced by Paul/Weiss and LCH.Clearnet—that is, what is required is that the FCM not ''use'' one customer's property to margin another customer's positions. For an interim phase-in period, the Commission is adopting the alternative proposal recommended by several commenters, including FIA. Thus, for the reasons set forth below, by the Residual Interest Deadline, which is defined in § 1.22(c)(5), an FCM would be required to maintain a residual interest in its customer funds accounts at least equal to its customers' aggregate margin deficits for the prior trade date.[376] The commenters asserted, and the Commission agrees that this alternative would significantly and materially reduce the financial burdens that would otherwise be imposed on

[367] *Id.*

[368] The Commission further notes that current Commission regulations also include such prohibitions. Namely, § 1.22 states that ''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,'' and § 22.2(d)(1) states that ''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.''

[369] *See* 80 Cong. Rec. 6159, 6162 (1936) (statement of Sen. James. P. Pope) (''It further appears that certain favored dealers have not been required actually to put up the money for margins, and have been extended credit in that respect. This gives these favored dealers an advantage. In some instances, large commission firms have become bankrupt and the funds placed with them by a large number of dealers were lost.''); ''Regulation of Grain Exchanges: Before the H. Comm. on Agriculture,'' 73 Cong. 31 (1934) (statement of Dr. J. W. T. Duvel, Chief Grain Futures Admin. Dept. of Agriculture) (''On the commodities exchanges certain classes of speculators and others are able to secure credit but in many cases the credit so extended represents margin money taken from one class of customers and used to extend credit on [sic] margin the trades of others. Our aim is to protect the customers' margin money and thereby protect the market as a whole.'').

[370] As some commenters report, institutional customers in particular are typically undermargined. This could mean that institutional customers are being favored over individual customers. *See, e.g.,* FIA Comment Letter at 15 (Feb. 15, 2013).

[371] As recognized by the Commission previously, the obligation to ensure that one customer's property is not used to margin or settle the trades or contracts of another customer rests with the FCM. *See* 46 FR 11668, 11669. (stating that ''section [4d(a)(2)] of the Act and §§ 1.20 and 1.22 of the Commission's regulations require an FCM to add its own money into segregation in an amount equal to the sum of all customer deficits.''). *See also* CFTC Letter 00–106 (Nov. 22, 2000) (stating that ''each FCM must segregate sufficient funds to cover any amounts it owes to its customers in connection with commodity interest transactions. The funds of multiple customers may be commingled in a single account for the benefit of the customers as a group. If, however, the balance of any one of those customers falls into a deficit, the FCM is obligated to restore the amount of such deficit out of its own funds or property in order to avoid the use of the funds or property or any other customer to meet the obligations of the customer in deficit. The Commission requires FCM's [sic] to maintain minimum levels of capital to help assure that, among other things, they are able to meet such obligations.'').

[372] *See* Jefferies Comment Letter at 8–9 (Feb. 15, 2013). Jefferies states that the proposal would require them to increase residual interest by $15 million (non-peak) to $30 million (peak).

[373] *See* ISDA Comment Letter at 4–5 (Feb. 15, 2013). ISDA argued that the long term impact of the ''at all times'' portion of the proposal could be as high as $335 billion.

[374] *See* FIA Comment Letter at 15–17 (Feb. 15, 2013). FIA also estimated that the annual financing costs associated with the $100 billion cost could range from $810 million to $8.125 billion.

[375] *See* Transcript, U.S. Commodity Futures Trading Commission Agricultural Advisory Committee Meeting held on July 25, 2013, available at *http://www.cftc.gov/ucm/groups/public/@newsroom/documents/file/aac_transcript072513.pdf.*

[376] *See, e.g.,* Advantage Comment Letter at 8 (Feb. 15, 2013); CMC Comment Letter at 2 (Feb. 15, 2013); CME Comment Letter at 5–6 (Feb. 15, 2013); FIA Comment Letter at 4–5 (Feb. 15, 2013); LCH.Clearnet Comment Letter at 4–5 (Jan. 25, 2013); MGEX Comment Letter at 2 (Feb. 18, 2013); NPPC Comment Letter at 2 (Feb. 15, 2013); RCG Comment Letter at 3 (Feb. 12, 2013); RJ O'Brien Comment Letter at 5 (Feb. 15, 2013); TD Ameritrade Comment Letter at 4–5 (Feb. 15, 2013).

customers and FCMs alike under the Commission's Proposed Residual Interest Requirement [377] because, among other things, this alternate approach would not cause an extreme drain on market liquidity, market consolidation, increase in systemic risk, and detrimental effect on agricultural producers, small and mid-size FCMs, and hedgers.[378]

After careful consideration of the comments and the applicable statutory provisions, the Commission has decided to adopt the Proposed Residual Interest Requirement with modifications.

Section 4d(a)(2) of the Act expressly states that the money, securities, and property received by an FCM from a customer to margin, guarantee, or secure the trades or contracts of that customer shall be separately accounted for and *shall not be* commingled with the funds of such commission merchant or be *used to margin or guarantee the trades or contracts, or to secure or extend the credit, of any customer or person other than the one for whom the same are held.*[379] Moreover, the Commission notes that when section 22 of the rules and regulations of the Secretary of Agriculture under the Act (the predecessor of § 1.22) was adopted in 1937,[380] the year after adoption of the Act, it expressly stated that ''No futures commission merchant shall use, or permit the use of, the money, securities, or property of one customer to margin or settle the trades or contracts, or to secure or extend the credit, of any person other than such customer. The *net equity of one customer shall not be used to carry the trades or contracts or to offset the net deficit of any other customer or person* or to carry the trades or offset the net deficit of the same customer in goods or property not included in the term 'commodity' as defined herein.'' [381] This language addresses, by its terms, more than net deficits, and appears to have remained substantively unchanged for the next four decades.

In 1981, in its Regulation of Domestic Exchange-Traded Commodity Options, the Commission revised § 1.22 to combine segregation requirements for options with existing segregation requirements for futures.[382] In doing so, the Commission generalized the regulatory language and deleted specific references to ''net equity.'' However, neither the adopting release nor the proposing release for the ''Regulation of Domestic Exchange-Traded Commodity Options'' rulemaking indicated an intent to alter or modify the existing segregation requirements for futures.[383]

The current version of § 1.22 states that ''[n]o 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 Commission's Proposed Residual Interest Requirement was intended to ensure compliance with section 4d(a)(2) and § 1.22 by shifting the risk of loss in the event of a double default back to the customer whose positions incurred the loss and away from those customers with excess margin at the FCM. Contrary to the assertion of certain commenters, whenever an FCM uses the funds of customers with excess margin to collateralize the positions of undermargined customers, the customers with excess funds are subject to heightened risk, and diminished availability of those excess funds for transfer in the event the FCM is in financial distress.

Nonetheless, commenters asserted that there is ambiguity regarding (1) the point at which an FCM has ''used'' or ''permitted 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, another futures customer, and (2) what an FCM is required to do to comply with this requirement. Accordingly, the Commission is adopting proposed §§ 1.20(i) and 1.22 with certain modifications.

First, the Commission is revising proposed § 1.20(i) by removing the Proposed Residual Interest Requirement from paragraph (i)(4). In addition, the Commission is revising the language in § 1.22 to add an amended residual interest requirement and additional technical corrections to § 1.20(i) as described further below. Moreover, the Commission is reorganizing proposed § 1.22 as follows: (1) The sentence that reads ''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.'' will be in paragraph (a); (2) the remaining language in proposed paragraph (a) will be deleted; (3) the sentence that reads ''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.'' will remain in paragraph (b); and (4) as discussed below, a new paragraph (c) will be added to address the revised residual interest requirements.

As highlighted above, several commenters questioned the ability of FCMs to measure compliance on a continuous and real-time basis,[384] and argued that the potential cost associated with a continuous residual interest requirement would have an adverse impact on the market.[385] The Commission is persuaded that continuous calculation and monitoring requirements are not technologically feasible at this time. The Commission is also persuaded that it would not be practical to make such calculations in the futures markets based on intra-day

[377] The Commission notes that representatives from FIA, ISDA, and ADM Investor Services have all indicated in meetings with Commission staff that such an alternative would better protect customers, benefit FCMs risk management practices, and materially reduce many costs associated with the Commission's original proposal.

[378] *See* ISDA Comment Letter at 3 (May 8, 2013) (noting that a substantial majority of customer margin calls are met by 5:00 p.m. on the day the calls are issued and therefore the this approach would not impose the costs and cause the problems associated with the Proposed Residual Interest Requirement); FIA Comment Letter at 9 (June 20, 2013) (estimating that the alternative approach would be 10 times less costly for FCMs to finance). *See also* MFA Comment Letter at 8–9 (Feb. 15, 2013); RJ O'Brien Comment Letter at 5 (Feb. 15, 2013).

[379] *See also* section 4d(f)(2) of the Commodity Exchange Act, as well as § 1.22 of this section and § 22.2(d)(1) of this chapter.

[380] 2 FR 1223, 1225 (July 16, 1937).

[381] *Id.* at 1225 (emphasis supplied).

[382] *See* 46 FR 54500 (Nov. 3, 1981).

[383] *See id.* at 54508 (Final Release) (stating that because the Commission did not receive any comments on its proposed regulations relating to segregation of customer funds, it was adopting the amendments essentially as proposed). In addition, in stating that ''the Commission is now proposing that the option segregation requirements be combined with the existing segregation requirements for futures,'' the proposing release noted that certain definitions ''have also been added or modified to permit defined terms to be used in the sections, as amended, and thereby simplify the regulations.'' *See* 46 FR 33293–01, 33298 (June 29, 1981).

[384] *See, e.g.,* Advantage Comment Letter at 8 (Feb. 15, 2013); CMC Comment Letter at 2 (Feb. 15, 2013); CME Comment Letter at 5–6 (Feb. 15, 2013); FIA Comment Letter at 4–5 (Feb. 15, 2013); LCH.Clearnet Comment Letter at 4–5 (Jan. 25, 2013); MGEX Comment Letter at 2 (Feb. 18, 2013); NPPC Comment Letter at 2 (Feb. 15, 2013); RCG Comment Letter at 3 (Feb. 12, 2013); RJ O'Brien Comment Letter at 5 (Feb. 15, 2013); TD Ameritrade Comment Letter at 4–5 (Feb. 15, 2013).

[385] *See, e.g.,* CMC Comment Letter at 2 (Feb. 15, 2013); CME Comment Letter at 5 (Feb. 15, 2013); MGEX Comment Letter at 2 (Feb. 18, 2013); NPPC Comment Letter at 2 (Feb. 15, 2013); RJ O'Brien Comment Letter at 4 (Feb. 15, 2013).

changes.[386] However, as discussed in more detail below, the Commission is persuaded that the calculations required by the residual interest requirement are feasible using a point in time approach.

As noted above, the Commission is moving the Proposed Residual Interest Requirement from proposed § 1.20(i) to new paragraph (c) in § 1.22. Moreover, and as suggested by commenters,[387] the Commission agrees that a point in time approach to the determination of the adequate size of the residual interest amount would ''ensure that an FCM has appropriately sized the residual interest buffer to cover the aggregated gross margin deficiencies in respect of customer transactions in the relevant origin.'' [388] Further, the Commission agrees that this approach is consistent with the Act and Commission regulations, and would help ensure that the collateral of one customer is never used to margin the positions of another customer.[389] Moreover, the Commission notes that a point in time approach is consistent with the current practice with respect to residual interest buffer calculations for Cleared Swaps and with the approach set forth in JAC Update 12–03.[390]

Accordingly, the Commission is revising the Proposed Residual Interest Requirement as follows. Regulation 1.22 (c)(1) defines the undermargined amount for a futures customer's account as the amount, if any (*i.e.,* the amount must be greater than or equal to zero), by which (i) the total amount of collateral required for that futures customer's positions [391] in that account, at the time or times referred to in § 1.22(c)(2), exceeds (ii) the value of the net liquidating equity for that account, as calculated in § 1.20(i)(2). An FCM is required to perform the calculation set forth in § 1.22(c)(1) on a customer by customer basis. Regulation 1.22(c)(2) requires an FCM to perform a residual interest buffer calculation, at the close of each business day, *based on the information available to the FCM at that time,*[392] by calculating (i) the undermargined amounts, based on the clearing initial margin that will be required to be maintained by that FCM for its futures customers, at each DCO of which the FCM is a member, at the point of the daily settlement (as described in § 39.14) that will complete during the following business day for each such DCO less (ii) any debit balances referred to in § 1.20(i)(4) included in such undermargined amounts.[393]

An FCM is required to perform the calculation in § 1.22(c)(2) once per day, based on the information at the close of business on that day, so that it can determine the amount of customer funds which will be needed to avoid using the funds of one customer to margin, guarantee, or secure the positions of another customer. Consistent with this revised residual interest requirement, § 1.20(i)(4) is being amended to state that the amount of funds an FCM is holding in segregation may not be reduced by any debit balances that the futures customers of the FCM have in their accounts. In addition, § 1.20(i)(2)(ii) is being removed because this requirement is now set forth in § 1.22(c). Consistent with **Federal Register** requirements, § 1.20(i)(2) is being renumbered and, for clarity, the first sentence will be revised to read as follows ''The futures commission merchant must reflect in the account that it maintains for each futures customer the net liquidating equity for each such customer, calculated as follows: the market value of any futures customer funds that it receives from such customer, as adjusted by: . . . .'' [394] Further, under § 1.22(c)(3), an FCM is required, prior to the Residual Interest Deadline, as defined in § 1.22(c)(5), to have residual interest in the segregated account in an amount that is at least equal to the computation set forth in § 1.22(c)(2).[395] However, the amount of residual interest that an FCM must maintain may be reduced to account for payments received from or on behalf of (net of disbursements made to or on behalf of) undermargined futures customers between the close of the previous business day and the Residual Interest Deadline.

Regulation 1.22(c)(4) provides that for purposes of § 1.22(c)(2), an FCM should include, as ''clearing initial margin,'' customer initial margin that the FCM will be required to maintain, for that FCM's futures customers, at another FCM, and, for purposes of § 1.22(c)(3), must do so prior to the Residual Interest Deadline. In other words, § 1.22(c)(4) is intended to make clear that the requirements with respect to futures customer funds used by an FCM that clears through another FCM are parallel to the requirements applied with respect to futures customer funds used when an FCM clears through a DCO.

Regulation 1.22(c)(5) defines the Residual Interest Deadline. Paragraph (c)(5)(i) sets forth that except during the phase-in period defined in paragraph (c)(5)(ii), the Residual Interest Deadline shall be the time of the settlement referenced in paragraph (c)(2)(i), or, as appropriate, (c)(4). However, in response to the comments that urge that achieving compliance with these requirements may take time, and in order to mitigate some of the cost concerns raised by commenters, paragraph (c)(5)(ii) provides that the Residual Interest Deadline during the phase-in period shall be 6:00 p.m.

[386] *See, e.g.,* Advantage Comment Letter at 7 (Feb. 15, 2013); CME Comment Letter at 5 (Feb. 15, 2013); FIA Comment Letter at 4, 15, 21–22 (Feb. 15, 2013); MFA Comment Letter at 8 (Feb. 15, 2013); NPPC Comment Letter at 2 (Feb. 15, 2013); RCG Comment Letter at 3 (Feb. 12, 2013); TD Ameritrade at 4–5 (Feb. 15, 2013). *Cf.* ISDA Comment Letter at 1–2 (Aug. 27, 2013).

[387] *See* ISDA Comment Letter at 6 (Feb. 15, 2013); FIA Comment Letter at 23–25 (Feb. 15, 2013); LCH.Clearnet comment Letter at 5 (Feb. 15, 2013); Paul/Weiss Comment Letter at 4–5 (Feb. 15, 2013); RJ O'Brien Comment Letter at 5 (Feb. 15, 2013).

[388] Paul/Weiss Comment Letter at 4 (Feb. 15, 2013).

[389] *See generally id.;* FIA Comment Letter at 23 (Feb. 15, 2013); ISDA Comment Letter at 4 (May 8, 2013).

[390] Joint Audit Committee Regulatory Update # 12–03, Part 22 of CFTC Regulations—Treatment of Cleared Swaps Customer Collateral—Legally Segregated Operationally Commingled (''LSOC'') Compliance Calculation (Oct. 18, 2012).

[391] For purposes of this calculation, the FCM should include as ''positions'' any trade or contract that (i) would be required to be segregated pursuant to 4d(f) of the Act or (ii) would be subject to § 30.7 of this chapter, but which is, in either case, pursuant to a Commission rule, regulation, or order (or a derivatives clearing organization rule approved in accordance with § 39.15(b)(2) of this chapter), commingled with a contract for the purchase or sale of a commodity for future delivery and any options on such contracts in an account segregated pursuant to section 4d(a) of the Act and should exclude as ''positions'' any trade or contract that, pursuant to a Commission rule, regulation, or order, is segregated pursuant to section 4d(f) of the Act. This requirement is intended to be analogous to the definition of Cleared Swap in § 22.1 of this chapter.

[392] An FCM is not expected to account for changes in circumstances that occur after the close of business and prior to the next business day's settlement, outside of normal end-of-day reconciliation processes. In other words, an FCM may use the information (such as position and value information) available to it at the close of each business day for this calculation.

[393] This subtraction is intended to address the potential double-counting of deficit balances that was pointed out in a number of comments. *See, e.g.,* Vanguard Comment Letter at 8 (Feb. 22, 2013).

[394] As noted in the preamble to the proposal, the purpose of the amendments to 1.20(i) is to ''provid[e] more detail implementing the Net Liquidating Method of calculating segregation requirements.'' 77 FR at 67882.

[395] Following the completion of the phase-in period, when the Residual Interest Deadline moves to the time of settlement, an FCM may be subject to multiple Residual Interest Deadlines, in which case the FCM must maintain residual interest prior to the Residual Interest Deadline in an amount that is at least equal to the *portion of* the computation set forth in § 1.22(c)(2) attributable to the clearing initial margin required by the DCO making such settlement. Thus, where an FCM is a member of more than one DCO and the DCOs conduct their daily settlement cycles at different times, an FCM would be required, at the time of the daily settlement for each DCO, to maintain the proportionate share of residual interest in the futures customer account.

Eastern Time on the date of the settlement referenced in paragraph (c)(2)(i) or, as appropriate, (c)(4). The phased compliance schedule for § 1.22(c) is *set forth in § 1.22(c)(5)(iii). However, the Residual Interest Deadline of 6:00 p.m. Eastern Time in § 1.22(c)(5)(ii) shall begin one year following the publication of this rule in the* ***Federal Register***.[396]

Additionally, in further response to the commenters' request for additional study,[397] in paragraph (c)(5)(iii)(A), the Commission is directing staff to complete and publish for public comment a report (''the Report''), no later than 30 months following the date of publication of this release, addressing, to the extent information is practically available, the practicability (for both FCMs and customers) of moving the Residual Interest Deadline from 6:00 p.m. Eastern Time on the date of the settlement referenced in § 1.22(c)(2)(i) to the time of that settlement (or to some other time of day), including whether and on what schedule it would be feasible to do so. The Report is also expected to address cost and benefit considerations of such potential alternatives. Moreover, staff shall, using the Commission's Web site, solicit public comment and shall conduct a public roundtable regarding specific issues to be covered by the Report. Paragraph (c)(5)(iii)(B) sets forth that within nine months after the publication of the Report, the Commission may (but shall not be required to) do either of the following: (1) terminate the phase-in period, in which case the phase-in shall end as of a date established by order published in the **Federal Register**, which date shall be no less than one year after the date such order is published, or (2) determine that it is necessary or appropriate in the public interest to propose through rulemaking a different Residual Interest Deadline, in which event, the Commission shall establish, by order published in the **Federal Register**, a phase-in schedule. Finally, paragraph (c)(5)(iii)(C) provides that if the phase-in schedule has not been amended pursuant to § 1.22(c)(5)(iii)(B), then the phase-in period shall end on December 31, 2018.

With respect to the suggestion that a portion (*i.e.,* that portion attributable to customer business) of the funds contributed to an exchange's guaranty fund by an FCM should be considered in that FCM's residual interest calculations,[398] the Commission notes that contributions to a guarantee fund are not segregated for the benefit of customers. Rather, they are, by design, available to meet the defaults of other clearing members, and thus cannot be counted as customer segregated funds. As such, the Commission declines to adopt this suggestion.

The Commission also received several requests for clarifications. CIEBA stated that ''while futures market participants may be familiar with terms such as 'residual interest' and the technical features of the proposed rule, other market participants may not appreciate the full scope of the rule and the additional protections provided without further explanation.'' [399] CIEBA requested that the Commission clarify ''how this requirement is intended to work with examples of its application so as to more broadly communicate the Commission's intent to bolster the depth of customer protections to minimize customer risk and promote confidence in the markets.'' [400] The Commission recognizes CIEBA's concern and, as discussed above, has provided clarification in this release regarding the mechanism by which FCMs measure compliance with the statutory requirement of 4d(a)(2). However, the Commission also recognizes that FCMs engage in a broad range of acceptable business practices and should be given flexibility in how best to tailor their businesses to comply with such requirement.

AIMA requested clarification that §§ 1.17(c)(5) and 1.20(i)(4) are not duplicative and therefore does not require FCMs to ''double count'' residual interest.[401] The Commission reiterates that § 1.17(c)(5) and the residual interest requirement now set forth in 1.22(c)(2) are two separate requirements. As discussed above, § 1.17 sets forth the Commission's minimum capital requirements for FCMs and requires, among other things, an FCM to incur a charge to capital for customer and noncustomer accounts that are undermargined beyond a specified period of time.[402] The residual interest requirements, on the other hand, are intended to help make sure that the collateral of one customer is never used to margin the positions of another customer. These requirements are, therefore, not duplicative, and the Final Rule does not actually require an FCM to double count the residual interest amount.[403]

Paul/Weiss requested that the Commission confirm that the requirements of jurisdiction and denomination in § 1.49 do not apply to an FCM's cash management procedures for meeting its residual interest obligation.[404] Paul/Weiss noted that JAC Update 12–03,[405] provides that the denomination and jurisdiction requirements set forth in § 1.49 do not apply to the extent that an FCM deposits additional funds in order to cover margin deficiencies in the Cleared Swaps Customer Account prior to a [406] DCO's settlement.[407] The Commission agrees that, for purposes of meeting any undermargined amount in a customer account with a deposit of additional funds prior to payment to any DCO, the requirements of Commission § 1.49 with respect to denomination or jurisdiction should not apply, and accordingly, they will not.

FCStone asked the Commission to set price limits at levels equal to or below the margin requirement in all commodities to mitigate the potential for under margined customer positions.[408] NPPC requested that the Commission give ''customers the opportunity to 'opt out' of allowing segregated funds to be used outside of the customer accounts,'' so that ''customers can proactively protect their funds from being used for potentially fraudulent purposes'' and when ''coupled with higher fees to help balance the trade off, customers could determine the level of risk to which they are comfortable subjecting their funds.'' [409] The Commission notes that

[396] For further discussion regarding the phase-in schedule for the requirements in § 1.22(c), *see* section III.F.

[397] *See, e.g.,* AIMA Comment Letter at 3 (Feb. 15, 2013); CCC Comment Letter at 2–3 (Feb. 15, 2013); CHS Hedging Comment Letter at 2–3 (Feb. 15, 2013); CME Comment at 5–7 (Feb. 15, 2013); AFBF Comment Letter at 2 (Feb. 15, 2013); Jefferies Comment Letter at 9 (Feb. 15, 2013); JSA Comment Letter at 1–2 (Feb. 15, 2013); NCBA Comment Letter at 2 (Feb. 15, 2013); NGFA Comment Letter at 5 (Feb. 15, 2013); NIBA Comment Letter at 1–2 (Feb. 15, 2013); TCFA Comment Letter at 2 (Feb. 15, 2013); AFMP Group Comment Letter at 1–2 (Sept. 18, 2013).

[398] *See, e.g.,* Newedge Comment Letter at 3 (Feb. 15, 2013); RJ O'Brien Comment Letter at 5 (Feb. 15, 2013).

[399] CIEBA Comment Letter at 3 (Feb. 15, 2013).

[400] *Id.*

[401] *See* AIMA Comment Letter at 3 (Feb. 15, 2013).

[402] *See* section II.F. above.

[403] *See* section II.F. above regarding the requirement set forth § 1.17(c)(5).

[404] Paul/Weiss Comment Letter at 6 (Feb. 15, 2013).

[405] This update provides that, for purposes of meeting any margin deficiency in the cleared swaps customer account with a deposit of additional funds prior to payment to any DCO, the requirements of Commission § 1.49 with respect to denomination or jurisdiction will not apply.

[406] Paul/Weiss Comment Letter at 5–6 (Feb. 15, 2013).

[407] Paul/Weiss Comment Letter at 5–6 (Feb. 15, 2013).

[408] FCStone Comment Letter at 6 (Feb. 15, 2013).

[409] NPPC Comment Letter at 2 (Feb. 15, 2013).

these comments are outside the scope of this rulemaking.

FCStone objected to proposed § 1.20(i), believing that the Commission was mandating changing a customer's account balance to record margin deficits, which they believe would impact the tax treatment of customers' accounts.[410] The Commission clarifies that the proposed amendments were not intended to require any additional charges to individual customer accounts, but to ensure that the FCM separately tracked the sum of such amounts to ensure it was holding residual interest in its segregated accounts greater than the gross total of such undermargined amounts.

10. Segregation Regimes

Several commenters proposed that language contained in customer account agreements used by certain FCMs should be restricted by the Commission. These commenters referred to clauses permitting customer collateral to be pledged, liquidated or transferred by the FCM and asked that the account agreements be viewed as contracts of adhesion due to the necessity to agree to such clauses in order to open a commodity futures trading account.[411] These commenters, among other issues, requested that the Commission limit the ability of FCMs to require such contractual language.

The Commission notes that any such contractual language does not limit the applicability of the Act and Commission regulations with respect to the treatment of customer property by FCMs. The customer protection regime applies to all segregated customer funds regardless of any broader contractual terms.

The specific ability of an FCM to pledge, liquidate or transfer customer collateral is constrained by the Act and Commission regulations regardless of any reference in a customer agreement to such applicable law, or a lack of reference thereto. Section 4d is the relevant provision of the Act that addresses how FCMs must hold customer funds. Section 4d(a)(2) of the Act provides that each FCM must treat and deal with all money, securities, and property received by the FCM to margin, guarantee, or secure the trades or contracts of any customer of the FCM, or accruing to such customer as the result of such trades or contracts, as belonging to the customer. Section 4d(a)(2) further provides that customer funds must be separately accounted for and may not be commingled with the funds of the FCM, or be used to margin or guarantee the trades or contracts, or to secure or extend credit, of any customer or person other than the customer that deposited the funds.

Commission regulations also set requirements on how customer funds may be held. Regulation 1.20(a) provides that all customer funds must be separately accounted for by the FCM and segregated as belonging to commodity or option customers. The funds, when deposited with a bank, trust company, clearing organization, or another FCM must be deposited under an account name that clearly identifies the funds as belonging to customers and shows that the funds are segregated from the FCM's own funds as required by Section 4d(a)(2) of the Act. Regulation 1.20(c) provides that each FCM must treat and deal with the customer funds of a customer as belonging to the customer. The FCM must separately accounted for customer funds and may not commingle the funds with the FCM's own funds, or use the funds to margin, guarantee, or secure futures positions of any person, or extend credit to any person, other than the customer that owns the funds.

Regulation 1.25 sets forth requirements on how FCMs may invest customer funds. Pursuant to § 1.25, an FCM is permitted to use customer funds to purchase permitted investments. The investments, however, are required to be separately accounted for by the FCM under § 1.26, and segregated from the FCM's own assets in accounts that designate the funds as belonging to customers of the FCM and held in segregation as required by the Act and Commission regulations.

FCMs also may sell customer deposited securities under agreements to repurchase the securities pursuant to § 1.25(a)(2)(ii). Regulation 1.25(d)(9) provides that the cash transferred to the segregation account for customer-owned securities sold under a repurchase agreement must be on a payment versus delivery basis, and the customer segregated funds account must receive same-day funds credited to the segregated account simultaneously with the delivery or transfer of the securities from the customer segregated accounts. A customer, however, may condition its deposits of securities with an FCM by requiring that that FCM not engage in reverse repurchase transactions with the customer's collateral.

Accordingly, FCMs do not have an unfettered ability to pledge, rehypothecate, or otherwise use customer funds (including customer deposited securities) for their own benefit or purposes. However, FCMs also have the ability, as limited by all such applicable law and regulation for the benefit of customers, to liquidate customer securities if the customer that deposited the securities fails to meet a margin call. FCMs also may pledge customer deposited securities to DCOs as margin for the customer accounts carried by the FCM. The customer collateral pledged to a DCO, however, also must be held in customer segregated accounts.

Even if transformed as permissible under the Act and regulations and contemplated by customer agreements, such collateral maintains its character as segregated customer property and remains subject to the customer protection regime. Commission staff has further confirmed that there is variability in the FCM community regarding the specific language included in customer account agreements and that not all agreements include broad authorities to the FCM for the use of customer collateral. However, as noted above, the contractual terms and conditions could not result in an FCM holding or using customer funds in a manner that was not in conformity with the Act and Commission regulations.

Several commenters also requested that the Commission provide alternatives to the current segregation regime, including individual segregation, the ability to use third-party custodial accounts, or the ability to opt-out of segregation.[412] While these issues are beyond the scope of the Proposal, the Commission notes that in adopting the final regulations for the protection of Cleared Swaps Customer Collateral in February 2012, it stated that the issue of alternative segregation regimes raise important risk management and cost externality issues, particularly in ensuring that deposited collateral is immediately available to the FCM or DCO in the event of the default of the customer or FCM.[413] The Commission directed staff to continue to analyze different proposals with the goal of developing a proposal to provide additional or enhanced customer protection.[414] In this regard, staff is continuing to review and meet with

[410] FCStone Comment Letter at 4 (Feb. 15, 2013).

[411] *See* Premier Metal Services Comment Letter at 2–3 (Jan. 1, 2013) and ISRI Comment Letter at 4–5 (Dec. 4, 2012), which letters were cited and supported by several other commenters. *See also* Pilot Flying J Comment Letter at 2 (Feb. 14, 2013), which stated that FCMs should not be permitted to use customer funds for outside investments, capitalization or collateralization.

[412] *See, e.g.,* ISRI Comment Letter at 6 (Dec. 4, 2013); AIM Comment Letter at 2–7 (Jan. 24, 2013); MFA Comment Letter at 9 (Feb. 15, 2013); State Street Comment Letter at 2 (Jan. 16, 2013).

[413] 77 FR 6336, 6343 (Feb. 7, 2012).

[414] *Id.*

industry representatives regarding alternative segregation regimes.

In addition, the Commission noted that customer funds held in third-party custodial accounts constitute customer property within the meaning of the Bankruptcy Code. As such, positions and collateral held in third-party accounts are subject to the U.S. Bankruptcy Code and applicable provisions of the Act, which provide for the pro rata share of available customer property. The Commission also received several comments requesting specific and defined protections for funds provided to an FCM by retail counterparties engaged in off-exchange foreign currency transactions.[415] The Proposal, however, focused on customer protection issues in the futures market, and the issue of the protection of funds held by an FCM for retail foreign currency counterparties is beyond the scope of the Proposal.

H. § 1.22: Use of Futures Customer Funds

RCG commented that the proposed amendments to §§ 1.22, 1.23, 30.7(f) and 30.7(g) are inconsistent as to when an FCM should use its own funds to cover margin deficits with § 1.30, which provides that an FCM cannot make an unsecured loan to a customer.[416] The Commission does not believe that the regulations are inconsistent. Regulation § 1.30 provides that an FCM may not make a loan to a customer, unless such loan is done a fully secured basis. Regulations 1.22 and 30.7(f) provide that an FCM cannot use the funds of one customer to secure or extend credit to another customer. Regulations 1.23 and 30.7(g) impose conditions upon when an FCM may withdraw proprietary funds from segregated accounts.

As discussed in greater detail in section II.G.9. above, the Commission has considered the comments and has revised and reorganized § 1.22.

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

The Commission proposed amending § 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.

Proposed § 1.23(a) provides that an FCM may deposit unencumbered proprietary funds, including securities from its own inventory that qualify as permitted investments under § 1.25, into segregated futures customer accounts in order to provide a buffer or cushion of funds to protect against the firm failing to maintain sufficient funds in such accounts to meet its total obligations to futures customers.

Under proposed § 1.23(a), an FCM has access to its own funds deposited into futures customer accounts to the extent of the FCM's residual interest in such funds, subject to the restriction on withdrawal of residual interest required to cover undermargined amounts. However, proposed § 1.23(b) prohibits an FCM from withdrawing its residual interest or excess funds from futures customer accounts (any withdrawal not made to or 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 proposed additional required layers of authorization and documentation if the withdrawal exceeds, individually or in the aggregate with other such withdrawals, 25 percent or more of the FCM's residual interest computed as of the close of business on the prior business day. 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) requires 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. Regulation 1.23 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 to deposit proprietary funds sufficient to restore the residual interest targeted amount when a withdrawal of funds from segregated futures customer accounts, not for the benefit of the firm's customers, causes the firm to fall below its targeted residual interest in such accounts. The FCM must deposit the proprietary funds into such segregated accounts 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. Proposed § 1.23 also stated that should an FCM's residual interest, however, be exceeded by the sum of the FCM's futures customers' margin deficits (*i.e.,* undermargined amounts), an amount necessary to restore residual interest to that sum must be deposited immediately. Identical requirements with respect to procedures required for withdrawals of residual interest in Cleared Swaps Customer Collateral Accounts and 30.7 secured accounts were proposed in §§ 22.17(c) and 30.7(g), respectively.

NFA commented recommending that the Commission revise the language in § 1.23 to keep it consistent with the language in NFA Financial Requirements Section 16 (prohibiting withdrawals that are made ''not for the benefit of commodity and option customers and foreign futures and

[415] *See* forex form letter group: Michael Krall; David Kennedy; Robert Smith; Michael Carmichael; Andrew Jackson; Donald Blais; Suzanne Slade; Patricia Horter; JoDan Traders; Jeff Schlink; Sam Jelovich; Matthew Bauman; Mark Phillips; Deborah Stone; Po Huang; Aaryn Krall; Vael Asset Management; Kos Capital; James Lowe; Tracy Burns; Treasure Island Coins; Clare Colreavy, Brandon Shoemaker.

[416] RCG Comment Letter at 7 (Feb. 12, 2013).

foreign options customers'').[417] NFA commented that without a definition of ''proprietary use'' a withdrawal that may not be for an FCM's own proprietary use may still be a withdrawal that is not for the benefit of customers and, therefore, would trigger NFA's approval and notice requirements pursuant to NFA Financial Requirements Section 16, but not the Commission's approval and notice requirements pursuant to § 1.23.[418] NFA also commented that the Commission should remove proposed § 1.23(d)'s reference to ''business days'' in order to ensure that FCMs understand that the requirements related to withdrawals of 25 percent or more apply at all times.[419]

The Commission has considered NFA's comment and is revising § 1.23 to remove the term ''proprietary use'' and is replacing it with the concept of withdrawals that are not made to or for the benefit of customers. The Commission also is revising § 1.23 to remove the reference to ''business days.'' The revisions will more closely align the Commission's and NFA's regulations governing an FCM's withdrawal of proprietary funds from a segregated account by making the language and conditions more consistent. This consistency of the Commission and NFA requirements is appropriate as it will allow FCMs to operate under one set of conditions, while also retaining the overall policy goals of the Commission to limit an FCM's ability to withdraw funds from segregated accounts until the FCM can be reasonably assured that the funds are excess, proprietary funds.[420]

NFA further requested the Commission to clarify that pre-approval of a series of transactions that in the aggregate exceeded the 25 percent threshold would not require after the fact approvals of the first transactions of the series, but only approvals of the transactions resulting in the 25 percent threshold being exceeded.[421] The Commission confirms that an FCM would need to obtain the necessary approvals only for the transaction that caused the withdrawals to exceed the 25 percent threshold.

Jefferies commented that it generally supported proposed amendments to § 1.23, but stated that requiring FCMs to report when they draw down more than 25 percent of their residual interest will discourage an FCM from voluntarily adding to its residual interest.[422] Jefferies commented that FCMs should be permitted to withdraw any residual interest amount in excess of their target level and to withdraw up to 25 percent of the target level before providing notice, or if the last calculated residual interest was below the target level, the calculation should be 25 percent of the lower amount.[423] LCH.Clearnet and the FIA also recommended revising §§ 1.23(d) and 22.17(c) to apply only to withdrawal of FCM funds in excess of 25 percent of the FCM's targeted residual interest, rather than on 25 percent of the total residual interest in the customer segregated account, specifically to ensure that FCMs have no disincentive to maintain significant excess funds above the targeted residual interest segregation at DCOs for swaps clearing.[424]

The Commission does not believe that substituting the targeted residual amount for the actual residual interest amount would appropriately focus management attention on significant withdrawals relative to the actual, not just target, excess, as well as clearly establish a chain of responsibility for such withdrawals, as is the intended purpose of the proposed regulation. The Commission clarifies that pre-approval would be required, with respect to a series of transactions, for the transactions which would result in the threshold being exceeded and not earlier transactions in the series. Accordingly, the Commission is adopting § 1.23 and the conforming provisions in §§ 22.17 and 30.7(g), with changes as recommended by NFA substituting language ''not for the benefit of customers'' (with description of customer as applicable to each such provision) for ''proprietary use'' and eliminating the reference to business days.[425]

In addition, and in light of the changes discussed herein with respect to the residual interest requirements set forth in §§ 1.22, 22.2, and 30.7, the Commission is amending § 1.23 and the conforming provisions in §§ 22.17 and 30.7(g) to make clear that if an FCM's residual interest is less than the amounts required to be maintained in § 1.22, 22.2(f)(6), or 30.7(f), as applicable, at any particular point in time, the FCM must immediately restore the residual interest to exceed the sum of such amounts.

J. § 1.25: Investment of Customer Funds

1. General Comments Regarding the Investment of Customer Funds

Regulation 1.25 sets forth the financial investments that an FCM or DCO may make with customer funds. The Commission received 32 comment letters regarding the investment and handling of customer funds by FCMs and DCOs.[426] In general, all of the commenters supported the position that FCMs and DCOs only be allowed to make safe/non-speculative investments of customer funds and not be allowed to add risk that customers are unaware of or do not sanction. More specifically, 29 of the commenters proposed that the Commission amend its regulations to provide commodity customers with the ability to ''opt out'' of granting FCMs permission to invest their funds (including hypothecation and rehypothecation).[427] Additionally,

[417] NFA Comment Letter at 14 (Feb. 15, 2013).

[418] *Id.*

[419] *Id.*

[420] The Commission also is making comparable revisions to §§ 22.17(c) and 30.7(g) in light of NFA's comments.

[421] *Id.*

[422] Jefferies Comment Letter at 4–6 (Feb. 15, 2013).

[423] *Id.*

[424] LCH.Clearnet Comment Letter at 7 (Jan. 25, 2013); FIA Comment Letter at 6 (Feb. 15, 2013).

[425] *See* NFA Comment Letter at 14 (Feb. 15, 2013).

[426] Schippers Comment Letter (Dec. 10, 2013), Randy Fritsche Comment Letter (Feb. 14, 2013), NPPC Comment Letter at 2 (Feb. 14, 2013), Strelitz/California Metal X Comment (Jan. 15, 2013), Premier Metal Services Comment Letter at 4 (Jan. 3, 2013), ISRI Comment Letter at 5–7 (Dec. 4, 2012), AIM Comment Letter at 4 (Jan. 24, 2013), Kripke Enterprises Comment Letter (Dec. 12, 2012), Manitoba Comment Letter (Dec. 13, 2012), Solomon Metals Corp. Comment Letter (Jan. 15, 2013), Michael Krall Comment Letter (Dec. 17, 2012), David Kennedy Comment Letter (Dec. 17, 2012), Robert Smith Comment Letter (Dec. 17, 2012), Michael Carmichael Comment Letter (Dec. 17, 2012), Andrew Jackson Comment Letter (Dec. 17, 2012), Donald Blais Comment Letter (Dec. 17, 2012), Suzanne Slade Comment Letter (Dec. 17, 2012), Patricia Horter Comment Letter (Dec. 17, 2012), JoDan Traders Comment Letter (Dec. 17, 2012), Jeff Schlink Comment (Dec. 18, 2012), Sam Jelovich Comment Letter (Dec. 18, 2012), Matthew Bauman Comment Letter (Dec. 20, 2012), Mark Phillips Comment Letter (Dec. 22, 2012), Deborah Stone Comment Letter (Dec. 24, 2012), Po Huang Comment Letter (Dec. 24, 2012), Aarynn Krall Comment Letter (Jan. 8, 2013), Vael Asset Management Comment Letter (Jan. 10, 2013), Kos Capital Comment Letter (Jan. 11, 2013), James Lowe Comment Letter (Jan. 13, 2013), Tracy Burns Comment Letter (Jan. 14, 2013), Treasure Island Coins Comment Letter (Jan. 14, 2013), and Clare Colreavy Comment Letter (Jan. 9, 2013).

[427] NPPC Comment Letter at 2 (Feb. 14, 2013), Premier Metal Services Comment Letter at 4 (Jan. 3, 2013), ISRI Comment Letter at 5–7 (Dec. 4, 2012), AIM Comment Letter at 4 (Jan. 24, 2013), Kripke Enterprises Comment Letter (Dec. 12, 2012), Manitoba Comment Letter (Dec. 13, 2012), Solomon Metals Corp. Comment Letter (Jan. 15, 2013), Michael Krall Comment Letter (Dec. 17, 2012), David Kennedy Comment Letter (Dec. 17, 2012), Robert Smith Comment Letter (Dec. 17, 2012), Michael Carmichael Comment Letter (Dec. 17, 2012), Andrew Jackson Comment Letter (Dec. 17, 2012), Donald Blais Comment Letter (Dec. 17, 2012), Suzanne Slade Comment Letter (Dec. 17, 2012), Patricia Horter Comment Letter (Dec. 17, 2012), JoDan Traders Comment Letter (Dec. 17, 2012), Jeff Schlink Comment Letter (Dec. 18, 2012), Sam Jelovich Comment Letter (Dec. 18, 2012), Matthew Bauman Comment Letter (Dec. 20, 2012), Mark Phillips Comment Letter (Dec. 22, 2012), Deborah Stone Comment Letter (Dec. 24, 2012), Po Huang Comment Letter (Dec. 24, 2012), Aarynn

seven of the 29 commenters requested that the Commission also mandate that an FCM cannot prevent a customer who so ''opts out'' from continuing to trade through that FCM merely because the customer elected to ''opt out.''[428]

The Commission did not propose to amend the list of permitted investments set forth in § 1.25, and believes that the current investments and regulatory requirements establish an appropriate balance between providing investment opportunities for FCMs with the overall objective of protecting customer funds. As further discussed in section II.L. below, the Commission also is amending § 1.29 to explicitly provide that an FCM is responsible for any losses resulting from the investment of customer funds under § 1.25.

The Commission further notes that the current regulatory structure does not provide for a system whereby customers can elect to ''opt-out'' of segregation or § 1.25. In the event of the insolvency of an FCM, where there also was a shortfall in customer funds, customers would be entitled to a pro-rata distribution of customer property under section 766 of the U.S. bankruptcy code.[429] Therefore, even if a customer was permitted by the FCM to ''opt-out'' of segregation, the funds held by the FCM would be pooled with other customer funds and distributed on a pro-rata basis to all customers participating in that account class.

2. Reverse Repurchase Agreement Counterparty Concentration Limits

Regulation 1.25 provides that 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 reverse repurchase agreements, including, limiting counterparties to certain banks and government securities brokers or dealers, and prohibiting an FCM or DCO from entering into such agreements with an 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.

The Commission proposed to amend § 1.25(b)(3)(v) to require an FCM or DCO to aggregate the value of the securities purchased under reverse repurchase agreements if the counterparties are under common control or ownership. The aggregate value of the securities purchased under a reverse repurchase agreement from the counterparties under common ownership or control could not exceed 25 percent of the total assets held in segregation by the FCM or DCO. The Commission proposed the amendment as it believed that the expansion of the counterparty concentration limitation to counterparties under common ownership or control is consistent with the original intent of the regulation, and to minimize potential losses or disruptions due to the default of a counterparty.

The Commission received comments from LCH.Clearnet and CFA in support of the proposed amendments.[430] No other comments were received. The Commission is adopting the amendments as proposed.

K. § 1.26: Deposit of Instruments Purchased With Futures Customer Funds

Regulation 1.26 requires each FCM or DCO that invests customer funds in instruments listed under § 1.25 to separately account for such instruments and to segregate the instruments from its own funds. An FCM or DCO also must deposit the instruments under an account name which clearly shows that they belong to futures customers and that the instruments are segregated as required by the Act and Commission regulations. The FCM or DCO also must obtain and retain in its files a written acknowledgment from the depository holding the instruments stating that the depository was informed that the instruments belong to futures customers and that the instruments are being held in accordance with the provisions of the Act and Commission regulations.

The Commission proposed amending § 1.26 to specify how direct investments by FCMs and DCOs in money market mutual funds (''MMMFs'') that qualify as permitted investments under § 1.25 must be held, and to adopt a Template Letter to be used with respect to direct investments in qualifying MMMFs. Like the proposed Template Letters for §§ 1.20 and 30.7, the proposed Template Letter for § 1.26 contained provisions providing for read-only access and release of shares upon instruction from the director of the Division of Clearing and Risk, the director of the Division of Swap Dealer and Intermediary Oversight, or any successor divisions, or such directors' designees.

With respect to the Template Letter for MMMFs, ICI noted that costs to create electronic access to FCM accounts at an MMMF would be ''borne by all investors and not just by FCMs,'' which likely only constitute a small percentage of an MMMF's investors.[431] As an alternative, ICI proposed that the Template Letter be amended to require the MMMF to provide FCM account data promptly (*i.e.,* within 48 hours) upon request.[432] ICI also commented that the Commission should confirm: (1) The ''examination or audit'' of the accounts authorized by the acknowledgment letter is limited to verification of account balances and that further inspection of an MMMF itself would be referred to the SEC as primary regulator; and (2) the proposal would require only those MMMFs in which FCMs directly invest customer funds (as opposed to those held through intermediated positions like omnibus accounts or intermediary-controlled accounts) to agree to provide FCM account information.[433]

The Commission originally proposed one Template Letter, Appendix A to § 1.26, to be used by both FCMs and DCOs when investing customer funds in an MMMF. However, as noted above in the discussion of the § 1.20 Template Letters, the Commission has determined to eliminate the read-only access requirement for DCOs. Therefore, the Commission is adopting different Template Letters for FCMs and DCOs in § 1.26. The Template Letter specific to FCMs is now set forth in Appendix A to § 1.26, and the Template Letter for DCOs is set forth in Appendix B to § 1.26. The Commission has made other modifications to the § 1.26 Template Letters consistent with the modifications to the § 1.20 Template Letters.

The Commission also confirms that examination of accounts authorized by the acknowledgment letter would not involve regulation or examination of the MMMF itself, over which the Commission does not have supervisory or regulatory authority. The examination would be limited to

Krall Comment Letter (Jan. 8, 2013), Vael Asset Management Comment Letter (Jan. 10, 2013), Kos Capital Comment Letter (Jan. 11, 2013), James Lowe Comment Letter (Jan. 13, 2013), Tracy Burns Comment Letter (Jan. 14, 2013), Treasure Island Coins Comment Letter (Jan. 14, 2013), and Clare Colreavy Comment Letter (Jan. 9, 2013).

[428] NPPC Comment Letter at 2 (Feb. 14, 2013); Premier Metal Services Comment Letter at 4 (Jan. 3, 2013); ISRI Comment Letter at 6 (Dec. 4, 2012); AIM Comment Letter at 6 (Jan. 24, 2013); Kripke Enterprises Comment Letter (Dec. 10, 2012); Manitoba Comment Letter (Dec. 13, 2012); and Solomon Metals Corp Comment Letter (Jan, 15, 2013).

[429] 11 U.S.C. 766.

[430] LCH.Clearnet Comment Letter at 4 (Jan. 25, 2013); CFA Comment Letter at 6 (Feb. 13, 2013).

[431] ICI Comment Letter at 4–5 (Jan. 14, 2013).

[432] *Id.* at 5.

[433] *Id.* at 4–6 (Jan.14, 2013).

verification of the account shares of the FCM or DCO, and the Template Letters required under § 1.26 are solely applicable to directly-held investments in MMMFs. For the purpose of clarification, an FCM or DCO that holds shares of an MMMF in a custodial account at a depository (not directly with the MMMF or its affiliate) is required to execute the Template Letter set forth in Appendix A or B of Regulation 1.20, as applicable. In addition, a MMMF would be required to provide the Commission with read-only access to accounts holding customer funds only if the FCM directly deposits customer funds with the MMMF.

Proposed paragraph (b) of § 1.26 has been modified to include a reference to Appendix B to § 1.20. Otherwise, the Commission is adopting § 1.26 as proposed.

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

1. FCM's Responsibility for Losses Incurred on the Investment of Customer Funds

Regulation 1.29 currently provides that an FCM or DCO is not required to pass the earnings from the investment of futures customer funds to the futures customers. An FCM or DCO may retain any interest or other earnings from the investment of futures customer funds.

The Commission proposed to amend § 1.29 to explicitly provide that an FCM or DCO is responsible for any losses incurred on the investment of customer funds. Investment losses cannot be passed on to futures customers. As the Commission noted in the Proposal, an FCM may not charge or otherwise allocate investment 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 funds 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.[434] Section 4d(b) of the Act also provides that it is unlawful for a DCO to use customer funds as belonging to any person other than the customers of the FCM that deposited the funds with the DCO. Accordingly, such investment losses are the responsibility of the FCM or DCO, as applicable. Similar regulations were proposed for Cleared Swaps Customer Collateral under part 22 (§ 22.2(e)(1)), and for 30.7 customer funds under part 30 (§ 30.7(i)).

FIA and CFA supported the proposed amendments to § 1.29.[435] No other comments were received. The Commission adopts the amendments to §§ 1.29, 22.2(e)(1), and 30.7(i) as proposed.

2. FCM's Obligation in Event of Bank Default

The Commission requested comment on the extent of an FCM's responsibility to cover losses in the event of a default of by a bank holding customer funds. The CFA commented that FCM's should be responsible as such an obligation will require that FCMs conduct adequate due diligence on the banks in which they place customers' funds, a factor that should limit the effect of a related future bank failure.[436]

The FIA noted that the Commodity Exchange Authority issued an Administrative Determination in 1971 setting out the appropriate standard of liability for an FCM in the event of a bank default.[437] The FIA also stated that the deposit of customer funds in a bank or trust company is not an investment of customer funds under § 1.25, but is a requirement by the Act and Commission regulations.[438] The FIA stated that FCMs should not be strictly liable for a bank's failure, and that to hold FCMs to such a standard would presume that FCMs have the ability to know more about a bank than the regulatory authorities responsible for overseeing the banks.[439]

The FIA further stated that the Commission's new § 1.11 will require each FCM to establish and enforce written policies and procedures reasonably designed to assure compliance with the segregation requirements. The policies and procedures also must include a process for the evaluation of depositories, and a program to monitor a depository on an ongoing basis, including a thorough due diligence review of each depository at least annually. FIA notes that the policies and procedures will be subject to Commission and DSRO review, and that either the Commission or DSRO can direct the FCM to make any changes to address identified weaknesses in the policies or procedures, or in their enforcement.[440]

Advantage stated that the deposit of customer funds into a bank is not an investment of the funds, and FCMs should be able to assume that banks are properly vetted by the relevant banking and futures regulatory authorities.[441]

The Commission has considered the issue and believes the issue of depository risk raises important legal and policy issues that were not addressed in the Administrative Determination. There are considerable reasons to question whether the Administrative Determination is consistent with the CEA and the Commission's regulations thereunder. Customers entrust their funds to FCMs, who are required by the Act and Commission regulations to treat the funds as belonging to the customers, to segregate the funds from the FCM's own funds, and to hold such funds in specially designated accounts that clearly state that the funds belong to commodity customers of the FCM and are being held as required by the Act and Commission regulations. Customers do not select the depositories to hold these funds; FCMs do. FCMs are responsible for conducting the initial due diligence and ongoing monitoring of depositories holding customer funds. Moreover, as a practical matter, FCMs are in a better position than customers to perform these functions, as well as in a better position than the customers individually to make claim in the insolvency proceeding for the depository.[442]

[434] 77 FR 67866, 67888.

[435] FIA Comment Letter at 30–31 (Feb. 15, 2013); CFA Comment Letter at 6 (Feb. 13, 2013).

[436] CFA Comment Letter at 6 (Feb. 13, 2013).

[437] FIA Comment Letter at 32–33 (Feb. 15, 2013). The Administrative Determination applies to both FCM and DCO deposits at banks, and provides as follows:

To: Associate Administrator
Division Directors
Regional Directors

If a futures commission merchant or a clearing association deposits regulated commodity customers' funds in a bank and the bank is later closed and unable to repay the funds, the liability of the futures commission merchant or clearing association would depend upon the manner in which the account was handled. It 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 Commodity Exchange Act and the regulations thereunder relating to the handling of customers' funds. If two banks were available in a particular city only one of which was a member of FDIC and the futures commission merchant or clearing association without a compelling reason elected to use the nonmember bank, we would contend that it had not used due care in its selection.

Administrative Determination No. 230 issued by Alex Caldwell, Administrator, Commodity Exchange Authority (Nov. 23, 1971).

[438] FIA Comment Letter at 32–33 (Feb. 13, 2013).

[439] *Id.*

[440] *Id.*

[441] Advantage Comment Letter at 3 (Feb. 15, 2013).

[442] By a parity of reasoning, this would also apply to relationships between DCOs and FCMs. Indeed, it would be difficult to see how a DCO would be liable for such losses, but an FCM would not.

Importantly, the AD fails to address the question of precisely *which* customers are exposed to depository losses, and how much should be allocated to each such customer. This question is particularly important in the context of omnibus customer accounts permitted in the futures industry. Would losses be allocated to persons who are customers at the point the depository becomes insolvent, to persons who were customers at any point the FCM maintained funds at the depository, or to persons who were customers at the point the losses were crystalized? Would losses be allocated to all customers, or could certain favored customers avoid such exposure by negotiation? If the depository lost only securities, would customers who deposited only cash share in the loss? If the depository lost only cash, would customers who deposited only securities share in the loss? Would customers whose margin was all used to cover requirements at the DCO share in losses of funds at a depository other than a DCO? Moreover, would customers to whom losses were allocated share in dividends recovered from the estate of the defaulting depository? How would such customers have the practical opportunity to demonstrate their claims in such a proceeding? How and when would such recoveries be distributed to such customers? These practical questions, none of which was answered in the Administrative Determination, call its wisdom into question.[443]

Accordingly, the Commission has directed staff to inquire into these issues, and to develop an appropriate proposed rulemaking.

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

Regulation 1.30 provides that an FCM may lend its own funds to customers on securities and property pledged by such customers, and may repledge or sell such securities and property pursuant to specific written agreement with such customers. This provision generally allows customers to deposit non-cash collateral as initial and variation margin. Absent the provision, an FCM may be required to liquidate the non-cash collateral if the customer was subject to a margin call that could not be met with other assets in the customer's account. Regulation 1.30 further provides that the proceeds of loans used to margin the trades of customers shall be treated and dealt with by an FCM as belonging to such customers, in accordance with and subject to the provisions of the Act and regulations.

The Commission proposed to amend § 1.30 by adding that an FCM may not lend funds to a customer for margin purposes on an unsecured basis, or secured by the customer's trading account. The Commission stated in the Proposal that it did not believe that FCMs extended unsecured credit as a common practice, as the FCM would be required to take a 100 percent charge to capital for the value of the unsecured loan under § 1.17. The Commission also noted that a trading account did not qualify as collateral for the loan under § 1.17 and the FCM would have to take a charge to capital for the full value of the unsecured loan. The Commission further noted that the proposed amendment to § 1.30 was consistent with CME Rule 930.G, which provides that a clearing member 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.[444]

RCG commented that it believes that the proposal prohibiting an FCM from making unsecured loans to customers contradicts proposed § 1.22 as it applies to funding customers' margin deficits.[445] The Commission notes that the requirement in § 1.22 for an FCM to cover an undermargined account with its own funds is intended to ensure that the FCM complies with section 4d of the Act by not using the funds of one futures customer to margin or guarantee the commodity interests of another customer. The FCM is obligated under section 4d to maintain sufficient funds in segregation to cover undermargined accounts. The FCM, however, is not loaning funds to a particular customer as performance bond is contemplated by § 1.30. When the FCM deposits proprietary funds into segregated accounts under § 1.22, the FCM is not loaning any particular customer funds, and the customers with an undermargined account are not credited with an increase in their cash balance.

Newedge also requested confirmation the proposed prohibition in § 1.30 preventing an FCM from loaning unsecured funds to a customer to finance such customer's trading would not prohibit an FCM, when computing a customer's margin requirement, from giving credit for the customer's long option value. The Commission confirms that an FCM may continue to consider a customer's long option value when computing such customer's overall account value and margin requirements.[446]

The Commission is adopting the amendments to § 1.30 as proposed.

N. § 1.32: (§ 22.2(g) for Cleared Swaps Customers and § 30.7(l) for Foreign Futures and Foreign Options Customers): Segregated Account: Daily Computation and Record

The Commission proposed 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.[447]

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 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.

[443] This discussion does not apply to funds that have been deposited with a third-party depository selected by a customer.

[444] *See* CME rulebook at *www.cmegroup.com/rulebook/CME/I/9/9.pdf.*

[445] RCG Comment Letter at 4 (Feb. 12, 2013).

[446] Newedge Comment Letter at 5 (Feb. 15, 2013).

[447] The Commission also proposed amendments to § 22.2(g) and § 30.7(l) to impose requirements for Cleared Swaps and foreign futures and foreign options transactions, respectively, that correspond to the proposed amendments for § 1.32. The comments for §§ 1.32, 22.2(g), and 30.7(l) are addressed in this section.

The Commission proposed 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 proposed 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.[448]

As previously noted, 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 and is consistent with current practices.[449]

The Commission stated in the Proposal that the filing of daily Segregation Schedules by FCMs will enhance its ability to monitor and protect customer funds as the Commission 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.[450]

The Commission also proposed to require an FCM to file its Segregation Schedule 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 currently receives the Segregation Schedule electronically via the WinJammer filing system and the proposal would continue to require FCMs to submit the forms using WinJammer.

The Commission also proposed 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 also proposed 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 require each FCM to submit 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, U.S. government securities, U.S. 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.

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 requires 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.

FIA generally supported the proposal.[451] FIA noted that proposed § 1.32(a) requires an FCM to compute its daily segregation requirement on a currency-by-currency basis, and requested that the Commission confirm that a single Segregation Schedule can be completed for each account class (*i.e.,* futures customers funds, Cleared Swaps Customers funds, and § 30.7 customer funds) on a U.S. dollar-equivalent basis. FIA further stated that the detail regarding the investment of customer funds provided by NFA on its Web site is the appropriate level of detail that should be made public because additional detail would disclose proprietary financial and business information.[452]

Jefferies supported the proposal, and recommended that the listing of detailed investments should include all investments, including cash and other investments, regardless of where the investments are held, and should provide greater transparency for the FCMs' customers.[453] MFA supported the proposed amendments to § 1.32 to require FCMs to provide the Commission and their DSROs with: (1) Daily reporting of the segregation and part 30 secured amount computations; and (2) semi-monthly reporting of the location of customer funds and how such funds are invested under § 1.25.[454]

The Commission has considered the comments and is adopting the amendments to §§ 1.32, 22.2(g), and 30.7(l) as proposed. In response to Jefferies comment, the Commission notes that the proposed and final regulation require an FCM to report all investments, including cash and other investments, regardless of where the investments are held.

In response to FIA's comment, the Commission does not believe that a full disclosure of the investment of customer funds would disclose proprietary information of the FCM. The Commission would require the disclose of investment information in a manner consistent with the current NFA disclosures, which includes, for each FCM, the percentage of the invested customer funds that are held by banks, or invested in U.S. government securities, bank certificates of deposit, money market funds, municipal securities, and U.S. government sponsored enterprise securities. The Commission, however, further believes that FCMs also should disclose the amount of customer funds that are held by clearing organizations and brokers. The Commission also believes that FCMs should disclose the amount of customer-owned securities that are on deposit as margin collateral, and information regarding repurchase

[448] Each FCM currently already submits a daily Segregation Schedule to its DSRO pursuant to rules of the CME and NFA. Therefore, the Commission's amendments are codifying current regulatory practices for each FCM.

[449] 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.

[450] 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.

[451] FIA Comment Letter at 30 (Feb. 15, 2013).

[452] *Id.* at 31.

[453] Jefferies Comment Letter at 4 (Feb. 15, 2013).

[454] MFA Comment Letter at 3 (Feb. 15, 2013).

transactions involving customer funds or securities. The additional disclosures will provide customers and the market with additional information that may be relevant to their assessment of the risks of placing their funds with a particular FCM. The Commission further notes that it plans to work with the SROs to determine the most efficient and effective method to disclose this information to the public.

The Commission also confirms that an FCM satisfies the requirement of § 1.32 if it prepares and submits to the Commission, and to its DSRO, a consolidated Segregation Schedule for each account class on a U.S. dollar-equivalent basis. The FCM, however, must prepare segregation records on a daily basis on a currency-by-currency basis to ensure compliance with § 1.49, which governs how FCMs may hold funds in foreign depositories. The FCM is not required under § 1.32 to file the currency-by-currency segregation records with the Commission or with its DSRO.

O. § 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.[455] 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 enforce compliance with such requirements.[456]

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.[457] 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 the purpose of assigning to one of the SROs (the DSRO) of the joint audit plan the function examining member FCMs for compliance with minimum capital and related financial reporting obligations. The audit plan must be submitted to the Commission for approval. Currently all active SROs are members of a joint audit plan that was approved by the Commission on March 18, 2009.[458]

The Commission proposed additional amendments to § 1.52 to enhance and strengthen the minimum requirements that SROs must abide by in conducting financial surveillance. As the Commission explained in the Proposal, these amendments are intended to minimize the chances that FCMs 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. Proposed § 1.52(a) added a definitions section identifying the terms ''examinations expert,'' ''material weakness,'' and ''generally accepted auditing standards.''

The term ''examinations expert'' was 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.'' The Commission received several comments regarding the opinion that the examinations expert is required to provide on its review of the SRO programs, which is addressed in section II.O.4 below. The Commission did not, however, receive comments regarding the defined term ''examinations expert'' and is adopting the definition as proposed.

The term ''material weakness'' was defined as ''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 entity's financial statements and regulatory computations will not be prevented or detected on a timely basis by the entity's internal controls.'' The Commission has determined not to adopt the definition of material weakness to eliminate the concern that the SROs examinations are intended to replicate the financial statement audits performed by public accountants under § 1.16.

Proposed § 1.52(b) requires each SRO to adopt rules prescribing minimum financial and related reporting requirements, and requires its member FCMs to establish a risk management program that is at least as stringent as the risk management program required of FCMs under § 1.11. Proposed amendments to § 1.52 (c) requires each SRO to establish a supervisory program to oversee their member FCMs' compliance with SRO and Commission minimum capital and related reporting requirements, the obligation to properly segregated customer funds, risk management requirements, financial reporting requirements, and sales practices and other compliance requirements. The supervisory program must address: (1) Levels and independence of SRO examination staff; (2) ongoing surveillance of member FCMs; (3) procedures for identifying high-risk firms; (4) on-site examinations of member firms; and (5) the documentation of all aspects of the supervisory program. The supervisory program also must be based on an understanding of the internal control environment to determine the nature, timing, and extent of controls testing and substantive testing to be performed and must address all areas of risk to which the FCM can reasonably be foreseen to be subject. Proposed § 1.52(c) also requires that all aspects of the SRO's supervisory program must, at a minimum, conform to generally accepted auditing standards after consideration to the auditing standards issued by the PCAOB.

Proposed § 1.52(c) also requires each SRO to engage an ''examinations expert'' at least once every two years to evaluate the quality of the supervisory oversight program and the SRO's application of the supervisory program. The SRO must obtain a written report from the examinations expert with an opinion on 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 areas

[455] 7 U.S.C. 7(d)(11).

[456] 7 U.S.C. 21(p).

[457] 77 FR 36611 (June 19, 2012).

[458] 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.; and One Chicago, L.L.C.

that are subject to the supervisory program.

Proposed § 1.52(d) provides that two or more SROs may enter into an agreement to delegate the responsibility of monitoring and examining an FCM that is a member of more than one SRO to a DSRO. The DSRO would monitor the FCM for compliance with the Commission's and SROs' 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.

The Commission received several comments on the proposed amendments to § 1.52 and, with the exception of the issues discussed below, has determined to adopt the amendments as proposed.[459]

1. Swap Execution Facilities Excluded From the Scope of Regulation 1.52

The Commission is revising the final § 1.52 by adding a new defined term, ''self-regulatory organization,'' to paragraph (a). The term ''self-regulatory organization'' is defined in paragraph (a) to mean, for purpose of § 1.52 only, a contract market, as defined in § 1.3(h), or a registered futures association. The term ''self-regulatory organization'' is further defined in paragraph (a) to explicitly exclude a swap execution facility (''SEF''), as defined in § 1.3(rrrr).

The revision to definition of self-regulatory organization in § 1.52 is necessary due to the recent amendments to the definition of ''self-regulatory organization'' set forth in § 1.3(ee), which defines the term as a contract market, as defined in § 1.3(h), a SEF, as defined in § 1.3(rrrr), or a registered futures association under section 17 of the Act.[460] Therefore, since § 1.52 applies to each SRO, without including a definition for the term ''self-regulatory organization'' under § 1.52(a) that excludes SEFs, the full provisions of § 1.52 would apply to SEFs.

In adopting new regulations implement core principles and other requirements for SEFs, the Commission did not require SEFs to adopt minimum capital and related financial reporting requirements for its member firms.[461] The Commission further stated that a SEF's obligation to monitor its member for financial soundness extended only to a requirement to ensure that the members continue to qualify as eligible contract participants as defined in section 1a(18) of the Act.[462] Therefore, the Commission previously has determined that the extensive oversight program required of SROs that are contract markets or registered futures associations by § 1.52 is not applicable to SEFs.

2. Revisions to the Current SRO Supervisory Program

The Commission received several comments concerning the proposed amendments to § 1.52, many of which varied in support and context. The NFA stated that it fully supports the requirement that the supervisory program include both controls testing and substantive testing, and that the examinations process be driven by the risk profile of the FCM.[463] NFA noted that it has been modifying its procedures to enhance its examination of FCM internal controls as well as substantive testing, and also has updated its risk system to create risk profiles of each of its FCMs.[464] NFA also agreed that SROs should identify those FCMs that pose a high degree of potential risk so that the SRO can increase its monitoring of those firms and that the examinations should focus on the higher risk areas at each FCM.[465]

The CME and JAC generally did not support the proposed amendments to § 1.52, stating that the current limited role of regulatory exams is appropriate as its purpose is not intended to give the same level of assurances to the FCM, the FCM's investors, or third parties as that which external auditors provide in conducting financial statement audits of FCMs.[466] The CME also stated that regulatory reviews are not designed to protect investors in FCMs, nor should they be.[467] In addition, the CME believes that SROs and DSROs play regulatory roles, and it is no more appropriate to have them report to an audit committee of an FCM than it would be to have the Commission itself report to that audit committee.[468]

The JAC stated that the SRO examinations are compliance reviews focused on the particular and distinctive regulatory requirements and associated risks of the futures industry, including whether FCMs are in compliance with customer regulations and net capital requirements to protect customers and the functioning of the futures industry.[469] The JAC further stated that incorporating the full risk management requirements of § 1.11 into the SRO's examinations of FCMs, and the requirement that the SRO audit program address all areas of risk to which FCMs can reasonably be foreseen to be subject, are overly broad requirements that are impractical, and virtually impossible to meet.[470]

The JAC further stated that proposed § 1.52 imposes potential duplicative oversight of FCM risk management policies and procedures by SROs and DCOs. The JAC noted that § 39.13(h)(5) requires a DCO to review the risk management policies, procedures, and practices of each of its clearing members.[471] The JAC requested clarification on the oversight responsibilities of SROs and DCOs to address potential duplicative requirements.[472] Lastly, the JAC stated that expanding the SRO oversight program to include operational and technical risks will require additional expertise, time and resources to perform such reviews and will result in increased costs.[473]

The Commission believes that the CME, NFA, JAC, SROs and DSROs play a critical role in examining FCMs and other registrants under the self-regulatory structure of the futures industry. Recent events, however, demonstrate that the SROs' current focus on CFTC and SRO regulatory requirements, including segregation and net capital computations, are not in and of themselves adequate to assess risk and protect customers of the FCM. For instance, a failure in an FCM's non-futures operations may pose risks to

[459] MGEX stated that the Commission's Proposal generally supports the current DSRO program by requiring FCMs to file various reports and notices with the Commission and with the firms' DSROs. MGEX further stated that the Commission should not create a regulatory monopoly and should recognize that an SRO may not wish to join the JAC. The Commission believes that each SRO has a right to elect to perform the financial surveillance required under § 1.52 directly or to participate in a joint audit agreement with other SROs. In addition, § 38.604 requires each SRO to have rules in place that require member FCMs to submit financial information to the SRO.

[460] 77 FR 66288 (Nov. 2, 2012). Regulation 1.3 is the general definitions provision of the Commission's regulations.

[461] 78 FR 33476 (June 4, 2013).

[462] *Id.*

[463] NFA Comment Letter at 3 (Feb. 15, 2013). *See also* Paul/Weiss Comment Letter at 2 (Feb. 15 2013), BlackRock Letter at 3 (Feb. 15. 2013), and MFA Comment Letter at 4 (Feb. 15, 2013) expressing general support for the proposed enhancements to the SRO examinations program.

[464] *Id.*

[465] *Id.*

[466] CME Comment Letter at 8–9 (Feb. 15, 2013); JAC Comment Letter at 2–4 (Feb. 14, 2013); JAC Comment Letter 2–4 (July 25, 2013).

[467] CME Comment Letter at 11 (Feb. 15, 2013).

[468] *Id.*

[469] JAC Comment Letter at 2 (July 25, 2013).

[470] *Id. See also* JAC Comment Letter at 5 (Feb. 14, 2013).

[471] *Id.*

[472] *Id.*

[473] *Id.* The JAC noted that the examination of the controls and risk management policies and procedures over an FCM's technology systems would require particular expertise that is different from the knowledge and expertise or regulatory staff, and that SROs will have to hire specialized examiners to conduct such reviews.

futures customers and the operation of an FCM. In addition, technology failures at an FCM also may pose risks to the operation of an FCM and the overall protection of customer funds. Accordingly, to properly monitor and assess risks to the FCM, the SRO must be aware of non-futures related activities of the FCM.

Recent events also demonstrate that the examinations of FCMs must be risk based and that the testing must be based on an understanding of the registrant's internal control environment to determine the nature, timing and extent of the necessary tests. In order to help ensure an appropriate risk based exam is performed, an examiner must take into account the risk profile of the firm and build the examination program accordingly. For example, if a firm has weak controls over cash, the risk of inaccurate accounting for cash movements is greater and therefore more detailed substantive testing of cash transactions and balances is necessary to provide the examiner with sufficient assurance that reported balances are accurate. To the contrary, if controls are good over cash then less substantive testing is needed.

The Commission acknowledges that revised § 1.52 imposes new obligations on SROs by requiring their supervisory programs to include an assessment of whether member FCMs comply with the risk management requirements of § 1.11. However, § 1.52 also requires that the SRO's examination of FCMs be performed on a risk-based approach. The scope of the examinations should be based upon the SRO's assessment of risk at the FCM and full, detailed testing is not mandated by § 1.52 in each area. Lastly, the Commission recognizes that DCOs impose certain risk management requirements on clearing FCMs and are required to review the operation of such risk management requirements. While § 39.13(h)(5) is directed at risk that an FCM may pose to a DCO and, therefore, is more narrowly focused than the risk management requirements in § 1.11, SROs may coordinate with a DCO to ensure that duplicative work is not being performed by the separate organizations.[474]

3. Auditing Standards Utilized in the SRO Supervisory Program

Proposed § 1.52(c)(2)(ii) and (d)(2)(ii)(F) require all aspects of an SRO's or DSRO's, supervisory program to conform, at a minimum, to U.S. GAAS after giving full consideration to the auditing standards issued by the PCAOB. NFA, CME, and JAC questioned what is meant by the term ''after giving full consideration of auditing standards prescribed by the PCAOB.'' [475] NFA, CME, and JAC did not agree with basing the SRO Supervisory Program framework on either U.S. GAAS or PCAOB standards, largely because the DSRO does not issue a report that expresses an opinion with respect to the FCM's financial statements or issue an Accountant's Report on Material Inadequacies.[476] Additionally, CME noted that invoking U.S. GAAS and PCAOB standards opens up a complex and detailed regulatory structure, which includes a framework allowing auditor's to rely on interpretive publications, professional journals and auditing publications from state CPA societies, none of which were designed to address the regulatory function played by an SRO or DSRO.[477] However, NFA acknowledged that certain U.S. GAAS and PCAOB accounting standards and practices should be followed by DSROs in performing their regulatory examinations (*e.g.,* those standards focusing on recordkeeping, training and experience, the scope of the examination and testing, the confirmation process, and other related examination practices).[478]

The Commission notes that the objective of the Proposal was to ensure that the SRO examinations are conducted consistent with the professional standards that CPAs and others are subject to in conducting their examinations. The Commission recognizes that certain U.S. GAAS principles and PCAOB principles would not be applicable to the SRO examinations (such as principles addressing reporting, which provide that the CPA must state whether the financial statements are prepared in accordance with Generally Accepted Accounting Principles). However, other U.S. GAAS and PCAOB standards would be relevant to SRO examinations. Such principles include standards addressing the competency and proficiency of the examinations staff and the obtaining and documenting of adequate audit evidence to support the examiner's conclusions.

The Commission has considered these comments and has revised the proposed language to state that at a minimum, an examination should conform to PCAOB auditing standards to the extent such standards address non-financial statement audits. While it is acknowledged that PCAOB audit standards are directed at financial statement audits, the concept of many of the standards are just as applicable to an examination performed by an SRO or DSRO, and as such should be adopted in that light. The relevant PCAOB standards would include, but are not limited to, the training and proficiency of the auditor, due professional care in the performance of the work, consideration of fraud in an audit, audit risk, consideration of materiality in planning and performing an audit, audit planning, identifying and assessing risks of material misstatement, the auditor's responses to the risk of material misstatement, audit documentation, evaluating the audit results, communications with audit committees, and due professional care in the performance of work. In developing the supervisory program, consideration should also be given to other related guidance such as the standards adopted by the Institute of Internal Auditors (Standards & Guidance—International Professional Practices Framework) and the Policy Statement and Supplemental Policy Statement on the Internal Audit Function and its Outsourcing issued by the Board of Governors of the Federal Reserve System, and generally accepted auditing standards issued by the American Institute of Certified Public Accountants.[479]

4. ''Examinations Expert'' Reports

Proposed § 1.52(c)(2)(iv) and (d)(2)(ii)(I) require each SRO and DSRO, respectively, to engage an examinations expert to evaluate the SROs or DSROs programs and to express an opinion as to whether the program is reasonably likely to identify a material deficiency in internal controls over financial and/or regulatory reporting and in any of the other areas that are subject to SRO or DSRO review under the programs. The JAC, CME, Center for Audit Quality, Ernst & Young, and PWC did not support the ''examinations expert'' requirement.[480] Several of these commenters expressed concern that the term ''examinations expert'' as defined

[474] Under the current JAC structure, the CME is the only entity that is both an SRO that performs periodic examinations of FCMs and a DCO that has responsibilities under § 39.13(h)(5) to perform risk management on clearing FCMs.

[475] NFA Comment Letter at 3 (Feb. 15, 2013); CME Comment Letter at 9–10 (Feb. 15, 2013); JAC Comment Letter at 2–3 (Feb 14, 2013).

[476] *Id.*

[477] CME Comment Letter at 9–10 (Feb. 15, 2013).

[478] NFA Comment Letter at 3–4 (Feb. 15, 2013).

[479] The Commission is revising final § 1.52 to remove from paragraph (a) a definition for the term ''U.S. Generally accepted auditing standards'' as that term is no longer contained in the final regulation.

[480] JAC Comment Letter at 3–4 (Feb. 14, 2013); Center for Audit Quality Comment Letter at 3 (Jan. 14, 2013); Ernst & Young Comment Letter at 3–4 (Jan. 14, 2013); PWC Comment Letter at 3 (Jan. 15, 2013).

by § 1.52 imposes a criterion that most CPA firms may not possess or would not be willing to issue such a report.[481] Moreover, NFA, JAC, and MGEX stated that requiring an ''examinations expert'' is unnecessary and duplicative of already existing Commission responsibilities, noting that the JAC provides the examination programs to the Commission annually, and that the Commission can perform a review of the examination programs.[482]

NFA and JAC suggested, as cost effective and more practical solution, inviting individuals meeting the ''examinations expert'' designation to participate in the already existing JAC audit committee meetings.[483] CME suggested that if the proposed structure is adopted, the time frame for review be extended from 18 months to 3½ years, matching that required by the AICPA in its Peer Review program.[484]

The Commission has taken these comments into consideration and has revised the final regulation by providing that the report of the examinations expert should conform to the consulting services standards of the AICPA. The Commission recognizes that generally accepted auditing standards do not provide a reporting framework by which a certified public accountant can issue an audit opinion consistent with the requirements contained in § 1.52. Accordingly, the Commission has revised the final regulation by removing the requirement that the examinations expert provide an audit opinion.

The Commission also does not believe that it is in a position to perform the type of review of the SRO examination reports required by § 1.52 given its limited resources. Furthermore, the examinations expert is an independent party with expert knowledge of risk assessment and internal controls reviews and will be able to provide more thorough and detailed review of the joint audit program than Commission staff can currently devote to such a review. In addition, the Commission staff has communicated to the JAC that it would be very supportive of having the accounting and auditing experts join the JAC meetings to discuss current industry issues.

The Commission has also considered the impact of performing such a review every two years and has modified the proposal to require such a report on a three year basis. This reflects the fact that the DSROs will be updating their programs as needed and therefore the program should not be stagnant during the intervening years. Finally, it was pointed out that given the nature of the report and to facilitate an open and frank dialogue amongst the examinations expert, the DSROs, and the Commission, such report should be considered confidential. The Commission is revising the regulation to provide that the report is confidential, which is consistent with how the PCAOB conducts its reviews of CPA firms.

P. § 1.55: Public Disclosures by Futures Commission Merchants

Regulation 1.55(a) currently requires an FCM, or an IB in the case of an introduced account, to provide a customer with a separate written risk disclosure statement prior to opening the customer's account (''Risk Disclosure Statement''). Regulation 1.55(a) also provides that the Risk Disclosure Statement may contain only the language set forth in § 1.55(c) (with an exception for non-substantive additions such as captions), except that the Commission may authorize the use of Risk Disclosure Statements approved by foreign regulatory agencies or self-regulatory organizations if the Commission determines that such Risk Disclosure Statements are reasonably calculated to provide the disclosures required by the Commission under § 1.55.[485] Regulation 1.55(a) further requires the FCM or IB to receive a signed and dated statement from the customer acknowledging his or her receipt and understanding of the Risk Disclosure Statement.[486]

The Commission reviewed the adequacy of the current prescribed Risk Disclosure Statement in light of its experience with customer protection issues during the recent failures of two FCMs, MFGI and PFGI. In this regard, in responding to questions and issues raised primarily by non-institutional market participants, including market participants from the agricultural community and retail market participants, the Commission recognized that such market participants would benefit from several additional disclosures regarding the potential general risks of engaging in futures trading through an FCM, and the potential specific risks resulting from the bankruptcy of an FCM. In addition to proposing new general risk disclosures, the Commission proposed to also require each FCM to provide customers and potential customers with information about the FCM, including its business, operations, risk profile, and affiliates. The firm specific disclosures are intended to provide customers with access to material information regarding an FCM to allow the customers to independently assess the risk of entrusting funds to the firm or to use the firm for the execution of orders.

1. Amendments to the Risk Disclosure Statement

The mandatory Risk Disclosure Statement currently addresses the risks of engaging in commodity futures trading. The risks that must be disclosed include: (1) The risks that a customer may experiences losses that exceed the amount of funds that he or she contributed to trading and that the customer may be responsible for losses beyond the amount of funds deposited for trading; (2) the risks that under certain market conditions, a customer may find it difficult or impossible to liquidate a position, such as when a market has reached a daily price move limit; (3) the risks that placing certain contingent orders (such as a stop limit order) may not necessarily limit the customer's losses; (4) the risks associated with the high degree of leverage that may be obtainable from the futures markets; and (5) the risks of trading on non-U.S. markets, which may not provide the same level of protections provided under Commission regulations.

As noted above, the Commission proposed several additional disclosures based upon its experience in working with customers, particularly retail and other non-institutional market participants, during the recent failures of MFGI and PFGI. Specifically, the Commission proposed to amend the Risk Disclosure Statement to provide market participants with more information regarding the risks associated with an FCM holding customer funds. In this regard, certain market participants believed that the fact that their funds were segregated from the FCM's proprietary funds protected them from loss in the event of

[481] CME Comment Letter at 13 (Feb. 15, 2013); Center for Audit Quality Comment Letter at 3 (Jan. 14, 2013); Ernst & Young Comment Letter at 3–4 (Jan. 14, 2013); PWC Comment Letter at 3 (Jan. 15, 2013).

[482] NFA Comment Letter at 4–5 (Feb. 15, 2013); JAC Comment Letter at 4 (Feb. 14, 2013) MGEX Comment Letter at 3–4 (Feb. 18, 2013).

[483] NFA Comment Letter at 4–5 (Feb. 15, 2013); JAC Comment Letter at 4 (Feb. 14, 2013).

[484] CME Comment Letter at 13 (Feb. 15, 2013).

[485] The Commission has previously approved an alternative ''generic'' risk disclosure statement for use in the United Kingdom, Ireland and the U.S.

[486] FCMs and IBs are permitted to open commodity futures accounts for ''institutional customers'' pursuant to § 1.55(f) without furnishing such institutional customers with a Risk Disclosure Statement or obtaining the written acknowledgment required by § 1.55. The term ''institutional customer'' is defined by § 1.3(g) and section 1a of the Act as an eligible contract participant. The Commission did not propose to amend § 1.55(f) to require FCMs or IBs to furnish institutional customers with Risk Disclosure Statements.

an FCM bankruptcy. Other customers believed that a DCO guaranteed customer losses, and other customers believed that funds deposited for futures trading were protected by the Securities Investor Protection Corporation in the event of an FCM/BD bankruptcy.

To provide greater clarity as to the how customer funds are held and the potential risks associated with FCMs holding customer funds, the Commission proposed to revise the Risk Disclosure Statement by amending § 1.55(b) to include new paragraphs (2) through (7) as follows:

(2) The funds you deposit with an FCM 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 an FCM for trading futures positions are not protected by the Securities Investor Protection Corporation even if the futures commission merchant is registered with the SEC as a BD;

(4) The funds you deposit with an FCM are not guaranteed or insured by a DCO in the event of the bankruptcy or insolvency of the FCM, or if the FCM is otherwise unable to refund your funds;

(5) The funds you deposit with an FCM are not held by the FCM in a separate account for your individual benefit. FCMs commingle the funds received from customers in one or more accounts and you may be exposed to losses incurred by other customers if the FCM does not have sufficient capital to cover such other customers' trading losses;

(6) The funds you deposit with an FCM may be invested by the FCM 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 FCM 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 an FCM may invest customer funds in; and

(7) FCMs 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 FCM deposits funds with affiliates and assess whether such deposits by the FCM with its affiliates increases the risks to your funds.

The Commission received several comments on the proposed amendment to the Risk Disclosure Statement. NFA stated that it fully supported the Commission's goal of ensuring that customers receive a full description of the risk associated with futures trading, and agreed with the Commission that it is important to update the Risk Disclosure Statement to provide information on the extent to which customer funds are protected when deposited with an FCM as margin or to guarantee performance for trading commodity interest.[487]

The FIA generally supported the proposed amendments to the general Risk Disclosure Statement set forth in § 1.55(b) and outlined above.[488] The FIA stated that many of the Commission's proposed amendments are consistent with FIA's recommendations to enhance disclosures set forth in its paper, ''Initial Recommendations for the Protection of Customer Funds,'' which was published on February 28, 2012 (''Initial Recommendations'') in response to MFGI.[489] FIA also stated that its document, ''Protection of Customer Funds—Frequently Asked Questions,'' is being used by FCMs to provide customers with increased disclosures on the scope of how the laws and regulations protect customers in the futures market.[490]

With respect to the Commission's proposed amendments to § 1.55(b), FIA recommended that the Commission delete the phrase ''due to fraud'' in § 1.55 (b)(2) because customer funds may be misappropriated for any reason.[491] Additionally, FIA suggested the disclosure in § 1.55(b)(4) be revised to take account of the CME Group Family Farmer and Rancher Protection Fund established in the wake of MFGI as this fund will provide up to $25,000 to qualifying individual farmers and ranchers and $100,000 to co-ops that hedge their risk in CME futures markets.[492]

The Commission has considered FIA's comments and had determined to revise the proposal. The Commission recognizes that customer funds may be misappropriated as a result of wrongful conduct that does not rise to the level of fraud. Accordingly, the Commission is revising § 1.55(b)(4) by removing the phrase ''due to fraud'' so that the disclosure provides that customers' funds are not covered by insurance in the event of the insolvency of the FCM or in the event the funds are misappropriated.

The Commission also is revising final § 1.55(b)(4) in response to FIA's comment to provide an overall statement that customer funds generally are not insured by DCOs. The Commission is further revising final § 1.55(b)(4) to include in the disclosure the fact that a DCO may offer an insurance program, and that a customer should inquire of the FCM the extent of any DCO insurance programs and whether the customer would qualify for coverage and understand the limitations and benefits of the coverage. The Commission believes that this approach is more flexible to address future developments in this area than a direct reference to specific DCO insurance programs that currently are available.

NEFI/PMAA questioned whether or not existing and proposed disclosures are sufficient, and further stated that disclosure of customer protections are equally important as the disclosure of potential risks to ensure customer confidence.[493] Pilot Flying J stated FCMs must be required to disclose information to their customers on how their accounts and positions will be managed, as well as associated risks and what kinds of financial protections are afforded to customers by the firm, exchange, and the Commission.

The Commission agrees with NEFI/PMAA and Pilot Flying J that a customer's understanding of the protections is as important as understanding the risks. The Risk Disclosure Statement is the minimum information that an FCM should provide to prospective customers, and is intended to provide a high level summary of the general risk of trading commodity interests. FCMs should provide additional information as necessary to ensure that customers have adequate information. The Commission believes that FIA's Initial Recommendation and FAQ, which includes the types of information that NEFI/PMAA and Pilot Flying J are requesting, should be made available to all potential customers. FIA should revise the documents, as appropriate, in

[487] NFA Comment Letter at 15 (Feb. 15, 2013).

[488] FIA Comment Letter at 41 (Feb. 15, 2013).

[489] FIA Comment Letter at 2 (Feb. 15, 2013). The FIA formed a special committee to develop and recommend specific measures that could be implemented by both the industry best practices and regulatory change to address the issues arising from the bankruptcy of MFGI.

[490] *Id.* FIA's ''Protection of Customer Funds—Frequently Asked Questions'' provides information covering five broad areas: (1) segregation of customer funds; (2) collateral management and investments; (3) basic information on FCMs, such as the purpose of capital requirements and margin processing: (4) issues for joint FCM/BDs; and (5) the role of the DCO guarantee fund.

[491] *Id.* at 41.

[492] *Id.* at 41–42.

[493] NEFI/PMAA Comment Letter at 2 (Jan. 14, 2013).

response to changing market events or other factors.

The Commission also requested comment on whether and how the new or revised Risk Disclosure Statement should be provided to existing customers at the effective date of the regulation. Particularly, the Commission requested comment on whether FCMs should be required to obtain new signature acknowledgments from existing customers.

FIA stated that it was not opposed to a requirement that FCMs provide the revised Risk Disclosure Statement to existing customers that are otherwise required to receive the disclosure document.[494] FIA stated, however, that FCMs should not be required to obtain a written acknowledgment from existing customers. FIA further stated that it should be sufficient if the FCM makes each customer aware of the revised Risk Disclosure Statement by any appropriate means, consistent with the means by which the FCM normally communicates important information to customers, including but not limited to, a separate mailing.[495] The CFA stated that it is very important for FCMs and their DSROs to ascertain whether existing and potential customers have acknowledged receipt of the Risk Disclosure Statement, and FCMs should keep records of acknowledgments that the Risk Disclosure Statements were received.[496] NGFA noted that providing updated risk disclosure, with signed acknowledgment of such to the FCM, is a sound concept.[497]

Regulation 1.55(a) will continue to require FCMs to obtain and retain signed acknowledgments from new customers that they received and understand the Risk Disclosure Statement. With respect to existing FCM customers on the effective date of the regulation, the Commission believes that it is adequate for an FCM to provide each of the customers with a revised Risk Disclosure Statement via its normal means of communicating with customers, including the use of a separate mailing, or providing a link on the firm's Web site to the revised Risk Disclosure Statement, provided that the FCM provides a paper copy of the Risk Disclosure Statement upon the request of a customer. The communication of the revised Risk Disclosure Statement to customers must be highlighted by the FCM in such a manner to reasonably ensure that the customers are adequately apprised of the revised Risk Disclosure Statement.

FIA also noted that the Commission previously approved, pursuant to § 1.55(c), an alternative risk disclosure statement for use in the U.S., the United Kingdom, and Ireland.[498] The alternative risk disclosure statement is set forth in Appendix A to § 1.55. FIA requested that the Commission confirm whether FCMs may continue to use the alternative risk disclosure statement and further encouraged the Commission to coordinate with other derivatives regulatory authorities to revise the alternative risk disclosure statement to meet its regulatory objectives.[499]

Regulation 1.55(c) provides that the Commission may approve for use in lieu of the standard Risk Disclosure Statement required by § 1.55(b) a risk disclosure statement approved by one or more foreign regulatory agencies or self-regulatory organizations if the Commission determines that such risk disclosure statement is reasonably calculated to provide the disclosure required by the standard Risk Disclosure Statement. As noted above, the Commission proposed amendments to the Risk Disclosure Statement due to its recent experiences with the MFGI and PFGI insolvencies where certain customers, particularly less sophisticated customers, did not fully comprehend the nature of the protections of customer funds. Based upon this recent experience, the Commission does not believe that the disclosures in the alternative risk disclosure statement contained in Appendix A provide sufficient detailed disclosures to customers regarding the risk of trading futures transactions. Accordingly, the Commission is revising § 1.55(c) to provide that an FCM may continue to use the alternative risk disclosure statement provided that the FCM also provides each customer required to receive a disclosure document with the revised Risk Disclosure Statement and receives such customer's written acknowledgment that it has received and understands the Risk Disclosure Statement. This will allow FCMs to continue to have a common risk disclosure statement with the United Kingdom and Ireland, and also ensure that customers receive additional risk disclosures to enhance their understanding of engaging in futures trading.

a. Firm Specific Disclosure Document

i. General Requirements

The Commission proposed new paragraphs (i) and (k) to § 1.55 to provide that an FCM may not enter into a customer account agreement or accept funds from a customer unless the FCM discloses to the customer all information about the FCM, including its business, operations, risk profile, and affiliates, that would be material to the customer's decision to entrust such funds to such FCM and otherwise necessary for full and fair disclosure to customers (''Firm Specific Disclosure Document'').

The Firm Specific Disclosure Document is intended to enable customers to make informed judgments regarding the appropriateness of selecting an FCM by providing information for the meaningful comparisons of business models and risks across FCMs. Such 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 the FCM to update the Firm Specific Disclosure Document at least once every 12 months and as and when necessary to keep it accurate and complete. The Commission believes that the proposed firm specific 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 and of opening an account with a particular firm.

Proposed § 1.55(j) requires an FCM to make the Firm Specific Disclosure Document available to customers and to the general public by posting the Firm Specific Disclosure Document on the FCM's Web site. An FCM may, however, use an alternative electronic means to provide the Firm Specific Disclosure document to its customers provided that the electronic version is presented in a format that is readily communicated to the customers. Paper copies of the Firm Specific Disclosure Document also must be available upon the request of a customer. The Commission also proposed that each FCM disclose certain financial information on its Web site to provide the public with additional information on the firm and the customer funds that it holds. The additional financial disclosures are set forth in § 1.55(o) and are discussed below.

SIFMA stated that the public disclosure requirements will help empower its members to choose safe and trustworthy FCMs, and that the

[494] FIA Comment Letter at 42–43 (Feb. 15, 2013).

[495] *Id.*

[496] CFA Comment Letter at 8 (Feb. 13, 2013).

[497] NGFA Comment Letter at 5 (Feb. 15, 2013).

[498] FIA Comment Letter at 43 (Feb. 15, 2013).

[499] *Id.*

disclosures will hold FCMs accountable to their customers, allowing the customers to conduct due diligence efficiently, actively monitor FCMs' financial condition and regulatory compliance, and make informed decisions when selecting and doing business with FCMs.[500] Vanguard expressed the view that the best protection for customers is their own due diligence, and that the proposed additional enhancements add significant, and much needed, protections and transparency.[501] The FHLB supported the proposal with respect to the publication of the Firm Specific Disclosure Document and strongly endorsed the requirement that the FCM update the document as circumstances warrant.[502]

FIA stated that it supports enhancing disclosures to customers regarding the FCM through which the customer may elect to trade.[503] FIA requested that the Commission confirm that an FCM that is part of a publicly-traded company, whether U.S. or non-U.S., or is otherwise required to prepare and to make public an annual report including information comparable to that required by the Firm Specific Disclosure Document under the proposed regulation, may comply with the regulation by making such annual report, and any amendments thereto, available on its Web site.[504] FIA noted that the Management Discussion and Analysis (''MD&A'') required under SEC rules (17 C.F.R. 229.303) requires publicly traded companies to discuss essentially the same topics required to be discussed under the Commission's proposal. FIA stated that the topics include business environment; critical accounting policies; use of estimates; results of operations; balance sheet and funding sources; off-balance sheet arrangements and contractual obligations; overview and structure of risk management; liquidity risk management; market risk management; credit risk management; operational risk management; recent accounting developments; and certain risk factors that may affect the company's business.[505] FIA estimated that approximately 90 percent of customer funds are held by FCMs that are also SEC registered or part of a bank holding company or publicly-traded company and believes this position is necessary to avoid customer confusion in certain circumstances and to assure that FCMs are not subject to duplicative and, perhaps conflicting, disclosure requirements.[506]

FIA further requested that the Commission confirm the level of detail required to be provided by privately-held FCM companies should be consistent with that provided in the annual reports of publicly-traded companies.[507] Additionally, FIA stated that privately-held companies would need a period of time to develop the required disclosures and requested that the Commission make the compliance date of the regulation no sooner than six months after the effective date of the regulation.[508]

The Commission has considered the comments and is adopting § 1.55(i) and (j) as proposed. In response to FIA's comments, the Commission confirms that beyond the requirements stated in § 1.55, the Commission is not mandating the form in which the required information is conveyed, provided it is responsive to the information requirements of § 1.55 and provides such information in a clear, concise, and understandable matter. Accordingly an FCM that is part of a publicly traded company, or is otherwise required to prepare and make public an annual report including information comparable to the information required by proposed § 1.55(k), may satisfy the disclosure requirements in § 1.55 by making an annual report, and any amendments thereto, available on its Web site; provided that such annual report provides the information required by § 1.55 in a manner that is clear, concise and understandable. The Commission is similarly confirming that a privately-held company may satisfy the requirements in § 1.55 by making an annual report, and any amendments thereto, available on its Web site; provided that such annual report provides the information required by § 1.55 in a manner that is clear, concise and understandable.

In assessing whether the annual report contains the necessary information required by § 1.55 in a clear, concise and understandable manner, the FCM must ensure that the disclosures specifically address the risks at the FCM and are not so general in nature that they reflect that the FCM's business may not be material to the public or private company for which the annual report is prepared. An FCM is not in compliance with § 1.55 if the annual report information does not disclose the information required by § 1.55 as it relates to the FCM. The objective of the disclosures is to provide prospective and existing customers of the FCM with material information that could have an impact on their decision to engage in a relationship with the FCM. If the annual report does not include information regarding the FCM, or such information is not clear concise and understandable, the FCM would have to enhance the disclosure by providing supplemental material or otherwise making the required disclosures available to customers and the public in a manner that is clear, concise and understandable. In addition, in order to provide customers with clear, concise and understandable disclosures, an FCM may be required to extract information from various sections of its annual report and provide such information in an easy to read format. If customers are required to search through detailed annual reports to locate the required § 1.55 disclosures, the FCM is not providing the information in a clear, concise and understandable manner.

ii. Specific Disclosure Information Required (by Rule Paragraph)

Proposed § 1.55(k)(1) requires an FCM to disclose contact information for the firm including the address of its principal place of business and its phone number. No comments were received on the proposed § 1.55(k)(1) and the Commission is adopting the amendments as proposed.

Proposed § 1.55(k)(2) requires an FCM to disclose the name and business addresses of the FCM's senior management, including business titles and background, areas of responsibility and nature of duties of each person. The FIA recommended the disclosure be limited to those individuals identified as principals on the NFA BASIC system.[509]

The term ''principal'' is defined in § 3.1 to mean, with respect to an FCM: (1) The proprietor and chief compliance officer if the FCM is organized as a sole proprietorship; (2) any general partner and chief compliance officer if the FCM is organized as a partnership; (3) any director, the president, chief executive officer, chief operating officer, chief financial officer, chief compliance officer, and any person in charge of a principal business unit, division or function subject to regulation by the Commission if the FCM is organized as

[500] SIFMA Comment Letter at 2 (Feb. 21, 2013).

[501] Vanguard Comment Letter at 4 (Feb. 2, 2013). *See also,* Prudential Comment Letter at 2 (Jun. 9, 2013) and Security Benefit Comment Letter at 2 (Jan. 11, 2013 supporting the additional disclosures proposed under § 1.55(i).

[502] FHLB Comment Letter at 10 (Feb. 15, 2013).

[503] FIA Comment Letter at 41 (Feb. 15, 2013).

[504] FIA Comment Letter at 43–44 (Feb. 15, 2013).

[505] *Id.*

[506] *Id.*

[507] *Id.* at 44.

[508] *Id.*

[509] FIA Comment Letter at 51 (Feb. 15, 2013).

a corporation; (4) any director, the president, chief executive officer, chief operating officer, chief financial officer, chief compliance officer, the manager, managing member or those members vested with the management authority for the entity, and any person in charge of a principal business unit, division or function subject to regulation by the Commission if the FCM is organized as a limited liability company or limited liability partnership; and (5) in addition, any person at the FCM occupying a similar status or performing similar functions as described above, having the power, directly or indirectly, through agreement or otherwise, to exercise a controlling influence over the entity's activities that are subject to regulation by the Commission.

The Commission agrees with FIA's comment and is revising the final regulation to require an FCM to disclose persons that are defined as ''principals'' of the FCM under § 3.1.

Proposed § 1.55(k)(3) requires an FCM to disclose the significant types of activities and product lines that the FCM engages in and the approximate percentage of assets and capital that are contributed to each type of business activity or product line. FIA recommended that an FCM be required to update the description in its annual report, only if it adds a new business activity or product line that requires higher minimum capital under applicable capital rules because the approximate percentage of the FCM's assets and capital used in each type of activity can change frequently.[510]

The Commission believes that FIA is defining the requirements of § 1.55(k)(3) too narrowly. The regulation is intended to provide the public with information concerning the major businesses activities that an FCM engages in to provide information regarding the benefits and risks of using such firm to conduct transactions in commodity interests. Minimum capital requirements are generally driven by regulated business, such a being registered as a BD. While such information is material to potential customers and is required to be disclosed under § 1.55(k)(3), the regulation also requires the disclosure of non-regulated business that a firm may engage in.

The Commission also recognizes that an FCM's assets and capital contributed to different business activities can change frequently, but such information may be material for the public in determining to entrust funds with the firm and to perform effective due diligence in monitoring the firm. Each FCM will need to assess the materiality of changes and use its judgment to determine whether the Firm Specific Disclosure Document should be revised. In addition, the Commission notes that § 1.55(i) requires that the Firm Specific Disclosure Document must be revised as and when necessary, but at least annually, to keep the information accurate and complete. The Commission has considered the comments and is adopting the amendments as proposed.

Proposed § 1.55(k)(4) requires an FCM to disclose its business on behalf of customers, including types of accounts, markets traded, international business, and clearinghouses and carrying brokers used, and its policies and procedures concerning the choice of bank depositories, custodians, and other counterparties. FIA requested the Commission confirm that: (1) The disclosure required under this paragraph is limited to the activities of the FCM in its capacity as such; (2) the term ''accounts'' means ''customers''; and (3) the term ''counterparties'' is limited to counterparties for § 1.25 investments.[511]

Regulation 1.55(k)(4) is intended to provide customers and the public with information regarding the FCM operating its FCM's business. Accordingly, the Commission confirms that the disclosures required under § 1.55(k)(4) are limited to the activities of the FCM acting in its capacity as an FCM. The term ''types of accounts'' in § 1.55(k)(4) should be ''types of customers,'' and requires the FCM to disclose the nature of its customer base in the futures markets (*i.e.,* institutional, retail, agricultural, hedgers,) to provide the public with information regarding the firm's experiences with different types of markets and market participants. The Commission also confirms that the term ''counterparties'' is limited to § 1.25 counterparties. The Commission is revising final § 1.55(k)(4) accordingly.

Proposed § 1.55(k)(5) requires an FCM to discuss the material risks, accompanied by an explanation of how such risks may be material to its customers, of entrusting funds to the FCM, including, without limitation, the nature of investments made by the FCM (including credit quality, weighted average maturity, and weighted average coupon); the FCM's creditworthiness, leverage, capital, liquidity, principal liabilities, balance sheet leverage and other lines of business; risks to the FCM 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.

FIA commented that the word ''risks'' in § 1.55(k)(5) should be replaced with the word ''information,'' and that the Commission remove the phrase ''accompanied by an explanation of how such risks may be material to its customers.'' [512] FIA believed it sufficient that an FCM present the required information to the customer and that it is the customer's responsibility to analyze this information and determine the extent to which it is important or relevant to the customer's decision to open or maintain an account with the FCM.[513] FIA further stated that if the Commission believes FCMs should provide guidance to customers regarding the potential importance of specific information, FIA believes this guidance should be provided by means of a generic statement.[514] In addition, FIA asked the Commission to confirm that the term ''investments'' is limited to investments of customer funds, and does not include all investments made by the FCM as an entity.[515] Additionally, FIA requested that the Commission delete the term ''creditworthiness,'' stating that such reference is incongruous with instructions under section 939A of the Dodd-Frank Act.[516] Moreover, FIA opined that the only lines of business that an FCM should be required to disclose are those that would require higher minimum capital under applicable capital rules, and that this information should only be required to be updated annually.[517] Additional clarification was requested by FIA regarding the phrase ''investment of customer funds with an affiliated entity,'' and whether that phrase refers to the ''deposit of customer funds in an affiliated bank.'' [518] Further clarification was requested regarding the types of liabilities and commitments requiring disclosure under this section and whether this information should updated no more often than semiannually, consistent with comparable disclosures applicable to

[510] *Id.* at 45.

[511] *Id.* at 47–48.

[512] FIA Comment Letter at 45 (Feb. 15, 2013).

[513] *Id.*

[514] *Id.*

[515] *Id.*

[516] Section 939A required that the Commission, ''remove any reference to or requirement of reliance on credit ratings and to substitute in such regulations such standard of creditworthiness as each respective agency shall determine as appropriate for such regulations.'' FIA Comment Letter at 46 (Feb. 15, 2013).

[517] FIA Comment Letter at 46 (Feb. 15, 2013).

[518] *Id.* at 51.

BDs.[519] Finally, FIA, while not opposed to providing leverage information, believed that disclosure should not be required until it is certain the calculation provides the most appropriate measure of risk.[520]

The Commission believes that it is appropriate that § 1.55(k)(5) requires an FCM to identify material risks and to explain how such risks may be material to customers. The Commission further believes, based upon its experiences during MFGI, that customers (particularly retail and less sophisticated customers) would benefit from an FCM providing its assessment of the risks of the firm, accompanied by an explanation of such risks.

The Commission notes, in response to FIA's comments, that § 1.55(k)(5) requires an FCM to provide information regarding its general investments and is not limited to the investment of customer funds. The disclosures contemplated by § 1.55(k)(5) go to the full operation of the FCM and not just its regulated or futures activities. In addition, limiting the disclosures only to investments that result in an increase in minimum capital requirements may result in the non-disclosure of significant operations that may impact a customer's decision to do business with an FCM.

The Commission also notes that the requirement in § 1.55(k)(5) for FCMs to disclose leverage information would be met by an FCM providing the leverage information that each FCM is required to calculate under § 1.10 and in accordance with the regulations of the NFA. An FCM should define the leverage calculation in the Disclosure Document and may provide any other information necessary to make the information meaningful for the public, but if materially different from the then prevailing NFA methodology, should provide an explanation of the differences therefrom.

Proposed § 1.55(k)(6) requires an FCM to disclose the name of its DSRO and the DSRO's Web site, and the location of where the FCM's annual financial statements are available. The Commission received no comments on proposed § 1.55(k)(6) and is adopting the regulation as proposed.

Proposed § 1.55(k)(7) requires an FCM to disclose any material administrative, civil, enforcement, or criminal action then pending, and any enforcement actions taken in the last three years. FIA requested that the Commission confirm that a ''pending'' action is an action that has been filed but not concluded, and recommended the Commission confirm that the disclosure required under this paragraph would be limited to matters required to be disclosed in accordance with § 4.24(l)(2).[521]

The Commission agrees with FIA that the regulation should require an FCM to disclose administrative, civil, enforcement, and criminal actions that have been filed but not concluded. The proposal was not intended to cover open or closed investigations that have not resulted in the filing of a complaint. The Commission is revising § 1.55(k)(7) as appropriate to reflect this concept.

The Commission, however, does not agree with FIA's comment that disclosures under proposed § 1.55(k)(7) should be limited to administrative, civil, enforcement, or criminal matters that would be required to be disclosed under § 4.24(l)(2). Regulation 4.24(l)(2) provides that an action will be deemed material if: (1) The action would be required to be disclosed in the footnotes to a commodity pool's financial statements under generally accepted accounting principles as adopted in the U.S.; (2) the action was brought by the Commission, provided that if the matter was concluded and did not result in a civil monetary penalty in excess of $50,000, it does not need to be disclosed; and (3) the action was brought by any other federal or state regulatory agency, a non-U.S. regulatory agency, or an SRO and involved allegations of fraud or other willful misconduct. The Commission believes that the regulation's requirement to disclose material actions is appropriate in the context of disclosures so that a customer can perform adequate due diligence to assess the risk of engaging an FCM to conduct futures business and in entrusting funds to the FCM. In this regard, the Commission believes that FCMs should disclose Commission disciplinary actions that are pending or have been concluded against the FCM without regard to the amount of the civil monetary penalty that may have been imposed. In addition, the Commission believes that there may be circumstances in addition to fraud or other willful misconduct that should be disclosed to customers to allow customers to better appreciate the potential risks of entering into a business relationship with an FCM.

Proposed § 1.55(k)(8) requires the Firm Specific Disclosure Document to contain a basic overview of customer fund segregation, collateral management and investments, FCMs, and dual registrant FCM/BDs. The disclosures included under § 1.55(k)(8) should not only include information regarding the segregation of funds for trading on designated contract markets, but should also include information regarding the risk to customers of engaging in foreign futures and foreign options trading. In conjunction with § 1.55(k)(4), which requires an FCM to provide a profile of its customer business, including its international business and clearinghouses and carrying brokers used, an FCM in order to comply with § 1.55(k)(8) should disclose the risks of engaging in trading on foreign markets. The disclosures required by § 1.55(k)(8) should include information that in the event of the insolvency of the FCM, or the insolvency of a foreign broker or foreign depository that is holding customer funds, customer funds held in foreign jurisdictions may be subject to a different bankruptcy regime and legal system than if the funds were held in the U.S. In addition, an FCM should disclose that a customer also is subject to fellow customer risk in foreign jurisdictions and that, for purposes of bankruptcy protection, a customer that trades only in one country or in one market is also exposed to fellow customer risk from losses that may be incurred in other countries and other markets. The Commission did not receive comment on § 1.55(k)(8) and is adopting the amendments as proposed.

Proposed § 1.55(k)(9) requires the FCM to include in the Firm Specific Disclosure Document information on how a customer may obtain information regarding filing a complaint with the Commission or the firm's DSRO. The Commission did not receive comment on § 1.55(k)(9) and is adopting the amendments as proposed.

Proposed § 1.55(k)(10) requires the Firm Specific Disclosure Document to include the following financial information for the most recent month end: (1) The FCM's total equity, regulatory capital, and net worth, all computed in accordance with U.S. Generally Accepted Accounting Principles and the Commission's capital rule, § 1.17; (2) the dollar value of the FCM's proprietary margin requirements as a percentage of the aggregated margin requirements for futures customers, Cleared Swaps Customers, and 30.7 customers; (3) the number of futures customers, Cleared Swaps Customers, and 30.7 customers that comprise 50 percent of the funds held for such customers, respectively; (4) the aggregate notional value, by asset class, of all non-hedged, principal over-the-counter transactions into which the

[519] *Id.* at 46.

[520] *Id.* at 34.

[521] Regulation 4.24(l)(2) requires a CPO to disclose in a disclosure document for a commodity pool certain material administrative, civil, or criminal actions against an FCM that the CPO engages to trade futures.

FCM has entered; (5) 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; (6) the aggregated amount of financing the FCM provides for customer transactions involving illiquid financial products for which it is difficult to obtain timely and accurate prices; and (7) the percentages of futures customers, Cleared Swaps Customers, and 30.7 customers receivable balances that the FCM had to write-off as uncollectable during the past 12 months, as compared to the current balance held for such customers.

CMC generally supported proposed § 1.55(k)(10), as it would enhance transparency to the public.[522] NFA provided a general comment supporting the Commission's objective of providing customers with meaningful information, but expressed concern that much of the information proposed to be disclosed under § 1.55(k)(10) may not be understandable to smaller and less sophisticated customers.[523] NFA specifically questioned whether such customers would comprehend: (1) The dollar value of the FCM's proprietary margin requirements as a percentage of the aggregate margin requirements for futures customers, Cleared Swaps Customers, and 30.7 customers; (2) the number of futures customers, Cleared Swaps Customers, and 30.7 customers that comprise 50 percent of the funds held for such customers, respectively; (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; and (6) the percentages of futures customers, Cleared Swaps Customers, and 30.7 customers receivable balances that the FCM had to write-off as uncollectable during the past 12 months, as compared to the current balance held for such customers.[524] NFA noted that as one of its responses to MFGI, its Board of Directors formed a special committee on the protection of customer funds (''Special Committee'') that was comprised of NFA's public directors.[525] NFA stated that the Special Committee spent a significant amount of time reviewing information that FCMs should make available to customers, while focusing on the needs of smaller, less sophisticated customers, and concluded that much of the information in § 1.55(k)(10) is complicated and not meaningful for less sophisticated customers.[526] NFA also noted that more sophisticated institutional customers could request and would likely receive this information directly from an FCM.[527]

The Commission understands that not all customers would have the same use for the detailed information required by § 1.55(k)(10). In developing the proposal, the Commission sought to balance the information needs of all types of customers and their respective levels of sophistication. While certain customers may not use the full amount of information in assessing risks, the Commission anticipates that other customers will incorporate all or most of the information into their risk management process and will benefit from the disclosures in performing their due diligence. The Commission also believes that the information should be available to all customers without the need for customers to specifically request the § 1.55(k)(10) disclosures from the FCM.

FIA agrees that customers should be advised whether an FCM engages in proprietary futures trading but does not believe that FCMs should be required to disclose the dollar value of their proprietary margin requirements as a percentage of customer margin requirements as proposed in § 1.55(k)(10(ii) as such percentages will change frequently.[528] FIA also questions the implication that customers may be at greater risk if an FCM carries proprietary futures positions noting, for instances, that the FCM's funds to margin its proprietary positions would be available to cover a potential customer default.[529] RJ Obrien, however, noted that it is important that customers be aware of the nature and extent of a firm's proprietary trading.[530]

The Commission believes that information regarding an FCM's proprietary trading is necessary for customers to appropriately assess the risks of entrusting their funds to an FCM. The risk profile of an FCM is certainly different if it acts primarily as an agent in handling customer funds, or if it acts as agent for customers and also engages in proprietary trading. The Commission further believes that customers would benefit from some measure of the FCM's proprietary trading rather than a simple statement that the firm does or does not engage in proprietary trading. The dollar value of the FCM's margin requirements for its proprietary trading listed as a percentage of its customer margin requirements provides a means of measuring how active and extensive a firm's proprietary trading may be relative to its customer business, which will factor into the public's risk profile of the firm.

FIA requested confirmation that the requirement in § 1.55(k)(10)(iii) for an FCM to disclose the number of futures customers, cleared swap customers, and 30.7 customers that comprise 50 percent of the FCM's total funds held for such customers, respectively, should be based upon the smallest number of customers that comprise the 50 percent threshold.[531] The Commission confirms that FIA's assumption is correct and is revising the final regulation accordingly. A purpose of the disclosure is to provide information on the extent to which a firm may have customers with large positions relative to the FCM's general customer base.

FIA stated that the requirement in § 1.55(k)(10)(iv) for an FCM to disclose the aggregate notional value, by asset class, of its non-hedged, principal over-the-counter transactions would require the FCM to disclose proprietary information. In addition, FIA stated that providing such information is not practical as firms generally do not manage their books this way and the categorization of a swap transaction as being hedged or not hedged would change each day.

The objective of § 1.55(k)(10)(iv) is for an FCM to disclose the extent of the risk it is exposed to from over-the-counter transactions that are not hedged or for which the FCM does not hold margin from the counterparty sufficient to cover the exposure. While the Commission recognizes that such information may change frequently, § 1.55 only requires an FCM to update the information on an annual basis, or more frequently if the changes are material. The information also is in the aggregate, which should minimize the risk of disclosing detailed proprietary information. After considering the comments, the Commission is adopting the regulation as proposed.

FIA stated that the Commission should distinguish between committed

[522] CMC Comment Letter at 2 (Feb. 15, 2013).

[523] NFA Comment Letter at 15–16 (Feb. 15, 2013).

[524] *Id.*

[525] *Id.* at 1.

[526] *Id.* at 16.

[527] *Id.*

[528] FIA Comment Letter at 48 (Feb. 15, 2013).

[529] *Id.*

[530] RJ O'Brien Comment Letter at 11 (Feb. 15, 2013).

[531] FIA Comment Letter at 46–47 (Feb. 15, 2013).

and uncommitted lines of credit in the requirement in § 1.55(k)(10)(v), which requires an FCM to disclose the amount, generic source and purpose of any unsecured lines of credit it has obtained but not yet drawn upon.[532] The Commission agrees that it would be more appropriate to disclose committed lines of credit and to exclude lines of credit that could be withdrawn by the potential lender. The Commission is revising the final regulation to reflect this change. In addition, the Commission is clarifying that the provision in § 1.55(k)(10)(v) that requires the disclosure of the amount, source and purpose of any unsecured lines of credit or similar short-term funding would include secured and unsecured short-term funding.

Regulation 1.55(k)(10)(vi) requires an FCM to disclose the aggregated amount of financing the FCM provides for customer transactions involving illiquid financial products for which it is difficult to obtain timely and accurate prices. FIA requested that the Commission define the type of financing covered by the regulation, and also requested that the Commission define the term ''illiquid financial products'' and confirm whether the information should include secured as well as unsecured financing.[533]

The Commission notes that the purpose of the disclosure is to provide the public with information regarding the possible extent of exposures an FCM may have if customers failed to meet their financial obligations to the FCM. The Commission is adopting the requirement as proposed. FCMs are required to provide the necessary information in the Disclosure Document, and may explain the factors it uses to determine if a financial product is liquid or illiquid and the extent to which transactions are secured or unsecured.

Regulation 1.55(k)(10)(vii) requires an FCM to disclose the percentage of futures customer, Cleared Swaps Customer, and 30.7 customer receivable balances that the FCM had to write-off as uncollectable during the past 12 months, as compared to the current balances of funds held for such customers.

Newedge and RJ O'Brien commented that providing this information would provide customers with valuable insight into the strength of an FCM's credit policies, which benefits all customers.[534] FIA, however, commented that it did not recognize the relevance of the requested information, which may be misleading without the proper context (such as whether the losses were caused by one or two large customers or an aggregate of small customers).[535] FIA further stated that if the Commission were to adopt the rule, normal business write-offs should be excluded, and the Commission should establish a *de minimis* threshold were reporting would not be required.

The Commission has considered the comments and is adopting the regulation as proposed. The Commission believes that the disclosure of the amount of write-offs an FCM had to incur as a result of customers failing to pay receivable balances will provide information regarding the credit policies of the FCM. The Commission does not believe that there should be any *de minimis* level or threshold amount before the disclosure of the information becomes a requirement. In response to FIA's comments that the information may be misleading if not provided in context, the Commission notes that FCMs may include explanatory text in the Disclosure Document provided such information is not misleading.

Finally, proposed § 1.55(k)(11) requires a summary of the FCM's current risk practices, controls and procedures. FIA asked for confirmation that the discussion of the FCM's current risk practices, controls and procedures may be general in nature, noting that the Commission has recognized that an FCM's risk practices, controls and procedures may include proprietary information.[536] The Commission confirms that the discussion of the current risk practices, controls and procedures may be general in nature so that it does not disclose confidential proprietary information.

2. Public Availability of FCM Financial Information

Proposed § 1.55(o) requires each FCM to make the following information available to the public on its Web site: (1) The daily Segregation Schedule, Secured Amount Schedule, and the Cleared Swaps Segregation Schedule for the most current 12-month period; (2) a summary schedule of the FCM's adjusted net capital, net capital, and excess net capital, all computed in accordance with § 1.17 and reflecting balances as of the month-end for the 12 most recent months; and, (3) the Statement of Financial Condition, the Segregation Schedule, Secured Amount Schedule, and Cleared Swaps Segregation Schedule and all related footnotes contained in the FCM's most recent certified annual financial report. Regulation 1.55(o) also requires each FCM to include a statement on its Web site that additional financial information on the firm and other FCMs may be obtained from the NFA and the Commission, and to include hyperlinks to the NFA and Commission Web sites.

MFA, SIFMA, Prudential, Security Benefit, CoBank, and the FHLBs supported the requirement for FCMs to post their daily Segregation Schedule, Secured Amount Schedule, and Cleared Swaps Segregation Schedule on their Web site each day, stating that the disclosure of such information would place customers in a better position to assess an FCM's stability, and if customers identify concerns and deem appropriate, to transfer their positions and funds to a different FCM.[537] MFA, SIFMA, Prudential, Security Benefit, CoBank, and the FHLBs also stated that the Commission should require FCMs to disclose additional information, including the FCM's monthly Segregation Schedule, Secured Amount Schedule, and Cleared Swaps Segregation Schedule, and monthly summary balance sheet and income statement information, for the most recent 12-month period.[538] MFA noted that each FCM's monthly Segregation Schedule, Secured Amount Schedule, and Cleared Swaps Segregation Schedule are publicly available under § 1.10, and suggested that each FCM should be required to disclose the schedules to the public without the public having to request such statements from the firms as is currently required under § 1.10.[539]

The ACLI encouraged the Commission to make public as much information as possible regarding FCMs' financial condition, treatment of customer funds, and regulatory compliance.[540] The ACLI also noted that access to these categories of information should be straightforward and simple.[541] TIAA–CREF supported the proposed enhanced financial disclosures and encouraged the Commission to require the prompt public disclosure of relevant FCM

[532] *Id.*

[533] *Id.*

[534] Newedge Comment Letter at 4 (Feb. 15, 2013); RJ O'Brien Comment Letter at 11 (Feb. 15, 2013).

[535] FIA Comment Letter at 50 (Feb. 15, 2013).

[536] FIA Comment Letter at 50 (Feb. 15, 2013).

[537] MFA Comment Letter at 4 (Feb. 15, 2013); SIFMA Comment Letter at 2 (Feb. 21, 2013); Prudential Comment Letter at 2 (Jun. 9, 2013); Security Benefit Comment Letter at 2 (Jan. 11, 2013); CoBank Comment Letter at 2 (Jan. 14, 2013); FHLB Comment Letter at 7 (Feb. 15, 2013).

[538] *Id. See also* The Commercial Energy Working Group Comment Letter at 2–3 (Feb. 12, 2013).

[539] MFA Comment Letter at 4–6 (Feb. 15, 2013); SIFMA Comment Letter at 2 (Feb. 21, 2013).

[540] ACLI Comment Letter at 2–3 (Feb. 15, 2013).

[541] *Id.*

information.[542] TIAA–CREF stated that such disclosures would be a positive step towards ensuring a level playing field between each FCM and its customers and among FCMs themselves, and supported the Commission's efforts to require FCMs to disclose information regarding the FCM's segregation of customer property (*e.g.,* the Cleared Swaps Segregation Schedule), financial health and creditworthiness and would also support efforts by the Commission to cause such disclosures to be posted on the relevant FCM's Web site, in lieu of requiring customers to make a request to the Commission to receive such information (which may be administratively burdensome).[543]

FXCM noted that currently the Commission's monthly ''net capital'' reports is the only publicly available way to determine how much money an FCM or RFED has set aside for net capital, but this provides very little insight into how the firm is doing financially.[544] FXCM stated that FCMs and RFEDs should be required to publish quarterly consolidated balance sheets and income statements, including holding company financials, for the trading public so they will know the level of risk involved in dealing with a firm.[545]

FIA stated that the daily segregation, secured amount, and cleared swaps customer account calculations should not be made publicly available. FIA noted that NFA currently makes this information available on its Web site as of the 15th and last business day of each month and believes disclosure twice each month should be sufficient. If the Commission concludes more frequent disclosure is necessary, FIA recommended that disclosure should be required no more often than weekly, *i.e.,* as of the close of business each Friday (or the last business day of the week if Friday is a holiday).

Phillip Futures Inc. proposed that the Commission limit the financial data made public to that which is most appropriate for the average customer to make an educated decision regarding his choice of broker.[546] It further stated that rather than making the financial information public, it should only be provided to customers at their request.[547]

RCG stated that if the Commission makes the Segregation Schedule, Secured Amount Schedule, and Cleared Swaps Segregation Schedule public, the public will only see a targeted residual interest amount, without realizing and comprehending the many factors that have impacted a particular firm's determination of its target.[548]

TD Ameritrade expressed its concern regarding the public disclosure of the firm's targeted residual interest computation.[549] TD Ameritrade stated that the public would not be privy to any of the internal discussions and analysis that goes into the development and setting of the firm's targeted residual interest, and that any changes to its target could cause market upheaval, volatility, and unintended consequences.[550]

The Commission has considered the comments and is adopting the regulations as proposed, with the revision to § 1.55(o) to require each FCM to disclose on its Web site its monthly Segregation Schedule, Secured Amount Schedule, and Cleared Swaps Segregation Schedule for the 12 most recent month-end dates.

The Commission currently discloses FCM financial data on its Web site. Specifically, § 1.10(g) provides that the Form 1–FR–FCM (or FOCUS Report) is exempt from mandatory public disclosure under the Freedom of Information Act and the Government in the Sunshine Act, except for the following information: (1) The amount of the FCM's adjusted net capital under § 1.17 as of the reporting date, the amount of adjusted net capital maintained by the firm on the reporting date, and the amount of excess net capital on the reporting date; (2) the Segregation Schedule and Secured Amount Schedule as of the reporting date; and (3) the Statement of Financial Condition in the certified annual report and related footnote disclosures. The Commission summarizes the FCM's segregation, secured amount and capital information each month and makes such information available to the public on its Web site.

The Commission believes that customers should have access to sufficient financial information for each FCM to allow such customers to adequately assess and monitor the financial condition of firms. The disclosure of the daily segregation and secured amount computations will provide customers with additional information to assess the adequacy of an FCM's targeted residual interest given the firm's business operations and amount of customer funds held in segregated or secured accounts. The Commission also believes that the expanded disclosures required under § 1.55 offer each FCM with the ability to provide an explanation describing the rationale and business justification for its computation of the target residual interest to better inform the public. The reporting of segregated and secured account balances on a daily basis also will provide customers with information regarding any trends developing with particular reported balances that the customers may wish to consider as part of their risk assessment of the FCMs.

The Commission further believes that customers should have access to an FCM's financial information by reviewing such information directly on the FCM's Web site as part of the Firm Specific Disclosures. By reviewing the Firm Specific Disclosures and having access to financial data of the FCM, customers will be able to better assess the risks of engaging a particular FCM. The Commission also believes that customers would benefit from being informed that additional financial information on each FCM is available from the NFA and Commission, and by requiring the FCMs to maintain a hyperlink to the Commission's and NFA's Web sites. NFA and Commission data provide historical information that allows customers to assess financial trends on a customer-by-customer basis, and provides sufficient financial information such that customers can compare financial data across FCMs as part of their risk management program. The NFA also discloses additional information regarding how FCMs are holding customer funds and investing customer funds under § 1.25, which is material information for customers in assessing risk at particular FCMs.

Regulation 1.10(g) currently requires a customer to request from the FCM monthly Segregation Schedules and Secured Amount Schedules, as well as the Statement of Financial Condition contained in the FCM's certified annual report. In response to several of the comments, the Commission is revising § 1.55(o) to require each FCM to post such financial information on its Web site. The Commission agrees with the commenters that FCMs should disclose this information, which is currently

[542] ACLI Comment Letter at 2–3 (Feb. 15, 2013).

[543] TIAA–CREF Comment Letter at 2–3 (Feb. 15, 2013).

[544] FXCM Comment Letter at 2–3 (Dec. 14, 2013).

[545] *Id. See also* forex form letter group: Michael Krall; David Kennedy; Robert Smith; Michael Carmichael; Andrew Jackson; Donald Blais; Suzanne Slade; Patricia Horter; JoDan Traders; Jeff Schlink; Sam Jelovich; Matthew Bauman; Mark Phillips; Deborah Stone; Po Huang; Aaryn Krall; Vael Asset Management; Kos Capital; James Lowe; Tracy Burns; Treasure Island Coins; Clare Colreavy, Brandon Shoemaker.

[546] Phillip Futures Inc. Comment Letter at 3 (Feb. 14, 2013).

[547] *Id.*

[548] RCG Comment Letter at 6 (Feb. 12, 2013).

[549] TD Ameritrade Comment Letter at 4 (Feb. 15, 2013).

[550] *Id.*

publicly available under § 1.10(g), without requiring each customer or member of the public having to specifically request such information from the FCM.

The Commission is not expanding the required disclosures to include summary income statement information or balance sheet information as requested by several commenters. As noted above, § 1.10(g) currently provides that the Form 1–FR–FCM and FOCUS Reports are not subject to mandatory public disclosure under the Freedom of Information Act or the Government in the Sunshine Act, and the Commission did not propose to amend § 1.10(g) in the Proposal. In addition, the comments addressing quarterly financial statements and consolidated financial statements for FCMs and RFEDs are beyond the scope of the Proposal as the Commission did not propose to amend the regulations to require an FCM or RFED to prepare or file with the Commission quarterly financial statements on either an individual or consolidated basis. Accordingly, the Commission is not revising final § 1.55(o) to require such disclosures.

Q. Part 22—Cleared Swaps

As discussed above, the Commission adopted final regulations in part 22 that implement certain provisions of the Dodd Frank Act and impose requirements on FCMs and DCOs regarding the treatment of Cleared Swaps Customer contracts (and related collateral).[551] Although substantive differences in the segregation regimes between futures and cleared swaps exist at the clearing level under the final part 22 regulations, requirements with respect to collateral which is not posted to clearinghouses and maintained by FCMs for Cleared Swaps Customers replicate or incorporate by reference many of the same regulatory requirements applicable to the segregation of futures customer funds under section 4d(a)(2) of the Act and Commission regulations (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 both part 1 and 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. In this regard, the risk management program that each FCM that holds customer funds is required to implement under § 1.11 encompasses the firm's business with futures customers, Cleared Swaps Customers, and 30.7 customers.

In addition, the Commission proposed amendments to § 22.2(d)(1) and (f)(6) that require an FCM to maintain at all times sufficient residual interest in Cleared Swaps Customer Accounts to exceed the sum of the margin deficits (*i.e.,* undermargined amounts) of all of its Cleared Swaps Customers. The proposed amendments to § 22.2(e)(1) that explicitly provide that an FCM shall bear sole responsibility for any losses resulting from the investment of Cleared Swaps Customer Funds in § 1.25 compliant instruments is consistent with the amendments adopted for § 1.29(b) that require an FCM to bear sole responsibility for any losses resulting from the investment of futures customers funds in § 1.25 compliant instruments. The proposed amendments to § 22.2(f)(4) provide that an FCM must be in compliance at all times with its segregation requirements for Cleared Swaps Customers is consistent with amendments adopted in § 1.20(a) that require an FCM to be in compliance at all times with its segregation requirements for futures customers. The proposed amendments in § 22.2(f)(5)(iii)(B) permit an FCM to develop its own program to assess credit risk for purposes of computing haircuts on securities securing a Cleared Swaps Customer's deficit account is consistent with the amendments adopted in 1.32 for computing haircuts on securities securing a futures customer's deficit account. The proposed amendments to § 22.2(g)(2), (3), and (5) require an FCM to prepare and submit to the Commission and the FCM's DSRO a daily Cleared Swap Segregation Schedule and twice monthly listing of the holding of Cleared Swaps Customer funds is consistent with the amendments adopted to § 1.32 that require an FCM to prepare and submit to the Commission and the FCM's DSRO a daily Segregation Schedule and twice monthly listing of the holding of futures customer funds.

Comments on the substantive provisions being adopted by the Commission under part 22 have been considered and addressed in large part in the discussion of the related substantive provisions in part 1 with respect to futures customer segregated funds. The Commission has considered those comments and, with the exception of the proposed amendments to § 22.2(a) and (f)(6), is adopting the amendments to part 22 as proposed.

In addition, several commenters, including MFA, CIEBA and Franklin urged the Commission to adopt a full physical segregation option specific for Cleared Swaps Customer Collateral.[552] This comment is outside of the scope of the proposal. The Commission, however, has previously clarified the ability of FCMs to employ third party custodial accounts for Cleared Swaps Customer Collateral, while reiterating that as customer property, in the event of an FCM insolvency, any funds held in such a third party custodial account would be subject to pro-rata distribution along with all other customer property.[553] Commission staff is also continuing to explore alternative collateral custody arrangements as directed by the Commission.[554]

As discussed in more detail above, several commenters objected to proposed residual interest requirements under §§ 1.20(i) and 22.2(f).[555] Of those commenters, a number focused on the proposed residual interest requirements for Cleared Swaps and highlighted the inconsistency of the ''at all times'' requirement with the Commission's analysis in the part 22 final rules.[556] LCH.Clearnet, ISDA, Paul/Weiss, and other commenters specifically stated that the inclusion of the language ''at all times'' is inconsistent with the LSOC requirement to calculate such deficits at the time of a margin call by a DCO to its clearing FCMs, and with the requirement to have sufficient residual interest to cover such deficit by the time the clearing FCMs are required to meet such payment obligations.[557] These commenters argued that when the Commission adopted the part 22 final rules, it considered this point in time

[551] *See* discussion in section I.A. above.

[552] MFA Comment Letter at 9 (Feb. 15, 2013); CIEBA Comment Letter at 3–4 (Feb. 20, 2013); Franklin Comment Letter at 2 (Feb. 15, 2013).

[553] 77 FR 6336, 6343.

[554] *Id.* at 6343–6344.

[555] *See* section II.G.9. above.

[556] *See* LCH.Clearnet Comment Letter at 4–5 (Jan. 25, 2013); FIA Comment Letter at 22–23 (Feb. 15, 2013).

[557] *See, e.g.,* LCH.Clearnet Comment Letter at 4–5 (Jan. 25, 2013); Paul/Weiss Comment Letter at 3–5 (Feb. 15, 2013); ISDA Comment Letter at 2–3 (Feb. 15, 2013). ISDA further argued that variation margin payments are not ''used'' until the point of settlement. *See* ISDA Comment Letter at 1–2 (Aug. 27, 2013) (citing CFTC Letter No. 12–31, ''Staff Interpretation Regarding Part 22,'' (November 1, 2012) (''Part 22 Staff Interpretation'') and arguing that the use restriction set forth in 4d(f)(2)(B) of the CEA ''is driven by the meaning of 'property . . . received' '' and that '''received' in this context cannot be intended to include variation margin fluctuations pre-settlement because it is only upon settlement that an item of property will have been received by the FCM.'').

approach to be consistent with the Act and sufficient to ensure that the collateral of one Cleared Swaps Customer is never used to margin the positions of another customer.[558]

In response to these comments, the Commission notes that the proposed amendments to § 22.2(a) and (f)(6) were meant to capture the current practice with respect to residual interest buffer calculations for Cleared Swaps using language that was consistent with the Proposed Residual Interest Requirement for futures. In other words, the Commission did not intend to alter the current residual interest requirements, as set forth in the part 22 final rules.[559] Indeed, the Commission notes that Staff guidance from November 1, 2012, states that ''FCMs are prohibited from 'us[ing] or permit[ing] 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.' Where a Cleared Swaps Customer is undermargined, then the FCM must ensure that, to the extent of such shortfall, its own money, securities, or other property—and not that of other Cleared Swaps Customers—is used to cover a margin call (whether initial or variation) attributable to that Cleared Swaps Customer's portfolio of rights and obligations.'' [560]

Because of the confusion expressed by commenters regarding the residual interest requirements for Cleared Swaps, the Commission is revising § 22.2(a) and (f). The Commission is revising proposed § 22.2(a) by deleting the last sentence. The Commission is revising § 22.2(f)(6) by replacing the language from the proposal with new language which sets forth the residual interest requirements for Cleared Swaps in a manner that is consistent with current market practice and that parallels the language used in § 1.22. To be clear, and as requested by several commenters, the Commission confirms that the language in § 22.2(f)(6) is not intended to, and thus should not be read to, change current practice with respect to an FCM's residual interest requirements for Cleared Swaps as set forth in Commission regulations and JAC Update 12–03, and consistent with Staff Interpretation 12–31. Thus, ''where a Cleared Swaps Customer is undermargined,[561] the FCM must ensure that, to the extent of such shortfall, its own money, securities, or other property—and not that of other Cleared Swaps Customers—is used to cover a margin call (whether initial or variation) attributable to that Cleared Swaps Customer's portfolio of rights and obligations.'' [562] Consistent with this revised residual interest requirement, § 22.2(f)(4) is being amended to state that the amount of funds an FCM is holding in segregation may not be reduced by any debit balances that the futures customers of the futures commission merchants have in their accounts. Finally, § 22.2(f)(2) is being revised, consistent with 1.20(i)(2) and current market practice, to clarify that the calculation set forth therein is the Net Liquidating Equity Method.

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 was adopted in 1987 and governs the offer and sale in the U.S. of futures contracts and options traded on or subject to the rules of a foreign board of trade.[563] The Commission proposed to amend several regulations in part 30 to provide a more coordinated approach to the regulations governing the offer and sales of futures contracts traded on foreign boards of trade and the comparable regulations governing the offer and sale of futures contracts traded on designated contract markets. Aligning the regulations, including regulations governing how an FCM holds funds for customers trading on non-U.S. markets with the requirements for customers trading on U.S. markets, will greatly enhance the protection of customer funds, and avoid competitive imbalances between trading on domestic and foreign contract markets that might result in regulatory arbitrage. The Commission's Proposal, along with the comments received, is discussed in the sections below.

1. Elimination of the ''Alternative Method'' for Calculating the Secured Amount

Regulation 30.7(a) 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 customer'' is defined in § 30.1 as any person located in the U.S., its territories, or possessions who trades in foreign futures or foreign options. 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 as defined in § 1.3(rr) is referred to as the ''Alternative Method.''

Requirements concerning the collateral of foreign futures or foreign options customers are substantially less robust for funds deposited with an FCM under the Alternative Method than requirements concerning the collateral of futures customers deposited with an FCM under section 4d(a)(2) of the Act or Cleared Swaps Customer Funds deposited under section 4d(f) of the Act. Section 4d(a)(2) of the Act and §§ 1.20 and 1.22 require an FCM to hold in accounts segregated for the benefit of futures customers a sufficient amount of funds to satisfy the full account equities of all of the FCM's futures customers trading on designated contract markets.[564] Section 4d(f) and § 22.2 require an FCM to segregate for the benefit of Cleared Swaps Customers a sufficient amount of funds to satisfy the full account equities of all of the FCM's Cleared Swaps Customers. The calculations required under sections 4d(a)(2) and 4d(f) of the Act are referred to as the ''Net Liquidating Equity Method.''

The Alternative Method contrasts with the Net Liquidating Equity Method in that the Alternative Method obligates an FCM to set aside in separate accounts for the benefit of its customers an amount of funds sufficient to cover only the margin required on open foreign futures and foreign option 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 amount required to be set aside in separate accounts may be held by the

[558] *See* LCH.Clearnet Comment Letter at 4–5 (Jan. 25, 2013); FIA Comment Letter at 22–23 (Feb. 15, 2013); ISDA Comment Letter at 2–3 (Feb. 15, 2013).

[559] *See also* Part 22 Staff Interpretation.

[560] *See id.* at 2 (answer to Question 2.1).

[561] In this context, a Cleared Swaps Customer is undermargined to the extent that (a) the minimum margin requirement, attributable to that Cleared Swaps Customer's portfolio of rights and obligations, at the DCO (for an FCM that is clearing such Cleared Swaps Customer's positions directly) or at the Collecting FCM (for a Depositing FCM) exceeds (b) the customer's net liquidating value, including securities posted at margin value.

[562] *See* Part 22 Staff Interpretation at 2.

[563] 52 FR 28980 (Aug. 5, 1987).

[564] The Commission is also adopting as final amendments to § 1.20(a) that clarify and provide explicitly that an FCM is required to hold funds in segregated accounts in an amount at all times in excess of its total obligations to all futures customers. *See* section II.G.9. above for a discussion of the amendments to § 1.20.

FCM in operating cash accounts and may be used by the FCM as if it were its own capital. Since an FCM is not required under the Alternative Method to set aside in separate accounts an amount of funds sufficient to repay the full account balances of each of its foreign futures or foreign options customers, the FCM may not be in a financial position to return 100 percent of the account equities (or transfer such account equities to another FCM) of each foreign futures or foreign options customer in the event of the insolvency of the FCM.

In addition § 30.7 further differs from the regulations governing how FCMs hold funds for futures customers and Cleared Swap Customers in that § 30.7 requires an FCM to set aside in a separate account funds only for ''foreign futures or foreign options customers.'' As previously stated, the term ''foreign futures or foreign options customer'' is defined in § 30.1 as any person located in the U.S., its territories, or possessions who trades in foreign futures or foreign options. Thus, an FCM is not required to set aside in separate accounts funds for foreign-domiciled customers trading on foreign futures markets. Regulation 30.7 permits an FCM to set aside funds for foreign futures customers located outside of the U.S., but an FCM is not obligated under the regulations to do so. Requiring FCMs to include foreign-domiciled customers' funds in segregated accounts benefits all customers placing funds on deposit for use in trading foreign futures and foreign options. Neither Subchapter IV of Chapter 7 of the Bankruptcy Code nor the Commission's part 190 regulations discriminate between foreign-domiciled and domestic-domiciled customers. Thus, any deficiency arising from the reduced requirements will impact both foreign and domestic customers pro rata.

The Commission proposed various amendments to 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 foreign futures or foreign options customers. The Commission also proposed to extend the protections of part 30 to foreign-domiciled customers trading on foreign markets through an FCM. The intent of the proposed amendments is to provide 30.7 customers with equivalent protections available to futures customers and Cleared Swaps Customers by requiring each FCM to hold in secured accounts sufficient funds to cover the full Net Liquidating Equity of each customer trading on foreign futures markets.

To implement these revisions, the Commission proposed to define the term ''30.7 customer'' in § 30.1 to mean any person, whether domiciled within or outside of the U.S., that engages in foreign futures or foreign options transactions through the FCM. The Commission also proposed to amend § 1.3(rr) to match structurally the definition of the term ''customer funds'' in § 1.3(gg) [565] and to define the term ''foreign futures or foreign options secured amount'' 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 and foreign options transactions, and all funds accruing to ''30.7 customers'' as a result of such foreign futures and foreign options transactions.'' The effect of the proposed amendments is to adopt the Net Liquidating Equity Method for foreign futures and foreign options by requiring an FCM to set aside in separate accounts a sufficient amount of funds to cover the full account balances (*i.e.,* the Net Liquidating Equities) of both the U.S. and foreign-domiciled customers.

The Commission also proposed to amend § 30.7(a) to allow an FCM to use an internal credit risk model to compute the appropriate market deductions, or haircuts, on readily marketable securities deposited by customers that have account deficits. The proposal is consistent with the proposed amendments for computing haircuts on securities under § 1.32(b) in section II.N. above. The result of these amendments as discussed should be consistency 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 proposed 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 (*i.e.,* undermargined amounts) 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

With the exception of the residual interest proposal, the Commission did not receive any comments on the various proposed amendments discussed above, including its proposal 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. Accordingly, the amendments referred to above, with the exception of the residual interest proposal as discussed further below, are being adopted by the Commission.[566]

2. Funds Held in Non-U.S. Depositories

The Commission proposed to amend § 30.7(c) to 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 U.S., except to the extent that the funds held outside of the U.S. 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 proposal further allowed an FCM to deposit additional 30.7 customer funds outside of the U.S. up to a maximum of 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 meet anticipated margin requirements. The proposal also provided that the FCM must hold 30.7 customer funds under the laws and regulations of the foreign jurisdiction that provide the greatest degree of protection to such funds; and that the FCM may not by contract or otherwise waive any of the protections afforded customer funds under the laws of the foreign jurisdiction.

Several comments were received on the proposal. Pilot Flying J supported the requirement that 30.7 customer funds, if held outside of the U.S., must be held under the laws of the foreign jurisdiction that provides the funds with the greatest degree of protection.[567]

FIA and Jefferies each recommended that an FCM be permitted to maintain an excess of up to 50 percent of the amount an FCM is required to deposit with a foreign broker to maintain customer foreign futures and foreign options positions, a position that they

[565] The Commission recently adopted final regulations that revised the definitions in § 1.3. In this rulemaking, § 1.3(gg) was renumbered as 1.3(jjj) and re-designated ''futures customer funds.'' The substance of the definition, however, was not revised and the final rulemaking has no impact on the analysis in this rulemaking. *See* 77 FR 66288 (Nov. 2, 2012).

[566] *See* section II.R.4. below for a discussion of the residual interest proposal. CFA stated that it generally supported the proposed amendments to § 30.7 and treating customers from all parts of the globe in a similar manner. CFA Comment Letter at 9 (Feb. 13, 2013).

[567] Pilot Flying J Comment Letter at 2 (Feb. 14, 2013).

stated is consistent with § 1.17 that requires an FCM to incur a capital charge for unsecured receivables due from a foreign broker greater than 150 percent of the amount required to maintain positions in accounts with the foreign broker.[568] FIA recommended that, at a minimum, a cushion of 20 percent should be provided.[569] FIA stated that the proposal is more restrictive than the provisions of § 1.49, which set out the terms and conditions pursuant to which an FCM may hold futures customers' segregated funds and Cleared Swaps Collateral outside of the U.S. and suggested that the proposal be revised to permit an FCM to hold funds comprising the foreign futures and foreign options secured amount in depositories outside of the U.S. to the same extent that an FCM may hold futures customer segregated funds and Cleared Swaps Collateral outside of the U.S.[570] They further recommended that the ''10% limitation'' apply only to funds deposited with a foreign broker or foreign clearing organization.[571]

RCG requested the Commission to clarify application of § 30.7(c) as it relates to banks located outside the U.S. that FCMs use for settlement purposes, and how the limitation applies to variation amounts.[572]

Jefferies stated that the proposed rule disadvantages customers who may no longer deposit ''customer owned'' securities and would instead have to prefund their obligations with cash.[573]

Advantage stated that FCMs typically must maintain a relationship with a foreign bank in order to meet cutoff times for payment of fees and clearing on foreign exchanges and that if an FCM can't maintain funds at a foreign institution, it may inhibit its ability to trade foreign futures.[574] The effect, they asserted, could be that U.S. FCMs will be required to use non-U.S. brokers that are not regulated by the Commission for their foreign futures business.[575] They further requested that the Commission clarify how the prohibition on keeping non-margin foreign futures funds in an institution outside the U.S. would apply to § 30.7(b), which appears to allow such funds to be held at a bank or trust company outside the U.S.[576]

In response to commenter concerns, the Commission is adopting the amendments generally as proposed, but the final rule will permit an FCM to post with depositories outside of the U.S. sufficient funds to cover the full margin obligations imposed by foreign brokers or foreign clearing organizations on the FCM's 30.7 customers' positions, plus an additional amount equal to 20 percent of the required margin on such positions.

The Commission is increasing the amount of 30.7 customer funds that an FCM may hold in a foreign jurisdiction in response to the comments. The Commission is adopting this regulation to provide greater protection to both U.S. and foreign-domiciled customers in the event of the insolvency of the FCM. Recent experience has demonstrated that funds held outside of the U.S, at depositories subject to foreign insolvency regimes, present challenges and potential delays in the ability of the Trustee to return customer property to the customers of the FCM. In increasing the amount of funds an FCM may hold outside of the U.S. from 10 percent of the required margin to 20 percent of the required margin, the Commission is striving to strike a proper balance that would not interfere with the ability of 30.7 customers to trade on foreign markets (and the ability of FCMs to facilitate such transactions by allowing them to meet their 30.7 customers' margin and other financial obligations to foreign brokers and clearing organizations), with the Commission's desire to provide 30.7 customers with an appropriate level of protection in the event of the insolvency of an FCM. The Commission believes that, to the maximum extent commercially practicable, funds deposited by 30.7 customers that are not required to margin positions with foreign brokers or foreign clearing organizations should be held within in the U.S. to provide greater assurance that such funds would be subject to the bankruptcy provision of U.S. law and the Commission's regulations under the jurisdiction of U.S. courts.

The Commission further notes that the 20 percent limitation is based upon the amount of margin required on open positions. In response to RCG's request for clarification, FCMs may transfer funds to foreign depositories to cover variation margin calls and exclude such funds from the calculation of the 20 percent ''cushion.'' In addition, the Commission notes that FCMs may deposit 30.7 customer funds with any of the foreign depositories listed under § 30.7(b), provided that the FCMs do not exceed the 20 percent limit on the amount of funds that are permitted to be held in foreign jurisdictions. The Commission believes that the ability to post variation margin in foreign jurisdictions and an additional 20 percent cushion should allow FCMs to conduct foreign futures activities on behalf of their customers, while also providing additional protections to the current regulatory regime.

3. Commingling of Positions in Foreign Futures and Foreign Options Accounts

Commission staff previously issued an Advisory stating that while it was desirable for FCMs to hold only a customer's foreign futures transactions (and the funds supporting such transactions) in such customer's foreign futures account, this limitation was not mandatory and that the FCM could also hold such customer's unregulated transactions (and the funds supporting such transactions) in the foreign futures accounts.[577] Thus, pursuant to this Advisory, FCMs were permitted to commingle the funds supporting a customer's foreign futures and options transactions with such customer's unregulated transactions, including over-the-counter transactions. The Advisory was issued before the passage of Dodd-Frank, section 724(a) of which established in section 4d(f) of the CEA a segregation regime for the funds of cleared swaps customers, and the Commission's promulgation of part 22, implementing that statute.

In response to an FIA recommendation at a public roundtable held in advance of the Commission's publication of the proposal, the Commission proposed to amend § 30.7 by adopting new paragraph (e) to prohibit an FCM from commingling funds from unregulated transactions with funds for foreign futures and options transactions in part 30 secured accounts, except as authorized by Commission order. The prohibition on holding unregulated transactions or other non-foreign futures or foreign option transactions in part 30 set aside accounts is consistent with the treatment applicable under section 4d(a)(2) of the Act for segregated accounts and section 4d(f) of the Act for Cleared Swaps Customers' accounts.

The Commission noted in the proposal that when part 30 was being adopted, commenters cited back office operational difficulties with establishing multiple ''customer'' account classes or origins.[578] Given the technological changes during the intervening decades, and the new statutory and regulatory

[568] FIA Comment Letter at 37 (Feb. 15, 2013); Jefferies Bache Comment Letter at 6 (Feb. 15, 2013).

[569] FIA Comment Letter at 37 (Feb. 15, 2013).

[570] *Id. See also* RJ O'Brien Comment Letter at 11 (Feb.15, 2013).

[571] FIA Comment Letter at 37 (Feb. 15, 2013).

[572] RCG Comment Letter at 7 (Feb. 12, 2013).

[573] Jefferies Bache Comment Letter at 6 (Feb. 15, 2013).

[574] Advantage Letter at 8 (Feb. 15, 2013).

[575] *Id.* at 9.

[576] *Id.*

[577] CFTC Advisory No. 87–4 (Nov. 18, 1987).

[578] *See* 52 FR 28980, 28985–28986.

framework, these concerns should no longer dictate the advisability of commingling the funds of regulated foreign futures and foreign options transactions with unregulated transactions.

New § 30.7(e) extends the prohibition against commingling of customer funds currently found in section 4d(a)(2) futures customer accounts and section 4d(f) Cleared Swaps Customer Accounts to 30.7 customer accounts, except as otherwise permitted by Commission regulation or order.

CIEBA stated that it supported the prohibition on the commingling of funds deposited by futures customers, Cleared Swaps Customers, and 30.7 customers.[579] Nodal requested that the Commission make explicit in the adopting release that 30.7 accounts may continue to hold customer funds to margin contracts traded on a market that is pending designation as a contact market at the time the rules become effective, until such market is registered as a DCM or upon the withdrawal or denial of the DCM application.[580] LCH.Clearnet noted that while it does not have a position on whether the Commission should prohibit commingling of 30.7 customer funds with the funds of futures customers and Cleared Swaps Customers, if adopted, it urged the Commission to preserve the ability to allow such commingling pursuant to a Commission rule or order.[581]

The Commission is adopting new § 30.7(e) as proposed. As it noted in the proposal, 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 or rule pursuant to section 4d of the CEA. Absent such a rule or order, however, protection for such customer property would not be available under the Commission's part 190 regulations or the Bankruptcy Code, and thus such commingling would not be permitted. In addition, the Commission does not agree with Nodal's request that FCMs may continue to hold margin funds in 30.7 accounts for positions that are executed on markets that are pending approval as designed contract markets. As noted above, a purpose of § 30.7(e) is to enhance the protection of 30.7 customers by prohibiting the commingling of 30.7 customer funds with funds held by an FCM for unregulated transactions. Commingling of unregulated transactions with regulated transactions could also impede the resolution of 30.7 customer claims in the event of the insolvency of the FCM carrying the funds.

4. Further Harmonization With Treatment of Customer Segregated Funds

The Commission proposed to adopt new paragraphs (f) and (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. These proposed requirements would make clear that: (1) 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; (2) FCMs must hold sufficient residual interest in 30.7 accounts to make sure that 30.7 customer funds of one 30.7 customer are not used to margin, secure or guarantee the obligations of other customers; (3) 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 (4) 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 positions of 30.7 customers. In addition to extending the existing Commission regulations noted above to § 30.7, the Commission also proposed a new requirement prohibiting an 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. This requirement parallels that currently applicable to cleared swap customers with respect to the segregation of Cleared Swaps Collateral.[582]

As discussed above, the Commission received several comments regarding the residual interest requirements set forth in the Proposal.[583] While most of the commenters focused on the impact of the Proposed Residual Interest Requirement to the futures market, some of the more general comments would also apply to the foreign futures or foreign options market. Given the statutory prohibition in sections 4d(a) and 4d(f) of the Act against using one customer's funds to margin, secure or guarantee the obligations of another customer, FCMs that participate in the swaps and futures market may not ''use'' one customer's property to margin another customer's positions. Nonetheless, the Commission clarified that an FCM does not ''use'' a customer's funds until the time of settlement.[584]

The Commission recognizes that the statutory prohibitions set forth in sections 4d(a) and 4d(f) of the Act apply to the futures and swaps markets. Conversely, as discussed above, the proposed changes to § 30.7 were intended to provide a more coordinated approach to the regulations governing foreign futures and foreign options, with standards that are consistent with those for the futures and swaps markets. These regulations, including regulations governing how an FCM holds funds for customers trading on non-U.S. markets, would greatly enhance the protection of customer funds and avoid regulatory arbitrage. Such consistency would, to the extent practicable and appropriate, contribute to the goal of having customer protection across futures, swaps and foreign futures markets be substantively similar.

The Commission did not receive any comments opposing the concept of having consistent residual interest requirements across markets. The Commission did, however, receive comments regarding the additional complexities associated with trading foreign futures and foreign options.[585] As such, the Commission is adopting residual interest requirements in part 30 that are substantively similar to the amended requirement in part 1, but with a modification as to the time by which an FCM must maintain such residual interests that will give FCMs the flexibility necessary to account for differences in the regulatory requirements and market practices applicable to foreign brokers and clearing organizations in other jurisdictions. Thus, the Commission is revising § 30.7(f) as follows.

Regulation 30.7(f)(1)(i) sets forth the general requirement that an FCM may 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. Regulation 30.7(f)(1)(ii)(A) states that the undermargined amount for a 30.7 customer's account is the amount, if any (*i.e.,* the must be amount equal to or

[579] CIEBA Comment Letter at 4 (Feb. 20, 2013).

[580] Nodal Comment Letter at 1–2 (Jan. 21, 2013).

[581] LCH.Clearnet Comment Letter at 6–7 (Jan. 25, 2013).

[582] *See* § 22.2(d)(2).

[583] *See* sections II.G.9. and II.Q. above for discussion of the Proposed Residual Interest Requirement.

[584] *See* section II.G.9. above.

[585] *See* Roundtable Tr. at 266–267 (Feb. 5, 2013).

greater than zero), by which the total amount of collateral required for that 30.7 customer's positions in that account at a specified time exceeds the value of the 30.7 customer funds in that account, as calculated in new § 30.7(f)(2)(ii). Regulation 30.7(f)(1)(ii)(B) requires FCMs to perform a residual interest buffer calculation, at the close of each business day, based on the information available to the FCM at that time, by calculating (*1*) the undermargined amounts, based on the clearing initial margin that will be required to be maintained by that FCM for its 30.7 customers, at each clearing organization of which the FCM is a member, at any settlement that will occur before 6:00 p.m. Eastern Time on the following business day for each such clearing organization less (*2*) any debit balances referred to in § 30.7(f)(2)(B)(iv) that is included in such undermargined amounts.

In addition, and for the reasons set forth above, pursuant to § 30.7(f)(1)(ii)(C)(*1*) FCMs must maintain residual interest prior to 6:00 p.m. Eastern Time on the date referenced in § 30.7(f)(1)(ii)(B) in segregated funds that is equal to or exceeds the computation set forth in (ii)(B). Moreover, § 30.7(f)(1)(ii)(C)(*2*) provides that an FCM may reduce the amount of residual interest required in § 30.7(f)(1)(ii)(C)(*1*) to account for payments received from or on behalf of undermargined 30.7 customers (less the sum of any disbursements made to or on behalf of such customers) between the close of business the previous business day and 6:00 p.m. Eastern Time on the following business day. Regulation 30.7(f)(1)(ii)(D) provides that for purposes of § 30.7(f)(1)(ii)(B), an FCM should include, as clearing initial margin, customer initial margin that the FCM will be required to maintain, for that FCM's 30.7 customers, at a foreign broker, and, for purposes of § 30.7(f)(1)(ii)(C), must do so by 6:00 p.m. Eastern Time. In other words, § 30.7(f)(1)(ii)(D) is intended to make clear that the requirements with respect to 30.7 customer funds that are used by an FCM that clears through a foreign broker are parallel to the requirements applied to 30.7 customer funds that are used when an FCM clears directly on a clearing organization.

Finally, to provide greater clarity, the Commission is adding a new subparagraph (2) to paragraph (f), which sets out the requirements as to the FCM's calculation of the Net Liquidating Equities of their 30.7 customers. Because of the addition of new subparagraph (2), the Commission is renumbering proposed § 30.7(f)(2) and (f)(3) to § 30.7(f)(3) and (f)(4), and since the Commission did not receive any comments on the substantive provisions of these paragraphs, it is adopting them as proposed.

The Commission did not receive any comments on the substantive provisions of proposed § 30.7(k) and is adopting this new paragraphs as proposed.

MFA, however, requested confirmation that the Commission's prior guidance with respect to a customer's authority to grant liens or security interests on its own Cleared Swaps Customer Account under part 22 would also be applicable to customers on their foreign futures or foreign options secured amount under § 30.7.[586] The Commission agrees with this position and hereby confirms the applicability of its prior guidance.[587]

5. Harmonization With Other Commission Proposals

The Commission also proposed various other amendments to its part 30 regulations to harmonize the rules with those applicable to U.S. customers under other Commission regulations.

As discussed in section II.I. above, the Commission is adopting in this release new limitations on withdrawals of segregated funds in § 1.23. The amendments provide for an FCM's residual interest in segregated funds, and permit 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 necessary to maintain proper residual interest to cover undermargined amounts. The Commission proposed and is adopting 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.

Current § 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.[588] As proposed, the Commission is moving this permitted investment requirement to a new paragraph § 30.7(h), and further is adopting a new paragraph § 30.7(i) to make 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. New paragraph § 30.7(i) is intended to apply the same standard as is being adopted in the amendment to § 1.29 for segregated funds discussed above.

The Commission also proposed and is adopting 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 adopted with respect to futures customers and 4d segregated funds in the amendment to § 1.30 discussed above.

Finally, the Commission proposed and is adopting 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 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 adopted in § 1.32.

No comments were received on the above proposals and the Commission is adopting the amendments as proposed.

S. § 3.3: Chief Compliance Officer Annual Report

Regulation 3.3 requires each FCM (as well as swap dealers and major swap participants) to designate an individual to serve as its CCO. The CCO is required

[586] MFA Comment Letter at 10 (Feb. 15, 2013).

[587] Specifically, In the Final LSOC Release the Commission clarified:

an FCM may not, under any circumstances, grant a lien to any person (other than to a DCO) on its Cleared Swaps Customer Account, or on the FCM's residual interest in its Cleared Swaps Customer Account. On the other hand, a Cleared Swaps Customer may grant a lien on the Cleared Swaps Customer's individual cleared swaps account (an 'FCM customer account') that is held and maintained at the Cleared Swaps Customer's FCM.

77 FR at 6352.

In addition, Commission Staff issued an interpretive letter that stated:

Regulation 22.2(d) does not prohibit a Cleared Swaps Customer from granting security interests in, rights of setoff against, or other rights in its own Cleared Swaps Customer Collateral, regardless of whether those assets are held in the Cleared Swaps Customer's FCM customer account. Furthermore, nothing in the rule is intended to inhibit this right of the Cleared Swaps Customer.

CFTC Letter No. 12–28 at 2 (Oct. 17, 2012).

[588] 76 FR 78776, 78802 (December 19, 2011).

to be vested with the responsibility and authority to develop, in consultation with the FCM's board of directors or senior officer, appropriate policies and procedures to fulfill the duties set forth in the Act and Commission regulations relating to the FCM's activities as an FCM. Regulation 3.3(e) also requires the FCM's CCO to prepare an annual compliance report that includes a description of any non-compliance events that occurred during the last reporting period along with the action taken to address such events. The annual compliance report currently is required to be filed electronically with the Commission simultaneously with the FCM's certified annual financial report, and in no event later than 90 days after the firm's fiscal year end.

The Commission proposed a conforming amendment to § 3.3(f)(2) to reflect the amendments to § 1.10(b)(1)(ii), discussed in section II.A. above, that require an FCM to file its annual certified financial statements with the Commission within 60 days of the firm's fiscal year end. In this regard, the Commission proposed to require that each FCM file the CCO annual report with the Commission simultaneously with the filing of the firm's certified annual report, and in no event later than 60 days after the FCM's fiscal year end.

The NFA commented that it supported the proposal.[589] No other comments were received. The Commission has determined to amend § 3.3 as proposed.

III. Compliance Dates

The final regulations will be effective January 13, 2014. The compliance date for the regulations will be the effective date, subject to the following exceptions:

A. Financial Reports of FCMs: § 1.10

An FCM that is not dually-registered as a BD currently is required to submit its certified annual report to the Commission within 90 days of the firm's year end date. The Commission has amended § 1.10(b)(1)(ii) to require such certified annual report to be submitted within 60 days of the firm's year end date.

The Commission recognizes that many FCMs have contracted with public accountants to perform the current year's audit examination, and that those audits are currently in process. In order to allow the current year audits to be completed, the Commission is setting a compliance date for § 1.10(b)(1)(ii) for FCMs with years ending after June 1, 2014. This date will also coincide with several other compliance dates affecting public accountants discussed under § 1.16 below.

B. Risk Management Program for FCMs: § 1.11

Section 1.11 requires each FCM that carries customer funds to establish a risk management program. RJ O'Brien requested that the Commission provide at least one year for FCMs to comply with the new risk management regulations in the event the proposed Risk Management Program is adopted. RJ O'Brien stated that the new requirements would likely necessitate a period of time for firms to reorganize, develop the policies and procedures, implement the policies and procedures, acquire adequate personnel, and conduct extensive training of new and existing employees. Advantage stated ''that most aspects of proposed § 1.11 are appropriate and unlikely to be burdensome as FCMs typically have most (if not all) of these requirements in place.'' [590]

The Commission recognizes that some FCMs may need a sufficient period of time to develop and implement a risk management program that complies with § 1.11, but believes that many firms already maintain programs that comply with many of the requirements in § 1.11. Accordingly, FCMs must file their initial Risk Management Program within 180 days of the effective date of the regulation. The filings must be made via electronic transmission to the Commission using the WinJammer electronic filing system.

C. Qualifications and Reports of Accountants: § 1.16

The Commission is amending § 1.16 to require a public accountant to meet certain qualification standards in order to be qualified to conduct audits of FCMs. The Commission is amending § 1.16(b) to require that the public accountant: (1) Must be registered with the PCAOB; (2) must have undergone a PCAOB inspection; and (3) may not be subject to a temporary or permanent bar to engage in the audit of public issuers or BDs as a result of a PCAOB disciplinary action. The Commission is further amending § 1.16(c) to require that the public accountant's audit report must state whether the audit was conducted in accordance with PCAOB auditing standards.

The Commission is establishing a compliance date of June 1, 2014 for the amendment to § 1.16(b)(1) that requires a public accountant to be registered with the PCAOB in order to conduct an audit of an FCM. The Commission also is establishing a compliance date of June 1, 2014 for the amendment to § 1.16(c) that requires a public accountant to conduct an audit of an FCM in accordance with the standards issued by the PCAOB. A compliance date of June 1, 2014 will allow current year audits to be completed without interruption, and provides sufficient time for public accountants that audit FCMs to register with the PCAOB if such public accountants are not already registered. In addition, a June 1, 2014 compliance date will align the Commission's requirements for the use of PCAOB standards in the audit of an FCM with the SEC audit standards for public accountants auditing BDs.[591] Without such alignment, public accounts of a dually-registered FCM/BD would have to issue two different audit reports; one audit report to the SEC for an examination conducted under PCAOB audit standards, and a second audit report for the Commission for an examination conducted under U.S. GAAS.

The Commission also is establishing a compliance date of December 31, 2015 for the requirement in § 1.16 that a public accountant must have undergone an inspection by the PCAOB in order to qualify to conduct an audit of an FCM. The extension of the compliance date to December 31, 2015 will provide additional time for the PCAOB to conduct inspections of public accountants that registered with, but have not been inspected by, the PCAOB.

Lastly, the compliance date for the amendment to § 1.16(b)(1) the provides that a public accountant may not be subject to a temporary or permanent bar to engaging in the audit of public issuers or BDs as a result of a PCAOB disciplinary action is the effective date of the amendment. The Commission believes that if a public accountant is registered with the PCAOB and is subject to a PCAOB disciplinary action that temporarily or permanently bars the public accountant from auditing public issuers, the public accountant is not qualified to conduct audits of FCMs.

D. Minimum Financial Requirements for FCMs

The Commission is amending the capital rule to require an FCM to incur a capital charge for undermargined

[589] NFA Comment Letter at 9 (Feb. 15, 2013).

[590] Advantage Comment Letter at 2 (Feb. 15, 2013).

[591] The SEC recently amended its regulations to require public accountants to conduct audits of BDs pursuant to the audit standards issued by the PCAOB. This requirement is effective for audits of BDs with a year-end of June 1, 2014 or later. *See* 78 FR 51910 (Aug. 21, 2013).

customer, noncustomer, and omnibus accounts that are undermargined more than one business day after a margin call is issued by the FCM. For example, if an account is undermargined on Monday and the FCM issues a margin call on Tuesday, the FCM would have to take a reduction to capital equal to the amount of the margin call that was not met by close of business Wednesday.

The Commission is establishing a compliance date for the revised timeframe for the capital charges required by § 1.17(c)(5)(viii) and (ix) of one year following publication of this rule in the **Federal Register**. The compliance date provides FCMs with a period of time that the Commission believes is sufficient to adjust its systems for issuing and collecting margin from customers and provides customers with an opportunity to adjust their operations, as necessary, to meet its margin obligations on a reduced timeframe for the current regulation.

E. Written Acknowledgment Letters: §§ 1.20, 1.26, and 30.7

The Commission is amending §§ 1.20(d) and (g), 1.26(b), and 30.7(d) to require FCMs and DCOs, as applicable, to obtain standard form acknowledgment letters from each depository that the FCMs or DCOs use to hold customer funds.[592] The Commission is further requiring FCMs and DCOs to use Template Letters set forth in appendices to the regulations.

The Commission is establishing a compliance date of 180 days after the effective date of the regulations in order to provide FCMs and DCOs with sufficient time to obtain from depositories new acknowledgment letters that conform to the Template Letters.

F. Undermargined Amounts: §§ 1.22(c), 30.7(f)

The Commission received several comments on the appropriate timing for the effectiveness of the Proposed Residual Interest Requirement. At the public roundtable held on February 5, 2013, several panelists argued that the Proposed Residual Interest Requirement would require substantial time to implement in order to change the behavior of all futures markets participants.[593] In addition, FIA asserted that implementation would require multiple years and ''radical'' changes to processing procedures for futures market participants,[594] and RCG requested that the Commission provide ''with a period of time not less than one year from the promulgation of the relevant final rules for FCMs to implement them.'' [595]

As discussed above, the residual interest requirements set forth in part 22 are the requirements that are currently in place today. As such, FCMs are expected to continue meeting their regulatory requirements. With respect to the residual interest requirements set forth in §§ 1.22(c) and 30.7(f), the Commission recognizes that these requirements represent a significant change in current market practice. Given the costs associated with compliance with these requirements, as well as comments received from the interested parties requesting sufficient time to achieving compliance with these requirements, the Commission has determined that a phased compliance schedule for § 1.22(c) is necessary and appropriate. The phased compliance schedule for § 1.22(c) is set forth in § 1.22(c)(5)(iii). However, the Residual Interest Deadline of 6:00 p.m. Eastern Time in § 1.22(c)(5)(ii) shall begin one year following the publication of this rule in the **Federal Register**.[596] With regards to the residual interest requirements set forth in § 30.7(f), the Commission is establishing a compliance date of one year following the publication of this rule in the **Federal Register**.

G. SRO Minimum Financial Surveillance: § 1.52

The Commission amended § 1.52 to require each SRO to establish a supervisory program to oversee their member FCMs' compliance with SRO and Commission minimum capital and related reporting requirements, the obligation to properly segregated customer funds, risk management requirements, financial reporting requirements, and sales practices and other compliance requirements. The Commission also amended § 1.52(c) to require each SRO to engage an ''examinations expert'' at least once every three years to evaluate the quality of the supervisory oversight program and the SRO's application of the supervisory program. The SRO must obtain a written report from the examinations expert with an opinion on 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 areas that are subject to the supervisory program.

The Commission established a compliance date in amended § 1.52(e) that requires each SRO to submit a supervisory program to the Commission for review, together with the examinations expert's report on the supervisory program, within 180 days of the effective date of the amendments to § 1.52, or such other time as may be approved by the Commission. The Commission further revised § 140.91(10) to delegate the authority to extend the time period for the submission of the initial supervisory program to the Director of the Division of Swap Dealer and Intermediary Oversight and the Director Division of Clearing and Risk, with the concurrence of the General Counsel or, in his or her absence, a Deputy General Counsel.[597]

Commission staff will consult with the SROs to assess their progress in preparing an initial supervisory program, including the examinations expert's review, and may adjust compliance dates as appropriate.

H. Public Disclosures by FCMs: § 1.55

The Commission has amended § 1.55(b) by revising the Risk Disclosure Statement to include several additional disclosures intended to provide customers and potential customers with enhanced information to further their understanding of the risks of engaging in the futures markets. The Commission recognizes that FCMs will be required to revise the Risk Disclosure Statement to implement the revisions, and is establishing a compliance date for the amendments to 1.52(b) of 90 days after the effective date of the amendments. The Commission believes that this provides sufficient time for FCMs to revise the Risk Disclosure Statement and to modify their systems, if necessary, in the case of firms that

[592] The regulations, however, provide that an FCM is not required to obtain an acknowledgment letter from a DCO if the DCO maintains rules that have been submitted to the Commission and that provide for the segregation of customer funds in accordance with all relevant provisions of the Act and Commission regulations or orders. *See* §§ 1.20(d)(1) and 30.7(d)(1).

[593] *See* Roundtable Tr. at 252–255, 257, 266–267 (Feb. 5, 2013).

[594] *See* FIA Comment Letter at 21 (Feb. 15, 2013).

[595] *See* RCG Comment Letter at 8 (Feb. 12, 2013).

[596] For further discussion regarding the phase-in schedule for the requirements in § 1.22(c), *see* section II.G.9.

[597] The Commission also amended § 1.52(d)(2)(ii)(H) to provide that a Joint Audit Committee must submit an initial Joint Audit Program to the Commission, along with an examinations expert's report on the Joint Audit Program, within 180 days of the effective date of the regulation. The Director of the Division of Swap Dealer and Intermediary Oversight and the Director of the Division of Clearing and Risk also are authorized under § 1.52(d)(2)(ii)(H) an § 140.91(10), with the concurrence of the General Counsel or, in his or her absence, a Deputy General Counsel, to extend the initial filing deadline if warranted.

provide electronic account opening documents.

The Commission also amended § 1.55(i)–(k) to require each FCM to disclose to customers all information that would be material to the customers' decision to entrust funds to, or otherwise do business with, the FMC, including its business, operations, risk profile, and affiliates. The Commission is establishing a compliance date of 180 days after the effective date of the regulation to provide adequate time for FCMs to develop the required disclosures and make them available to the public.

The Commission also amended § 1.55(o) to require each FCM to disclose on its Web site certain current and historical information regarding its holding of customer funds, and its certified annual report. The Commission is establishing a compliance date of 180 days after the effective date of the regulation to provide FCMs with sufficient time to modify electronic systems, and make any additional operational changes, necessary for the firms to comply with the requirements.

IV. Cost Benefit Considerations

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 the 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.

In the NPRM, the Commission established, based on the subject matter of the proposals, that it did not consider any of the proposals contained therein to have any significant impact on price discovery. The Commission received no responses from commenters with respect to its analysis regarding price discovery. For the remaining areas, the Commission addressed, section by section, the qualitative substantial benefits perceived to be obtained from the regulatory proposals contained in the NPRM. Where reasonably possible, the Commission has estimated costs quantitatively associated with such proposals section by section. The Commission asked specifically and generally for comments with respect to its analysis of benefits and such cost estimates, and requested information from commenters where the Commission qualitatively considered but could not reasonably quantitatively estimate costs.

The underlying purpose of the regulations adopted herein as stated in the NPRM was to bolster the protection of customers and customer funds, in response to the misuse or mishandling of customer funds at specific FCMs like MFGI or PFGI. Further, the purpose of certain proposals was to provide regulators the means by which to detect and deter the misuse or mishandling of customer funds by FCMs, including bolstering standards for the examination and oversight of FCMs by SROs and public accountants. In addition to the significant benefits to the protection of market participants and the public, the Commission determined that a strong package of reforms, including enhanced information and disclosures available to customers, adopted in light of the recent FCM failures resulting in and from misuse of customer funds, would be extremely beneficial to restore trust in the financial integrity of futures markets. The Commission also included certain proposals intended to both increase the protection of customer funds and strengthen FCM risk management, specific to customer funds processes and procedures.

As stated in the NPRM, a loss of trust in the financial integrity of futures markets could deter market participants from the benefits of using regulated, transparent markets and clearing. The overarching purpose of the reforms contained in this rulemaking is to produce the benefits that accrue by virtue of avoiding similar defaults in the future. This prevents the costs certain to follow, 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 losses in other clearing members.[598]

In this rulemaking, the Commission adopted new rules and amended existing rules to improve the protection of customer funds. The content of the Commission's adopted new rules and amended rules 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.

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

The Commission designed the adopted reforms to improve the protection of customer funds. The Commission expects each of the seven categories identified above to significantly increase the 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 helps to 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 rules enable the Commission, DSROs, and other auditors to evaluate each FCM's compliance with their own policies and procedures. Moreover, the 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 helps to ensure

[598] The failure of one clearing member could lead to losses for 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.

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 are able to perform regularly with existing resources, which provides helpful scrutiny of each FCM's procedures on a regular basis. This, together with the 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 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 helps 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 rules 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 review by senior management for large withdrawals protects customers by helping to ensure that such withdrawals do not cause segregated account balances to drop below required amounts, which are, in turn, designed to prevent losses of customer funds. Moreover, requiring personal accountability by senior management for withdrawals that affect the balance of such accounts promotes more effective oversight of customer segregated accounts.

The acknowledgments and commitments depositories are required to make through §§ 1.20, 1.26, and 30.7 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 provides additional protection of customer funds and fosters prompt transfer in the event of an FCM's default.

In addition, depositories must agree in the acknowledgment letter to give the Commission and DSROs read-only electronic access to an FCM's segregated accounts, which benefits customers by enabling the Commission and DSROs to review the accounts for discrepancies between the FCM's reports and the balances on deposit at various depositories. These enhancements to oversight 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 customers' funds in segregated accounts benefits all customers placing funds on deposit for use in trading foreign futures and foreign options. Because neither the Bankruptcy Code nor the Commission's part 190 regulations distinguish between foreign-domiciled and U.S. domiciled customers at the point customer funds are distributed, any shortfall in available funds would be shared among all such customers. As discussed below, the Commission understands that most, if not all, FCMs currently compute secured amount requirements for both U.S.-domiciled and foreign-domiciled customers. However, incorporating foreign-domiciled customers within the calculations required for 30.7 customers ensures that both groups are fully protected. 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 of financial strain. As discussed below, this change provides protection to both U.S-domiciled and foreign-domiciled customers with funds in 30.7 accounts.

The 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 amendments 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 amendments 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 § 1.55 requires disclosure of firm-specific risks to customers. This additional information should be helpful to customers when selecting an FCM to deposit their funds. In doing so, the rules promote market discipline that incents FCMs to manage their risks carefully and assists customers in understanding how their funds are held and what risks may be relevant to the safety of their funds.

Last, FCMs maintaining residual interest in customer accounts is an important aspect of protection for customer funds. While an FCM's residual interest is not exhausted, it may be used to meet the FCM's obligations to each customer without using another customer's funds to do so. All else being equal, the larger the residual interest, the less likely that market participants will lose customer funds posted as collateral, with associated detriment to members of the public with interests in such market participants.

Efficiency, Competitiveness and Financial Integrity of Futures Markets

The proposed amendments should 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 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 promotes the competitiveness of futures markets by preventing an FCM from skimping on customer protection safeguards. There are also provisions in the proposal that permit FCMs that are not BDs to implement certain securities net capital haircuts that apply to jointly registered FCM/BDs by the SEC. This enhances competition between FCMs that are not dually registered and jointly registered FCM/BDs with respect to such requirements.

Smaller FCMs may have more difficulty than large FCMs in absorbing the additional costs created by the requirements of the rules (particularly § 1.22). It is possible that some smaller FCMs may elect to stop operating as FCMs as a result of these costs. The Commission does not anticipate,

however, that the rules will have a material effect on FCM pricing due to reduced competition (although the increased costs may affect pricing).

More specifically, the amendments to §§ 1.10, 1.11, 1.12, 1.32, 22.2, and 30.7 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 receive under the proposed regulations enhances their ability to monitor each FCM's segregated accounts, which promotes the integrity of futures markets by helping to ensure proper handling of customer funds at FCMs.

In addition, the changes 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 should enable the Commission and DSROs to increase monitoring of such FCMs to ensure that customer funds are handled properly in such circumstances. The rules also require FCMs to obtain an acknowledgment letter from depositories that should give the Commission and DSROs electronic access to view customer accounts at each depository when requested by the Commission. That should 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 rules also require FCMs to establish policies and procedures regarding several aspects of how they handle customer funds. The rules should 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 requirement that FCMs 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, should enhance the integrity of the futures markets by promoting a culture of compliance by the FCM's personnel. The training should 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.

The rules 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 change is needed as the SEC has proposed a change for BDs which would permit joint registrants to possibly apply a lower regulatory haircut for certain securities, but which would not be applicable to FCMs that are not dual registrants without this rule. Therefore, the rule should help to ensure that FCMs that are not dual registrants are not competitively disadvantaged and are able to continue applying the same regulatory capital haircuts for such securities as joint registrants.

Last, residual interest is an important aspect of protection for customer funds because it enables the FCM to ensure that it can meet its obligations to each customer without using another customer's funds to do so. All else being equal, the larger the residual interest, the more secure are customer funds. This contributes to confidence in U.S. futures markets and their financial integrity. Adequate residual interest improves the competition between FCMs, inasmuch as FCMs are competing less by transferring risks from customers with deficit funds to customers with surplus funds.

Sound Risk Management

The amendments should 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 reducing 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 reporting requirements should 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 should be valuable to customers selecting an FCM and monitoring the location of their funds deposited with the FCM which should promote market discipline. For example, if an FCM were to establish a low target for residual interest, or maintain a very low residual interest, then market participants are likely to recognize this as a practice that could increase risk to the funds they have on deposit at the FCM. Consequently, customers 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 should 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 rules should 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 are required to establish procedures for continual monitoring of depositories where segregated customer funds are held, and should 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 should 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 should have a greater ability to address and protect against operational errors and fraud that put customer funds at risk of loss.

Further, through the 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 rule should provide the Commission with the flexibility to deal with emerging liquidity drains at FCM s 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 should 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 should 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, FCMs maintaining residual interest in customer accounts is an important aspect of protection for customer funds. While an FCM's residual interest is not exhausted, it may be used to meet the FCM's obligations to each customer without using another customer's funds to do so. All else being equal, the larger the residual interest, the more secure are customer funds. Moreover, these requirements will create incentives for FCMs to monitor their customers' undermargined amounts, thereby enhancing the FCM's risk management. 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 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 MFGI and PFGI, 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 hopes 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 amendments are not, however, without costs. First, the most significant costs created by the amendments are those that result from the increased amount of capital that FCMs are required to hold in segregated accounts as part of establishing a target for their residual interest and requiring residual interest for undermargined amounts. Second, additional costs may be created by the amendments that incent FCMs to hold additional capital, and prevent them from holding excess segregated funds overseas. Third, operational costs are likely to arise from amendments that result in the formation of a risk management unit and adoption of new policies and procedures.

Multiple rule changes are expect to 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; (3) requiring them to report to the Commission and their DSROs any time their residual interest drops below that target, and (4) requiring FCMs to hold residual interest large enough to cover their customers' undermargined amounts. 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 regulations should 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. These regimes may provide less effective protections for customer funds than those applicable under U.S. law. By prohibiting FCMs from holding some excess customer funds overseas, and thereby reducing investment opportunities for customer funds, the regulations may reduce the returns that FCMs can obtain on invested customer funds.

And last, the 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 the changes should be minor. For example, some proposed requirements should 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 changes codify practices that are already required by SROs, and therefore would impose no additional costs.

The initial and ongoing costs of the rules for FCMs should 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 rules. In the NPRM, the Commission estimated that the initial operational cost [599] of implementing the rules would be between $193,000 and $1,850,000 per FCM.[600] And the initial cost to the SROs and DSROs would be between $41,100 and $63,500 per SRO or DSRO. The Commission estimated

[599] The Commission was 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 did 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.

[600] 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.

that the ongoing operational cost to FCMs would be between $287,000 and $2,300,000 per FCM per year.[601] As described below in § 1.52, the Commission did not have adequate information to determine the ongoing cost of the proposed requirements for SROs and DSROs.

On a minor note, the rules also harmonize the definition of leverage ratio reporting with the definition established by a registered futures association.

In the sections that follow, the Commission provides its analysis of cost benefit considerations including comments received, section by section, in light of the relevant 15(a) public interest, cost-benefit considerations.

Consideration of Costs and Benefits Section by Section

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

The Commission adopted an amendment to § 1.3(rr) replacing the term ''foreign futures or foreign options customers'' with the term ''30.7 customers.'' The former only included 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 expanded the range of funds that the FCM must include as part of the foreign futures or foreign options secured amount.

In addition, the definition of ''foreign futures or foreign options secured amount'' was amended 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 30.7 customers at all times. This definitional change is necessary to implement the conversion in § 30.7 from the ''Alternative Method'' to the ''Net Liquidating Equity Method'' of calculating the foreign futures or foreign options secured amount.

Costs and Benefits

These definitional changes determine how much 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 analyzed with respect to changes adopted to § 30.7 and discussed below.

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

The Commission adopted amendments to § 1.10 revising the Form 1–FR–FCM by establishing a new schedule called the ''Cleared Swap Segregation Schedule'' that is included in the FCM's monthly report, together with the Segregation Schedule and Secured Amount Schedule. The amendments also provide that the Cleared Swap Segregation Schedule is a public document.[602] The Commission also amended the Segregation Schedule and the Secured Amount Schedule to include reporting of 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. The Commission also required each FCM to report to the Commission monthly leverage information.

Costs and Benefits

In the NPRM, the Commission considered the amendments to § 1.10 to have significant benefits to the protection of market participants, namely, customers. The Commission anticipated that continuing the public availability of the Segregation Schedule and the Secured Amount Schedule, with the addition of the Cleared Swaps Segregation Schedule, would be beneficial to customers in assessing the financial condition of the FCMs with whom they choose to transact. The Commission posited that FCMs would have competing incentives to set higher or lower targeted residual amounts, but that public disclosure would enhance the quality of the assessment of a reasonable targeted amount of residual interest. The Commission stated that providing publicly the additional information would permit customers to weigh this consideration, along with considerations of price, in selecting an FCM, benefiting the protection of market participants. The Commission also stated that requiring FCMs to report their leverage to the Commission on a monthly basis 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, enhancing the protection of market participants.

The Commission could not quantitatively estimate the cost of FCMs having an incentive by public disclosure to hold higher targeted residual amounts in customer segregated accounts. The Commission did consider that qualitatively it expected that costs would be incurred as a result, as a return available to FCMs on restricted investments permissible under § 1.25 would likely be lower than returns on capital not restricted by being held as target residual amounts subject to the investment requirements of § 1.25, and public disclosure would, other factors being equal, give an incentive to FCMs to hold a larger target residual amount.

The Commission estimated quantitatively costs associated with system modifications to produce additional reports for leverage. The Commission did not receive comments regarding its quantitative estimates of those costs or its qualitative analysis that costs would be associated with the amendments to § 1.10, particularly the public disclosure of the Cleared Swaps Segregation Schedule and the changes to the Segregation Schedule and Secured Amount Schedule to include the targeted residual amount. Specifically, the Commission received no comments regarding the assumption that the target residual amount would in fact be higher once publicly disclosed, or as to what forms or costs associated with any additional capital that may be required following disclosure of the target residual amount, if any at all. Nor did the Commission receive comments discussing the quantitative spread difference between § 1.25 investments compared to investments that are not subject to § 1.25. Without comment as to these cost drivers, the Commission is unable to accurately estimate these costs.

The Commission received a comment from NFA to consider an alternative to the regulatory language proposed for leverage ratio reporting to refer to the formulation of leverage established by a registered futures association.[603] The Commission, believing that this alternative would have no detrimental impact on the benefits anticipated from obtaining reporting of leverage, modified the language in the final regulation to conform to the alternative

[601] 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.

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

[603] NFA Comment Letter at 8 (Feb. 15, 2013).

suggested by NFA. The alternative language in the final regulation will permit the leverage reporting requirement to stay harmonized with NFA's leverage reporting requirement as NFA has indicated it intends to update and refine the formulation, which will continue to provide the Commission with information necessary to monitor FCMs for the protection of market participants.[604]

The Commission received numerous comments regarding the benefits of the public disclosure of the Segregation Schedule, Secured Amount Schedule, and Cleared Swaps Segregation Schedule, and the amounts of the FCM's targeted residual interest.[605] Many commenters reiterated the utility of, and value to, customers of the public availability of the schedules and financial condition information of FCMs.[606] However, several FCMs commented, and FIA expressed concern, that the information would not be useful to customers and would be difficult for customers to understand without understanding all the factors involved in setting a target residual amount.[607] These commenters were concerned that customers may, to their detriment, overweigh the consideration of the targeted residual amount.[608] These comments are discussed in detail at section II.P. above.

The Commission understands the concerns of both sets of commenters but believes that the protection of market participants is enhanced in this circumstance by the greater availability of public information, particularly concerning customer funds, to customers and potential customers. Notwithstanding the concerns of FIA and several FCMs particularly questioning the benefits of the public availability of the targeted residual amount, the Commission believes that public disclosure—and consequent market discipline—is an important counterweight to other FCM incentives with respect to establishing the target. The Commission herein has adopted numerous measures increasing disclosures to customers, believing, on balance, that additional disclosures regarding customer funds in particular to have significant benefits to the protection of market participants. Greater availability of information may also provide additional confidence in the financial integrity of futures markets.

Finally, the Commission, in its consideration of costs and benefits for the amendments to § 1.10, asked questions for particular comments on the costs and benefits of making public daily segregation and secured amount calculations, or other more frequent calculations, and solicited comments on alternatives. Similar to the comments on the public availability of the Segregation Schedule, Secured Amount Schedule, and the Cleared Swaps Segregation Schedule, some commenters supported and other commenters opposed the public availability of daily margin segregation calculations.

The Commercial Energy Working Group noted, generally, that the Commission's proposals for the publication of information would be a cost-effective mechanism to make FCMs more accountable to their customers.[609] The Commercial Energy Working Group posited that additional costs of publication of daily segregation calculations should be nominal.[610] There were no other specific comments on the costs of making publicly available daily or more frequent information. The Commission proposed requiring daily segregation disclosures in the amendments adopted to § 1.55, and the benefits of such disclosures will be further discussed in that section, although the only comment received as to the costs of such publication of information was as discussed herein.

The NFA commented that the Commission should consider the alternative of directing customers to its BASIC system where certain financial information on FCMs would be available in one place, as opposed to requiring FCMs to publish financial information, including the Segregation Schedule, Secured Amount Schedule, and Cleared Swaps Segregation Schedule on their respective Web sites.[611] NFA commented that the Commission should carefully distinguish between categories of information, as those meaningful to all customers which should be readily available, meaningful to regulators but which may be sensitive and subject to misinterpretation if made public, and meaningful to more sophisticated customers that FCMs should be required to provide upon request.[612] The Commission believes enhanced benefits to the protection of market participants and the financial integrity of futures markets, and market discipline, are best achieved by the public availability of the Segregation Schedules, Secured Amount Schedules, and Cleared Swaps Segregation Schedules in their entirety on a monthly basis, but also agrees with NFA's concern regarding the sensitivity of information that may be readily available to regulators but not publicly disclosed. The Commission does not agree that there may be a benefit to distinguishing between categories of customers with respect to public availability of information. The Commission agrees there could be enhanced utility to customers by having schedules provided by the NFA through its BASIC portal as an alternative, however, also notes that NFA could implement this under the rule as adopted so long as the schedules are required to be made publicly available and are not exempt from public disclosure.

Section 1.11 Risk Management Program for Futures Commission Merchants

The Commission adopted new § 1.11 requiring an FCM that carries accounts for customers to establish a risk management unit that is independent from the business unit handling customers or customer funds and reports directly to senior management. In addition, each FCM must 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, 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

[604] *Id.*

[605] *See, e.g.,* SIFMA Comment Letter at 2 (Feb. 21, 2013); SUNY Buffalo Comment Letter at 8 (Mar. 19, 2013); Vanguard Comment Letter at 5–6 (Feb. 22, 2013).

[606] *Id.*

[607] *See, e.g.,* FIA Comment Letter at 52 (Feb. 15, 2013); RJ O'Brien Comment Letter at 6 (Feb. 15, 2013).

[608] *Id.*

[609] Commercial Energy Working Group Comment Letter at 2 (Feb. 12, 2013).

[610] *Id.* at 3

[611] NFA Comment Letter at 15 (Feb. 15, 2013).

[612] *Id.* at 16.

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 versus 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 new § 1.11 requires 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.

Costs and Benefits

In the NPRM, the Commission provided a detailed discussion of the significant benefits of the new risk management requirements for FCMs to the protection of market participants and customer funds, sound risk management, and directly as well as by extension, the financial integrity of futures markets. Specifically, the Commission stated that it considered the specific requirements of § 1.11 to reduce the negative impact of conflicts of interest on decision making relating to customer funds, to result in stronger controls which could quickly focus management attention on emerging risks and minimize the risk of a breakdown in control at times of financial stress, and to promote more formal responsibility and require specific accountability up the chain of FCM management and governance for risk controls both generally and specific to customer funds processes and procedures. Documentation requirements for policies and procedures were considered beneficial to promote Commission and SRO oversight of the tools chosen by FCMs in putting the stronger controls in place, although the Commission also determined that permitting flexibility with respect to the manner of the policies and procedures would be beneficial to the efficiency of FCMs in putting the new stronger and more rigorous requirements into practice. The Commission considers the requirements adopted under § 1.11 to be extremely important in eradicating the potential for poor internal controls environments at FCMs, which could be susceptible to fraud or operational error, which in turn could result in losses to customer funds without clear and documented management accountability. Documentation of the criteria for decision making and management determinations with respect to choice of depositories, and other management determinations impacting customer funds such as residual interest and investment choices, as well as requiring periodic review and testing of the risk management program, allows for an iterative process with a clear purpose, the protection of customers and customer funds, transparent to both Commission and SRO examination. Providing clear factors which must be considered by FCMs in their adopted practices, such as selection of depositories, was also considered by the Commission to provide greater clarity to customers with respect to determinations of significant consequence for customers, with a result being likely enhanced market discipline coming from customers evaluating FCMs. In many specific areas, the Commission considered the requirements being adopted to greatly benefit risk management, the protection of market participants and the financial integrity of futures markets as the requirements would necessarily require FCMs to improve internal management communication, internal controls, management accountability, separation of duties, and training of personnel in many respects. The Commission considered that FCMs were already responsible under the Act and existing regulations for the protection of customer funds. The adoption of § 1.11 requires now that FCMs develop written policies and procedures and put programs and controls into practice, to ensure going forward that they have in place consistent and reviewable processes to achieve the required outcomes for protecting customers and customer funds. The Commission, in adopting the rules, was however, cognizant that there would be significant costs involved in compliance with § 1.11, to the extent that for some FCMs these processes and procedures were not already in place or have no equivalent foundation. However, the Commission considered an additional benefit to the requirements to be that there would no longer be a competitive cost advantage to FCMs to not put in place such important measures. Many FCMs are anticipated by the Commission to already have in place strong internal controls and practices similar to what is now specifically being required to be put in place under § 1.11, and those FCMs will not have to bear a competitive disadvantage any longer for doing so with respect to bearing the costs of such practices in order to adequately protect customers. The Commission, cognizant of the significance of its estimates of costs with respect to the requirements, adopted the regulations in a manner that provides FCMs with flexibility in the manner of adopting practices that fulfill the requirements. The Commission did not receive specific comments on its quantitative estimates of the initial and recurring costs of adopting § 1.11.

The Commission did receive comments from several FCMs objecting to the requirements of § 1.11 to require the independence of risk management from the business unit (defined to identify parties responsible for customer business or dealing with customer funds or supervising such lines of responsibility). RCG and Phillip Futures cited the loss of a talent pool available to participate in risk management as a negative consequence of the requirement.[613] Phillip Futures also recommended that the Commission consider as an alternative that internal controls, senior leadership and training programs could suffice in lieu of required separations between risk management and the business unit.[614] Phillip Futures contended that natural conflicts of interest will always exist and can be mitigated by supervisory levels, policies and procedures.[615]

CHS Hedging and RJ O'Brien cited the difficulty of a small or mid-size FCM having a separate unit for risk management personnel, noting it to be impracticable operationally or financially and not cost effective.[616] Frontier Futures generally commented that the costs associated with requiring FCMs to increase risk management standards for the purpose of protecting an FCM's customers from losses caused by fellow customers, would be prohibitive to smaller FCMs being able

[613] RCG Comment Letter at 5 (Feb. 12, 2013); Phillip Futures Comment Letter at 2 (Feb. 14, 2013).

[614] Phillip Futures Comment Letter at 2 (Feb. 14, 2013).

[615] *Id.*

[616] CHS Hedging Comment Letter at 3 (Feb. 15, 2013); RJ O'Brien Comment Letter at 9–10 (Feb. 15, 2013).

to continue operations, and is an area that FCMs were adept at and already have a large incentive to properly manage.[617] FIA asked for clarification that § 1.11 does not require formal structured risk management units, provided that the FCM is able to identify all personnel responsible for required risk management activities in order to comply with the line reporting requirements and independence from supervision by the business unit.[618]

The Commission understands the general concerns of commenters regarding the costs of the requirements of § 1.11, along with the other new provisions being adopted herein by the Commission. The Commission did provide clarity in section II.B. as requested by FIA, which is intended to make clear the amount of flexibility available in complying with the separation of duties of risk management adopted in § 1.11. However, the Commission notes that such separation as a fixed requirement is particularly important to the protection of market participants, as the Commission continues to believe conflicts of interest to be a significant risk to the protection of customer funds during periods of financial or operational stress absent such clear reporting and accountability lines being established.

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

The changes to § 1.12 alter the notice requirements so that it is no longer acceptable to give ''telephonic notice to be confirmed, in writing, by facsimile.'' Instead, all notices from FCMs must be made in writing and submitted through an electronic submission protocol in accordance with instructions issued or approved by the Commission (currently, WinJammer).

In addition, the amendments to § 1.12 require that if an FCM has a shortfall in net capital, but is unable to accurately compute its current financial condition, the FCM should not delay reporting the under capitalization to the Commission. 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 Commission proposed requirements in paragraphs (i), (j), (k) and (l) of § 1.12 to 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 BD. Those circumstances were: (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 its segregated accounts to meet its 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 SRO, the FCM must notify the Commission, and provide a copy of the communication as well as a copy of its response to the Commission. The Commission adopted the proposed additional notification requirements with some changes in response to commenters, narrowing the scope of certain of the new notification requirements.

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

Costs and Benefits

The benefits of 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. Ensuring that important regulatory notices go directly through electronic systems will result in appropriate staff being alerted as soon as possible and that there are no unnecessary delays to regulatory attention to the notice, which should benefit the protection of market participants and the financial integrity of futures markets, potentially significantly depending on the importance of the issue being addressed.

For example, with respect to the adopted 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 for the protection of its customers and counterparties. Therefore, it is important that the Commission, DSRO, and SEC (if the FCM is also a BD) be notified immediately so that they can begin assessing the FCM's condition, and if necessary, make 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.

The situations enumerated as adopted in § 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 enables 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 closely monitor the FCM's actions, benefiting the continued protection of customer segregated funds.

The Commission also asked questions in the NPRM regarding whether public availability of § 1.12 notices would enhance customer protection, but did not propose to make the notifications public as it did other additional disclosures relevant to customer funds, such as the various segregation schedules. Comments were received both in favor of and in opposition to public availability. One commenter, FHLB, posited that the costs of public availability would be negligible because the reporting would already be done and be done electronically, and the benefit substantial, so that the Commission should require public availability.[619] However, other commenters, including RJ O'Brien and FIA, raised concerns about potential detrimental market impacts on FCMs from the public availability of § 1.12 notices, at odds with FHLB's assertion that FCMs could not be impacted by a ''run on the bank'' scenario and that costs would be negligible, with RJ O'Brien believing a main risk of public availability being precisely a possibly disorderly and erroneous ''run on the bank'' scenario.[620]

[617] Frontier Futures Comment Letter at 2 (Feb. 14, 2013).

[618] FIA Comment Letter at 55 (Feb. 15, 2013).

[619] FHLB Comment Letter at 3 (Feb. 15, 2013).

[620] FIA Comment Letter at 37 (Feb. 15, 2013); RJ O'Brien Comment Letter at 10 (Feb. 15, 2013).

The Commission, although in most circumstances believing there to be substantial benefits to greater availability of public information concerning segregated funds, declined to adopt any requirement for public availability of § 1.12 notices, weighing the comments received, and recognizing an additional benefit to maintaining equivalence of treatment with the SEC for joint registrants, whose similar notices are not made public. The Commission agrees that the risk of the possibility of a disorderly ''run on the bank'' scenario from § 1.12 notices being made immediately public would be too great relative to the benefit of such publication. The possibility of that result could exacerbate a potentially solvable problem at an FCM and not result in the best protection of market participants. The Commission is adopting other types of additional customer disclosures required of FCMs under § 1.55, which it believes are more beneficial to the protection of customers and appropriate to the disclosure purposes than the public availability of § 1.12 notices.

The situations enumerated that were proposed in § 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 SROs in such circumstances will benefit the protection of market participants by fostering their ability to monitor such FCMs 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 the relevant SROs. In response to commenters who proposed alternatives, believing the proposals to be overly broad and difficult to clearly comply with, the Commission adopted the requirements but narrowed and provided additional detail for the circumstances under which such notices would be required. The Commission believes the requirements as adopted continue to provide the intended benefits to the protection of market participants.

The proposed § 1.12(m) requirement that the FCM notify the Commission whenever it receives a notice or results of an examination from its DSRO, the SEC, or a securities-industry SRO, was intended to 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 and self-regulatory organizations to address any concerns about how developments in the FCM's business could affect customer funds.

The Commission adopted § 1.12(m), with changes to address the requests of commenters that the scope of the requirement needed to be narrowed in order to provide the benefit intended without potentially overly burdensome costs. TD Ameritrade, in particular, commented that the volume of its filings with securities regulators would make the § 1.12(m) requirement both overly costly with respect to the intended benefit, and also not likely to result in the benefit as intended.[621] The Commission believes the narrowed language adopted for § 1.12(m) should appropriately address the comment and provide the benefit intended without overly burdensome costs.

The 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 would help them quickly gauge the potential severity of related problems that have been or are developing at the reporting FCM, IB, or SRO. The benefit of requiring the additional information is that it will assist Commission or SRO staff in determining whether the situation is likely to be corrected quickly or to continue deteriorating. Commission staff may be best able to protect market participants with appropriate and timely intervention, with more information received initially regarding how a potential regulatory problem is being handled.

The Commission made quantitative estimates of costs for the amendments to § 1.12 in the NPRM, including the new notice requirements, the additional information required to be included in notices, and monitoring that would be necessary in order for FCMs to submit notices and received no comments specific to those estimates. The Commission estimated the costs of requiring electronic filing of notices for FCMs to be negligible as the filing system is already in place, and received no comment on that estimate. The Commission asked specific questions regarding costs for the additional notice requirements and did not receive any response to such questions from commenters.

[621] TD Ameritrade Comment Letter at 3 (Feb. 15, 2013).

Section 1.16 Qualifications and Reports of Accountants

The adopted changes to § 1.16 require that in order for an accountant to be qualified to conduct an audit of an FCM, the accountant would have to be registered with the PCAOB, and have undergone inspection by the PCAOB. In addition, the amendments also 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. Finally, the amendments require the public accountant to state in the audit opinion that the audit was conducted in accordance with the auditing standards adopted by the PCAOB.

Costs and Benefits

The Commission adopted amendments to § 1.16 primarily to obtain the benefits of quality control and oversight of accountants and higher standards to apply to certified audits of FCMs, for the greater protection of market participants, and to increase the financial integrity of futures markets. In at least one circumstance of FCM failure, which was an impetus for the package of additional protections to customer funds contained in the Proposal, the experience and quality of the FCM auditor contributed to the audit failure and the inability of an audit to be an effective additional check on the compliance and financial integrity of FCMs and customer funds.[622]

The Commission also considers the newly adopted requirement for the governing body of the FCM to have accountability for assessing auditor qualifications to be an appropriate tool to ensure responsibility for a lack of conflicts, true independence and a quality audit by experienced auditors to be connected back to the FCM's governing body and to be clearly understood to be a responsibility of that governing body. The Commission believes this enhanced accountability will benefit the protection of market participants and promote the financial integrity of futures markets by contributing to ensuring audit quality of FCMs.

In the NPRM, the Commission did not quantitatively estimate costs associated with the amendments to § 1.16, however, it qualitatively considered the

[622] *See* In the Matter of Jeannie Veraja-Snelling, CFTC Docket No. 13–29, available at *http://www.cftc.gov/ucm/groups/public/@lrenforcementactions/documents/legalpleading/enfverajaorder082613.pdf.*

likelihood that PCAOB registered accountants would be expected, all else being equal, to have higher audit fees, thereby incurring additional costs. The Commission requested, but did not receive, quantitative information from commenters to better assess these costs. However, the Commission did receive several comments regarding the proposed amendments to § 1.16 and the Commission altered some of the proposed § 1.16 requirements in response to such comments, as discussed in section II.E. above.

One commenter, the AICPA, proposed that the Commission consider a practice monitoring program, such as the AICPA peer review, as an alternative to the PCAOB inspection requirement.[623] The AICPA stated it did not believe the PCAOB inspection requirement would have the benefit of enhancing audit engagements in situations where inspections are not required (*i.e.,* non-issuer FCMs).[624] The Commission does believe the PCAOB inspection requirement will enhance audit quality over time, particularly as inspections become required for the audits of SEC registered BDs.

However, in considering the practical impediments to registering and becoming inspected by the PCAOB, the Commission made several clarifications in adopting the amendments.[625] Most notably, the Commission extended the compliance date for inspection by the PCAOB until December 31, 2015. As noted above in section II.E., based on the Commission's most recent review, currently there are only seven CPA firms (auditing fifteen FCMs) that would not meet this requirement. Six of those firms are registered with the PCAOB as and indicate that they will be subject to the PCAOB BD inspection program and will presumably receive a PCAOB inspection in the future. Therefore, the Commission is adopting the inspection requirement as proposed but has extended the compliance date to December 31, 2015 in order to provide additional time for accountants to be subject to PCAOB inspections.

The Commission received no comments addressing costs associated with an anticipated increase in audit fees for PCAOB registration. Nor did the Commission receive comment as to any increased costs associated with becoming PCAOB registered. Nonetheless, the Commission believes that currently only one FCM audit firm is not PCAOB registered, and would therefore be required to register to continue to conduct audits of FCMs. Currently, a public accountant that audits less than 49 public issuers is required to pay the PCAOB a registration fee of $500.[626] Annual fees for public accountants with less 200 issuers also are $500 per year.[627] Therefore, any costs associated with registering the one and only existing accounting firm which would not be in compliance, or any firm in the future that will need to register with the PCAOB, will be nominal.

Section 1.17 Minimum Financial Requirements for Futures Commission Merchants and Introducing Brokers

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. The Commission's minimum capital requirements for FCMs are set forth in § 1.17 which, among other things, 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 Commission proposed 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. Additionally, FCMs that are also registered BDs will be allowed to use the SEC's BD approach[628] to evaluate the credit risk of securities that the FCM invests in and assign smaller haircuts[629] to those that are deemed to be a low credit risk.[630] The Commission's amendment to § 1.17(c)(5)(v) allows FCMs that are not dual registrants to use the same approach. Finally, the Commission has adopted amendments revising the period of time that an FCM is permitted to wait before taking an undermargined capital charge from three business days after the call is issued on a customer's account to one business day, and from two business days after the call is issued on a noncustomer or omnibus account to one business day.

Costs and Benefits

In the NPRM, the Commission provided a detailed discussion of the benefits the changes to § 1.17 would provide. Regarding the potential transfer of customer accounts if the FCM was unable to certify and demonstrate sufficient access to liquidity to continue operating as a going concern, several commentators stated that the Commission should not adopt the rule before clearly articulated objective standards were established and exigent circumstances that would give the Commission authority to require an FCM to cease operating were defined. The Commission understands the concerns of commenters regarding the process by which the Commission, or the Director of the Division of Swap Dealer and Intermediary Oversight acting pursuant to delegated authority under § 140.91(6), could require immediate cessation of business as an FCM and the transfer of customer accounts.

However, that same authority currently exists should a firm fail to meet its minimum capital requirement. 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 under the Act. Moreover, because liquidity difficulties will not be made transparent to the FCM's customers pursuant to 1.12, it is especially important that the Commission be permitted to act.

[623] AICPA Comment Letter at 3 (Feb. 11, 2013).

[624] *Id.* at 2–3.

[625] *See* additional discussion at section II.E. above.

[626] *See http://pcaobus.org/Registration/rasr/Pages/AnnualFees.aspx.*

[627] *Id.*

[628] 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).

[629] 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.

[630] The adoption of the Commission's rule is conditional upon the SEC adoption as final its proposed rule to eliminate references to credit ratings.

Regarding the proposed amendment to § 1.17(c)(5)(v) revising the capital charge (or haircut) procedures for FCMs, the Commission notes that it only impacts FCMs that are not dual registrants. Because 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, the change should not have a significant impact on the capital requirements for such FCMs. The CFA believes that capital models should be established by the relevant regulatory agencies for use by FCMs or BDs and has serious concerns that internal models used for calculating minimum capital requirements are prone to failure in crisis.[631] The Commission appreciates the CFA's concerns, however, the Commission notes that 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.[632] This 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.[633] 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.[634] The Commission's amendment merely allows FCMs that are not dual registrants to follow the same rules as those that are dual registrants. This change would harmonize the regulation of FCMs with respect to minimal financial requirements and would place FCMs that are not dual registrants on a more level playing field with those that are dual registrants, which improves the competition between FCMs. The FCMs that use their own internal models will also be subject to review by regulators, including the SEC, SROs, or securities SROs.

Regulation 1.17(c)(5)(viii) required an FCM to take a capital charge if a customer account is undermargined for three business days after the margin call is issued. Likewise, § 1.17(c)(5)(ix) required 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. These timeframes were 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. They are obsolete, however, in today's markets with the use of wire transfers to meet margin obligations. Therefore, the Commission has amended § 1.17(c)(5)(viii) and (ix) to require an FCM to take capital charges for undermargined customer, noncustomer, and omnibus accounts that are undermargined for more than one business day after a margin call is issued.

FIA stated that while institutional and many commercial market participants generally meet margin calls by means of wire transfers, the proposal creates operational problems because it does not consider delays arising from accounts located in other time zones that cannot settle same day, or ACH settlements, or the requirement to settle or convert certain non-U.S. dollar currencies.[635] FIA also stated that a substantial number of customers that do not have the resources of large institutional customers (in particular members of the agricultural community) depend on financing from banks to fund margin requirements, which may require more than one day to obtain.[636]

RJ O'Brien objected to the proposed amendment because many customers that use the markets to hedge commercial risk still meet margin calls by check or ACH because of the impracticality and costliness of wire transfers to their circumstances.[637] RJ O'Brien stated that in many cases, the costs of a wire transfer would exceed the transaction costs paid by the client to its FCMs, and additionally, that some customers in the farming and ranching community finance their margin calls, which can require additional time to arrange for delivery of margin call funds due to routine banking procedures.[638] RJ O'Brien also stated that if the proposal is adopted, FCMs that service non-institutional clients will struggle to remain competitive and the proposal may result in fewer clearing FCMs and greater systemic risk to the marketplace.[639] RJ O'Brien further stated that a loss of such smaller FCMs will result in fewer options available to these ranchers, farmers and other commercial market participants that wish to hedge their commercial risks.[640]

Other commenters expressed the general concern that the proposal will harm the customers it is meant to protect by requiring more capital to be kept in customer accounts, possibly forcing users to hold funds at FCMs well in excess of their margin requirements.[641] Those commenters argued that such pre-funding could add significant financial burdens to trading as customers find themselves having to provide excess funds to their brokers which could increase their risk with regard to the magnitude of funds potentially at risk in the event of future FCM insolvencies.[642] The commenters generally expressed significant concerns that reducing margin calls to one day will harm many customers as: (1) Many small businesses, farmers, cattle producers and feedlot operators routinely pay by check and forcing them to use wire transfers increases their cost of doing business; (2) clients who make margin calls by ACH payments instead of wire transfers because ACH is cheaper, would no longer be able to do so because there is a one-day lag in availability of funds; and (3) foreign customers would not be able to make margin calls due to time zone differences, the time required to convert certain non-USD currencies, and for whom banking holidays fall on different days.[643]

The CCC stated that the proposed amendment to the capital rule places an undue burden on the FCMs, which will likely result in FCMs demanding that customers prefund trades to prevent market calls and potential capital charges.[644] The CCC also stated that the proposal could result in forced liquidations of customer positions to ensure that the FCM does not incur a capital charge.[645]

FIA and RJ O'Brien suggested alternatives to the Commission's

[631] CFA Comment Letter at 4–5 (Feb. 13, 2013).

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

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

[634] *See* discussion adopting § 1.17(c)(5)(vi) for options haircuts, 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. 43 FR 39956, 39964.

[635] FIA Comment Letter at 26 (Feb. 15, 2013).

[636] *Id.*

[637] RJ O'Brien Comment Letter at 3–4 (Feb. 15, 2013).

[638] *Id.*

[639] *Id.*

[640] *Id.*

[641] NPPC Comment Letter at 2 (Feb. 14, 2013); NGFA Comment Letter at 3 (Feb. 15, 2013); NEFI/PMAA Comment Letter at 3 (Jan. 14, 2013); AIM Comment Letter at 15 (Jan. 24, 2013); Amarillo Comment Letter at 1 (Feb. 14, 2013); NCFC Comment Letter at 1 (Feb. 15, 2013); NFA Comment Letter at 12–13 (Feb. 15, 2013); FCStone Comment Letter at 3 (Feb. 15, 2013); Advantage Comment Letter at 1–2 (Feb. 15, 2013); AFBF Comment Letter at 2 (Feb. 15, 2013); CCC Comment Letter at 2 (Feb. 15, 2013); CME Comment Letter at 5 (Feb. 15, 2013); AIM resubmitted the comment letters of Premier Metal Services, NEFI/PMAA, and the ISRI and indicated its support for the recommendations therein (Jan. 14, 2013).

[642] *Id.*

[643] *Id.*

[644] CCC Comment Letter at 2–3 (Feb. 15, 2013).

[645] *Id.*

proposal. Both FIA and RJ O'Brien offered that an FCM be required to take a capital charge for any customer margin deficit exceeding $500,000 that is outstanding for more than one business day.[646] FIA further suggested that if the customer's margin deficit is $500,000 or less, the FCM should take a capital charge if the margin call is outstanding two business days or more after the margin call is issued.[647] RJ O'Brien also stated that the Commission should provide at least a one year period of time for any changes to the timeframe for taking a capital charge for undermargined accounts to be effective, and that the Commission should require futures exchanges to increase their margin requirements to 135% of maintenance margin to reduce the number and frequency of margin calls.[648]

The NFA and FIA stated that if the Commission adopts the amendments regarding residual interest as proposed, then the Commission should consider whether a capital charge for undermargined accounts remains necessary at all because the FCM will have already accounted for an undermargined account by maintaining a residual interest sufficient at all times to exceed the sum of all margin deficits; hence the capital charges related to an undermargined account appear to impose an additional financial burden without any necessary financial protection.[649]

The Commission has considered the comments and is adopting the amendments to § 1.17(c)(5)(vii) and (ix) as proposed. The revised regulation will provide the intended benefits to customers and the marketplace. Commenters have stated that the proposal would increase customer costs by requiring the prefunding of margin calls, which will also potentially expose more customer funds to FCM control. Commenters, however, did not provide any quantitative estimates or provide any substantive analysis in support of their statements. In addition, the Commission notes that much of this argument is based on the assumption that FCMs would not be able to support the additional capital charge through their existing excess capital. In addition, many FCMs utilize a variety of funding sources from which additional capital may be obtained, if required, and therefore costs could vary significantly from one FCM to another FCM. Without quantitative estimates as to how much excess capital FCMs typically maintain, would be required to maintain, or the difference of these costs in relation to aged margin calls between one and three days, the Commission cannot quantify any increase in costs associated with this amendment.

Moreover, the Commission believes that the benefits of the final regulation will enhance the protection of the markets and customers. The Commission notes that 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 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.

Regulation 39.13(g)(2) requires that a sufficient amount of funds is maintained in an account to cover 99 percent of the observed market moves over a specified period of time. Customers that maintain fully margined accounts are exposed to greater risk to the safety of their funds if some of the accounts of their fellow customers are undermargined. The intent of the proposed amendment is to encourage an FCM to require customers to promptly fund margin deficiencies, or to reserve a sufficient amount of capital to cover the amount of the deficiencies. 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. Customers also benefit by FCMs requiring more prompt payments on undermargined accounts, as it is less likely that FCMs would close out the positions of customers failing to meet margin obligations more quickly, reducing the potential losses that would be passed on to non-defaulting customers in the event of a default of a customer and a default of a clearing member.

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

The amendments to § 1.20 reorganize the section and alter the substance of the section's requirements in certain places.

The final § 1.20 includes Appendix A and Appendix B, which set forth the Template Letters for the written acknowledgments that FCMs and DCOs, respectively, must obtain from any depository with which they open an account to hold futures customer funds. The rule requires FCMs and DCOs to use the applicable Template Letter to obtain the required acknowledgment before depositing any funds with a depository. Regulation 1.20 also requires FCMs, DCOs, and depositories to file the written acknowledgment with the Commission within three business days of executing the letter, and to update the written acknowledgment within 120 days of any changes to the business name, address, or account numbers referenced in the letter.

The Commission received 15 comment letters related to the proposed acknowledgment letter requirements. Some commenters addressed the costs and benefits associated with these requirements; none of them, however, provided any data to aid the Commission in estimating costs. In the sections that follow, the Commission considers the benefits and costs arising from the adoption of the acknowledgment letter requirements. The Commission also discusses the corresponding comments accordingly.

Benefits

Regulation 1.20(d)(2) requires an FCM to use the Template Letter in Appendix A to obtain a written acknowledgment from any depository that holds futures customer funds. A depository accepting customer funds is required to: (1) Acknowledge that the funds are customer segregated funds subject to section 4d of the Act and the Commission's regulations thereunder; (2) acknowledge and agree that the funds cannot be used to secure any obligation of the FCM to the depository or used by the FCM to secure or obtain credit from the depository; (3) agree to reply promptly and directly to any request from the Commission or the FCM's DSRO for confirmation of account balances or provision of any other information regarding or related to an account; (4) agree that the depository will allow the Commission and the FCM's DSRO to examine the accounts at any reasonable time; and (5) acknowledge and agree that the

[646] FIA Comment Letter at 27 (Feb. 27, 2013); RJ O'Brien Comment Letter at 4 (Feb. 15, 2013).

[647] FIA Comment Letter at 27 (Feb. 15, 2013).

[648] RJ O'Brien Comment Letter at 4 (Feb. 15, 2013).

[649] NFA Comment Letter at 13 (Feb. 15, 2013).

depository will provide the Commission with technological connectivity necessary to permit read-only electronic access to the accounts.

Regulation 1.20(g)(4) requires a DCO to use the Template Letter in Appendix B to obtain a written acknowledgment from any depository that holds futures customer funds. The DCO Template Letter is largely the same as the FCM Template Letter except that: (1) It does not require read-only electronic access; and (2) it does not require the depository to agree to Commission or DSRO examination of customer accounts.

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 recognizes that it must comply with relevant statutory and regulatory requirements related to its handling of those funds. Second, the depository acknowledges that neither the FCM (or DCO) nor the depository is permitted to use customer funds as belonging to any person other than the customer which deposited them, *i.e.,* an FCM or DCO cannot use customer funds to secure its obligations to the depository. Third, the Template Letter for FCMs constitutes written permission by the depository to allow Commission or DSRO officials to examine the FCM's customer accounts at any reasonable time and to provide the Commission with read-only electronic access to those accounts. As a consequence, the Template Letters would enable both the Commission and the DSRO to monitor actual balances at the depository more readily. This would help to ensure 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 the explicit agreement from the depository permitting the examination of customer segregated accounts, both the Commission and DSRO would be better able to move quickly to resolve a problem.

By requiring FCMs and DCOs to submit copies of the executed Template Letters to both the Commission and, as applicable, an FCM's DSRO, the Commission and DSROs would be better able to act quickly to protect customer funds because the necessary legal permissions will be in place. In addition, the Template Letters provide account information such as account numbers, essential for management of an FCM or DCO bankruptcy situation. Also, requiring that the Template Letters be retained for five years past the time when customer segregated funds are no longer held by a depository helps 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.

Commenters were generally supportive of adopting the Template Letters. The Depository Bank Group stated that ''the acknowledgment letters will help to facilitate a more efficient process for the establishment and maintenance of customer segregated accounts by FCMs and DCOs and serve to clarify the rights and responsibilities of depository institutions holding customer segregated funds.'' [650] Eurex expressed their appreciation for ''the potential convenience and increases in certainty and transparency that such a standardized approach would likely afford.'' [651] CME stated its support for ''the Commission's efforts to strengthen and standardize the form of acknowledgment letters.'' [652]

Costs

To date, FCMs and DCOs have negotiated each acknowledgment letter with depositories; accordingly, the use of standardized non-negotiable language in the Template Letter may result in cost savings. However, FCMs and DCOs are likely to bear some initial and ongoing costs as a result of the requirement to use the Template Letters. Regarding initial costs, some depositories may not be willing to sign the Template Letter, which would require the FCM or DCO to move any customer funds held by that depository to a different depository, creating certain due diligence and operational costs. These cost concerns were discussed in the comment letters from MGEX and RCG.[653]

In the NPRM, the Commission estimated that the cost of obtaining a new acknowledgment letter from each existing depository is between $1,300 and $4,200.[654] The Commission estimated that FCMs and DCOs would have approximately 1 to 30 depositories each, from which they would need to obtain a new acknowledgment letter. Therefore, the Commission estimated that the cost of obtaining new acknowledgment letters from existing depositories would be between $2,700 and $82,000 per FCM or DCO.[655] In addition, the Commission estimated that the process of identifying new potential depositories, conducting necessary due diligence, formalizing necessary agreements, opening accounts, and transferring funds to a new depository would likely take between three to six months and would likely require support from compliance attorneys, as well as operations, risk management, and administrative personnel. In the NPRM, the Commission estimated that the cost of moving accounts from an existing depository that is not willing to sign the letter would be between $50,000 and $102,000.[656]

There may be additional operational costs associated with any changes 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 be for obtaining the letter from existing depositories (*i.e.,* $1,300 and $4,200). In the NPRM, the Commission estimated that the cost associated with changes that would require the acknowledgment letter to be updated would be between $1,100 and $2,800 per year.[657]

[650] Depository Bank Group Comment Letter at 2 (Feb.15, 2013).

[651] Eurex Comment Letter at 1 (Aug. 1, 2013).

[652] CME Comment Letter at 7 (Feb. 15, 2013).

[653] MGEX Comment Letter at 3 (Feb. 18, 2013) and RCG Comment Letter at 7 (Feb. 12, 2013).

[654] This estimate assumed 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 were taken from the 2011 SIFMA Report on Management and Professional Earnings in the Securities Industry.

[655] 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.

[656] This estimate assumed 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 were taken from the 2011 SIFMA Report on Management and Professional Earnings in the Securities Industry.

[657] This assumed 20–50 hours per year from an office manager for operational 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 was taken from the 2011

Continued

RCG discussed the need to develop policies and procedures as well as train personnel.[658] These costs were considered in the NPRM and are discussed above. MGEX asserted, based on the Commission's estimates in the NPRM, that the costs of using the Template Letters would outweigh the benefits of using them. It did not, however, provide further analysis as to the basis for its conclusion.[659] In the NPRM, the Commission quantified some of the potential costs and only discussed the benefits qualitatively. Consequently, there is no direct comparison between the costs and benefits based on the Commission's estimates in the NPRM.

The Depository Bank Group, FIA, and Schwartz & Ballen expressed concern that the Template Letters' standard of liability provision would shift significant amount of risk onto depository institutions and would likely increase the costs incurred in both monitoring for violations and maintaining customer segregated accounts.[660] As discussed in the preamble, the Commission revised the language in the Template Letters to address these concerns. FCStone and Schwartz & Ballen commented that the proposed restriction on depositories placing liens on customer accounts when there is an overdraft in an account would likely lead to losses to depositories. As discussed in the preamble, the Template Letter clarifies that liens on accounts are permitted only in certain limited circumstances and that a depository may not take a lien against a customer account to cover overdrafts. The final Template Letters do not deny a depository the right to recover funds advanced in the form of cash transfers, lines of credit, repurchase agreements or other similar liquidity arrangements made in lieu of liquidating non-cash assets held in an account or in lieu of converting cash in one currency to cash in a different currency.

The requirement, embedded in the FCM Template Letter, that depositories provide the Commission with read-only electronic access to customer accounts would create certain costs for depositories that would likely be passed onto FCMs. ICI noted that the read-only access requirement would result in a process that might be burdensome.[661] The Commission does not have adequate data to estimate the cost for establishing such a system and no data was provided by commenters to aid the Commission in estimating such costs.[662] The Commission also has decided not to adopt the read-only electronic access requirement for DCOs.[663]

FCStone asserted that the ultimate costs of requiring Template Letters will be borne by customers of FCMs.[664] ICI noted that the costs with respect to a MMMF Template Letter requirements would be borne by all investors in a MMMF and not just by the FCMs.[665] The Commission, however, is unable to forecast how these costs will ultimately be allocated.

Section 1.22 Use of Customer Funds Restricted

Under current regulations, an FCM is not permitted to use one customer's funds to purchase, margin, secure, or settle positions for another customer. However, prior regulations did not specify how FCMs should demonstrate compliance with this requirement. Revised regulation 1.22(c) provides such a mechanism.

Section 1.22(c)(1) defines the undermargined amount for an account. Sections 1.22(c)(2) and (c)(4) require FCMs to compute, based on the information available to the FCM as of the close of each business day, (i) the undermargined amounts, based on the clearing initial margin that will be required to be maintained by that FCM for its futures customers, at each DCO of which the FCM is a member or FCM through which the FCM clears, at the point of the daily settlement (as described in 39.14) that will complete during the following business day for each such DCO (or FCM through which the FCM clears) less (ii) any debit balances referred to in 1.20(i)(4) included in such undermargined amounts.

Moreover, under section 1.22(c)(3), an FCM is required to, prior to the Residual Interest Deadline defined in section 1.22(c)(5), have residual interest in the segregated account in an amount that is at least equal to the computation set forth in section 1.22(c)(2).[666] The amount of residual interest that an FCM must maintain may be reduced to account for payments received from or on behalf of undermargined futures customers between the close of the previous business day and the Residual Interest Deadline.

Section 1.22(c)(5) defines the Residual Interest Deadline. During an initial phase-in period, the Residual Interest Deadline is 6:00 p.m. Eastern Time on the date of the settlement referenced in (c)(2)(i) or (c)(4). On December 31, 2018, which is the expiration of the phase-in period, the Residual Interest Deadline shifts to the time of the settlement referenced in (c)(2)(i) or (c)(4). In the interim, paragraph 1.22(c)(5)(iii) requires Commission staff to solicit further public comment and conduct further analysis in a report (the ''Report'') for publication in the **Federal Register** regarding the practicability of moving the Residual Interest Deadline from 6:00 p.m. Eastern Time on the date of settlement to the time of settlement (or to some other time of day). The Report will discuss whether and on what schedule it would be feasible to move the Residual Interest Deadline, and the cost and benefits of such potential requirements. In addition, staff is instructed to, using the Commission's Web site, solicit public comment and conduct a public roundtable regarding specific issues to be covered by the Report. Paragraph 1.22(c)(5)(iii)(B) provides that the Commission may, taking into account the Report, (1) terminate the phase-in period, in which case the phase-in shall end as of a date established by Commission order published in the **Federal Register**, which date shall be no less than one year after the date of such Commission order, or (2) determine that it is necessary and appropriate in the public interest to propose through rulemaking a different Residual Interest Deadline. In that event, the Commission shall establish by order published in the **Federal Register**, a phase-in schedule.

Costs and Benefits

The requirement in § 1.22(c) benefits customers whose accounts are not undermargined by reducing the risk that their segregated funds would be used to cover a shortfall in customer funds due

SIFMA Report on Management and Professional Earnings in the Securities Industry.

[658] RCG Comment Letter at 8 (Feb. 12, 2013).

[659] MGEX Comment Letter at 3 (Feb.18. 2013).

[660] Depository Bank Group Comment Letter at 2 (Feb. 15, 2013), FIA Comment Letter at 40 (Feb. 15, 2013) and Schwartz & Ballen Comment Letter at 6 (Feb. 15, 2013).

[661] ICI Comment Letter at 5 (Jan. 14, 2013). Although ICI's comments focused on MMMFs, some of the costs they discussed apply generally to read-only access requirements.

[662] The Commission intends to rely primarily on other means of obtaining account information from depositories, and would activate the read-only electronic access only in situations where it was deemed necessary. The Commission will generally seek to obtain account information from the NFA and CME automated daily segregation confirmation system and/or from depositories directly prior to requesting a depository to activate electronic access.

[663] DCOs hold omnibus customer segregated accounts that do not reflect funds attributable to individual clearing members or customers.

[664] FCStone Comment Letter at (Feb. 15, 2013).

[665] ICI Comment Letter at 5 (Jan. 14, 2013).

[666] *See* note 395 above regarding the operation of the requirement in § 1.22(c)(3) where an FCM is subject to multiple Residual Interest Deadlines.

to a ''double default.'' [667] When combined with the reporting requirements in §§ 1.10, 1.32, 22.2, and 30.7, the requirement in § 1.22(c) will further provide the Commission and the public with information that should allow them to determine whether FCMs are using one customer's funds to purchase, margin, secure or settle positions for another customer.[668]

It would be difficult to quantify these benefits reliably. An estimate would depend on the expected value of losses due to a double default (*i.e.,* a default of both a customer and the FCM) which, in turn, depend on the probability of a double default and the magnitude of deficits that would exist in customer accounts compared to the amount of residual interest at the time of the double default. Given the small number of historical examples, it is unlikely that any estimate of probability would be reliable. Moreover, the magnitude of the impact of a loss of customer funds is dependent on an estimate of the amount of funds lost, a number that is also difficult to predict with any reliability, as well as the loss of market confidence (which may be even more important), which is also difficult to estimate reliably.

As discussed above, the Commission has revised the residual interest requirements in the final rule by adopting a point in time approach.[669] As a consequence, once the requirement in § 1.22(c) is phased in, FCMs will have several hours between the close of business on a particular day (the point in time upon which the calculation is based), and the time of day when the requisite amount of residual interest must be held in segregation (that is, the time of the daily settlement). Moreover, during the phase-in period described in § 1.22(c)(5), FCMs will initially have a longer period (until 6:00 p.m. Eastern Time on the following business day) to ensure that the requisite amount of residual interest is held in segregation.

These adjustments to the final rule will avoid the need for FCMs continuously to monitor whether they are maintaining residual interest in their segregated customer accounts that is sufficient to cover the sum of the undermargined amounts in customers' accounts. Instead, FCMs will have to ensure that they are able to cover the sum of the undermargined amounts in customers' accounts by the Residual Interest Deadline. This should significantly reduce the amount of residual interest that an FCM must maintain in segregated accounts on an ongoing basis. In the absence of information regarding what specific changes various market participants might make to their systems and operations in order to expedite margin payments, it is not possible for the Commission to provide an estimate of the costs of such technical changes.

Moreover, the FCM's funding requirement will be reduced to the extent that customers are able to reduce the undermargined amount in their accounts prior to the Residual Interest Deadline. The Commission expects that FCMs will work with customers during the phase-in period to develop the systems and operational patterns that will be necessary to facilitate more prompt margin calls and payments. As a consequence, those FCMs' customers that do not already have the capability to make margin payments before the Residual Interest Deadline may develop that capability, which will further reduce the funding burden borne by FCMs.

The cost associated with maintaining sufficient residual interest to cover undermargined amounts will also depend upon the policies and procedures that FCMs put into place to meet the targeted residual interest requirement set forth in § 1.11. To the extent that the undermargined amount is greater than the targeted residual interest amount that an FCM maintains in its customer accounts, the FCM would have to increase the amount of residual interest it maintains in the customer segregated account by the time it is obligated to make settlement payments to the DCO. Some FCMs may seek to avoid this situation by requiring their customers to pre-fund (*i.e.,* require customers to provide initial margin for a position before the FCM sends the position to a DCO to be cleared, and provide sufficient excess margin to the FCM to reduce any undermargined amount). If the FCM elects to increase the amount of residual interest that it maintains in the customer segregated accounts, this would likely reduce the range of investment options the FCM has for those additional funds and may prompt the FCM to hold additional capital to meet operational needs. Similarly, if the FCM requires additional margin from customers, that will result in capital costs to those customers.

On the other hand, to the extent the FCM would otherwise maintain targeted residual interest (*i.e.,* to the extent the targeted residual interest is greater than or is included within the undermargined amount), then the rule would not create any additional funding costs.

Despite these revisions to the proposed rule, the Commission recognizes that the requirements of final rule § 1.22(c) will create significant additional costs for FCMs and their customers. Developing and implementing the systems and operational changes necessary to facilitate more rapid margin payments will create costs for FCMs and their customers. Those costs are likely to vary significantly across FCMs depending on the infrastructure and operational patterns that each FCM already has in place, and depending on the specifications of the revised systems and operational patterns that FCMs and customers develop in order to facilitate more rapid margin payments.[670]

In addition, the Commission expects that some FCMs may choose to require some customers to increase the amount of margin they maintain in their accounts. This is more likely for those customers who are presently not able to make their margin payments prior to the Residual Interest Deadline. Customers subject to increased pre-funding requirements will bear costs from their cost of capital resulting from pre-funding multiplied by the amount of the increased pre-funding requirement. The cost of capital for each customer depends on the investment strategy of the individual customer, and the amount of increased pre-funding requirement is likely to vary depending on the ability of the customer to respond to margin calls promptly and the FCM's ability to cover the customer's deficits through increased residual interest contributions.[671]

Last, whatever undermargined amounts are not addressed through customer payments prior to the Residual Interest Deadline will have to be covered through increased residual interest contributions from the FCM.

The Commission expects that in order to comply with the requirements of § 1.22(c), FCMs may need to maintain

[667] *See* discussion of double defaults in sections I.D. and II.G.9. above.

[668] *See* the discussion in section II.G.9. above.

[669] *See* the discussion in section II.G.9. above.

[670] In the absence of information regarding what specific changes various market participants might make to their systems and operations in order to expedite margin payments, it is not possible for the Commission to provide an estimate of these costs.

[671] Commenters did not provide, and the Commission does not have, data characterizing the range of investment strategies used by FCM customers, its impact on their cost of capital for additional margin, the extent to which customers will not be able to develop the ability to make more rapid margin payments, or the extent of the margin requirements for those customers. In the absence of this information it is not possible at this time to estimate the additional cost associated with pre-funding requirements that some customers may bear. These are subjects that may be addressed in the Report.

additional residual interest in order to cover the sum of undermargined amounts in customers' accounts that still remain by the Residual Interest Deadline on ordinary trading days, and are likely to acquire and maintain access to additional liquidity that can be accessed rapidly to meet the sum of customers' gross undermargined amounts in a worst-case-scenario. Therefore, in order to estimate the cost of additional residual interest that FCMs will maintain, it is necessary to estimate the amount of additional residual interest that FCMs will need to maintain in their segregated accounts during ordinary trading days, the amount of additional residual interest that will be needed on highly volatile trading days, the ratio of ordinary to highly volatile trading days on an annual basis, the cost of capital for the additional funds that are deposited into residual interest, and the cost to maintain a revolving credit facility or some other source of funding that can be accessed quickly and that is sufficient to cover the projected largest undermargined amount in aggregate for customers' accounts.

As discussed further below, the Commission believes that the point in time approach adopted in this final rule will significantly reduce the amount of additional residual interest that FCMs need to maintain in their segregated accounts on an ongoing basis in order to comply with § 1.22(c).

Several commenters provided estimates of the cost of the ''at all times'' portion of the proposal. FIA estimated that compliance with the ''at all times'' portion of the proposal would require FCMs or their customers to deposit significantly in excess of $100 billion into customer funds accounts beyond the sum required to meet initial margin requirements, and that the annual financing costs for these increased deposits will range from $810 million to $8.125 billion.[672] FIA estimated the highest single day customer margin deficits per FCM would likely be between $196 million to $6.1 billion per FCM, depending on the size and composition of the FCM's customer accounts.[673] Jefferies estimated that it would be required to increase its own residual interest by $15 million (non-peak) or $30 million (peak), respectively.[674] Jefferies also stated that the industry would be required to increase its residual interest by $49 billion (non-peak) or $83 billion (peak) at a cost of approximately $2 billion (non-peak) or $5 billion (peak), respectively.[675] ISDA estimated that the highest single day sum of gross customer margin deficits would likely be approximately $73.2 billion for all FCMs combined, with a long term funding impact of $335 billion.[676]

While the Commission expects that the residual interest requirement will create additional capital costs for most FCMs, the Commission believes that the estimates presented by commenters include certain assumptions that may lead to overstated costs. First, residual interest that is not needed to be pledged as collateral for customers may be invested overnight and during the day in investments that are consistent with the requirements of Commission Regulation 1.25 (''§ 1.25 investments'').[677] The return on residual interest would offset a portion of the cost of funds. That is, the additional funds that FCMs place in residual interest will both incur costs and generate returns for the FCM. Estimates of the effective cost of the additional funds that must be used to increase residual interest must account for both.[678] The returns on § 1.25 investments have the potential to reduce the effective cost of funds.

Second, both FIA and ISDA confound total residual interest with additional residual interest by assuming that the total amount of residual interest that would be required by the proposed rule is equal to the additional amount of additional interest that would be required by the rule. FCMs, in general, maintained some residual interest prior to this rule, and are required to do so to comply with § 1.23.[679] Therefore, it is only the additional residual interest that is necessary because of rule 1.22(c) that is relevant for consideration here.

Third, the Commission agrees with FIA that U.S. Treasury securities are an appropriate proxy for the marginal cost of capital for a low-risk project, such as funds to be placed in residual interest. FIA and Jefferies did not explain why they chose long-dated maturities on the yield curve for their estimates. Presumably, an FCM could borrow funds at a much shorter maturity than five years, for example, a month or less, potentially lowering borrowing costs substantially.

The Commission notes, and discusses further below, that FCMs might mitigate costs by maintaining a credit facility that is sufficient to cover most of their additional residual interest needs on unusually volatile trading days, but that is not used on the majority of trading days. This approach would not only lower the amount of capital needed, but would also reduce the amount of time during which the capital is borrowed. As discussed further below, the Commission is not able to estimate accurately what fees banks would charge. However, the Commission has considered that FCMs would bear an ongoing cost associated with maintaining an open credit facility that is able to provide rapid access to sufficient liquidity to meet any additional residual interest requirements on highly volatile days.

As noted above, several commenters requested the Commission revise the proposal to require that the residual interest calculation be made once a day, specifically by the end of the business day.[680] These commenters suggested an alternative (the ''Industry Commenters' Alternative'') by which, at this point in time, an FCM would be required to maintain a residual interest in its customer funds accounts at least equal to its customers' aggregate margin deficits for the prior trade date. ISDA stated this alternative ''would rationally reduce'' FCMs cost of compliance[681] and that ''[f]or an FCM with robust credit risk management systems, covering end-of-day customer deficits should not be a significant cost.''[682] ISDA also noted that at the end of the day ''typically, all customer calls have been met, and all customer gains have been paid out; all achieved without the FCM having recourse to its own funding resources.''[683] FIA asserted that it would ''achieve the Commission's regulatory goals without imposing the

[672] FIA Comment Letter at 14, 16 (Feb. 15, 2013).

[673] *See* FIA Comment Letter at 2–3 (June 20, 2013).

[674] *Id.* at 8.

[675] *Id.*

[676] *See* ISDA Comment Letter at 4 (Feb. 15, 2013). ISDA used market data for FCMs (November 30, 2012) available at *http://www.cftc.gov/MarketReports/FinancialDataforFCMs/index.htm*.

[677] 17 CFR 1.25.

[678] For example, FIA cited a historical cost of funds of 8.125% in January 1990. At that time, the constant maturity one month Treasury yield was 7.86%, see *http://mortgage-x.com/general/indexes/cmt_tcm_history.asp?f=m*. Thus, using the cost of funds proxy from the commenter, the cost of funds would be closer to 0.365% (calculated as 8.125% − 7.86% + 0.10% (for underwriting and administrative overhead)).

[679] *See* section II.G.10. above.

[680] *See* ISDA Comment Letter at 6 (Feb. 15, 2013); FIA Comment Letter at 23–25 (Feb. 15, 2013); LCH.Clearnet comment Letter at 5 (Jan. 25, 2013); Paul/Weiss Comment Letter at 4–5 (Feb. 15, 2013); RJ O'Brien Comment Letter at 5 (Feb. 15, 2013).

[681] ISDA Comment Letter at 6 (Feb. 15, 2013).

[682] ISDA Comment Letter at 2 (May 8, 2013).

[683] *Id.* ISDA further observed that many FCM customers use custodians across the world, and ''many customers cannot assure payment of their morning FCM call before the end of the New York day,'' and therefore recommended that Commission study the feasibility of reducing the time in which customers have to meet margin calls, if that is ''imperative.'' *Id.* at 3. This will be addressed in the Report.

damaging financial and operational burdens on FCMs, and the resulting financial burdens on customers.'' [684]

ISDA and FIA evaluated the costs associated with requiring FCMs to perform the residual interest calculation once each day at the close of business on the first business day following the trade date.[685] ISDA estimated that ''removing the predictive element of FCM funding requirements'' of the ''at all times'' method in favor of the Industry Commenters' Alternative would permit markets to ''reap the efficiencies of end-of-day accounting,'' [686] thereby reducing the overall cost of compliance with the regulation. ISDA estimated that for exchange-traded futures, the costs associated with the alternative would be the cost of covering the outstanding margin deficits of between 2% and 5% of an FCM's futures customers, and thus that approach would impose only ''incremental funding requirements'' on FCMs.[687] ISDA estimated that the costs of the alternative would be even smaller for cleared swaps, due to the ''more professional'' nature of the market.[688] FIA acknowledged that if FCMs were given until the end of the following business day to ensure that the requisite amount of residual interest was maintained, that approach would eliminate approximately 90–95% of the anticipated additional residual interest that larger FCMs would need to maintain in order to meet an at all times requirement.[689] FIA estimated the financing costs to FCMs of complying with the Industry Commenters' Alternative, and concluded that the costs associated with an at all times residual interest requirement would be approximately ten times the costs associated with the Industry Commenters' Alternative.[690] Finally, the FIA concluded that the Industry Commenters' Alternative would not ''impos[e] damaging financial and operational burdens on FCMs . . . and the resulting financial burdens on customers'' that would result from the at all times approach.[691]

However, the point in time approach adopted in final rule § 1.22(c) gives FCMs until the time of settlement with the DCO (typically the beginning of the following business day for end of day margin calls from the DCO), and also provides an extended phase-in period, during which FCMs have until 6:00 p.m. Eastern Time on the date of such settlement. After the phase-in period, and absent further Commission action following the Report, the final rule does not provide FCMs until the end of the following business day to ensure that the requisite amount of residual interest is held, as would be the case in the Industry Commenters' Alternative. Therefore, the Commission expects that the point in time approach adopted by the Commission will reap much, but not all, of the cost reduction discussed by the industry commenters.[692]

During the phase-in period, FCMs would be subject to Industry Commenters' Alternative (and, thus, all of those cost savings would be realized).

The following analysis assumes that the Commission does not take further action to modify the Residual Interest Deadline after considering the results of the Report. It refers to estimates of ongoing costs and benefits that only would be incurred and realized after the end of the phase-in period.

The Commission expects that the post-phase-in form of § 1.22(c)—with a point in time requirement corresponding to the time of settlement—will achieve some, but not all of the cost reductions associated with Industry Commenters' Alternative. Moreover, during the phase-in period, the Commission anticipates that customers and FCMs will improve their abilities to submit and receive margin payments prior to the FCM's settlement with the DCO, and the Commission will be examining this issue further in the Report. In light of these factors, the Commission believes it is reasonable to suppose that the settlement time approach will significantly reduce—perhaps by 25% to 50%—the amount of additional residual interest that is needed on highly volatile trading days, and by a greater amount on ordinary trading days.

In order to reasonably estimate the potential range of the amount of additional capital that is necessary on highly volatile trading days, the Commission uses ISDA's formulation for the aggregate gross deficit across all customers. ISDA estimated that on high volatility days, the aggregate amount of all customers' gross margin deficits for all FCMs would be equal to 60% of initial margin required by all customers' positions. This estimate is based on an assumption that all of an FCM's customers will be holding positions in the same commodity (or that all commodities in which customers hold positions will move in unison) and that either shorts or longs will predominate.[693] This approach is conservative because it does not take into account diversification effects. For example, while some customers may hold positions in energy products, which may be volatile on a particular day, others may predominately hold positions in interest rates, which may not be volatile on the same day. Moreover, because of the point in time approach adopted by the Commission, FCMs will have time to react to such changes.

The Commission's cost estimates for the amount of additional residual interest that will be required reflect an effort to make a reasonable assumption regarding the potential range of additional residual interest that could be necessary on a volatile trading day. The amount of additional residual interest that could reasonably be expected to be necessary on an ordinary trading day would be much lower because the aggregate of all customers' gross undermargined amounts would be significantly lower on such days. However, commenters only estimated the aggregate of customers' gross undermargined amounts on highly volatile days. They did not estimate or provide data regarding the aggregate of customers' gross undermargined amounts on ordinary trading days. In the absence of either data or estimates from commenters regarding undermargined amounts in customers' accounts on ordinary trading days, the Commission is not able to quantify the amount of additional residual interest needed by FCMs in ordinary trading conditions, but believes that it is significantly less than what is estimated above for volatile trading days.

Commenters did not identify what level of volatility they had in view when offering estimates for additional residual interest that would be necessary for a ''volatile'' trading day. For example, commenters may have had in mind days that were volatile relative to market conditions over the last year or two, or that are volatile relative to the range of all possible outcomes. Context suggests

[684] FIA Comment Letter at 23 (Feb. 15, 2013). *See also* ISDA Comment Letter at 4 (May 8, 2013).

[685] ISDA Comment Letter at 1–2 (May 8, 2013); FIA Comment Letter at 8–10 (June 20, 2013).

[686] ISDA Comment Letter at 3 (May 8, 2013).

[687] *Id.* at 3–4.

[688] *Id.* at 4.

[689] *See* FIA Comment Letter at 3 (June 20, 2013).

[690] *See* FIA Comment Letter at 8–10 (June 20, 2013). While the rates used by FIA in this exercise may be conservative, and the Commission does not adopt these precise estimates, the exercise is nevertheless illustrative and useful for the purpose of comparing the costs of the at all times approach and the Industry Commenters' Alternative.

[691] *Id.* at 9.

[692] FIA estimated that the Industry Commenters' Alternative would reduce the amount of additional residual interest that is necessary by 90–95% when compared to the at all times approach. *See id.* at 3 (June 20, 2013). *See also* ISDA Comment Letter at 1–2 (May 8, 2013).

[693] *See* ISDA Comment Letter at 4–5 (Feb. 15, 2013).

the latter assumption, since commenters asserted elsewhere that FCMs would have to anticipate market movements in order to maintain sufficient residual interest at all times to cover the sum of customers' undermargined amounts during a highly volatile trading day.[694] Given this, the Commission notes that highly volatile days are only a small fraction of all total trading days, and therefore, the costs associated with additional residual interest required on such highly volatile days would only accrue on a correspondingly small fraction of the total trading days in a given year.

FCMs would, however, bear an ongoing cost associated with maintaining an open credit facility or some other source of funds that is able to provide rapid access to sufficient liquidity to meet any additional residual interest requirements when highly volatile days do occur. The Commission does not have adequate data to estimate the cost of this credit facility. Since it is not feasible to estimate the costs to FCMs to cover the need for additional residual interest between the times of the daily settlement and the end-of-day by obtaining intraday lines of credit from lenders, the Commission has taken a conservative approach, and has assumed, for the sake of quantification, that firms will raise capital sufficient to meet their residual interest needs on highly volatile trading days, and will keep that amount of capital on all days, holding it either in residual interest or in liquid assets that are available to be deposited into segregation.

The Commission is aware that the top-10 largest FCMs (ranked by total amount of customer funds in section 4d(a)(2) segregated accounts and 30.7 accounts as of November 30, 2012) are contained in bank holding companies.[695] Most of these bank holding companies have short-term credit ratings of Moody's P–1, Standard & Poor's A–1, and Fitch F1, while a few have holding companies with P–2, A–2, and F2 ratings. The FCM subsidiary usually derives its credit standing from the bank holding company, with the rating of the FCM subsidiary being often the same or sometimes one credit grade lower than the holding company. To estimate the interest rate that a bank holding company would charge its FCM subsidiary for funding additional residual interest, the Commission is using as a proxy for the costs of these funds the historical average of 30-day AA-financial commercial paper (consonant with the short-term credit ratings of the bank holding companies) minus the yield on the 4-week constant maturity U.S. Treasury bill (to account for the return that FCMs will earn on investments permitted under Regulation 1.25) and is adding 0.10% for underwriting and administrative overhead costs to issue commercial paper.[696] This results in an average cost of funds of 0.35% for the top-10 largest FCMs from July 2001 to July 2013. For the remaining FCMs, the Commission is using as a proxy for the costs of funds the difference between the prime rate and the yield on the 4-week constant maturity U.S. Treasury bill. This results in an average cost of funds of 3.25% from July 2001 to July 2013.[697] The Commission is using historical FCM data from November 30, 2012, even though there is more recent data available, to be consistent with the data ISDA used in the analysis in its comment letter.[698] As of November 30, 2012, there was approximately $147.1 billion in customer funds in section 4d(a)(2) segregated accounts (excluding excess amounts contributed by FCMs).[699] The top-10 FCMs held approximately $111.7 billion in section 4d(a)(2) segregated accounts,[700] and the remaining FCMs held approximately $35.4 billion in section 4d(a)(2) segregated accounts.[701]

ISDA estimated the potential future FCM funding requirement for futures arising from the residual interest proposal by subtracting the existing customer excess. ISDA estimated the futures excess to be between $40–$70 billion and employed the midpoint of this range, $55 billion in its calculations. Using ISDA's point estimate for existing customer excess of $55 billion, the Commission estimates there was, at the top-10 FCMs, (55/177.1) (*i.e.,* 31%) times $111.7 billion or approximately $34.7 billion in existing customer excess in section 4d(a)(2) segregated accounts. Similarly, for the remaining FCMs, the Commission estimates that there was approximately $11 billion in customer excess in section 4d(a)(2) segregated accounts.[702]

First, the Commission performs its calculations for the residual interest projected in the section 4d(a)(2) segregated accounts based on ISDA's assumption that residual interest were required ''at all times.'' For the top-10 FCMs, the Commission subtracts $34.7 billion from $111.7 billion giving approximately $77 billion in required margin. The Commission uses ISDA's suggestion for additional residual interest needed by FCMs and takes 60% of this figure, approximately $46.2 billion, as the estimate for total residual interest needed. As of November 30, 2012, the top-10 FCMs held approximately $6.5 billion in residual interest.[703] Using these figures, the top-10 FCMs would need to fund approximately $39.7 billion in additional residual interest. At a cost of funds of 0.35%, this would result in an annual cost of $139 million for the top-10 FCMs based on the historical costs of funds.

For the remaining FCMs, the Commission subtracts $11 billion (excess margin) from $35.4 billion (balance in 4d(a)(2) accounts) leaving approximately $24.4 billion (required margin in 4d(a)(2) accounts). Again, using ISDA's 60% formulation gives $14.6 billion in total residual interest needed under an at all times approach. The remaining FCMs are holding approximately $3.9 billion in residual interest.[704] Consequently, the remaining FCMs would need to fund approximately $10.7 billion ($14.6 billion–$3.9 billion) in additional residual interest. At a cost of funds of 3.25%, this gives the historical annual cost of approximately $348 million.

For all FCMs, the aggregate annual cost is approximately $487 million (that is, $139 million plus $348 million) to fund the additional residual interest needed by FCMs due to § 1.22 if residual interest were required at all times.

However, these figures change significantly if residual interest is not required until the daily settlement. As

[694] *See, e.g.,* LCH.Clearnet Comment Letter at 4–5 (Jan. 25, 2013) (noting that ''regardless of the amount of capital an FCM dedicated to continuous compliance, FCMs would still be at risk of a violation''). *See also* CMC Comment Letter at 2 (Feb. 15, 2013); CME Comment Letter at 5 (Feb. 15, 2013); FIA Comment Letter at 4, 13, 15 (Feb. 15, 2013); MFA Comment Letter at 8 (Feb. 15, 2013); NPPC Comment Letter at 2 (Feb. 15, 2013); TD Ameritrade Comment Letter at 4–5 (Feb. 15, 2013).

[695] *See http://www.cftc.gov/MarketReports/FinancialDataforFCMs/HistoricalFCMReports/index.htm.*

[696] The Commission computes the average yields from July 2001 to July 2013. The constant maturity 4-week Treasury yield time series with month observations begins in July of 2001. *See http://www.federalreserve.gov/releases/H15/data.htm.*

[697] The Commission recognizes that there may be some FCMs with weak credit ratings that would have to pay even more than the prime interest rate to secure additional residual interest. *See id.*

[698] The Commission believes that the November 30, 2012 FCM data is typical. Moreover, this permits comparison with other estimates in the comment letter.

[699] *See http://www.cftc.gov/MarketReports/FinancialDataforFCMs/HistoricalFCMReports/index.htm.*

[700] *See id.*

[701] *Id.*

[702] That is, 31% of $35.4 billion and $2.3 billion, respectively.

[703] *See http://www.cftc.gov/MarketReports/FinancialDataforFCMs/HistoricalFCMReports/index.htm.*

[704] *See id.*

noted above, both FIA and ISDA estimate that the residual interest requirement would be reduced by 90% or more if it were required to be present at the end-of-day on the following business day. As discussed above, the Commission estimates that using the point in time approach with morning settlement (rather than end-of-day) will reduce the need for additional residual interest by 25–50%. The midpoint of this range is 37.5%. A reduction of 37.5% (as a consequence of moving to the point in time approach) leaves a multiplier of 62.5%. Multiplying 62.5% by ISDA's estimate (for the at all times approach) of 60% of required margin results in a product of 37.5%.[705] For the top-10 FCMs, the Commission multiplies the $77 billion in required margin by 37.5% giving approximately $28.9 billion in residual interest needed. The top-10 FCMs are currently holding approximately $6.5 billion in residual interest. The top-10 FCMs would be required to fund approximately $22.4 billion ($28.9 billion–$6.5 billion) in additional residual interest. At a cost of funds of 0.35%, this would result in an annual cost of approximately $78 million for the top-10 FCMs.

For the remaining FCMs, the Commission multiplies $24.4 billion (required margin in 4d(a)(2) accounts) by 37.5% giving approximately $9.2 billion. The remaining FCMs are holding $3.9 billion in residual interest.[706] Consequently, the remaining FCMs would be required to fund approximately $5.3 billion ($9.2 billion − $3.9 billion) in additional residual interest. At a cost of funds of 3.25%, this would result in an annual cost of approximately $171 million with current economic conditions. This result in a total annual cost of approximately $249 million to fund the additional residual interest needed by FCMs due to § 1.22 using the Commission's assumption of 37.5% of initial margin needed for residual interest.

As explained above, the final rule does not require FCMs to take this approach. Instead, the Commission believes that firms are likely to manage margin calls to reduce the sum of customers' gross undermargined amounts prior to the time of settlement. They may also mitigate costs by using revolving credit facilities or other temporary sources of liquidity to meet, in part, the need for additional residual interest on volatile trading days. The Commission received comments on the proposed costs and benefits of § 1.22. Several commenters supported the proposal, noting that it would prevent customer funds from being used to subsidize an FCM's obligations, reduce systemic risk, and enhance customer protection, especially in the event of an FCM bankruptcy.[707] In particular, SIFMA stated that the proposal, ''in effect, shifts the costs and burdens of a margin shortfall from customers with excess margin to customers with deficits, where it properly belongs.'' [708] In addition, Vanguard argued that the ''proposed changes correctly shift the risk to customers in deficit and away from any excess margin transferred by other customers.'' [709]

On the other hand, a number of commenters interpreted the ''at all times'' language to require FCMs to continuously calculate their customers' aggregate margin deficits and stated that they believe such a requirement is infeasible.[710] As a result of this interpretation of the proposal, these commenters argued that the proposal would dramatically increase costs and create liquidity issues for FCMs and their customers.[711] Many commenters asserted that the proposal would therefore result in FCMs requiring customers to pre-fund their positions.[712] FHLB cautioned that ''[w]hile it cannot be disputed that a residual interest buffer should lower the risk that an FCM will fall out of compliance with its segregation requirements, there will likely be a real economic cost associated with maintaining whatever residual interest buffers is established by an FCM.'' [713] FHLB further noted that the ''funds maintained by an FCM as residual interest can reasonably be expected to earn less than the FCM's unrestricted funds,'' thus, the proposal ''represents a real cost to FCMs'' that will be passed on to customers.[714] ISDA stated that the proposal will make customers ''self-guaranteeing'' and diminish reliance on the FCM, and that, while this would diminish overall risk of FCM default, it comes at a very significant cost to market participants, market volumes, and liquidity.[715] CHS Hedging observed that ''pre-funding accounts concentrates additional funds at FCMs, which seems to contradict the spirit of the'' customer protection rules.[716]

As noted above, the Commission recognizes that some FCMs may require their customers, or some subset of their customers, to increase the margin they maintain in their accounts in order to cover possible deficits that could materialize during the period of time it would typically take that customer to respond to a margin call. This is particularly the case if and when the Residual Interest Deadline moves to the time of the daily settlement. However, the Commission expects that the number of customers and the amount of additional margin required from those customers would be significantly less than was asserted by some of the commenters because of modifications made to the final rule. As noted above, the final version of the rule allows FCMs to meet the gross sum of the undermargined amounts several hours after (and, during the phase-in period, at the end of the next business day after)

[705] The fact that the reduction of 37.5% (the midpoint of 25% and 50%) multiplied by ISDA's estimate of 60% results in a product that is also 37.5% is coincidental.

[706] *See http://www.cftc.gov/MarketReports/FinancialDataforFCMs/HistoricalFCMReports/index.htm.*

[707] *See, e.g.,* CFA Comment Letter at 5–6 (Feb. 13, 2013); CIEBA Comment Letter at 2–3 (Feb. 20, 2013); ICI Comment Letter at 3 (Jan. 14, 2013); Franklin Comment Letter at 2 (Feb. 15, 2013); Paul/Weiss Comment Letter at 3 (Feb. 15, 2013); SIFMA Comment Letter at 2 (Feb. 21, 2013); Vanguard Comment Letter at 7–8 (Feb. 22, 2013).

[708] SIFMA Comment Letter at 2 (Feb. 21, 2013).

[709] Vanguard Comment Letter at 7 (Feb. 22, 2013).

[710] *See, e.g.* Advantage Comment Letter at 6–8 (Feb. 15, 2013); CMC Comment Letter at 2 (Feb. 15, 2013); CME Comment Letter at 5 (Feb. 15, 2013); FIA Comment Letter at 4, 7–8, 13 (Feb. 15, 2013); LCH.Clearnet Comment Letter at 4–5 (Jan. 25, 2013); MFA Comment Letter at 8 (Feb. 15, 2013); MGEX Comment Letter at 2 (Feb. 18, 2013); Newedge Comment Letter at 2 (Feb. 15, 2013); NPPC Comment Letter at 2 (Feb. 15, 2013; RCG Comment Letter at 3 (Feb. 12, 2013); TD Ameritrade Comment Letter at 4–5 (Feb. 15, 2013).

[711] *See, e.g.,* Advantage Comment Letter at 8 (Feb. 15, 2013) (''The avalanche of buying or selling that this rule will induce contradicts decades of effort by the industry to thwart market panics and provide markets with liquidity and stability.''); CMC Comment Letter at 2 (Feb. 15, 2013) (stating that the proposal ''could create liquidity issues and increase costs for FCMs and end users. Such a decrease in liquidity could be substantial, and limit the number and type of transactions FCMs clear, the number of customers they service and the amount of financing they provide.''); CME Comment Letter at 5–6 (Feb. 15, 2013) (''We believe that this will be a significant and unnecessary drain on liquidity that will make trading significantly more expensive for customers to hedge financial or commercial risks. The liquidity drain will be exacerbated to the extent that the demand for excess margin will increase the costs and limit the activities of market makers.'').

[712] *See, e.g.,* FIA Comment Letter at 17 (Feb. 15, 2013); MFA Comment Letter at 8 (Feb. 15, 2013); Newedge Comment Letter at 2 (Feb. 15, 2013).

[713] FHLB Comment Letter at 3–4 (Feb. 15, 2013).

[714] *Id.* at 4 n.5.

[715] ISDA Comment Letter at 3 (Feb. 15, 2013) (noting that ''[e]ffectively doubling margins will damage futures and swaps markets by destroying the value proposition for many liquidity providers essential to the market's efficiency.''). *See also* ISDA Comment Letter at 2–3 (May 8, 2013) (stating that the proposal would cause customers to pre-fund margin, which ''would remake the cleared swaps and futures markets into one exclusively for 'self-guaranteeing' customers,'' which ''would be damaging to markets by destroying the incentives for continued participation by liquidity providers essential to the markets' efficiency.'').

[716] *Id.*

the undermargined amount is calculated, which is expected to significantly mitigate the need for FCMs to maintain a ''preventative buffer'' of residual interest or additional customer margin that is sufficient to cover customers' potential undermargined amounts in a worst case scenario. Moreover, in cases where customers develop the ability to submit margin payments prior to the Residual Interest Deadline, there will not be any need for additional customer margin on an ongoing basis. It is therefore likely that FCMs will require additional customer margin on an ongoing basis in situations only where (1) a particular customer is not be able to routinely make margin payments prior to the Residual Interest Deadline, and (2) the sum of the undermargined amounts in customers' accounts that cannot be collected before the Residual Interest Deadline is a relatively large compared to the amount of residual interest that the FCM otherwise chooses to maintain.[717]

The Commission does not agree that increased residual interest requirements are contrary to the spirit of the customer protection rules. The rules are intended to provide additional protections to funds held at FCMs, not to reduce the amount of funds held at FCMs. The likelihood of customer defaults leading to an FCM default is reduced. So, additional customer funds at FCMs are better protected with the increased residual interest requirements in place.

Several commenters argued that the costs associated with the proposal would decrease competition between FCMs.[718] In particular, FIA stated that the proposal may force a number of small to mid-sized FCMs out of the market, which will decrease access to the futures markets and increase costs for IBs, hedgers and small traders.[719] In addition, FIA argued that the proposal would significantly impair the price discovery and risk management functions served by the market.[720] JSA argued that the proposal would be ''punitive in a highly competitive environment that already places the midsize operator at a disadvantage to his better capitalized multinational competitors.'' [721] Moreover, JSA stated that the cost of the proposal would result in a higher cost of hedging, which would be prohibitive and prompt agricultural users to walk away from the futures market.[722] The Congressional Committees requested that the Commission consider these effects in drafting the final rule.[723]

Other commenters argued that the proposal would disproportionately burden smaller FCMs and the customers of smaller FCMs.[724] CME asserted that, given this increase in cost, some customers may transfer their accounts to the larger, better-capitalized FCMs to reduce the cost of trading,[725] but that agricultural customers ''likely will not be able to transfer to the larger FCMs because they do not fit their customer profile,'' thereby making these customers bear more of the cost burden.[726] Frontier Futures asserted that many small customers, including most farmers, do not watch markets constantly. Therefore, it would be difficult for them to meet margin calls on a moment's notice, thereby causing FCMs to require significantly higher margins or to liquidate customer positions where margin calls cannot be immediately met.[727] Frontier Futures also asserted that the proposal ''may force a number of small to mid-sized FCMs out of the market,'' making it more expensive, if not impossible, for IBs and small members to clear their business, removing ''significant capital from the futures industry,'' and ''reducing stability to the markets as a whole.''[728] RJ O'Brien stated that the proposed residual interest requirement is impractical because many farmers and agricultural clients still use checks and ACH to meet margin calls.[729] RJ O'Brien also stated that if the proposal is adopted, FCMs that service non-institutional clients will struggle to remain competitive and the proposal may result in fewer clearing FCMs and greater systemic risk to the marketplace.[730] Similarly, CME stated that the proposed residual interest requirement would lead to consolidation among FCMs, which will ''actually *increase*[ ] systemic risk by concentrating risk among fewer market participants.'' [731]

The Commission recognizes that smaller FCMs may have more difficulty than large FCMs in absorbing the additional costs created by the requirements in § 1.22. In general, it is likely that smaller FCMs have a larger percentage of customers who do not have requisite personnel or systems to receive margin calls and make margin payments in a matter of hours, thus creating a disproportionate need for pre-funding or additional residual interest at smaller FCMs. Smaller FCMs are also likely to have higher borrowing costs than larger FCMs, so the impact of obtaining additional capital to meet increased residual interest needs may be more significant for them. If increased costs force some smaller FCMs out of the market, it is possible, though not certain, that smaller customers could have difficulty finding alternative FCMs to service their needs. However, as noted above, the Commission believes that the changes made to § 1.22(c), and the extended phase-in period, in the final rule substantially reduce the costs to FCMs and their customers when compared to the proposed version of the requirement. By reducing the costs, these changes have also reduced some of the associated burdens that would potentially be disproportionately borne by smaller FCMs. The Commission does not agree that a reduced number of FCMs would necessarily reduce competition in a way that impacts the price of services. Any increases in costs to customers are more likely the result of increased costs to the FCM that are passed on to customers, which are the costs that have been mitigated by changes to the final rule. Moreover, the Commission is cognizant of the cost of an FCM failure where customers suffer a loss of segregated funds, both in terms

[717] The Commission expects that this would happen on normal trading days. On highly volatile trading days, the Commission expects that customers' gross undermargined amounts would likely be covered by residual interest acquired through a line of credit or credit facility, as discussed above, rather than through customer pre-funding since the costs of the former are likely to be considerably less than the costs of the latter.

However, the Commission does not, at this time, have data regarding individual customers' historical gross undermargined amounts and therefore does not have adequate information to estimate the number of FCM and customer combinations where additional customer margin would be required on an ongoing basis.

[718] *See, e.g.,* CHS Hedging Comment Letter at 2 (Feb. 15, 2013); CME Comment Letter at 6 (Feb. 15, 2013); FIA Comment Letter at 17 (Feb. 15, 2013); Frontier Futures Comment Letter at 3 (Feb. 15, 2013); Jefferies Comment Letter at 7 (Feb. 15, 2013); JSA Comment Letter at 1–2 (Feb. 15, 2013); NCFC Comment Letter at 2 (Feb. 15, 2013); NIBA Comment Letter at 1 (Feb. 15, 2013).

[719] *See* FIA Comment Letter at 17 (Feb. 15, 2013).

[720] *See id.* at 4, 17.

[721] JSA Comment Letter at 1 (Feb. 15, 2013).

[722] *Id.* at 2.

[723] *See* Congressional Committees Letter at 1 (Sept. 25, 2013).

[724] *See, e.g.,* CME Comment Letter at 5–6 (Feb. 15, 2013); FCStone Comment Letter at 3 (Feb. 15, 2013); Global Commodity Comment Letter at 1 (Feb. 13, 2013); Randy Fritsche Comment Letter at 1 (Feb. 15, 2013); JSA Comment Letter at 1 (Feb. 15, 2013); NCBA Comment Letter at 2 (Feb. 15, 2013); NCFC Comment Letter at 2 (Feb. 15, 2013); RJ O'Brien Comment Letter at 3 (Feb. 15, 2013); ICA Comment Letter at 1–2 (Feb. 15, 2013); TCFA Comment Letter at 2 (Feb. 15, 2013).

[725] CME Comment Letter at 6 (Feb. 15, 2013).

[726] *Id.*

[727] *See* Frontier Futures Comment Letter at 2–3 (Feb. 14, 2013).

[728] *Id.*

[729] RJ O'Brien Comment Letter at 3 (Feb. 15, 2013). *See also* ICA Comment Letter at 1–2 (Feb. 15, 2013).

[730] RJ O'Brien Comment Letter at 3 (Feb. 15, 2013).

[731] CME Comment Letter at 6 (Feb. 15, 2013) (emphasis in original).

of costs to the customers who lose such funds (or, if such funds are ultimately recovered, the use of such funds) as well as the industry-wide cost associated with a loss in confidence in the safety of customer funds. These costs support the importance of increasing the safety of the system. Moreover, the Commission will closely review these issues as part of considering the Report.

The Commission disagrees with the comments that there would be a consolidation of FCMs that would cause the rule to have a net effect of increasing systemic risk. Instead, the Commission expects that the overall effect of the final rule will be to significantly reduce systemic risk. For example, as noted by CIEBA,[732] the residual interest requirement will likely reduce systemic risk by enabling FCMs to ensure that they can meet all customer obligations at any time without using another customer's funds to do so. Moreover, larger, well-capitalized FCMs are more likely to be able to absorb losses than less well-capitalized FCMs. To the extent that FCMs that are affiliated with large financial institutions take on additional business as a result of a potential reduction in the number of FCMs, the increase in risk to these financial institutions is expected to be small relative to their existing risk and to not materially increase the systemic risk associated with these financial institutions. Finally, some of the costs that commenters asserted could lead to a reduction in the number of FCMs under the proposed rule have been mitigated by changes to the final rule.

Several commenters also observed that the proposal would mark a significant departure from current market practice and could have a material adverse impact on the liquidity and smooth functioning of the futures and swaps markets.[733] The Commission has chosen to provide an extended phase-in period for the requirement in § 1.22(c) and therefore does not expect that smooth functioning of the futures and swap markets will be disrupted. If customers withdraw from the futures and swap markets as a consequence of the additional costs, liquidity could be negatively affected. However, the Commission believes that by allowing FCMs several hours (and, during the phase-in period, until the end of the next business day) after customer accounts become undermargined to ensure that the requisite amount of residual interest is on deposit, the costs associated with the requirement have been mitigated, which reduces the likelihood that customers will be prompted to withdraw from the markets due to related expenses.

The Commission also considered several additional alternative proposals raised by the commenters.

Newedge suggested that the Commission consider less costly alternatives to the proposed rule, such as allowing the FCM ''to count guaranty fund deposits with [DCOs] as part of their residual interest'' or limiting the residual interest amount that an FCM must carry to only a limited number of its largest customers.[734] The Commission believes, however, that the latter proposal is not consistent with the statutory requirement that ''one customer's funds may not be used to margin, guarantee, or pay another customer's obligations'' and therefore did not adopt this suggestion. Regarding the former alternative, guarantee funds held at the DCO are a critical part of the waterfall that covers losses in the event of an FCM's default. One of the primary purposes of the customer protection regime is to protect customers from the risk of losses in the event that their FCM defaults. Using funds that may be used to cover the FCM's proprietary losses (*i.e.,* the guarantee fund) to guarantee customers' funds could expose customer funds to the FCM's losses in a double default scenario. The Commission, therefore, does not believe that this alternative is consistent with the goals of the customer protection regime.

Frontier Futures suggested that firm firewalls be put in place between customer funds and an FCM's proprietary funds in the form of approval by an independent agency for an FCM to transfer customer funds.[735] Frontier Futures also recommended that FCMs ''do their proprietary trading through another FCM thereby engaging the risk management of a third party.''[736] The Commission has chosen not to require FCMs to seek external approval before pulling excess residual interest out of a customer segregated account, or to conduct their proprietary trading through another FCM. The Commission expects that the requirements in § 1.23 will accomplish some of the same benefits—ensuring that FCMs only withdraw significant portions of excess residual interest when they have adequate information to ensure that it is truly excess and that senior management is accountable for such decisions—with greater efficiency and less operational costs. Internal verification of residual interest balances and obtaining signatures from individuals inside the organization is likely to be considerably faster, and therefore more efficient and less costly.

Regarding the second proposal, it is not clear how the commenter expected the third party FCM to augment the first FCM's risk management or what specific type of risk would be addressed by such an arrangement. A third party FCM would be responsible for collecting margin and for making payments to the DCO for positions related to the first FCM's proprietary positions. But this arrangement would not help protect customers at the first FCM from ''fellow customer risk.''

Finally, some commenters requested that the Commission refrain from adopting the proposal until it conducts further analysis with the industry regarding the costs and benefits of such proposal.[737] Further, the Congressional Committees requested that the Commission weigh the costs and benefits of the final rule, and in particular ''carefully consider the consequences of changing the manner or frequency in which 'residual interest' . . . is calculated.''[738] The ''point in time'' approach adopted by the Commission in this final rule and the extended phase-in period will significantly reduce (as compared to the proposed rule) the amount of additional residual interest that FCMs need to maintain in their segregated accounts on an ongoing basis in order to comply with § 1.22(c). As noted above, the final rule will mitigate some, though not all of the costs associated with pre-funding obligations that commenters expressed concern about, while simultaneously ensuring that the statutory obligations are met and that the corresponding protection from ''fellow customer risk'' is achieved.

In light of these concerns and in response to the commenters' requests, the Commission is directing staff to, within thirty months of the publication

[732] *See* CIEBA Comment Letter at 3 (Feb. 20, 2013).

[733] *See, e.g.,* MGEX Comment Letter at 2 (Feb. 18, 2013); AIMA Comment Letter at 3 (Feb. 15, 2013); CMC Comment Letter at 2 (Feb. 15, 2013).

[734] Newedge Comment Letter at 3 (Feb. 15, 2013). *See also* RJ O'Brien Comment Letter at 5 (Feb. 15, 2013).

[735] *See* Frontier Futures Comment Letter at 3 (Feb. 14, 2013).

[736] *Id.*

[737] *See, e.g.,* AIMA Comment Letter at 3 (Feb. 15, 2013); CCC Comment Letter at 2–3 (Feb. 15, 2013); CHS Hedging Comment Letter at 2–3 (Feb. 15, 2013); CME Comment at 5–7 (Feb. 15, 2013); AFBF Comment Letter at 2 (Feb. 15, 2013); Jefferies Comment Letter at 9 (Feb. 15, 2013); JSA Comment Letter at 1–2 (Feb. 15, 2013); NCBA Comment Letter at 2 (Feb. 15, 2013); NGFA Comment Letter at 5 (Feb. 15, 2013); NIBA Comment Letter at 1–2 (Feb. 15, 2013); TCFA Comment Letter at 2 (Feb. 15, 2013); AFMP Group Comment Letter at 1–2 (Sept. 18, 2013).

[738] Congressional Committees Comment Letter at 1 (Sept. 25, 2013).

of this release, solicit further public comment, hold a public roundtable, and conduct further analysis regarding the practicability of moving the Residual Interest Deadline from 6:00 p.m. Eastern Time on the date of settlement to the time of settlement (or to some other time of day). The Report should include an analysis of whether and on what schedule it would be feasible to move the Residual Interest Deadline, and the costs and benefits of such potential requirements. All of this will take place well before the expiration of the phase-in period. The Commission will consider the Report and within nine months after the publication of the Report may take additional action regarding the phase-in period by Commission order and may change the Residual Interest Deadline by rulemaking.

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

Revised § 1.23 places new restrictions regarding an FCM's withdrawal of residual interest funds not for the benefit of customers. As adopted, an FCM cannot withdraw any residual interest funds not for the benefit of customers unless it has prepared the daily segregation calculation from the previous day and has adjusted the segregation calculation for any activity or events that may have decreased residual interest since the close of business the previous day. In addition, an FCM is permitted to withdraw more than 25 percent of its residual interest for purposes other than the benefit of customers within one day only 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 Commission and the firm's DSRO indicating that the requisite approvals from the CEO, CFO or other senior official have 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 not for the benefit of customers, the next day it must either replenish residual interest sufficient to surpass its target, or if senior leadership believes that the original target is excessive, the FCM may revise its target in accordance with its policies and procedures established in § 1.11. The amendments to § 1.23 were also made for Cleared Swaps and foreign futures at § 22.17, and § 30.7(g) respectively, and the costs and benefits considerations of those amendments are considered to be substantively the same.

Costs and Benefits

Restrictions on withdrawals of residual interest provide the benefit of 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, the amount of residual interest an FCM has in a segregated account similarly fluctuates. A sufficient amount of residual interest to cover deficiencies in customers' accounts at one point in time may appear insufficient by the next settlement cycle in extreme market conditions. Therefore, it is important 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 maintains a stable base of residual interest and not withdraw it for other liquidity needs when doing so may result in jeopardizing customer funds in the segregated account if market conditions change quickly.

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.

The adopted amendments require FCMs to take several steps in order to remove more than 25 percent 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 to allow them to monitor the FCM and its segregated accounts closely over subsequent days and weeks. Additional monitoring will help to ensure that the integrity and sufficiency of the FCM's customer segregated accounts are 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 FCM's 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. The amendment also adds protection by ensuring that the Commission has records regarding the name and address of parties receiving funds from any withdrawal of residual interest in segregated funds not for the benefit of customers. Also, 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). Finally, the amendments are consistent with rules imposed on all FCMs by the DSROs.

In the NPRM, the Commission qualitatively analyzed that the amendments to § 1.23 would create costs for FCMs and quantitatively estimated costs associated with obtaining management approvals for withdrawals exceeding 25 percent of the prior day's residual interest. The restrictions on withdrawals were anticipated to potentially prevent an FCM from withdrawing funds quickly in order to meet certain operational needs, or to take advantage of specific investment opportunities, and in general could be expected to result in an FCM needing to hold additional capital outside of residual interest in order to meet operational needs.

The Commission did not receive comments on its quantitative estimates of the costs of obtaining management approvals. However, the Commission

did receive comments on its qualitative analysis of costs, and also received comments that the use of the prior day's actual residual interest as the amount applicable to the restriction would provide a disincentive to FCMs holding additional funds at DCOs as residual interest, which commenters posited as less beneficial to the protection of customers. Several commenters, including FIA and Jefferies suggested the Commission utilize the targeted residual amount as the threshold for notifications and withdrawal restrictions, in order to not discourage FCMs from holding additional funds as residual interest.[739] FIA suggested that the qualitative analysis of the costs was not sufficient and that the amendments would impose a tremendous operational and financial burden on the industry, requiring the development and implementation of entirely new systems to assure compliance and detrimentally impacting liquidity.[740] The Commission believes however, that this comment is not directed to the withdrawal restrictions as adopted or the necessity to replenish the targeted residual interest amount, but instead directed at requirements with respect to holding residual interest sufficient to cover customer under margined amounts, which is addressed separately in the cost benefit considerations for § 1.22.

Jefferies provided some quantitative estimates of the costs of holding increased residual interest, specifically positing that even a five percent increase in residual interest could cost Jefferies $500,000.[741] FIA posited that FCMs currently may increase residual interest day-to-day for expected events, including during stressed market conditions and for the purpose of currency facilitation, and to impose withdrawal restrictions based on the actual, as opposed to targeted, excess would reduce the actual likelihood of FCMs infusing of additional proprietary funds in those circumstances.[742]

The Commission understands that establishing a target and holding residual interest does have costs, but disagrees with the underlying assumptions of the cost estimates provided by Jefferies. The cost estimates provided by Jefferies imply the cost of holding additional residual interest is the same as the FCM's cost of capital. However, the cost considered for the amendments should be the difference in what can be earned by more conservative investments permitted for segregated funds versus otherwise if held by FCMs as unrestricted capital, unless the targeted residual amount exceeds an FCM's minimum net capital requirement. The costs of holding some amount of residual interest is an existing cost of doing business as an FCM because, practically speaking, there is a need to hold some amount of residual interest on a day to day basis to remain in segregation compliance. Significant minimum net capital requirements exist for FCMs, currently. Unless the targeted residual interest in fact exceeds a firm's minimum net capital requirement, the requirement to hold capital as residual interest in customer segregated accounts is not a separate additional capital requirement. Therefore, Jefferies' contention with respect to the costs of the withdrawal restrictions being represented by the costs of additional required capital for a firm is not persuasive. Such cost is only an incremental cost of the newly adopted requirements of establishing or publicizing targets or imposing withdrawal restrictions. Further, the withdrawal restrictions adopted require a one day delay, and management approval and regulatory notifications. These are not absolute restrictions to the withdrawal of residual interest funds and the costs considered and incentives or disincentives created should not be analyzed as if they were. Even the replenishment requirement adopted, with respect to withdrawals not for the benefit of customers resulting in residual interest dropping below the target for residual interest, in order to maintain the targeted residual amount, provides an FCM with the flexibility to reassess the target as an alternative. However, all these processes must be transparent to the Commission, including the FCM's management's accountability for such processes.

The Commission is not persuaded that the reduced incentives to provide added funds to residual interest would be a reason to adopt an alternative of using the targeted residual as opposed to the actual prior day residual as the measurement for the 25 percent withdrawal restriction, which is a requirement for notice and approval, and therefore, not an absolute restriction. The rationales for adding funds specific to certain anticipated events could just as easily provide a clear basis for the management approval and notification process required for the subsequent withdrawal of funds after those circumstances, as opposed to making them unlikely to occur at all. The benefits of clear management accountability and regulatory transparency with respect to such practices and related operational risks (such as potentially more volatile cash flows through segregated accounts not for the benefit of customers) would still be obtained.

Section 1.25 Investment of Customer Funds

Regulation 1.25 sets forth the financial investments that an FCM or DCO may make with customer funds. Among other things, § 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 referred to as a reverse repurchase agreement and in effect, is a collateralized loan by the FCM to its counterparty. Regulation 1.25(b)(3)(v) establishes a counterparty concentration limit, prohibiting FCMs and DCOs from using more than 25 percent of the total funds in the customer segregated account to conduct reverse repos with a single counterparty. The Commission's amendment expands the definition of a counterparty to include additional entities under common ownership or control. Thus, as adopted, 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 additional adopted changes to § 1.25 are conforming amendments proposed in order to harmonize this section with other amendments adopted in this release.

Costs and Benefits

In the NPRM, the Commission discussed how the expansion of the concentration limitation to counterparties under common control or ownership is consistent with the original intention of the concentration limitation, which was to mitigate the potential losses or disruptions due to the default of a counterparty. The Commission has elected to adopt the amendment as a further protection to customer funds, because a default by one counterparty that is under common control or ownership, may adversely impact all of the counterparties to the reverse repurchase agreement and hence adversely impact the FCM and the funds it holds for its customers. Because the amendment incorporates the Commission's interpretation of the existing rule, it does not alter the rule's meaning and, therefore, the amendment does not create any incremental costs or benefits. Likewise, the additional

[739] *See* FIA Comment Letter at 29 (Feb. 15, 2013); Jefferies Comment Letter at 4 (Feb. 15, 2013).

[740] FIA Comment Letter at 13 (Feb. 15, 2013).

[741] Jefferies Comment Letter at 5 (Feb. 15, 2013).

[742] FIA Comment Letter at 27–29 (Feb. 15, 2013).

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 incremental costs or benefits.

Because § 1.25 sets forth the financial investments that an FCM or DCO may make with customer funds, several members of the public [743] expressed their general opinions regarding the investment and handling of customer funds by FCMs and DCOs. In general, all of the commenters supported the position that FCMs and DCOs only be allowed to make safe/non-speculative investments of customer funds and not be allowed to add risk that customers are unaware of or do not sanction. In addition, some of the commenters [744] proposed that the Commission amend its regulations to provide commodity customers with the ability to ''opt out'' of granting FCMs the ability to invest customer funds (including hypothecation and rehypothecation); seven [745] of which further requested that the Commission mandate that an FCM cannot prevent a customer who so ''opts out'' from continuing to trade through that FCM merely because the customer elected to ''opt out.'' Additionally, Vanguard requested that customers have immediate access to the reports indicating that FCMs have failed to comply with various mandates including compliance with § 1.25 margin investment limits; and that customers have access on a twice monthly basis to reports on an FCM's actual investment of customer assets to determine whether such investments are concentrated in more or less liquid assets as allowed under § 1.25.[746] Although the Commission understands the concern of the public regarding the safety and investment of customer funds, because an ''opt out'' provision was not proposed by the Commission, and would in any case not be effective due to pro-rata distribution in an FCM bankruptcy, this alternative is not adopted in this final rulemaking.

Section 1.26 Deposit of Instruments Purchased with Customer Funds

Regulation 1.26 requires an FCM or DCO that invests futures customer funds in instruments described in § 1.25 to obtain a written acknowledgment from any depository holding such instruments. The FCM or DCO must use the Template Letters in the appendices to § 1.20, in accordance with the requirements established in § 1.20. 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. If, however, an FCM or DCO invests funds with a money market mutual fund (MMMF), the FCM or DCO must use the Template Letters in the appendices of § 1.26 rather than the acknowledgment letters in the appendices of § 1.20.[747] The content of the Template Letters in the appendices to § 1.26 is identical to those in the appendices to § 1.20 except that they include three additional provisions related specifically to funds held by the MMMF or its custodian. Specifically, the Template Letters set out the requirements established in § 1.25(c) that: (1) the value of the fund must be computed and made available to the FCM or DCO by 9:00 a.m. on the following business day; (2) 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 MMMF 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 Template Letters required under § 1.20, described above in the cost-and-benefit section related to § 1.20. However, there are benefits to requiring FCMs and DCOs to obtain a different Template Letter from MMMFs with respect to customer funds invested in MMMFs. Specifically, MMMFs or their custodians (as applicable) are required to acknowledge their additional obligations under § 1.25(c).

Costs

The costs are largely the same as for the Template Letters required under § 1.20. The general concerns raised by commenters regarding the costs arising from the Template Letters as well as the Commission's responses are detailed in the discussion of costs for § 1.20.

Section 1.29 Gains and Losses Resulting From Investment of Customer Funds

Regulation 1.29 provides that an FCM or DCO may keep as its own any interest or other gain resulting from the investment of customer funds in financial instruments permitted under § 1.25; however, the FCM or DCO must manage the permitted investments consistent with the objectives of preserving principal and maintaining liquidity. The Commission's amendment also explicitly provides that although an FCM or DCO is not required to pass the earnings on the investment of customer funds back to its futures customers, the FCM or DCO is solely responsible for any losses that result from its investment of customer funds.

[743] Schippers Comment Letter (Dec. 10, 2013), Randy Fritsche Comment Letter (Feb. 14, 2013), NPPC Comment Letter at 2 (Feb. 14, 2013), Strelitz/California Metal X Comment Letter (Jan. 15, 2013), Premier Metal Services Comment Letter at 4 (Jan. 3, 2013), ISRI Comment Letter at 5–7 (Dec. 4, 2012), AIM Comment Letter at 4 (Jan. 24, 2013), Kripke Enterprises Comment Letter (Dec. 12, 2012), Manitoba Comment Letter (Dec. 13, 2012), Solomon Metals Corp. Comment Letter (Jan. 15, 2013), Michael Krall Comment Letter (Dec. 17, 2012), David Kennedy Comment Letter (Dec. 17, 2012), Robert Smith Comment Letter (Dec. 17, 2012), Michael Carmichael Comment Letter (Dec. 17, 2012), Andrew Jackson Comment Letter (Dec. 17, 2012), Donald Blais Comment Letter (Dec. 17, 2012), Suzanne Slade Comment Letter (Dec. 17, 2012), Patricia Horter Comment Letter (Dec. 17, 2012), JoDan Traders Comment Letter (Dec. 17, 2012), Jeff Schlink Comment Letter (Dec. 18, 2012), Sam Jelovich Comment Letter (Dec. 18, 2012), Matthew Bauman Comment Letter (Dec. 20, 2012), Mark Phillips Comment Letter (Dec. 22, 2012), Deborah Stone Comment Letter (Dec. 24, 2013), Po Huang Comment Letter (Dec. 24, 2012), Aarynn Krall Comment Letter (Jan. 8, 2013), Vael Asset Management Comment Letter (Jan. 10, 2013), Kos Capital Comment Letter (Jan. 11, 2013), James Lowe Comment Letter (Jan. 13, 2013), Tracy Burns Comment Letter (Jan. 14, 2013), Treasure Island Coins Comment Letter (Jan. 14, 2013), and Clare Colreavy Comment Letter (Jan. 9, 2013).

[744] NPPC Comment Letter at 2 (Feb. 14, 2013), Premier Metal Services Comment Letter at 4 (Jan. 3, 2013), ISRI Comment Letter at 5–7 (Dec. 4, 2012), AIM Comment Letter at 4 (Jan. 24, 2013), Kripke Enterprises Comment Letter (Dec. 12, 2012), Manitoba Comment Letter (Dec. 13, 2012), Solomon Metals Corp. Comment Letter (Jan. 15, 2013), Michael Krall Comment Letter (Dec. 17, 2012), David Kennedy Comment Letter (Dec. 17, 2012), Robert Smith Comment Letter (Dec. 17, 2012), Michael Carmichael Comment Letter (Dec. 17, 2012), Andrew Jackson Comment Letter (Dec. 17, 2012), Donald Blais Comment Letter (Dec. 17, 2012), Suzanne Slade Comment Letter (Dec. 17, 2012), Patricia Horter Comment Letter (Dec. 17, 2012), JoDan Traders Comment Letter (Dec. 17, 2012), Jeff Schlink Comment Letter (Dec. 18, 2012), Sam Jelovich Comment Letter (Dec. 18, 2012), Matthew Bauman Comment Letter (Dec. 20, 2012), Mark Phillips Comment Letter (Dec. 22, 2012), Deborah Stone Comment Letter (Dec. 24, 2013), Po Huang Comment Letter (Dec. 24, 2012), Aarynn Krall Comment Letter (Jan. 8, 2013), Vael Asset Management Comment (Jan. 10, 2013), Kos Capital Comment (Jan. 11, 2013), James Lowe Comment Letter (Jan. 13, 2013), Tracy Burns Comment Letter (Jan. 14, 2013), Treasure Island Coins Comment Letter (Jan. 14, 2013), and Clare Colreavy Comment Letter (Jan. 9, 2013).

[745] NPPC Comment Letter at 2 (Feb. 14, 2013); Premier Metal Services Comment Letter at 4 (Jan. 3, 2013); ISRI Comment Letter at 6 (Dec. 4, 2012); AIM Comment Letter at 6 (Jan. 24, 2013); Kripke Enterprises Comment Letter (Dec. 10, 2012); Manitoba Comment Letter (Dec. 13, 2012); and Solomon Metals Corp. Comment Letter (Jan, 15, 2013).

[746] Vanguard Comment Letter at 4–6 (Feb. 22, 2013).

[747] Further, per § 1.25(c)(3), the FCM or DCO shall obtain the § 1.26 Template Letter from ''an entity that has substantial control over the [MMMF] 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 [MMMF] sponsor or depository acting as custodian for [MMMF] shares.''

Costs and Benefits

In the NPRM, the Commission discussed how the amendment clarifies that the allocation of losses on the investment of customer funds by an FCM or DCO to its customers would result in the use of customer funds in a manner that is not consistent with section 4d(a)(2) and § 1.20, as customer funds 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. This change was supported by FIA, which stated its belief that the FCM's or DCO's responsibility for losses in § 1.25 investments ''is clear and is implicit in the Act and the Commission's rules.'' [748] The Commission believes that market participants already recognize this responsibility and obligation and direct the investment of customer funds accordingly. Therefore, the Commission does not believe that the amendment to § 1.29(b) will create any additional costs; however, the marketplace will benefit in that the amendment provides clarity as to the FCM's or DCO's sole responsibility for any losses resulting from the investment of customer funds in the financial instruments listed under § 1.25. FIA filed a comment supporting the proposed amendments to § 1.29.[749] No other comments were received. The Commission has adopted the amendments to § 1.29 as proposed.

Section 1.30 Loans by Futures Commission Merchants; Treatment of Proceeds

The Commission adopted amendments to § 1.30 to clarify that, while an FCM may provide secured loans to a customer with adequate collateral, 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.

Costs and Benefits

The amendments prohibiting FCMs from providing unsecured loans to customers and from using a customer's positions to secure loans made to such customers reduce counterparty risk borne by the FCM. The former prohibition prevents the FCM from accumulating exposures to customers that have not margined their positions, while the latter prevents the additional exposure that otherwise would result from using the same collateral to secure two different risks (*i.e.,* the risks associated with the open positions and the risks associated with the secured loan). Additionally, to the extent that the amendments would force certain customers to obtain loans from another lender, it diversifies the counterparty risk across multiple entities. The amendments also are comparable to rules of the CME for its member firms.

The Commission did not quantitatively estimate the potential increase to customers' operational costs due to the inability of customers who need or desire to use borrowed funds to meet initial and maintenance margin requirements to obtain loans necessary to fund their futures or options positions from a third party lender. The Commission requested, but did not receive, comments regarding the prevalence of FCMs' extension of loans to customers and the potential costs customers might bear if it were necessary to obtain loans from third parties rather than from the FCMs with whom their segregated customer accounts are held. Neither were any comments received generally suggesting a qualitative burden in complying with the amendments.

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

The adopted amendments to § 1.32 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 adopted in § 1.17, except that in § 1.17 the amendment is with respect to the haircut for securities purchased by an FCM with its own capital, whereas this amendment applies to the haircut ascribed to the collateral value of securities deposited by customers for the purpose of securing customer net debits. The cost benefit considerations are the same as those analyzed with the corresponding amendment to § 1.17.

In addition, the adopted amendments (1) require FCMs to submit their daily Segregation Schedules, Secured Amount Schedules, and Cleared Swaps Segregation Schedules to the Commission and their DSROs electronically by noon the following business day; (2) require that twice per month, each FCM submits a detailed list 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, further identifying if any of the depositories are affiliated with the FCM; 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 and secured amount statements and the detailed listing of depositories be retained by the FCM in accordance with § 1.31.

Costs and Benefits

Requiring FCMs to submit their daily segregation and secured amount calculations to the Commission and DSROs will enable the Commission and DSROs 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 as reported to the DSRO and available to the Commission through an aggregator of depository balances. The ability of the Commission and DSRO to check for discrepancies more regularly, without notice, is likely to provide an additional deterrent to fraud. Moreover, it will enable both the Commission and DSROs to monitor for any trends that would indicate that 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. In addition, the amendments are consistent with the rules of SROs that currently require each FCM to submit daily segregation and secured amount calculations to the SROs.

The detailed list of depositories will provide additional information to the Commission and DSROs beyond what is required under §§ 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 just the total value. Second, the reports will account for any pending transactions that would not necessarily be apparent from the daily balances submitted to an aggregator by the depositories. Third, FCMs will, in these reports, provide to the Commission and DSROs a reconciled balance, which will not be included with balances provided to the aggregator by depositories. Last, the FCM will be required to specifically

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

[749] FIA Comment Letter at 30–31 (Feb. 15, 2013).

identify any depositories that are affiliated with the FCM. Each of these additional forms of information would enable the Commission and DSROs to provide better oversight and create additional accountability for the FCM, enhancing the protection of market participants.

FCMs are already calculating segregated funds information daily and reporting the results to 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.[750] Requiring FCMs to submit these reports to the Commission via the same platform is not expected to create any additional costs.

FIA commented in support of the amendments to § 1.32 and asked for clarification that on a daily basis, a single U.S. dollar equivalent, as opposed to multiple currency by currency schedules, is what is required to be filed.[751] Jefferies commented that the amendments to § 1.32 will not achieve the benefit of transparency to customers because of the way cash and investments are presented separately from balances at other FCMs and DCOs.[752] However, this comment appears related to the requirements of disclosure to customers of NFA's publicly available information, not the requirements of § 1.32, which require similar information to be reported to the Commission and DSROs. The Commission believes the detailed information required, along with all the additional disclosures being provided to customers in the amendments to all rules contained herein, do provide sufficient transparency for customers to be able to assess the risks of depositing funds with FCMs. The specific detailed amounts of cash and securities held in segregation must be provided, by individual depository, including DCOs, under the amendment to § 1.32. The Commission does not believe that customers will misinterpret the liquidity of cash held at DCOs as opposed to other types of depositories, and that therefore the requirements do not provide the transparency intended, although the Commission understands that Jefferies is concerned with the appearance of percentage calculations that are provided publicly on NFA's portal. The Commission notes, however, that the amendments to § 1.32 do not require reporting of any percentage calculations. There were no comments received regarding the Commission's analysis that, due to the existing NFA requirements, the Commission's amendments to § 1.32 were not expected to result in incremental costs for FCMs.

With respect to the adopted changes to allow FCMs to utilize lower haircuts applicable to the market value of customer securities, if such securities are determined to have minimal credit risk, in determining the allowance provided for securing net deficits of customers, the CFA specifically objected to the ability of FCMs to obtain the benefit of lower haircuts by utilizing the process of establishing credit risk proposed in the amendment to the SEC's rule 15c3–1.[753] However, the Commission has determined that the ability of FCMs to utilize haircuts lower than the standard deduction of 15% otherwise applicable under SEC rule 15c3–1 should be equally available to FCMs along with jointly registered BD/FCMs under the Commission's adopted amendment to the net capital rule at § 1.17, to promote equity and fairness of competition between FCMs and joint BD/FCMs and to maintain uniformity with the capital rule of the SEC for the treatment of securities as much as practicable. The Commission believes, despite the CFA's comments indicating the haircut could be manipulated, that the collateral value haircut for the same security for the purpose of securing net deficits should also be determined by reference to the net capital haircut for the same security, and notes both have always been determined by the SEC's net capital haircuts for securities. The Commission believes the benefits of continuing to have such uniformity are substantial. The alternative, which necessarily would be applying a very substantial standard haircut to a debt security with minimal credit risk collateralizing a short term obligation, would be overly harsh and not accurately reflect the market risk to such collateral for the stated purpose of valuing the extent to which the customer debit is adequately secured. The Commission further notes that the SEC's rule, which is the basis for these amendments at §§ 1.17, 1.32 and 30.7, and the formulation adopted in these amendments, still provides a standard, although lesser percentage, haircut, not a model-based haircut, and also provides for an audit trail of the BD/FCM's determinations supporting the determination of minimal credit risk, which should prevent the ability of FCMs to manipulate the haircut, as suggested by CFA.

Section 1.52 Self-regulatory Organization Adoption and Surveillance of Minimum Financial Requirements

The amendments to 1.52 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 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.

Costs and Benefits

The amendments adopted to § 1.52 provide significant additional protection to market participants and customer of FCMs by helping to ensure that SRO examinations of member FCMs are thorough, effective and risk-based, and include evaluation and testing of internal controls as well as meeting, as applicable, other objective criteria from related professional audit standards. Specifically, an SRO's audit program must be risk-based (*e.g.,* the scope and focus of such examinations would be determined by the risk profile that the SRO develops for each FCM) and address ''all areas of risk to which FCM can reasonably be foreseen to be subject,'' and that the examination itself includes both controls testing as well as substantive testing. Requiring regulatory examinations by SROs to include testing and review of internal controls will help ensure that each FCM is not only compliant with capital and segregation requirements at the time of the examination, but that they continue to operate in such a manner without undetected internal controls inadequacies that could jeopardize the FCM and its customers.

By requiring that the supervisory program for an SRO to adhere to professional standards for auditing as applicable, the Commission is provided with additional assurance as to standards for aspects of an examination such as the adequacy of the evaluation of evidence obtained supporting examination conclusions; the training and proficiency of the examinations staff; due professional care in the performance of the work; consideration of fraud, audit risk and materiality in conducting an audit; planning and supervision; understanding the entity and its environment and assessing the

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

[751] FIA Comment Letter at 30–31 (Feb. 15, 2013).

[752] *See* Jefferies Comment Letter at 3 (Feb. 15, 2013).

[753] *See* CFA Comment Letter at 7 (Feb. 13, 2013).

risk of material misstatement; communication with those charged with governance of the examined entity; and communicating internal control matters identified in an examination. These benefits are obtained by requiring SRO supervisory programs to include consideration of specific issues and be carried out in compliance with professional standards as may be applicable to non-financial audits. The Commission believes more rigorous requirements and the application of professional standards in carrying out such requirements will add additional protection to an FCM's counterparties and customers.

The Commission also proposed to require SROs and as applicable the JAC, to obtain an evaluation of the SRO's or JAC's supervisory program at least once every two years from an examinations expert, defined as a nationally recognized accounting and auditing firm with substantial expertise in audits of FCMs, risk assessment and internal control reviews, and that is an accounting and auditing firm that is acceptable to the Commission (as delegated to the Director of the Division of Swap Dealer and Intermediary Oversight). The benefits of such evaluation by examinations experts were expected to be that the Commission would ensure that the supervisory program and SRO audits continue to build on best practices, which further promotes thorough and effective audits of FCMs. The Commission quantitatively estimated costs for making incremental changes to the requirements of the supervisory program for each SRO and members of the JAC in the NPRM. The Commission did not quantitatively estimate the ongoing costs of obtaining an evaluation by an examinations expert or requiring examinations to comply with professional standards, although the Commission did consider that requiring such an evaluation and requiring compliance with such standards and coverage of additional risks would add costs to examinations by SROs and members of the JAC.

The Commission received many comment letters regarding the changes proposed to § 1.52. Several of the commenters objected to the requirements for having a review of the examination program by an examinations expert.[754] Specifically, PWC raised concern with the ability of nationally recognized accounting and auditing firms to be able to issue any type of assurance without a reporting framework.[755] NFA, MGEX, and CME all commented that costs would be prohibitive and that benefits would be reduced because such an evaluation would be duplicative to the functions of the Commission in review of the Joint Audit Program. NFA commented that it attempted to obtain cost estimates from a few nationally recognized firms but that such firms represented that they were unable to provide cost information without a better understanding of the type of review the Commission was proposing.[756] CME commented that the quantitative estimates of the Commission for revising the program were grossly underestimated.[757] CME analogized that requiring adherence to professional standards would result in examination requirements similar to the average man hours applicable to private and public company audits, which were represented at 1,951 and 17,457 respectively.[758] CME represented that the costs of compliance with professional standards and expanding the program were prohibitively expensive and requested that only applicable provisions should be carried into JAC protocols.[759] CME commented that any benefit from obtaining an evaluation from an examinations expert could be obtained at a much reduced cost by including representatives from such nationally recognized firms in the JAC meetings and in the current process to develop JAC protocols, without obtaining a formal assessment, which such firms would more likely to be willing to do.[760] CME further posited that if such alternative was not adopted, the timeframe should be lengthened from two to three and a half years.[761] MGEX further commented that if such report were to be required, highly qualified regional firms should be considered as well as nationally recognized firms, as more competition would likely result in more manageable costs.[762]

In consideration of the concerns of commenters, the Commission has adopted revised amendments to the examinations expert requirement to § 1.52, which extend the time between evaluations required to three years, and clarify that the standard for such evaluation should be that of a consulting services report. The Commission also has considered the comments of CME and others with respect to the costs and inapplicability of many aspects of the PCAOB auditing standards to regulatory examination and has adopted, in the revised amendments to the professional standards requirements, that only such standards as would be analogous to non-financial statement audits would be applicable.

The JAC also filed an additional comment letter positing that the requirements of proposed § 1.52, requiring review of risk management, would be duplicative to risk reviews required to be performed by DCOs.[763] Although the Commission agrees there may be overlapping responsibilities between oversight performed by DCOs and SROs which could result in duplicated costs, the primary focus of DCO requirements are the protection of the DCO, not the protection of customers and market participants. The Commission notes that the same duplication could exist if an FCM were examined by each SRO of which it was a member. The Commission already permits the Joint Audit Committee, the Joint Audit Plan and the DSRO structure for the purpose of mitigating duplicative examination work and costs. As stated in the preamble, a DSRO may be able to fulfill parts of its examination program by incorporating aspects of risk reviews and work already performed by a DCO, but the DSRO would be responsible for ensuring any such work was adequately and specifically incorporated into the DSRO program, and oriented to ensuring the protection of customers and risks to the FCM.

Additionally, the Commission notes it was not feasible to quantify any costs associated with utilizing an examinations expert. This is largely because several nationally recognized accounting firms expressed their reluctance to provide such information.[764] Such a response is not surprising given the fact that reviewing a DSRO's examination program is likely a unique and limited engagement for any firm, which would require fully understanding the scope and requirements of the review. Yet, the Commission notes there are several capable firms which would meet the definition of ''examinations expert'' and could perform the type of review required by the regulation. Thus, the costs for performing such a service will likely be competitive.

[754] CME, JAC, MGEX, NFA and PWC all commented objecting to or raising concern with this aspect of the amendment to § 1.52.

[755] *See* PWC letter at 3 (Jan. 15, 2013).

[756] *See* NFA Comment Letter at 5 (Feb. 15, 2013).

[757] CME Comment Letter at 11 (Feb. 15, 2013).

[758] *Id.*

[759] *Id.*

[760] *Id.*

[761] *See* CME Comment Letter at 12–13 (Feb. 15, 2013).

[762] *See* MGEX letter at 4 (Feb. 18, 2013).

[763] *See* JAC Comment Letter at 3–4 (July 25, 2013).

[764] *See* NFA Comment Letter at 5, n.2 (Feb. 15, 2013).

Section 1.55 Public Disclosures by Futures Commission Merchants

Amended § 1.55 significantly revises the disclosures that FCMs are required to provide to prospective customers and the public, detailed in § 1.55(b). The new required provisions include 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; (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. The required additional disclosures must be provided as an addition to the generic risk disclosure statement if used by an FCM as permitted under Appendix A to § 1.55.

In addition, the amendments at § 1.55(i), (j) and (k) 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.

The Firm Specific Disclosure Document is required to be made available electronically, which may be a link to the FCM's Web site, but must be provided in paper form upon request, 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 FCM'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 [765]; (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 are required to update the Firm Specific Disclosure Document as and when necessary to make the information accurate and complete, but at least annually.

The newly adopted § 1.55(l) also requires FCMs to adopt policies and procedures reasonably designed to ensure that advertising and solicitation activities of such FCMs and any introducing brokers associated with the FCMs are not misleading in connection with their decision to entrust funds and do business with such FCMs.

FCMs are further required by § 1.55(o) to disclose on their Web sites their daily Segregation Schedule, daily Secured Amount Schedule, and daily Cleared Swaps Segregation Schedule. Each FCM must maintain 12 months of such schedules on its Web site. Each FCM must disclose on its Web site 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.

Costs and Benefits

Current regulations require FCMs to provide a risk disclosure to potential customers before accepting customer funds, which existing risk disclosure statement primarily provides a customer with disclosure of the market risks of engaging in futures trading. The revised disclosure requirements of § 1.55 provide customers with additional information regarding 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 required by this amendments address firm-specific risk, which will give potential customers additional information that they may use when conducting due diligence and selecting an FCM. By requiring that the disclosure address several specific topics, the public comparability of information on such topics will be available, to potential customers conducting due diligence on potential FCMs. The non-firm specific additional disclosures will provide a significant benefit to the protection of market participants as many customers in the aftermath of recent FCM bankruptcies revealed fundamental misconceptions about the protection of their funds. Specifically, certain customers did not fully understand how FCMs held customer funds or the protections extended to such funds. Consequently, certain customers did not make informed choices to help themselves or to provide market discipline to their FCMs.

In the NPRM, the Commission described how each additional specific risk disclosure was expected to benefit the protection of market participants by providing more transparency and equal access to information among all customers and the public, enhancing customer's ability to make comparisons in choosing the FCMs with which they do business. The specific benefits of each disclosure required by the amendments were described in the NPRM, but the essential benefits derived from each additional required disclosure, and the aggregate of all the additional disclosures, are that they will result in more educated consumers of FCM services, and that such consumers will, through the greater transparency resulting from the additional disclosures, be better able to enforce market discipline on aspects of FCM business that are directly relevant to the risks customers accept in dealing with and depositing funds with FCMs.

The Commission quantitatively estimated expected costs of providing the additional general and firm specific disclosures in the NPRM and did not receive any comments about its specific estimates. However, the Commission

[765] 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.''

did receive many comments that supported the amendments to § 1.55 reiterating the benefits perceived from transparency resulting from the additional disclosures as are described at section II.P. and noting that these amendments were particularly cost effective at providing such benefits. FHLB stated ''[p]erhaps the most compelling argument for additional public disclosure of certain information addressed in the Proposed Customer Protection Rules is that the benefits should far exceed the additional cost associated with mandating such public disclosures.'' [766] ACLI and the Commercial Energy Working Group both stated ''the Proposed Customer Protection Rules represent a very cost-effective approach/means to making FCMs more accountable to their customers by providing current information that will enable customers to conduct appropriate due diligence regarding prospective FCMs and to actively monitor the financial condition and regulatory compliance of the FCMs to which they have entrusted funds.'' [767]

FIA specifically commented with respect to the disclosures required under § 1.55(k) that FCMs that are part of public companies, or dually registered BDs, or are part of a bank holding company, already have disclosure requirements and that the Commission should confirm that such an FCM may comply with this rule by making the annual reports and amendments thereto available on its Web site, in order to avoid duplicative or conflicting disclosure requirements.[768] FIA further commented that the level of detail required of privately owned FCM's disclosure should be consistent with that provided in the annual reports of publicly-traded companies.[769] Newedge commented that all FCMs should be required to disclose similar information in a standard format, and the proposal of FIA to satisfy disclosure requirements by linking to the annual report of a public company places firms without annual report preparation requirements at a competitive disadvantage and discriminates against smaller to mid-size FCMs.[770]

In the preamble discussion at section II.P., the Commission clarified both that disclosures could be satisfied by linking to appropriate existing relevant disclosures that were already required for the same matters, but that the disclosures required by the amendments are specific to the FCM and cannot be satisfied with more general disclosure at a holding company level. The Commission believes this clarification addresses the duplication concern raised by commenters.

Several commenters posited concerns regarding the benefit of various aspects of the mandated disclosures. The comments addressed the disclosures of leverage, the targeted residual interest, customer write-offs, and that such disclosures could in certain circumstances be potentially misleading to customers.[771] With respect to these comments the Commission notes that with all aspects of the mandated additional disclosures, appropriate explanations and additional information to ensure sufficient context should be provided if necessary to clarify anything that an FCM may regard as otherwise being misleading. Concerns raised by commenters that customers may inadequately assess risks particular to their FCM by inappropriately focusing on only one aspect of disclosure, such as leverage, or targeted residual interest, cannot be mitigated by declining wholesale to make relevant information publicly available. Furthermore, FCMs are free to supply additional context and information when they believe that any Firm Specific Disclosure is misleading.

Certain commenters have requested that the Commission consider the alternative to further require all § 1.12 notices to be made publicly available, which the Commission has declined to do as is discussed in the costs and benefits discussion of § 1.12. By requiring FCMs to update the disclosures 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, § 1.55(i) makes FCMs responsible to communicate with customers whenever such events occur. The Commission notes that there may be overlap in circumstances which give rise to notice obligations under § 1.12 and which require updated public disclosure, although the two are distinct and separate requirements. This requirement helps to ensure that the FCM's financial condition, business operations, or other important factors do not change in material ways without customers being able to ascertain 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 each FCM to adopt policies and procedures reasonably designed to ensure that its advertising and solicitation activities are not misleading to its FCM customers under § 1.55(l), the Commission is strengthening accountability for communication related to an FCM's sales and solicitation activities which helps to ensure the purposes of the other requirements for disclosure are not frustrated.

By requiring FCMs to provide their daily Segregation Schedules, daily Secured Amount Schedules, and daily Cleared Swaps Segregation Schedules, as well as the same schedules from the most recent certified annual report, the requirements under § 1.55(o) facilitate transparency. Requiring each FCM to post the above schedules and data on its Web site will help to ensure that market participants are aware that it is available, and will 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 reducing the search costs for obtaining that information.

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

The adopted amendments to § 22.2 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.[772] Those changes include: (1) Incorporating the same change to haircutting procedures as adopted in § 1.17 and § 1.32 but for Cleared Swaps; (2) requiring the FCM to

[766] *See* FHLB Comment Letter at 3 (Feb. 15, 2013).

[767] *See* ACLI Comment Letter at 2 (Feb. 15, 2013); Commercial Energy Working Group Comment Letter at 2 (Feb. 13, 2013).

[768] *See* FIA Comment Letter at 43 (Feb. 15, 2013).

[769] *Id.* at 44.

[770] Newedge Comment Letter at 4 (Feb. 15, 2013).

[771] *See* FCStone Comment Letter at 4 (Feb. 15, 2013); Phillip Futures Inc. Comment Letter at 2 (Feb. 14, 2013); CHS Hedging Comment Letter at 2 (Feb. 15, 2013); RJ O'Brien Comment Letter at 6–9 (Feb. 15, 2013); TD Ameritrade Comment Letter at 4 (Feb. 15, 2013); Advantage Comment Letter at 4 (Feb. 15, 2013); RCG Comment Letter at 5–6 (Feb. 12, 2013).

[772] As noted in section II.Q. above, the revisions to §§ 22.2(a) and (f) merely clarify that the calculation set forth therein is the Net Liquidating Equity Method and thus, the revision is not intended to, and should not be read to, change current practice with respect to an FCM's residual interest requirements for Cleared Swaps as set forth in Commission regulations and JAC Update 12–03, and consistent with Staff Interpretation 12–31.

send daily Segregation Calculations for Cleared Swaps to the Commission and DSROs; and (3) requiring that segregated investment detail reports be produced twice per month, listing assets on deposit at each depository, and sent to Commission and DSROs electronically by 11:59 p.m. the following business day. Records of both reports are required to be maintained in accordance with § 1.31.

Costs and Benefits

As discussed above, amendments to § 22.2(a) and (f) are not intended to change existing practice and thus do not introduce new costs. The other amendments to § 22.2 noted above are substantively similar to amendments to corresponding part 1 regulations and the relevant costs and benefits are similar to the costs and benefits discussed in those sections.

The amendments to § 22.2 have the benefits of harmonizing the protection of customer funds between Cleared Swaps and futures and clarifying further the regulatory requirements for Cleared Swaps.

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

The newly adopted § 22.17 imposes restrictions on an FCM's withdrawal of its residual interest, and requires that if a withdrawal of residual interest not for the benefit of customers 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.

Costs and Benefits

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 as described in §§ 1.23 and 1.11, but incremental thereto with respect to Cleared Swaps Customer Accounts.

Section 30.1 Definitions

Amendments adopted to § 30.1 establishes new 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 relate to the existing terms ''foreign futures or foreign options customer,'' ''foreign futures or foreign options customer account,'' and ''foreign futures or foreign options customer funds,'' respectively. The 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 new definitions, on the other hand, include both U.S. and foreign-domiciled customers that deposit funds with an FCM for use in trading foreign futures or foreign options.

Costs and Benefits

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.

Section 30.7 Treatment of Foreign Futures or Foreign Options Secured Amount

The adopted amendments to § 30.7 (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;[773] (4) add restrictions on withdrawing from residual interest not for the benefit of customers;[774] (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 a loan; (8) require daily segregation reports and a detailed list of depositories to 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 BD procedure for assigning a smaller net capital haircut to investments of 30.7 customer funds in certain types of 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 U.S.; and (11) require FCMs to, at a specified point in time, maintain residual interest in 30.7 accounts that is at least equal to the sum of all undermargined amounts for 30.7 customers. With the exception of the requirements with respect to limiting funds held outside the U.S., the permissibility of certain depositories outside the U.S., and the requirement that FCMs comply with the highest equivalent custody requirement relevant in a different country, these requirements are substantially similar to equivalent requirements adopted in §§ 1.20, 1.22, 1.23, 1.29, 1.30, 1.32 and 22.2 and 22.17. As a result of the adopted changes with the noted exceptions, the rules in § 30.7 for the protection of 30.7 customer funds are substantially similar to the rules for the protection of segregated customer funds under 4d(a) and §§ 1.11–1.32, and the rules for the protection of cleared swaps customer funds under 4d(f) and in part 22. However, portions of § 30.7 are notably different from rules protecting futures customer funds and cleared swap customer funds. These 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, due to the possibility of a higher requirement under a foreign regulatory regime; (2) the list of acceptable depositories for 30.7 customer 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; (3) § 30.7 limits the amount of funds from a 30.7 account that can be held outside the U.S; and (4) the Residual Interest Deadline for 30.7 funds is 6:00 p.m. Eastern Time, whereas the Residual Interest Deadline for futures customer funds will, after the phase-in period and absent further Commission action, move back to the time of the daily settlement.

The third and fourth are the only substantive differences in the custody regime created by the adopted amendments compared to the custody regimes put in place in the corresponding sections for domestic

[773] 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.

[774] The same requirements as are adopted for futures customers' funds and Cleared Swaps Customers' Collateral, including a requirement for the FCM to abide by its policies and procedures required by new § 1.11.

futures customer funds and cleared swaps customer funds.

Costs and Benefits

In the NPRM, the Commission stated it believed a significant benefit of the amendments adopted to § 30.7 would be the likelihood that in an FCM insolvency, the full amount owed to customers trading foreign futures and foreign options, whether such customers were foreign or domestic domiciled, would be intact as required to be held separately in 30.7 accounts. The Commission did not receive comments objecting to the changes to the calculations or the required inclusion of foreign-domiciled customers. The adopted changes also established new regulations for the protection of customer funds deposited for trading in foreign futures and options that, with limited exceptions, are substantively identical to the new protections adopted 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 part 22.

Various regulations designed to ensure that the new calculation requirement for the segregation of 30.7 funds 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 30.7 customer 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 further ensure the protection of market participants and provide, as much as possible, equivalent protections between domestic and foreign futures trading with respect to the treatment of funds held by the FCMs. The Commission did not quantitatively estimate costs of the amendments to § 30.7, but requested comment as to any costs to FCMs, including whether FCMs would need to obtain additional capital or obtain additional liquidity as a result of formally foreclosing their abilities to utilize the Alternative Method versus the Net Liquidating Equity segregation method in funding operations. The Commission did not receive comments addressing these questions, or addressing its analysis that costs and benefits would be incremental to the costs and benefits analyzed with respect to the same substantive provisions applicable to both 4d(a) (futures) and 4d(f) (Cleared Swaps) segregated funds. Moreover, the Commission believes any incremental costs associated with complying with these changes to be minimal, since much of the industry is already held to these standards as a result of previous rule changes made by NFA to its rulebook.[775]

In the NPRM, the Commission proposed in § 30.7(c) a limitation on 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 promptly 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 a foreign affiliate of the FCM, as the likelihood of coincident bankruptcies of affiliated financial firms has been observed to be exceedingly high.[776] In such an event, the funds held at the foreign 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 the amount of funds that can be held outside the U.S. was intended to assure 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 (and most prompt) pro rata distribution possible.

The Commission received comments from FIA, as well as others, that the proposed percentage limitation of 10% of required margin was not adequate in light of account volatility and other factors, and that the limitation should only be applicable to funds deposited with foreign brokers and that otherwise FCMs should be permitted to hold funds in a bank or trust company outside the U.S. to the same extent that an FCM may hold other customer segregated and Cleared Swaps Customer collateral outside the U.S.[777] Commenters including Jefferies and Advantage stated that the limitations may inhibit FCMs from trading foreign futures and that customers may need to utilize non-U.S. brokers for their foreign futures business as a result, because they would not be able to accept customer securities outside the U.S. and customers would have to pre-fund with cash instead.[778] In response to commenters and upon consideration, the Commission is increasing the limitation from 10% to 20%, but is declining to further expand the permissibility of holding 30.7 funds outside the U.S. due to the increased repatriation risk applicable to excess margin deposited outside the U.S. for 30.7 funds for foreign futures and foreign options.

For 30.7 accounts, an FCM must maintain residual interest that is at least equal to undermargined amounts by 6:00 p.m. Eastern Time on the following business day, which is substantively similar to the Industry Commenters' Alternative discussed above in the cost and benefit considerations related to § 1.22. As noted there, FIA and ISDA estimated that more than 90% of customer's margin deficits are collected by FCMs by 6:00 p.m. Eastern Time on the next trading day.

Thus, the Commission estimates the additional requisite residual interest needed for 30.7 accounts using the analysis described above for futures customer accounts. As of November 30, 2012, there was approximately $30 billion in 30.7 accounts (excluding, here, and in the following amounts, excess amounts contributed by FCMs).[779] At the top-10 FCMs, there was approximately $27.7 billion in 30.7 accounts.[780] For the remaining FCMs, there was approximately $2.3 billion in 30.7 accounts.[781] Using ISDA's point estimate for excess collateral deposited by customers,[782] the Commission estimates that there was, at the top-10 FCMs, approximately $8.6 billion (31% of $27.7 billion) of existing customer excess in 30.7 accounts. Similarly, for the remaining FCMs, the Commission estimates that there was approximately

[775] *See* NFA Interpretive Notice 9066 (Revised, July 1, 2013).

[776] *See, e.g.,* Lehman, MFGI.

[777] FIA Comment Letter at 36–37 (Feb. 15, 2013); RJ O'Brien Comment Letter at 11 (Feb. 15, 2013).

[778] Jefferies Comment Letter at 6 (Feb. 15, 2013); Advantage Comment Letter at 9 (Feb. 15, 2013).

[779] *See http://www.cftc.gov/MarketReports/FinancialDataforFCMs/HistoricalFCMReports/index.htm.*

[780] *See id.*

[781] *See id.*

[782] As discussed in the analysis of § 1.22(c) above, ISDA estimated the excess to be between $40 and $70 billion and employed the midpoint of this range, $55 billion in its calculations. $55 billion is 31% of the total 177.1 billion held in both section 4d(a)(2) and part 30 secured accounts.

$0.7 billion (31% of $2.3 billion) of customer excess corresponding to 30.7 accounts.

For the top-10 FCMs, the Commission subtracts $8.6 billion (existing customer excess for these accounts) from $27.7 billion (total funds held in these accounts) leaving approximately $19.1 billion in required margin for 30.7 accounts for these FCMs. Multiplying ISDA's 60% required margin estimate (which assumed that the residual interest requirement applies at all times) by 10% (*i.e.,* 1–90%) gives 6% of the required margin being needed in residual interest, or $1.1 billion for these FCMs. As of November 30, 2012, the top-10 FCMs were holding approximately $3.3 billion in residual interest in 30.7 accounts.[783] Thus, it would appear that the top-10 FCMs are already holding sufficient residual interest for 30.7 accounts. For the remaining FCMs, the Commission subtracts $0.7 billion (existing customer excess for these accounts) from $2.3 billion (total funds held in these accounts) giving approximately $1.6 billion in required margin. Multiplying $1.6 billion by 6% gives approximately $96 million, but FCMs already maintain over $1 billion in residual interest. Consequently, it would appear that the remaining FCMs also already maintain enough residual interest for 30.7 accounts.

V. Related Matters

A. Regulatory Flexibility Act

The Regulatory Flexibility Act (''RFA'') [784] requires Federal agencies, in promulgating regulations, to consider the impact of those regulations on small entities. As stated in the NPRM, 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.[785] 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.[786] 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.[787] The Commission also has previously determined that DCOs are not small entities for the purpose of the RFA.[788] Accordingly, the Chairman, on behalf of the Commission, certified pursuant to 5 U.S.C. 605(b) that the proposed regulations would not have a significant economic impact on a substantial number of small entities. The Commission then invited public comment on this determination. The Commission received no comments.

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'').[789] This final rulemaking contains several collections of information that were submitted to OMB in the form of proposed amendments to existing collection 3038–0024 and proposed revisions thereto, as well as pre-existing collections 3038–0052 and 3038–0091. There have been no substantive changes from the proposed rulemaking to this final rulemaking that would require any adjustment to the information collection burdens as they were originally proposed. As required by OMB regulations, the Commission shall submit to OMB this final rulemaking, together with ICRs that have been updated to include the comment summary contained herein.

The collections contained in this rulemaking are mandatory collections. In formulating burden estimates for the collections in this rulemaking, to avoid double accounting of information collections that already have been assigned control numbers by OMB, or are covered as burden hours in collections of information pending before OMB, the PRA analysis provided in the proposed rulemaking, along with the information collection request (''ICR'') with burden estimates that were incorporated into the rulemaking by reference and submitted to OMB, accounted only burden estimates for collections of information that have not previously been submitted to OMB. The Commission sought comment on the collections of information contained in the proposed rulemaking only to the extent that the collections in the proposed rulemaking would increase the burden hours contained with respect to each of the related currently valid or proposed collections.

The Commission received over 120 written submissions on the proposed rulemaking. Many of these comments discussed in general the need for, effectiveness of, and practicality of various proposed rules. However, none of the commenters questioned the burden estimates provided in the proposed rulemaking or the ICR that was submitted. To the extent that there were comments on the need for, effectiveness and practicality of various proposed rules, they related to the rulemaking as a whole rather than the collections in particular. Accordingly, those comments were addressed above, in the sections of the preamble of this final rulemaking that relate specifically to the proposed rules at issue.

As required by the PRA, the Commission submitted the proposed amendments, in the form of information collection requests related to collections 3038–0024, 3038–0052, and 3038–0091 on November 14, 2012, the same date that the proposed rulemaking was published in the **Federal Register**.[790] The Commission did not receive public comments on any of the proposed collections from OMB on or before January 13, 2013, within the 60 days established for such comments in the PRA after the notice of proposed rulemaking and the submission of the certified ICR to OMB.[791] Accordingly, the proposed amendments to collections 3038–0024, 3038–0052, and 3038–0091 are deemed to be approved by operation of the PRA.[792] The Commission therefore, pursuant to OMB regulations,[793] requests the assignment of OMB control numbers to the proposed amendments to collections 3038–0024, 3038–0052, and 3038–0091, which were submitted to OMB for approval on November 14, 2012.

[784] 5 U.S.C. 601 et seq.

[785] 47 FR 18618 (Apr. 30, 1982).

[786] *Id.* at 18619.

[787] *Id.*

[788] *See* 66 FR 45605, 45609 (Aug. 29, 2001).

[789] 44 U.S.C. 3501 *et seq.*

[790] *See* 44 U.S.C. 3507(d)(1)(A), providing for an agency to forward to the Director of OMB or his or her designee a notice of proposed rulemaking with a collection of information subject to notice and comment pursuant to the provisions of 44 U.S.C. 3506(c)(2)(B), on or before the date that the proposed rulemaking is published in the **Federal Register**, together with the ICR in the form required by OMB in 5 CFR 1320.8 and 1320.9.

[791] *See* 44 U.S.C. 3507(d)(1)(B), cross-referencing 44 U.S.C. 3508. *See also* 5 CFR 1320.11(c).

[792] *See* 44 U.S.C. 3507(3).

[793] *See* 5 CFR 1320.11(i), implementing 44 U.S.C. 3507(d)(3).

APPENDIX 1 TO SUPPLEMENTARY INFORMATION—TABLE OF COMMENT LETTERS

Abbreviation used (if applicable)	Full name
Advantage	Advantage Futures LLC.
AFMP Group	Agricultural Futures Market Participants: AMCOT, American Cotton Shippers Association, American Farm Bureau Federation, American Feed Industry Association, American Soybean Association, CoBank, Commodity Markets Council, National Association of Wheat Growers, National Barley Growers Association, National Cattlemen's Beef Association, National Corn Growers Association, National Cotton Council, National Council of Farmer Cooperatives, National Grain and Feed Association, National Pork Producers Council, National Sorghum Producers, National Sunflower Association, North American Millers Association, USA Rice Federation, US Canola Association, US Dry Bean Council.
AIMA	Alternative Investment Management Association.
Amarillo	Amarillo Brokerage Co.
ACLI	American Council of Life Insurers.
AFBF	American Farm Bureau Federation.
AICPA	American Institute of Certified Public Accountants.
AIM	American Iron & Metal.
BlackRock	BlackRock, Inc.
Depository Bank Group	BMO Harris Bank, Barclays Bank, The Bank of New York Mellon and Brown Brothers Harriman & Co.
Center for Audit Quality	Center for Audit Quality.
CFA	CFA Institute.
Chris Barnard	Chris Barnard.
CHS Hedging	CHS Hedging, Inc.
CME	CME Group Inc.
CoBank	CoBank.
Commercial Energy Working Group.	Commercial Energy Working Group.
CIEBA	Committee on Investment of Employee Benefit Assets.
CCC	Commodity Customer Coalition.
Congressional Committees	Congress of the United States: Frank D. Lucas, House Committee on Agricultural; Debbie Stabenow, Senate Committee on Agriculture, Nutrition, and Forestry.
Deloitte	Deloitte & Touche.
Ernst & Young	Ernst & Young LLP.
Eurex	Eurex Clearing AG.
FHLB	Federal Home Loan Banks.
Federal Reserve Banks	Federal Reserve Banks of New York and Chicago.
FXCM	Forex Capital Markets LLC.
Franklin	Franklin Templeton Investments.
Frontier Futures	Frontier Futures, Inc.
FIA	Futures Industry Association (Collectively—Barclays, State Street, Goldman Sachs, others).
Global Commodity	Global Commodity Analytics & Consulting LLC.
ISRI	Institute of Scrap Recycling Industries, Inc.
ISDA	International Swap Dealers Association, Inc.
FCStone	INTL FCStone, Inc.
ICI	Investment Company Institute.
ICA	Iowa Cattlemen's Association.
Jefferies	Jefferies Bache, LLC.
JSA	John Stewart and Associates.
JAC	Joint Audit Committee.
Katten-FIA	Katten Muchin Rosenman LLP on behalf of the Futures Industry Association.
KPMG	KPMG LLP.
Kripke Enterprises	Kripke Enterprises.
LCH.Clearnet	LCH.Clearnet Group Limited.
MFA	Managed Funds Association.
Manitoba	Manitoba Corporation.
MGEX	Minneapolis Grain Exchange, Inc.
NCBA	National Cattlemen's Beef Association.
NCFC	National Council of Farmer Cooperatives.
NFA	National Futures Association.
NGFA	National Grain and Feed Association.
NIBA	National Introducing Brokers Association.
NPPC	National Pork Producers Council.
NEFI/PMAA	New England Fuel Institute Petroleum Marketers Association of America.
NYPC	New York Portfolio Clearing, LLC.
Newedge	Newedge USA, LLC.
Nodal	Nodal Exchange, LLC.
Paul/Weiss	Paul, Weiss, Rifkind, Wharton & Garrison LLP.
Phillip Futures Inc.	Phillip Futures Inc.
Pilot Flying J	Pilot Travel Centers, LLC.
Premier Metal Services	Premier Metal Services, LLC.
Prudential	The Prudential Insurance Company of America.
PWC	PWC LLP.
Randy Fritsche	Randy Fritsche.
Rice Dairy LLC	Rice Dairy LLC.

APPENDIX 1 TO SUPPLEMENTARY INFORMATION—TABLE OF COMMENT LETTERS—Continued

Abbreviation used (if applicable)	Full name
RJ O'Brien	R.J. O'Brien & Associates, LLC.
RCG	Rosenthal Collins Group.
Schippers	Schippers Trading.
Schwartz & Ballen	Schwartz & Ballen LLP.
Security Benefit	Security Benefit Life Insurance Company.
SIFMA	SIFMA Asset Management Group.
Solomon Metals Corp.	Solomon Metals Corp.
State Street	State Street Corporation.
Steve Jones	Steve Jones.
SUNY Buffalo	State University of New York at Buffalo Law School.
TD Ameritrade	TD Ameritrade, Inc.
TCFA	Texas Cattle Feeder Association.
TIAA–CREF	TIAA–CREF.
Strelitz/California Metal X	Tim Strelitz/California Metal X.
Vanguard	Vanguard.

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Appendix 2 to Supplementary Information—CFTC Form 1–FR–FCM

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

9. Receivables from traders on U.S. commodity exchanges						
A. Customer debit and deficit accounts	$ -	1275		1280	$ -	1285
B. Noncustomer and proprietary accounts		1290		1295		1300
C. Other		1305		1310		1315
D. Allowance for doubtful accounts				1320		1325
10. Receivables from traders on foreign boards of trade						
A. Customer debit and deficit accounts		1330		1335		1340
B. Noncustomer and proprietary accounts		1345		1350		1355
C. Other		1360		1365		1370
D. Allowance for doubtful accounts				1375		1380
11. Inventories of cash commodities, raw materials, work in progress and finished goods						
A. Covered		1385		1390		1395
B. Not covered		1400		1405		1410
12. Secured demand notes		1425		1430		1435
Value of collateral $_____1415						
Safety factor $_____1420						
13. Other receivables and advances						
A. Merchandising accounts receivable		1440		1445		1450
B. Notes receivable		1455		1460		1465
C. Commissions and brokerage receivable		1470		1475		1480
D. Receivables from employees and associated persons		1485		1490		1495
E. Advances on cash commodities		1500		1505		1510
F. Dividends and interest		1515		1520		1525
G. Taxes receivable		1530		1535		1540
H. Receivables from subsidiaries and affiliates		1545		1550		1555
I. Other (Itemize on a separate page)		1560		1565		1570
J. Allowance for doubtful accounts				1575		1580
14. Unrealized gains on forward contracts and commitments		1585		1590		1595
15. Exchange memberships at cost						
Market value $_____1600				1605		1610
16. Investments in subsidiaries		1612		1615		1620
17. Plant, property, equipment and capitalized leases cost net of accumulated depreciation and amortization of $_____1625		1630		1635		1640
18. Prepaid expenses and deferred charges				1645		1650
19. A. Other assets (itemize on separate page)		1655		1660		1665
B. Retail Forex Aggregate Assets		xxxx		xxxx		xxxx
20. Total Assets		1670		1675		1680

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 Including short option value $ 0		2080
24. Payable to foreign commodity clearing organizations Including short option value $ 0		2090
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

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	

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	

BILLING CODE 6351–01–C

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).

For the reasons stated in the preamble, the Commodity Futures Trading Commission amends 17 CFR parts 1, 3, 22, 30, and 140 as follows:

PART 1—GENERAL REGULATIONS UNDER THE COMMODITY EXCHANGE ACT

■ 1. The authority citation for part 1 is revised to read as follows:

Authority: 7 U.S.C. 1a, 2, 5, 6, 6a, 6b, 6c, 6d, 6e, 6f, 6g, 6h, 6i, 6k, 6l, 6m, 6n, 6o, 6p, 6r, 6s, 7, 7a–1, 7a–2, 7b, 7b–3, 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 to revise 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 to:

■ a. Revise paragraph (b)(1)(ii);

■ b. Add paragraph (b)(5); and

■ c. Revise 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 as of the close of the business each month. For purpose of this section, the term ''leverage'' shall be defined by a registered futures association of which the futures commission merchant is a member. The futures commission merchant is required to file the leverage information with 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 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 § 30.1 of 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 in § 1.3, Cleared Swaps Customer as defined in § 22.1 of this chapter, and 30.7 customer as defined in § 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 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.

(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, 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 undermargined amounts 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, § 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. 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 including that the futures commission merchant manage the permitted investments consistent with the objectives of preserving principal and maintaining liquidity;

(G) 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;

(H) A process for the timely recording of all transactions, including transactions impacting customers' accounts, in the firm's books of record;

(I) 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, procedures for reporting 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

(J) 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, to ensure that all non-cash assets held in the customer segregated accounts, both customer-owned securities and investments in accordance with § 1.25, 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 to:

■ a. Revise paragraphs (a)(1) and (a)(2); (b)(1), (b)(2), and (b)(4); (c); (d); (e); (f)(2) through (f)(4) and (f)(5)(i); (g); (h); and (i); and

■ b. Add paragraphs (j), (k), (l), (m), and (n).

The revisions and additions 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 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);

(2) 110 percent of the amount required by § 1.17(a)(1)(i)(B);

* * * * *

(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 the existence of any material inadequacy, as specified in § 1.16(d)(2), 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, 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, 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, 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. 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), 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) (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), 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)) 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 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, 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, or has otherwise violated the requirements governing the investment of funds belonging to customers under § 1.25.

(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, in segregated accounts for Cleared Swaps Customers under part 22 of this chapter, or in secured amount accounts for customers trading on foreign markets 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, or whenever the futures commission merchant's amount of residual interest is less than the sum of the undermargined amounts in its customer accounts as determined at the point in time that the firm is required to maintain the undermargined amounts under § 1.22, and §§ 22.2 and 30.7 of this chapter.

(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, including any change that could adversely impact the firm's liquidity resources.

(l) A futures commission merchant must provide prompt notice, but in no event later than 24 hours, 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, or a material adverse change in the futures commission merchant's clearing arrangements.

(m) A futures commission merchant must provide notice, if the futures commission merchant has been notified by the Securities and Exchange Commission, a securities self-regulatory organization, or a futures self-regulatory organization, that it is the subject of a formal investigation. A futures commission merchant must provide a copy of any examination report issued

to the futures commission merchant by the Securities and Exchange Commission or a securities self-regulatory organization. A futures commission merchant must provide the Commission with notice of any correspondence received from the Securities and Exchange Commission or a securities self-regulatory organization that raises issues with the adequacy of the futures commission merchant's capital position, liquidity to meet its obligations or otherwise operate its business, or internal controls. The notices and examination reports required by this section must be filed in a prompt manner, but in no event later than 24 hours of the reportable event, and must be filed in accordance with paragraph (n) of the section; *Provided, however,* that a futures commission merchant is not required to file a notice or copy of an examination report with the Securities and Exchange Commission, a securities self-regulatory organization, or a futures self-regulatory organization if such entity originally provided the communication or report to the futures commission merchant.

(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 to revise 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 to:

■ a. Revise paragraphs (a)(4), (b)(1), (c)(1) and (c)(2), and (f)(1)(i)(C); and

■ b. Add paragraph (b)(4).

The revisions and addition read as follows:

§ 1.16 Qualifications and reports of accountants.

(a) * * *

(4) *Customer.* The term ''customer'' means customer, as defined in § 1.3, 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 and must have undergone an examination by the Public Company Accounting Oversight Board, and may not be subject to a permanent or temporary bar to engage in the examination of public issuers or brokers or dealers registered with the Securities and Exchange Commission as a result of a Public Company Accounting Oversight Board disciplinary hearing.

* * * * *

(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. The governing body should also review and consider the inspection reports issued by the Public Company Accounting Oversight Board as part of the assessment of the qualifications of the public accountant to perform an audit of the futures commission merchant.

(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 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 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 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 to revise 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 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, 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, 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, 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;

* * * * *

(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. 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 paragraph (c)(5) of this section;

(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. 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 paragraph 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 paragraph (c)(5) of this section;

* * * * *

■ 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 that 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 by 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 as computed under paragraph (i) of this section. The futures commission merchant must perform appropriate due diligence as required by § 1.11 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, 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.

(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)(i) A futures commission merchant shall deposit futures customer funds only with a depository that agrees to provide the director of the Division of Swap Dealer and Intermediary Oversight, or any successor division, or such director's designees, with direct, read-only electronic access to transaction and account balance information for futures customer accounts.

(ii) The written acknowledgment must contain the futures commission merchant's authorization to the depository to provide direct, read-only electronic access to futures customer account transaction and account balance information to the director of the Division of Swap Dealer and Intermediary Oversight, or any successor division, or such director's designees, without further notice to or consent from the futures commission merchant.

(4) A futures commission merchant shall 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 no later than three business days after the opening of the account or the execution of a new written acknowledgment for an existing account, as applicable. The Commission must receive the written acknowledgment from the depository via electronic means, in a format and manner determined by the Commission. 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 shall deposit futures customer funds only with a depository that agrees that accounts containing customer funds may be examined at any reasonable time by the director of the Division of Swap Dealer and Intermediary Oversight or the director of the Division of Clearing and Risk, or any successor divisions, or such directors' designees, or an appropriate officer, agent or employee of the futures commission merchant's designated self-regulatory organization. The written acknowledgment must contain the futures commission merchant's authorization to the depository to permit any such examination to take place without further notice to or consent from the futures commission merchant.

(6) A futures commission merchant shall deposit futures customer funds only with a depository that agrees to reply promptly and directly to any request from the director of the Division of Swap Dealer and Intermediary Oversight or the director of the Division of Clearing and Risk, or any successor divisions, or such directors' designees, or an appropriate officer, agent or employee of the futures commission merchant's designated self-regulatory organization for confirmation of account balances or provision of any other information regarding or related to an account. The written acknowledgment must contain the futures commission merchant's authorization to the depository to reply promptly and directly as required by this paragraph without further notice to or consent from the futures commission merchant.

(7) The futures commission merchant shall promptly file a copy of the written acknowledgment with the Commission in the format and manner specified by the Commission no later than three business days after the opening of the account or the execution of a new written acknowledgment for an existing account, as applicable.

(8) A futures commission merchant shall obtain a new written acknowledgment 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.

(9) A futures commission merchant shall maintain each written acknowledgment readily accessible in its files in accordance with § 1.31, for as long as the account remains open, and thereafter for the period provided in § 1.31.

(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.

(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 such funds are segregated as required by sections 4d(a) and 4d(b) of the Act and by this part.

(2) *Location of futures customer funds.* A derivatives clearing organization may deposit futures customer funds with a bank or trust company, which may include a Federal Reserve Bank with respect to deposits of a derivatives clearing organization that is designated by the Financial Stability Oversight Council to be systemically important.

(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.

(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 B to this part; *provided, however,* that a derivatives clearing organization shall obtain from a Federal Reserve Bank only a written acknowledgment that:

(A) The Federal Reserve Bank was informed that the customer funds deposited therein are those of customers who trade commodities, options, swaps, and other products and are being held in accordance with the provisions of section 4d of the Act and Commission regulations thereunder; and

(B) The Federal Reserve Bank agrees to reply promptly and directly to any request from the director of the Division of Clearing and Risk or the director of the Division of Swap Dealer and Intermediary Oversight, or any successor divisions, or such directors' designees, for confirmation of account balances or provision of any other information regarding or related to an account.

(iii) A derivatives clearing organization shall deposit futures customer funds only with a depository that agrees to provide the Commission with a copy of the executed written acknowledgment no later than three business days after the opening of the account or the execution of a new written acknowledgment for an existing account, as applicable. The Commission must receive the written acknowledgment from the depository via electronic means, in a format and manner determined by the Commission. 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.

(iv) A derivatives clearing organization shall deposit futures customer funds only with a depository that agrees to reply promptly and directly to any request from the director of the Division of Clearing and Risk or the director of the Division of Swap Dealer and Intermediary Oversight, or any successor divisions, or such directors' designees, for confirmation of account balances or provision of any other information regarding or related to an account. The written acknowledgment must contain the derivatives clearing organization's authorization to the depository to reply promptly and directly as required by

this paragraph without further notice to or consent from the derivatives clearing organization.

(v) A derivatives clearing organization shall promptly file a copy of the written acknowledgment with the Commission in the format and manner specified by the Commission no later than three business days after the opening of the account or the execution of a new written acknowledgment for an existing account, as applicable.

(vi) A derivatives clearing organization shall obtain a new written acknowledgment 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.

(vii) A derivatives clearing organization shall maintain each written acknowledgment readily accessible in its files in accordance with § 1.31, for as long as the account remains open, and thereafter for the period provided in § 1.31.

(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 the net liquidating equity for each such customer, calculated as follows: The market value of any futures customer funds that it receives from such customer, as adjusted by:

(i) Any uses permitted under paragraph (f) of this section;

(ii) Any accruals on permitted investments of such collateral under § 1.25 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 contracts for the purchase or sale of a commodity for future delivery and any options on such contracts;

(iv) Any charges lawfully accruing to the futures customer, including any commission, brokerage fee, interest, tax, or storage fee; and

(v) Any appropriately authorized distribution or transfer of such collateral.

(3) 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.

(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. This balance may not be reduced by any debit balances that the futures customers of the futures commission merchants have in their accounts.

Appendix A to § 1.20—Futures Commission Merchant 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] (''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] [if applicable, add ''FCM Customer Omnibus Account''] CFTC Regulation 1.20 Customer Segregated Account under Sections 4d(a) and 4d(b) of the Commodity Exchange Act [and, if applicable, '', Abbreviated as [short title reflected in the depository's electronic system]''] Account Number(s): [ ] (collectively, the ''Account(s)'').

You acknowledge 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 customers who trade commodities, options, swaps, 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 Account(s), 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 Funds must otherwise be treated in accordance with the provisions of Section 4d of the Act and CFTC regulations thereunder.

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, and they may not be used by us to secure or obtain 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, lines of credit, repurchase agreements or other similar liquidity arrangements you make in lieu of liquidating non-cash assets held in the Account(s) or in lieu of converting cash held in the Account(s) to cash in a different currency.

In addition, you agree that the Account(s) may be examined at any reasonable time 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 an appropriate officer, agent or employee of our

designated self-regulatory organization (''DSRO''), [Name of DSRO], and this letter constitutes the authorization and direction of the undersigned on our behalf to permit any such examination to take place without further notice to or consent from us.

You agree to reply promptly and directly to any request for confirmation of account balances or provision of any other information regarding or related to the Account(s) from 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 an appropriate officer, agent, or employee of [Name of DSRO], acting in its capacity as our DSRO, and this letter constitutes the authorization and direction of the undersigned on our behalf to release the requested information without further notice to or consent from us.

You further acknowledge and agree that, pursuant to authorization granted by us to you previously or herein, you have provided, or will promptly provide following the opening of the Account(s), the director of the Division of Swap Dealer and Intermediary Oversight of the CFTC, or any successor division, or such director's designees, with technological connectivity, which may include provision of hardware, software, and related technology and protocol support, to facilitate direct, read-only electronic access to transaction and account balance information for the Account(s). This letter constitutes the authorization and direction of the undersigned on our behalf for you to establish this connectivity and access if not previously established, without further notice to or consent from us.

The parties agree that all actions on your part to respond to the above information and access requests will be made in accordance with, and subject to, such usual and customary authorization verification and authentication policies and procedures as may be employed by you to verify the authority of, and authenticate the identity of, the individual making any such information or access request, in order to provide for the secure transmission and delivery of the requested information or access to the appropriate recipient(s). We will not hold you responsible for acting pursuant to any information or access request from 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 an appropriate officer, agent, or employee of [Name of DSRO], acting in its capacity as our DSRO, upon which you have relied after having taken measures in accordance with your applicable policies and procedures to assure that such request was provided to you by an individual authorized to make such a request.

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 offset or lien on assets that are not Funds maintained in the Account(s), or 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, in the ordinary course of your business as a depository, you have no notice of or actual knowledge of a potential violation by us of any provision of the Act or the CFTC regulations that relates to the segregation of customer funds; and you shall not in any manner not expressly agreed to herein be responsible to us for ensuring compliance by us with such provisions of the Act and CFTC regulations; however, the aforementioned presumption does not affect any obligation you may otherwise have under the Act or 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 action or omission to act pursuant to any such order, judgment, decree or levy, 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 and, for the avoidance of doubt, regardless of a change in the name of either 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 agreement, 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 thereunder, 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 to us the enclosed copy of this letter agreement, and that you further agree to provide a copy of this fully executed letter agreement directly to the CFTC (via electronic means in a format and manner determined by the CFTC) and to [Name of DSRO], acting in its capacity as our DSRO. We hereby authorize and direct you to provide such copies without further notice to or consent from us, no later than three business days after opening the Account(s) or revising this letter agreement, as applicable.

[Name of Futures Commission Merchant]
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:

Appendix B to § 1.20—Derivatives Clearing Organization Acknowledgment Letter for CFTC Regulation 1.20 Customer Segregated Account

[Date]
[Name and Address of Bank or Trust Company]

We refer to the Segregated Account(s) which [Name of Derivatives Clearing Organization] (''we'' or ''our'') have opened or will open with [Name of Bank or Trust Company] (''you'' or ''your'') entitled:

[Name of Derivatives Clearing Organization] Futures Customer Omnibus Account, CFTC Regulation 1.20 Customer Segregated Account under Sections 4d(a) and 4d(b) of the Commodity Exchange Act [and, if applicable, '', Abbreviated as [short title reflected in the depository's electronic system]'']
Account Number(s): [ ]
(collectively, the ''Account(s)'').

You acknowledge 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 customers who trade commodities, options, swaps, 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 Account(s), 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 Funds must otherwise be treated in accordance with the provisions of Section 4d of the Act and CFTC regulations thereunder.

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, and they may not

be used by us to secure or obtain 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, lines of credit, repurchase agreements or other similar liquidity arrangements you make in lieu of liquidating non-cash assets held in the Account(s) or in lieu of converting cash held in the Account(s) to cash in a different currency.

You agree to reply promptly and directly to any request for confirmation of account balances or provision of any other information regarding or related to the Account(s) from the director of the Division of Clearing and Risk of the CFTC or the director of the Division of Swap Dealer and Intermediary Oversight of the CFTC, or any successor divisions, or such directors' designees, and this letter constitutes the authorization and direction of the undersigned on our behalf to release the requested information without further notice to or consent from us.

The parties agree that all actions on your part to respond to the above information requests will be made in accordance with, and subject to, such usual and customary authorization verification and authentication policies and procedures as may be employed by you to verify the authority of, and authenticate the identity of, the individual making any such information request, in order to provide for the secure transmission and delivery of the requested information to the appropriate recipient(s). We will not hold you responsible for acting pursuant to any information request from the director of the Division of Clearing and Risk of the CFTC or the director of the Division of Swap Dealer and Intermediary Oversight of the CFTC, or any successor divisions, or such directors' designees, upon which you have relied after having taken measures in accordance with your applicable policies and procedures to assure that such request was provided to you by an individual authorized to make such a request.

In the event that we or any of our futures commission merchant clearing members become(s) 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 offset or lien on assets that are not Funds maintained in the Account(s), or 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, in the ordinary course of your business as a depository, you have no notice of or actual knowledge of a potential violation by us of any provision of the Act or the CFTC regulations that relates to the segregation of customer funds; and you shall not in any manner not expressly agreed to herein be responsible to us for ensuring compliance by us with such provisions of the Act and CFTC regulations; however, the aforementioned presumption does not affect any obligation you may otherwise have under the Act or 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 action or omission to act pursuant to any such order, judgment, decree or levy, 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 and, for the avoidance of doubt, regardless of a change in the name of either 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 agreement, 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 thereunder, 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 to us the enclosed copy of this letter agreement, and that you further agree to provide a copy of this fully executed letter agreement directly to the CFTC (via electronic means in a format and manner determined by the CFTC). We hereby authorize and direct you to provide such copy without further notice to or consent from us, no later than three business days after opening the Account(s) or revising this letter agreement, as applicable.

[Name of Derivatives Clearing Organization]
By:
Print Name:
Title:
ACKNOWLEDGED AND AGREED:
[Name of Bank or Trust Company]
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.

(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.

(c)(1) The undermargined amount for a futures customer's account is the amount, if any, by which:

(i) The total amount of collateral required for that futures customer's positions in that account, at the time or times referred to in paragraph (c)(2) of this section, exceeds

(ii) The value of the futures customer funds for that account, as calculated in § 1.20(i)(2).

(2) Each futures commission merchant must compute, based on the information available to the futures commission merchant as of the close of each business day,

(i) The undermargined amounts, based on the clearing initial margin that will be required to be maintained by that futures commission merchant for its futures customers, at each derivatives clearing organization of which the futures commission merchant is a member, at the point of the daily settlement (as described in § 39.14 of this chapter) that will complete during the following business day for each such derivatives clearing organization less

(ii) Any debit balances referred to in § 1.20(i)(4) included in such undermargined amounts.

(3)(i) Prior to the Residual Interest Deadline, such futures commission merchant must maintain residual interest in segregated funds that is at least equal to the computation set forth in paragraph (c)(2) of this section. Where a futures commission merchant is subject to multiple Residual Interest

Deadlines, prior to each Residual Interest Deadline, such futures commission merchant must maintain residual interest in segregated funds that is at least equal to the portion of the computation set forth in paragraph (c)(2) of this section attributable to the clearing initial margin required by the derivatives clearing organization making such settlement.

(ii) A futures commission merchant may reduce the amount of residual interest required in paragraph (c)(3)(i) of this section to account for payments received from or on behalf of undermargined futures customers (less the sum of any disbursements made to or on behalf of such customers) between the close of the previous business day and the Residual Interest Deadline.

(4) For purposes of paragraph (c)(2) of this section, a futures commission merchant should include, as clearing initial margin, customer initial margin that the futures commission merchant will be required to maintain, for that futures commission merchant's futures customers, at another futures commission merchant.

(5) *Residual Interest Deadline defined.* (i) Except as provided in paragraph (c)(5)(ii) of this section, the Residual Interest Deadline shall be the time of the settlement referenced in paragraph (c)(2)(i) or, as appropriate, (c)(4), of this section.

(ii) Starting on November 14, 2014 and during the phase-in period described in paragraph (c)(5)(iii) of this section, the Residual Interest Deadline shall be 6:00 p.m. Eastern Time on the date of the settlement referenced in paragraph (c)(2)(i) or, as appropriate, (c)(4), of this section.

(iii)(A) No later than May 16, 2016, the staff of the Commission shall complete and publish for public comment a report addressing, to the extent information is practically available, the practicability (for both futures commission merchants and customers) of moving that deadline from 6:00 p.m. Eastern Time on the date of the settlement referenced in paragraph (c)(2)(i) or, as appropriate, (c)(4), of this section to the time of that settlement (or to some other time of day), including whether and on what schedule it would be feasible to do so, and the costs and benefits of such potential requirements. Staff shall, using the Commission's Web site, solicit public comment and shall conduct a public roundtable regarding specific issues to be covered by such report.

(B) Nine months after publication of the report required by paragraph (c)(5)(iii)(A) of this section, the Commission may (but shall not be required to) do either or both of the following:

(*1*) Terminate the phase-in period, in which case the phase-in period shall end as of a date established by order published in the **Federal Register,** which date shall be no less than one year after the date such order is published; or

(*2*) Determine that it is necessary or appropriate in the public interest to propose through rulemaking a different Residual Interest Deadline. In that event, the Commission shall establish, by order published in the **Federal Register,** a phase-in schedule.

(C) If the phase-in schedule has not been amended pursuant to paragraph (c)(5)(iii)(B) of this section, then the phase-in period shall end on December 31, 2018.

■ 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 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, 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, except withdrawals that are made to or for the benefit of futures customers, from an account or accounts holding futures customer funds unless the futures commission merchant has prepared the daily segregation calculation required by § 1.32 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, in addition to withdrawals that are made to or for the benefit of futures customers, 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, 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.

(d) Notwithstanding any other paragraph of this section, a futures commission merchant may not withdraw funds, in a single transaction or a series of transactions, that are not made to or for the benefit of futures customers 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 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 futures 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 that are not made to or for the benefit of futures customers, 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, 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. Notwithstanding the foregoing, if a the futures commission merchant's residual interest in customer accounts is less than the amount required by § 1.22 at any particular point in time, the futures commission merchant must immediately restore the residual interest to exceed the sum of such amounts. Any proprietary funds deposited in the futures accounts must be unencumbered and otherwise compliant with § 1.25, as applicable.

■ 12. Amend § 1.25 to:

■ a. Remove paragraph (b)(6); and

■ b. Revise paragraphs (b)(3)(v), (c)(3), (d)(7), (d)(11), and (e).

The revisions 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 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. The futures commission merchant or the derivatives clearing organization shall obtain the acknowledgment letter required by § 1.26 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.

* * * * *

(11) The transactions effecting the agreement are recorded in the record required to be maintained under § 1.27 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. 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 part. For purposes of this section and §§ 1.27, 1.28, 1.29, and 1.32, 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. Investments permitted by § 1.25 that are owned by the futures commission merchant and deposited into a futures customer account pursuant to § 1.26 shall be considered futures customer funds until such investments are withdrawn from segregation in accordance with § 1.23. 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, 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. Each derivatives clearing organization which invests money belonging or accruing to futures customers of its clearing members in instruments described in § 1.25, 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.

(b) Each futures commission merchant or derivatives clearing organization which invests futures customer funds in money market mutual funds, as permitted by § 1.25, 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 that clearly shows that they belong to futures customers and are segregated as required by sections 4d(a) and 4d(b) of the Act and by 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, for as long as the account remains open, and thereafter for the period provided in § 1.31, a written acknowledgment and shall file such acknowledgment in accordance with the requirements of § 1.20. In the event such funds are held directly with the money market mutual fund or its affiliate, the written acknowledgment shall be in the form as set out in Appendix A or B to this section. In the event such funds are held with a depository, the written acknowledgment shall be in the form as set out in Appendix A or B to § 1.20. In either case, the written acknowledgment shall be obtained, provided to the Commission and designated self-regulatory organizations, and retained as required under § 1.20.

Appendix A to § 1.26—Futures Commission Merchant 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] (''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] [if applicable, add ''FCM Customer Omnibus Account''] CFTC Regulation 1.26 Customer Segregated Money Market Mutual Fund Account under Sections 4d(a) and 4d(b) of the Commodity Exchange Act [and, if applicable, '', Abbreviated as [short title reflected in the depository's electronic system]'']

Account Number(s): [ ]

(collectively, the ''Account(s)'').

You acknowledge that we are holding these funds, including any shares issued and amounts accruing in connection therewith (collectively, the ''Shares''), for the benefit of customers who trade commodities, options, swaps 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 Account(s), 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 Section 4d of the Act and CFTC regulations thereunder.

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, and they may not be used by us to secure or obtain 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 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 an appropriate officer, agent or employee of our designated self-regulatory organization (''DSRO''), [Name of DSRO], and this letter constitutes the authorization and direction of the undersigned on our behalf to permit any such examination to take place without further notice to or consent from us.

You agree to reply promptly and directly to any request for confirmation of account balances or provision of any other account information regarding or related to the Account(s) from 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 an appropriate officer, agent, or employee of [Name of DSRO], acting in its capacity as our DSRO, and this letter constitutes the authorization and direction of the undersigned on our behalf to release the requested information without further notice to or consent from us.

You further acknowledge and agree that, pursuant to the authorization granted by us to you previously or herein, you have provided, or will provide following the opening of the Account(s), the director of the Division of Swap Dealer and Intermediary Oversight of the CFTC, or any successor division, or such director's designees, with technological connectivity, which may include provision of hardware, software, and related technology and protocol support, to facilitate direct, read-only electronic access to transaction and account balance information for the Account(s). This letter constitutes the authorization and direction of the undersigned on our behalf for you to establish this connectivity and access if not previously established, without further notice to or consent from us.

The parties agree that all actions on your part to respond to the above information and access requests will be made in accordance with, and subject to, such usual and customary authorization verification and authentication policies and procedures as may be employed by you to verify the authority of, and authenticate the identity of, the individual making any such information or access request, in order to provide for the secure transmission and delivery of the requested information or access to the appropriate recipient(s).

We will not hold you responsible for acting pursuant to any information or access request from 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 an appropriate officer, agent, or employee of [Name of DSRO], acting in its capacity as our DSRO, upon which you have relied after having taken measures in accordance with your applicable policies and procedures to assure that such request was provided to you by an individual authorized to make such a request.

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 offset or lien on assets that are not Shares maintained in the Account(s), or 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, in the ordinary course of your business as a depository, you have no notice of or actual knowledge of a potential violation by us of any provision of the Act or the CFTC regulations that relates to the segregation of customer funds; and you shall not in any manner not expressly agreed to herein be responsible to us for ensuring compliance by us with such provisions of the Act and CFTC regulations; however, the aforementioned presumption does not affect any obligation you may otherwise have under the Act or 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 action or omission to act pursuant to such order, judgment, decree or levy, 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 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 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, and for the avoidance of doubt, regardless of a change in the name of either 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 agreement, 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 thereunder, 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 to us the enclosed copy of this letter agreement, and that you further agree to provide a copy of this fully executed letter agreement directly to the CFTC (via electronic means in a format and manner determined by the CFTC) and to [Name of DSRO], acting in its capacity as our DSRO, in accordance with CFTC Regulation 1.20. We hereby authorize and direct you to provide such copies without further notice to or consent from us, no later than three business days after opening the Account(s) or revising this letter agreement, as applicable.

[Name of Futures Commission Merchant]
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:

Appendix B to § 1.26—Derivatives Clearing Organization 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 Derivatives Clearing Organization] (''we'' or ''our'') on behalf of customers in shares of [Name of Money Market Mutual Fund] (''you'' or ''your'') under account(s) entitled (or shares issued to):

[Name of Derivatives Clearing Organization] Futures Customer Omnibus Account, CFTC Regulation 1.26 Customer Segregated Money Market Mutual Fund Account under Sections 4d(a) and 4d(b) of the Commodity Exchange Act [and, if applicable, '', Abbreviated as [short title reflected in the depository's electronic system]'']
Account Number(s): [ ]
(collectively, the ''Account(s)'').

You acknowledge that we are holding these funds, including any shares issued and amounts accruing in connection therewith (collectively, the ''Shares''), for the benefit of customers who trade commodities, options, swaps and other products, 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 Account(s), 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 Section 4d of the Act and CFTC regulations thereunder.

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, and they may not be used by us to secure or obtain 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.

You agree to reply promptly and directly to any request for confirmation of account balances or provision of any other account information regarding or related to the Account(s) from the director of the Division of Clearing and Risk of the CFTC or the director of the Division of Swap Dealer and Intermediary Oversight of the CFTC, or any successor divisions, or such directors' designees, and this letter constitutes the authorization and direction of the undersigned on our behalf to release the requested information without further notice to or consent from us.

The parties agree that all actions on your part to respond to the above information requests will be made in accordance with, and subject to, such usual and customary authorization verification and authentication policies and procedures as may be employed by you to verify the authority of, and authenticate the identity of, the individual making any such information request, in order to provide for the secure transmission and delivery of the requested information to the appropriate recipient(s).

We will not hold you responsible for acting pursuant to any information request from the director of the Division of Clearing and Risk of the CFTC or the director of the Division of Swap Dealer and Intermediary Oversight of the CFTC, or any successor divisions, or such directors' designees, upon which you have relied after having taken measures in accordance with your applicable policies and procedures to assure that such request was provided to you by an individual authorized to make such a request.

In the event that we or any of our futures commission merchant clearing members become(s) 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 offset or lien on assets that are not Shares maintained in the Account(s), or 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, in the ordinary course of your business as a depository, you have no notice of or actual knowledge of a potential violation by us of any provision of the Act or the CFTC regulations that relates to the segregation of customer funds; and you shall not in any manner not expressly agreed to herein be responsible to us for ensuring compliance by us with such provisions of the Act and CFTC regulations; however, the aforementioned presumption does not affect any obligation you may otherwise have under the Act or 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 action or omission to act pursuant to any such order, judgment, decree or levy, 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 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 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, and for the avoidance of doubt, regardless of a change in the name of either 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 agreement, 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 thereunder, 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 to us the enclosed copy of this letter agreement, and you further agree to provide a copy of this fully executed letter agreement directly to the CFTC (via electronic means in a format and manner determined by the CFTC) in accordance with CFTC Regulation 1.20. We hereby authorize and direct you to provide such copies without further notice to or consent from us, no later than three business days after opening the Account(s) or revising this letter agreement, as applicable.

[Name of 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 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. 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 the regulations in this chapter 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 to:

■ a. Revise the section heading;

■ b. Revise paragraphs (b) and (c); and

■ c. Add paragraphs (d), (e), (f), (g), (h), (i), (j), and (k).

The revisions and additions 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.

(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.

■ 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; and

(2) *Self-regulatory organization* means a contract market (as defined in § 1.3(h)) or a registered futures association under section 17 of the Act. The term ''self-regulatory organization'' for purpose of this section does not include a swap execution facility (as defined in § 1.3(rrrr)).

(b)(1) Each self-regulatory organization must adopt rules prescribing minimum financial and related reporting requirements for members who are registered futures commission merchants or registered retail foreign exchange dealers. Each self-regulatory organization other than a contract market must adopt rules prescribing minimum financial and related reporting requirements for members who are 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, 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)) 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 II, Part IIA, or Part CSE provided by such member registrant. The definition of adjusted net capital must be the same as that prescribed in § 1.17(c) 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.

(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 other than a contract market 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, which takes into consideration the time elapsed since the self-regulatory organization's previous examination of the introducing broker.

(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 and substantive testing, and must address all areas of risk to which the futures commission merchant can reasonably be foreseen to be subject. The supervisory program must be based on an understanding of the internal control environment to determine the nature, timing and extent of the controls and substantive testing to be performed. 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.

(ii) All aspects of the supervisory program, including the standards pursuant to paragraph (c)(2)(iii) of this section, must, at minimum, conform to auditing standards issued by the Public Company Accounting Oversight Board as such standards would be applicable to a non-financial statement audit. These standards would include the training and proficiency of the auditor, due professional care in the performance of work, consideration of fraud in an audit, audit risk and materiality in conducting an audit, planning and supervision, understanding the entity and its environment and assessing the risks of material misstatement, performing audit procedures in response to assessed risk and evaluating the audit evidence obtained, auditor's communication with those charged with governance, and communicating internal control matters identified in an audit.

(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, or the functional equivalent of the regulatory oversight committee, of the self-regulatory organization of which the 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. The examination report is intended solely for the information and use of the self-regulatory organizations and the Commission, and is not intended to be and should not be used by any other person or entity.

(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 three years.

(A) The self-regulatory organization must obtain from such examinations expert a written report on findings and recommendations issued under the consulting services standards of the American Institute of Certified Public Accountants that includes the following:

(*1*) A statement 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*) A statement 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; and

(*3*) The examinations expert's report should include an analysis of the supervisory program's design to detect material weaknesses in an entity's internal control environment;

(*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 Public Company Accounting Oversight Board, 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 thirty days following the receipt thereof. The self-regulatory organization may also provide to the Commission a response, in writing, to any of the findings, comments or recommendations made by the examinations expert. Upon resolution of any questions or comments raised by the Commission, and upon written 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 for all examinations conducted with an ''as-of'' date later than the date of the Commission's written notification.

(v) The supervisory program must require the self-regulatory organization to report to its risk and/or audit committee of the board of directors, or a functional equivalent committee, 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, or a functional equivalent committee, to fulfill its responsibility of overseeing the examination function.

(vi) The initial supervisory program shall be established as follows. Within 180 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. The self-regulatory organization may provide the Commission a written response to any findings, comments or recommendations made by the

examinations expert. Upon resolution of any questions or comments raised by the Commission, and upon written 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 for all examinations conducted with an ''as-of'' date later than the date of the Commission's written notification.

(vii) The examinations expert's report, the self-regulatory organization's response, as well as any information concerning the supervisory program or any review conducted pursuant to the program that is obtained by the examinations expert, is confidential. Except as expressly provided for in this section, such information may not be disclosed to anyone not involved in the review process.

(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 self-regulatory organization 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 self-regulatory organization 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 and substantive testing, and must address all areas of risk to which the futures commission merchant can reasonably be foreseen to be subject. The Joint Audit Program must be based on an understanding of the internal control environment to determine the nature, timing and extent of the controls and substantive testing to be performed. 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.

(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 auditing standards issued by the Public Company Accounting Oversight Board as such standards would be applicable to a non-financial statement audit. These standards would include the training and proficiency of the auditor, due professional care in the performance of work, consideration of fraud in an audit, audit risk and materiality in conducting an audit, planning and supervision, understanding the entity and its environment and assessing the risks of material misstatement, performing audit procedures in response to assessed risk and evaluating the audit evidence obtained, auditor's communication with those charged with governance, and communicating internal control matters identified in an audit.

(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 180 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 (d)(2)(ii)(I)(*3*) of this section from an examinations expert who has evaluated the Joint Audit Program. The Joint Audit Committee members may also provide to the Commission a response, in writing, to any of the findings, comments or recommendations made by the examinations expert. Upon resolution of any questions or comments raised by the Commission, and upon written 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 for all examinations conducted with an ''as-of'' date later than the date of the Commission's written notification.

(I) Following the establishment of the Joint Audit Program, no less frequently than once every three 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 Joint Audit Committee members may also provide to the Commission a response, in writing, to any of the findings, comments or recommendations made by the examinations expert. The examinations expert's written report must include the following:

(*1*) A statement 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*) A statement 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 report on findings and recommendations issued under the consulting services standards of the American Institute of Certified Public Accountants and should include an analysis of the supervisory program's design to detect material weaknesses in an entities internal control environment; 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 Public Company Accounting Oversight Board, the Internal Audit Association and The Risk Management Association.

(J) The examinations expert's report, the Joint Audit Committee's response, as well as any information concerning the supervisory program or any review conducted pursuant to the program that is obtained by the examinations expert, is confidential. Except as expressly provided for in paragraphs (d)(2)(ii)(G) or (d)(2)(ii)(H) of this section, such information may not be disclosed to anyone not involved in the review process.

(K) The Joint Audit Program must require each Joint Audit Committee member to provide to its risk and/or audit committee of the board of directors, or a functionally equivalent committee, 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, or a functionally equivalent committee, in fulfilling 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 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 written 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 for all examinations conducted with an ''as-of'' date later than the date of the Commission's written notification.

(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 regulatory reporting issues and financial and operational internal control issues and modifying the Joint Audit Program accordingly;

(*6*) Issuing risk alerts for futures commission merchants and/or designated self-regulatory organization examiners on an as-needed basis as issues arise;

(*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 to:

■ a. Revise the section heading;

■ b. Revise paragraphs (b)(2) through (b)(8) and (c); and

■ c. Add paragraphs (b)(9) through (b)(14), (i), (j), (k), (l), (m), (n), and (o).

The revisions and additions 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.

(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 generally 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. Certain derivatives clearing organizations, however, may have programs that provide limited insurance to customers. You should inquire of your futures commission merchant whether your funds will be insured by a derivatives clearing organization and you should understand the benefits and limitations of such insurance programs.

(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

(c) The Commission may approve for use in lieu of the risk disclosure document required by paragraph (b) of this section a risk disclosure statement approved by one or more foreign regulatory agencies or self-regulatory organizations if the Commission determines that such risk disclosure statement is reasonably calculated to provide the disclosure required by paragraph (b) of this section. Notice of

risk disclosure statements that may be used to satisfy Commission disclosure requirements, what requirements such statements meet and the jurisdictions which accept each format will be set forth in appendix A to this section; *Provided, however,* that an FCM also provides a customer with the risk disclosure statement required by paragraph (b) of this section and obtains the customer's acknowledgment that it has read and understands the disclosure document.

* * * * *

(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. For purposes of this section, the disclosures required pursuant to this paragraph 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 name, title, business address, business background, areas of responsibility, and the nature of the duties of each person that is defined as a principal of the futures commission merchant pursuant to § 3.1 of this chapter;

(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 customers, 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 counterparties to permitted transactions under § 1.25;

(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 complaints or actions filed against the FCM where such complaints or actions have not concluded, and any enforcement complaints or actions filed against the FCM during the 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, 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 smallest 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 committed 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 and reflecting balances as of the month-end for the 12 most recent months;

(v) The Statement of Financial Condition, the Statement of Segregation Requirements and Funds in Segregation 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; and

(vi) 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 Regulation30.7, and the Statement of Cleared Swaps Customer Accounts Under Section 4d(f) of the Act that are part of the futures commission merchant's unaudited Form 1–FR–FCM or Financial and Operational Combined Uniform Single Report under the Securities Exchange Act of 1934 (''FOCUS Report'') for the most current 12-month period.

(2) To the extent any of the financial data identified in paragraph (1) of this section is amended, the FCM must clearly notate that the data has been amended.

(3) 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.

(4) 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, 23.

■ 20. Amend § 3.3 to revise 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 Pub. L. 111–203, 124 Stat. 1376.

■ 22. Amend § 22.2 to:

■ a. Revise paragraphs (d)(1), (e)(1), (f)(2), (f)(4), (f)(5)(iii)(B), and (g)(2); and

■ c. Add paragraphs (f)(6) and (g)(3) through (g)(10).

The revisions and additions read as follows:

§ 22.2 Futures Commission Merchants: Treatment of Cleared Swaps and Associated Cleared Swaps 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.

* * * * *

(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 net liquidating equity for each such Cleared Swaps Customer, calculated as follows: The market value of any Cleared Swaps Customer Collateral that it receives from such customer, as adjusted by:

(i) Any uses permitted under paragraph (d) of this section;

(ii) Any accruals on permitted investments of such collateral under paragraph (e) of this section 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. This balance may not be reduced by any debit balances that the Cleared Swaps Customers of the futures commission merchants 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 (§ 240.15c3–1(c)(2)(vi) of this title) 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)(i) The undermargined amount for a Cleared Swaps Customer Account is the amount, if any, by which:

(A) The total amount of collateral required for that Cleared Swaps Customer's Cleared Swaps, at the time or times referred to in paragraph (f)(6)(ii) of this section, exceeds—

(B) The value of the Cleared Swaps Customer Collateral for that account, as calculated in paragraph (f)(2) of this section.

(ii) Each futures commission merchant must compute, based on the information available to the futures commission merchant as of the close of each business day,

(A) The undermargined amounts, based on the clearing initial margin that will be required to be maintained by that futures commission merchant for its Cleared Swaps Customers, at each derivatives clearing organization of which the futures commission merchant is a member, at the point of the daily settlement (as described in § 39.14 of this chapter) that will complete during the following business day for each such derivatives clearing organization less

(B) Any debit balances referred to in paragraph (f)(4) of this section included in such undermargined amounts.

(iii)(A) Prior to the time of settlement referenced in paragraph (f)(6)(ii)(A) of this section such futures commission merchant must maintain residual interest in segregated funds that is equal to or exceeds the portion of the computation set forth in paragraph (f)(6)(ii) of this section attributable to the clearing initial margin required by the derivatives clearing organization making such settlement.

(B) A futures commission merchant may reduce the amount of residual interest required in paragraph (f)(6)(iii)(A) of this section to account for payments received from or on behalf of undermargined Cleared Swaps Customers (less the sum of any disbursements made to or on behalf of such customers) between the close of the previous business day and the time of settlement.

(iv) For purposes of paragraph (f)(6)(ii) of this section, a Depositing Futures Commission Merchant should include, as clearing initial margin, customer initial margin that the Depositing Futures Commission Merchant will be required to maintain, for that Depositing Futures Commission Merchant's Cleared Swaps Customers, at a Collecting Futures Commission Merchant, and, for purposes of paragraph (f)(6)(iii) of this section, must do so prior to the time it must settle with that Collecting Futures Commission Merchant.

(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 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 paragraph (g)(5) of this section; and

(iii) The total amount of cash and investments that each entity listed in paragraph (g)(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 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, except withdrawals that are made to or for the benefit of Cleared Swaps Customers, from a Cleared Swaps Customer Account unless the futures commission merchant has prepared the daily segregation calculation required by § 22.2 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, in addition to withdrawals that are made to or for the benefit of Cleared Swaps Customers, 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.

(c) A futures commission merchant may not withdraw funds, in a single transaction or a series of transactions, that are not made to or for the benefit of Cleared Swaps Customers 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 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 (c)(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 paragraph (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 that are not for the benefit of Cleared Swaps Customers from Cleared Swaps Customer Accounts, 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 the futures commission merchant's residual interest in Cleared Swaps Customer Accounts is less than the amount required to be maintained by § 22.2 at any particular point in time, the futures commission merchant must immediately restore the residual interest to exceed the sum of such amounts. 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 that are not for the benefit of Cleared Swaps Customers 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, 6, 6c, and 12a, unless otherwise noted.

■ 25. Amend § 30.1 to add 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 § 1.3(y) 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.

(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 20 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. A futures commission merchant 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. A futures commission merchant 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) A futures commission merchant must obtain a written acknowledgment from each depository prior to or contemporaneously with the opening of an account by the futures commission merchant with such depository.

(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 (h) 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)(i) A futures commission merchant shall deposit 30.7 customer funds only with a depository that agrees to provide the director of the Division of Swap Dealer and Intermediary Oversight, or any successor division, or such director's designees, with direct, read-only electronic access to transaction and account balance information for 30.7 customer accounts.

(ii) The written acknowledgment must contain the futures commission merchant's authorization to the depository to provide direct, read-only electronic access to 30.7 customer account transaction and account balance information to the director of the Division of Swap Dealer and Intermediary Oversight, or any successor division, or such director's designees, without further notice to or consent from the futures commission merchant.

(4) A futures commission merchant shall 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 no later than three business days after the opening of the account or the execution of a new written acknowledgment for an existing account, as applicable. The Commission must receive the written acknowledgment from the depository via electronic means, in a format and manner determined by the Commission. 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 shall deposit 30.7 customer funds only with a depository that agrees that accounts containing 30.7 customer funds may be examined at any reasonable time by the director of the Division of Swap Dealer and Intermediary Oversight or the director of the Division of Clearing and Risk, or any successor divisions, or such directors' designees, or an appropriate officer, agent or employee of the futures commission merchant's designated self-regulatory organization. The written acknowledgment must contain the futures commission merchant's authorization to the depository to permit any such examination to take place without further notice to or consent from the futures commission merchant.

(6) A futures commission merchant shall deposit 30.7 customer funds only with a depository that agrees to reply promptly and directly to any request from the director of the Division of Swap Dealer and Intermediary Oversight or the director of the Division of Clearing and Risk, or any successor divisions, or such directors' designees, or an appropriate officer, agent or employee of the futures commission merchant's designated self-regulatory organization for confirmation of account balances or provision of any other information regarding or related to an account. The written acknowledgment must contain the futures commission merchant's authorization to the depository to reply promptly and directly as required by this paragraph without further notice to or consent from the futures commission merchant.

(7) A futures commission merchant shall promptly file a copy of the written acknowledgment with the Commission in the format and manner specified by the Commission no later than three business days after the opening of the account or the execution of a new written acknowledgment for an existing account, as applicable.

(8) A futures commission merchant shall obtain a new written acknowledgment 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.

(9) A futures commission merchant shall 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 30.7 customer funds with funds deposited by futures customers as defined in § 1.3 of this chapter and held in segregated accounts pursuant to section 4d(a) and 4d(b) of the Act or with funds deposited by Cleared Swap Customers as defined in § 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)(i) 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.

(ii)(A) The undermargined amount for a 30.7 customer's account is the amount, if any, by which

(*1*) The total amount of collateral required for that 30.7 customer's positions in that account, at the time or times referred to in paragraph (f)(1)(ii)(B) of this section, exceeds

(*2*) The value of the 30.7 customer funds for that account, as calculated in paragraph (f)(2)(ii) of this section.

(B) Each futures commission merchant must compute, based on the information available to the futures commission merchant as of the close of each business day,

(*1*) The undermargined amounts, based on the clearing initial margin that will be required to be maintained by that futures commission merchant for its 30.7 customers, at each clearing organization of which the futures commission merchant is a member, at 6:00 p.m. Eastern on the following business day for each such clearing organization less

(*2*) Any debit balances referred to in paragraph (f)(2)(iv) of this section included in such undermargined amounts.

(C)(*1*) Prior to 6:00 p.m. Eastern Time on the date of the settlement referenced in paragraph (f)(1)(ii)(B)(*1*) of this section, such futures commission merchant must maintain residual interest in segregated funds that is at least equal to the computation set forth in paragraph (f)(1)(ii)(B) of this section.

(*2*) A futures commission merchant may reduce the amount of residual interest required in paragraph (f)(1)(ii)(C)(*1*) of this section to account for payments received from or on behalf of undermargined 30.7 customers (less the sum of any disbursements made to or on behalf of such customers) between the close of the previous business day and 6:00 p.m. Eastern Time on the following business day.

(D) For purposes of paragraph (f)(1)(ii)(B) of this section, a futures commission merchant should include, as clearing initial margin, customer initial margin that the futures commission merchant will be required to maintain, for that futures commission merchant's 30.7 customers, at a foreign broker, and, for purposes of paragraph (f)(1)(ii)(C) of this section, must do so prior to 6:00 p.m. Eastern Time on the date referenced in paragraph (f)(1)(ii)(B)(*1*) of this section.

(2) *Requirements as to amount.* (i) For purposes of this paragraph (f)(2), the term ''account'' shall mean the entries on the books and records of a futures commission merchant pertaining to the 30.7 customer funds of a particular 30.7 customer.

(ii) The futures commission merchant must reflect in the account that it maintains for each 30.7 customer the net liquidating equity for each such customer, calculated as follows: The market value of any 30.7 customer funds it receives from such customer, as adjusted by:

(A) Any uses permitted under paragraph (e) of this section;

(B) Any accruals on permitted investments of such collateral under § 1.25 of this chapter 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 foreign futures or foreign option positions;

(D) Any charges lawfully accruing to the 30.7 customer, including any commission, brokerage fee, interest, tax, or storage fee; and

(E) Any appropriately authorized distribution or transfer of such collateral.

(iii) If the market value of 30.7 customer funds in the account of a 30.7 customer is positive after adjustments, then that account has a credit balance. If the market value of 30.7 customer funds in the account of a 30.7 customer is negative after adjustments, then that account has a debit balance.

(iv) The futures commission merchant must maintain in segregation an amount equal to the sum of any credit balances that 30.7 customers of the futures commission merchant have in their accounts. This balance may not be reduced by any debit balances that the 30.7 customers of the futures commission merchants have in their accounts.

(3) 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.

(4) 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, except withdrawals that are made to or for the benefit of 30.7 customers, 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, in addition to withdrawals that are made to or for the benefit of 30.7 customers, 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 guarantee the foreign futures or foreign options positions, or extend the credit of any other 30.7 customer or other person.

(3) A futures commission merchant may not withdraw funds, in a single transaction or a series of transactions, that are not made for the benefit of 30.7 customers 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 (c)(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 the identity 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 that are not for the benefit of 30.7 customers from the separate accounts holding 30.7 customer funds, 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 the futures commission merchant's residual interest in separate accounts for the benefit of 30.7 customers is less than the amount required to be maintained by paragraph (f) of this section at any particular point in time, the futures commission merchant must immediately restore the residual interest to exceed the sum of such amounts. Any proprietary funds deposited in the 30.7 customer accounts must be unencumbered and otherwise compliant with § 1.25 of this chapter, as applicable.

(7) Notwithstanding any other provision of this part, a futures commission merchant may not withdraw funds from 30.7 accounts, except withdrawals that are made for the benefit of 30.7 customers, 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 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 chapter.

■ 27. Add appendix E 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 under Section 4(b) of the Commodity Exchange Act [and, if applicable, '', Abbreviated as [short title reflected in the depository's electronic system]'']

Account Number(s): [ ]

(collectively, the ''Account(s)'').

You acknowledge 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'') of customers who trade foreign futures and/or foreign options (as such terms are defined in U.S. Commodity Futures Trading Commission (''CFTC'') Regulation 30.1, as amended); that the Funds held by you, hereafter deposited in the Account(s) or accruing to the credit of the Account(s), 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; that the Funds may not be commingled with our own funds in any proprietary account we maintain with you; and that the Funds must otherwise be treated in accordance with the provisions of Section 4(b) of the Act and CFTC Regulation 30.7.

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, and they may not be used by us to secure or obtain 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, lines or credit, repurchase agreements or other similar liquidity arrangements you make in lieu of liquidating non-cash assets held in the Account(s) or in lieu of converting cash held in the Account(s) to cash in a different currency.

In addition, you agree that the Account(s) may be examined at any reasonable time 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 an appropriate officer, agent or employee of our designated self-regulatory organization (''DSRO''), [Name of DSRO], and this letter constitutes the authorization and direction of the undersigned on our behalf to permit any such examination to take place without further notice or consent from us.

You agree to reply promptly and directly to any request for confirmation of account balances or provision of any other information regarding or related to the Account(s) from 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 an appropriate officer, agent, or employee of [Name of DSRO], acting in its capacity as our DSRO, and this letter constitutes the authorization and direction of the undersigned on our behalf to release the requested information without further notice to or consent from us.

You further acknowledge and agree that, pursuant to authorization granted by us to you previously or herein, you have provided, or will promptly provide following the opening of the Account(s), the director of the Division of Swap Dealer and Intermediary Oversight of the CFTC, or any successor division, or such director's designees, with technological connectivity, which may include provision of hardware, software, and related technology and protocol support, to facilitate direct, read-only electronic access to transaction and account balance information for the Account(s). This letter constitutes the authorization and direction of the undersigned on our behalf for you to establish this connectivity and access if not previously established, without further notice to or consent from us.

The parties agree that all actions on your part to respond to the above information and access requests will be made in accordance with, and subject to, such usual and customary authorization verification and authentication policies and procedures as may be employed by you to verify the authority of, and authenticate the identity of, the individual making any such information or access request, in order to provide for the secure transmission and delivery of the requested information or access to the appropriate recipient(s).

We will not hold you responsible for acting pursuant to any information or access request from 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 an appropriate officer, agent, or employee of [Name of DSRO], acting in its capacity as our DSRO, upon which you have relied after having taken measures in accordance with your applicable policies and procedures to assure that such request was provided to you by an individual authorized to make such a request.

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 offset or lien on assets that are not 30.7 customer funds maintained in the Account(s), or 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, in the ordinary course of your business as a depository, you have no notice of or actual knowledge of a potential violation by us of any provision of the Act or Part 30 of the CFTC regulations that relates to the holding of customer funds; and you shall not in any manner not expressly agreed to herein be responsible to us for ensuring compliance by us with such provisions of the Act and CFTC regulations; however, the aforementioned presumption does not affect any obligation you may otherwise have under the Act or 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 action or omission to act pursuant to any such order, judgment, decree or levy, 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 and, for the avoidance of doubt, regardless of a change in the name of either 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 agreement, 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 4(b) of the Act and the CFTC's regulations thereunder, 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 to us the enclosed copy of this letter agreement, and that you further agree to provide a copy of this fully executed letter agreement directly to the CFTC (via electronic means in a format and manner determined by the CFTC) and to [Name of DSRO], acting in its capacity as our DSRO. We hereby authorize and direct you to provide such copies without further notice to or consent from us, no later than three business days after opening the Account(s) or revising this letter agreement, as applicable.

[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:

■ 28. Add appendix F to part 30 to read as follows:

Appendix F to Part 30—Acknowledgment Letter for CFTC Regulation 30.7 Customer Secured 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] (''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] [if applicable, add ''FCM Customer Omnibus Account''] CFTC Regulation 30.7 Customer Secured Money Market Mutual Fund Account under Section 4(b) of the Commodity Exchange Act [and, if applicable, '', Abbreviated as [short title reflected in the depository's electronic system]'']
Account Number(s): [ ]
(collectively, the ''Account(s)'').

You acknowledge that we are holding these funds, including any shares issued and amounts accruing in connection therewith (collectively, the ''Shares''), for the benefit of customers who trade foreign futures and/or foreign options (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 Account(s), 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 Section 4(b) of the Act and CFTC Regulations 1.25 and 30.7.

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, and they may not be used by us to secure or obtain 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 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 an appropriate officer, agent or employee of our designated self-regulatory organization (''DSRO''), [Name of DSRO], and this letter constitutes the authorization and direction of the undersigned on our behalf to permit any such examination to take place without further notice to or consent from us.

You agree to reply promptly and directly to any request for confirmation of account balances or provision of any other information regarding or related to the Account(s) from 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 an appropriate officer, agent, or employee of [Name of DSRO], acting in its capacity as our DSRO, and this letter constitutes the authorization and direction of the undersigned on our behalf to release the requested information, without further notice to or consent from us.

You further acknowledge and agree that, pursuant to authorization granted by us to you previously or herein, you have provided, or will promptly provide following the opening of the Account(s), the director of the Division of Swap Dealer and Intermediary Oversight of the CFTC, or any successor division, or such director's designees, with technological connectivity, which may include provision of hardware, software, and related technology and protocol support, to facilitate direct, read-only electronic access to transaction and account balance information for the Account(s). This letter constitutes the authorization and direction of the undersigned on our behalf for you to establish this connectivity and access if not previously established, without further notice to or consent from us.

The parties agree that all actions on your part to respond to the above information and access requests will be made in accordance with, and subject to, such reasonable and customary authorization verification and authentication policies and procedures as may be employed by you to verify the authority of, and authenticate the identity of, the individual making any such information or access request, in order to provide for the secure transmission and delivery of the requested information or access to the appropriate recipient(s).

We will not hold you responsible for acting pursuant to any information or access request from 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 an appropriate officer, agent, or employee of [Name of DSRO], acting in its capacity as our DSRO, upon which you have relied after having taken measures in accordance with your applicable policies and procedures to assure that such request was provided to you by an individual authorized to make such a request.

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 offset or lien on assets that are not Shares maintained in the Account(s), or 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, in the ordinary course of your business as a depository, you have no notice of or actual knowledge of a potential violation by us of any provision of the Act or Part 30 of the CFTC regulations that relates to the holding of customer funds; and you shall not in any manner not expressly agreed to herein be responsible to us for ensuring compliance by us with such provisions of the Act and CFTC regulations; however, the aforementioned presumption does not affect any obligation you may otherwise have under the Act or 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 action or omission to act pursuant to any such order, judgment, decree or levy, 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 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 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 and, for the avoidance of doubt, regardless of a change in the name of either 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 agreement, 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 4(b) of the Act and the CFTC's regulations thereunder, 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 to us the enclosed copy of this letter agreement, and that you further agree to provide a copy of this fully executed letter agreement directly to the CFTC (via electronic means in a format and manner determined by the CFTC) and to [Name of DSRO], acting in its capacity as our DSRO. We hereby authorize and direct you to provide such copies without further notice to or consent from us, no later than three business days after opening the Account(s) or revising this letter agreement, as applicable.

[Name of Futures Commission Merchant]
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

■ 29. The authority citation for part 140 is revised to read as follows:

Authority: 7 U.S.C. 2(a)(12), 12a, 13(c), 13(d), 13(e), and 16(b).

■ 30. Amend § 140.91 to:
■ a. Revise the section heading;
■ b. Redesignate paragraph (a)(8) as paragraph (a)(12), and paragraph (a)(7) as paragraph (a)(8);
■ c. Add new paragraphs (a)(7), (a)(9), (a)(10), and (a)(11); and
■ d. Revise paragraph (b).

The revisions and additions 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.

Issued in Washington, DC, on November 1, 2013, by the Commission.

Melissa D. Jurgens,

Secretary of the Commission.

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 Chilton and Wetjen voted in the affirmative. Commissioner O'Malia voted in the negative.

Appendix 2—Statement of Chairman Gary Gensler

I support this final set of customer protection reforms, which comprehensively enhances the protection around the handling and segregation of futures and swaps customer funds.

Segregation of customer funds is the core foundation of the commodity futures and swaps markets. Segregation must be maintained at all times. That means every moment of every day.

Market events, though, of these last two years highlighted that the Commission must do everything within our authorities and resources to strengthen oversight programs and protection of customer funds.

These reforms are the sixth set of rules finalized by this Commission during a two-year process to ensure that customers have confidence that their funds are segregated and protected. These reforms benefit from the Commission's thorough review of existing customer protection rules—looking for any gaps in those rules and the oversight of these markets.

They benefit from significant public input, including staff roundtables, the Technology Advisory Committee, the Agricultural Advisory Committee and numerous reports submitted by market participants.

They also benefit from input through a coordinated effort of the CFTC with other regulators; the self-regulatory organizations (SROs), such as the CME and the National Futures Association (NFA); as well as congressional reports and input on these matters. I support these rules, in summary, for at least six reasons:

- First, FCMs and clearing members must significantly enhance their supervision of and accounting for customer funds. They will have to put in place additional policies and procedures for these new protections.
- Second, significant enhancements around outside accounting and auditing—regarding the actual accountants or certified public accountants that audit futures commission merchants (FCMs), and also regarding the SROs and how they audit the FCMs.
- Third, significant customer fund protections with regard to how funds are moved around. Basically, when a firm moves money within a firm, how can they move that money around? Some of these reforms were adopted by SROs last year, such as requiring senior management signoff, and the pre-approval of moving those monies. There are also significant new changes to required acknowledgement letters from the banks and custodians.
- Fourth, reforms related to investing in foreign futures accounts. Our Part 30 regime really had not kept pace with protections for domestic futures accounts. With these reforms and the reforms that the NFA had put in place last year, investing in foreign futures accounts will be significantly aligned with the domestic protections.
- Fifth, there's significant new transparency. Transparency to the regulators—we will be able to see electronically custodial accounts and cash accounts on a daily basis. There is transparency to customers, as well, with the twice-a-month statements regarding the details of their funds in the investment accounts. These reforms also have been put in place by the SROs, but it is important that we do this at the federal level as well, and put them in our rules.
- Sixth, the final rules include provisions on capital and residual interest of the FCMs themselves. This was quite possibly the most debated feature of these reforms, but I think they are important. In response to commenters on this provision, we are phasing in compliance to smooth implementation. This section calls for studies and roundtables, and provides for a five-year phase in on these matters.

It is important that we look very closely at the law and work to ensure that one customer's funds or property are not used in some way to secure or guarantee other customer's positions.

Prior to this final rule set, the Commission already had made important improvements to protections for customers:

- 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 have to collect margin on a gross basis and FCMs are no longer 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;
- 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; and
- Rules enhancing the protection of customer funds when entering into uncleared swap transactions. These reforms fulfill Congress' mandate that counterparties of swap dealers be given a choice regarding whether or not they get the protections that come from segregation of monies and collateral they post as initial margin.

Appendix 3—Dissenting Statement of Commissioner Scott D. O'Malia—Enhancing Protections Afforded Customers and Customer Funds Held by Futures Commission Merchants and Derivatives Clearing Organizations [1]

I respectfully dissent from the Commission's approval today of the final Customer Protection Rules.

I supported the proposed rules because I wanted to solicit public comment and engage market participants in an open discussion about how the Commission should improve its customer protection regulatory oversight.

In the wake of the global financial crisis, it is extremely important to intensify regulatory efforts to strengthen customer protection policies in order to promote the financial stability of the derivatives markets. There is no dispute customer protection must be the cornerstone of the Commission's oversight. Sound customer protection policies and measures, such as the electronic customer verification confirmation services will improve the efficiency and transparency of financial markets.[2]

The Commission must promulgate workable regulations that provide clear guidance to industry participants and ensure cost-effective access to markets. Such regulations must be designed to address real weaknesses in the current regulatory regime and allow industry participants to continue with well-established industry practices that had nothing to do with the financial crisis or the recent bankruptcies of MF Global and Peregrine Financial.

Unfortunately, the Commission's customer protection rules fall short of these objectives. Instead of mitigating customer risk, the rules

[1] ''Customer Protection Rules''

[2] In this regard, I applaud the efforts of the Chicago Mercantile Exchange Inc. (CME) and the National Futures Association (NFA) to protect customer accounts by introducing daily electronic confirmation services. This new technology allows CME and NFA to review balances held at bank depositories and compare the balances with customer account information provide by futures commission merchants (FCMs).

create a false sense of security by imposing broad and ambiguous requirements and introducing another layer of governmental oversight. Even worse, they force a change in a longstanding and generally accepted industry practice that will likely result in seriously harmful consequences for small FCMs and their end-user customers.

I do support several provisions that allow customers greater insight into the operations of an FCM. These provisions include: An improved FCM disclosure regime that will give customers new and critical information about their FCM exposures, elimination of the alternative method of calculating segregation requirements for § 30.7 funds (treatment of foreign futures or foreign options), improved reporting of segregated fund balances, and enhancements to risk management procedures. However, I am unable to support the final rule for the reasons stated below.

Reinterpretation of the Residual Interest Deadline Will Result in Costly Prefunding of Margin Payments

My main concern with the final rules is their radical reinterpretation of the longstanding residual interest deadline. This reinterpretation decreases the time in which customers' margin calls must arrive to their FCM from the current three days to just one day.

Such a change would mean a drastic increase in pre-funding of margin, perhaps nearly double the amounts currently required. As a result, many small agribusiness hedgers will have to consider alternative risk management tools or, even worse, will be forced out of the market.[3] I am disappointed that yet again the Commission has rushed to implement a rule that disregards the express Congressional directive to protect end-users.

I recognize that the Commodity Exchange Act (CEA) does not permit an FCM to use the money or property of one customer to margin the futures or option positions of another customer.[4] Despite this fact, it has been the prevailing industry practice authorized by the Commission for decades.

To the extent that the Commission must reinterpret this statutory provision, I believe this reinterpretation must be based on the thorough analysis of the market data and the full evaluation of the costs of strict compliance with the statute before implementing policy changes, and not after as is the case with the residual interest deadline.

The residual interest deadline rule makes no effort to respond to the commenters' concerns that the residual interest deadline would be especially costly for smaller FCMs and end-users.[5] Given the express Congressional directive to protect end-users, I would have expected the Commission to conduct meaningful cost-benefit analysis to justify the costs when compared to the actual risk to customer accounts and the derivatives markets and to explain why the Commission could not have adopted an alternative approach. Regrettably, the Commission has failed to do so.

Even the Commission's own cost benefit analysis points out, while significantly understating the impact, that:

''Smaller FCMs may have more difficulty than large FCMs in absorbing the additional cost created by the requirements of the rules (particularly § 1.22). It is possible that some smaller FCMs may elect to stop operating as FCMs as a result of these costs.'' [6]

I cannot support a rule that will impose such onerous costs and compliance burdens on the smallest FCMs and small, non-systemically relevant customers.

Finally, although I support a phase-in compliance schedule for the residual interest deadline, I am disappointed that the Commission, in deciding whether to change the deadline at a future time, is not required to make such a decision based on data. Instead, the Commission will simply come up with another arbitrary residual interest deadline that has nothing to do with customer or FCM risk exposure.

Yet again, the Commission has chosen to avoid fact-based analysis. I strongly believe that the Commission should utilize facts and data to make an informed decision about the appropriate time for the residual interest deadline.

The Rules Fail To Provide a Clear Standard for Compliance.

In addition to my serious concerns about the final rules' treatment of the residual interest deadline, I am concerned that the rules unreasonably expand the scope of the new regulatory compliance regime without providing a clear regulatory objective.

For example, the rules require that a Self-Regulatory Organization (SRO) supervisory program ''address *all areas of risk* to which [FCMs] can reasonably be foreseen to be subject (emphasis added).'' [7] This broad language requires the SRO to guess at what criteria the programs would be measured against, and under what framework the SRO would make this determination. In short, the new language does nothing but adds more ambiguity to the SRO's customer protection program and increases the cost of compliance with vague requirements.

Examination Experts do not add Value to the Customer Protection Regime

I also have concerns about the requirement that each SRO supervisory program of its member FCMs be reviewed by an ''examinations expert.'' [8] I question the benefit of this requirement given the fact that the Joint Audit Committee (JAC) currently performs this function. The JAC's primary responsibility is to oversee the practices and procedures that each SRO must follow when it conducts audits and financial reviews of FCMs. This regulatory task is already in place and implemented in a less costly and more efficient manner than set forth in the final rules.

Moreover, in light of the Commission's regulatory oversight of all SROs and the Commission's review of all JAC examination programs, this additional layer of review does not provide any benefit except for isolating the Commission from its primary responsibility to oversee customer protection programs.

Customers Deserve Better Protections in Bankruptcy Proceedings

Going forward, the Commission should address key customer protections in the areas of bankruptcy. Congress should make changes to the Bankruptcy Code to ensure that certain bankruptcy protections are afforded to FCM customers. Specifically, Congress should amend the pro-rata distribution rules in bankruptcy. Despite the Commission's customer segregation requirements, individual customer accounts are still subject to a pro-rata distribution in bankruptcy. In addition to these changes to the Bankruptcy Code, the Commission should amend its rules to allow the Commission to appoint a trustee to oversee derivatives customers' accounts in the bankruptcy of a broker-dealer FCM.

Conclusion

I support implementation of a rigorous customer protection program that provides clear and meaningful mechanisms for mitigating customer risks. However, the customer protection rules approved today have missed the mark.

In sum, many of the new rules impose overly broad and nonsensical regulatory requirements and, in doing so, impede the industry's ability to operate in an efficient manner. Regrettably, the negative effects will be felt most by farmers and other end-users, whose ability to hedge risk in a cost-effective manner will be hampered if not eliminated altogether. This is contrary to the Congressional directive, and I cannot support rules that result in such an outcome.

[FR Doc. 2013–26665 Filed 11–13–13; 8:45 am]

BILLING CODE 6351–01–P

[3] *See e.g.;* National Grain and Feed Association Comment Letter at 2 (Dec. 28, 2012) (stating that the Commission's proposed changes ''could have the unintended impact of disadvantaging smaller and mid-size FCMs that provide 'hands-on' service to many of the relatively smaller hedgers in agribusiness''); Texas Cattle Feeders Association Comment Letter (Jan. 14, 2013) (warning that such changes ''could have the potential to cause unintended consequences such as added costs eventually borne by customers''); Iowa Cattlemen's Association Comment Letter (Feb. 15, 2013) (''it is imperative that the CFTC understand all sizes of businesses . . . [in order to have] . . . a better opportunity to write rules that provide a logical fit. Our fear is that if this rule is put in place, we will have members who will not take advantage of the risk management tools . . . .'').

[4] CEA § 4d(a)(2).

[5] Futures Industry Association Comment Letter at 16 (Feb. 15, 2013).

[6] Customer Protection Rules at 313.

[7] § 1.52(c)(2).

[8] § 1.52.