COMMODITY FUTURES TRADING COMMISSION

17 CFR Parts 22 and 190

RIN 3038–AC99

Protection of Cleared Swaps Customer Contracts and Collateral; Conforming Amendments to the Commodity Broker Bankruptcy Provisions

AGENCY: Commodity Futures Trading Commission.

ACTION: Notice of proposed rulemaking.

SUMMARY: The Commodity Futures Trading Commission (the "Commission") hereby proposes rules to implement new statutory provisions enacted by Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"). Specifically, the proposed rules contained herein impose requirements on futures commission merchants ("FCMs") and derivatives clearing organizations ("DCOs") regarding the treatment of cleared swaps customer contracts (and related collateral), and make conforming amendments to bankruptcy provisions applicable to commodity brokers under the Commodity Exchange Act (the "CEA").

DATES: Comments must be received on or before August 8, 2011.

ADDRESSES: You may submit comments, identified by RIN number 3038–AC99, by any of the following methods:

- The agency's Web site, at *http://comments.cftc.gov.* Follow the instructions for submitting comments through the Web site.
- *Mail:* David A. Stawick, Secretary of the Commission, Commodity Futures Trading Commission, Three Lafayette Centre, 1155 21st Street, NW., Washington, DC 20581.
- *Hand Delivery/Courier:* Same as mail above.
- *Federal eRulemaking Portal: http://www.regulations.gov.* Follow the instructions for submitting comments.

Please submit your comments using only one method.

All comments must be submitted in English, or if not, accompanied by an English translation. Comments will be posted as received to *http://www.cftc.gov.* You should submit only information that you wish to make available publicly. If you wish the Commission to consider information that you believe is exempt from disclosure under the Freedom of Information Act, a petition for confidential treatment of the exempt information may be submitted according to the procedures established in § 145.9 of the Commission's regulations.[1]

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

FOR FURTHER INFORMATION CONTACT: Robert B. Wasserman, Associate Director, Division of Clearing and Intermediary Oversight (DCIO), at 202–418–5092 or *rwasserman@cftc.gov;* Jon DeBord, Attorney-Advisor, DCIO, at 202–418–5478 or *jdebord@cftc.gov;* Martin White, Assistant General Counsel, at 202–418–5129 or *mwhite@cftc.gov;* David Reiffen, Senior Economist, Office of the Chief Economist, at 202–418–5602 or *dreiffen@cftc.gov;* or Todd Prono, Financial Economist, Office of the Chief Economist, at 202–418–5460 or *tprono@cftc.gov,* in each case, also at the Commodity Futures Trading Commission, Three Lafayette Centre, 1155 21st Street, NW., Washington, DC 20581.

SUPPLEMENTARY INFORMATION:

Table of Contents

[1] 17 CFR 145.9.

I. Introduction

The Dodd-Frank Act [2] mandates that each FCM and DCO "segregate" customer collateral supporting cleared swaps. In other words, the FCM and the DCO (i) must hold such customer collateral in an account (or location) that is separate from the property belonging to the FCM or DCO, and (ii) must not use the collateral of one customer to (A) cover the obligations of another customer or (B) the obligations of the FCM or DCO.[3]

In order to implement the segregation requirements in the Dodd-Frank Act, the Commission has determined to propose that each FCM and DCO be required to enter (or "segregate"), in its books and records, the cleared swaps of each individual customer and relevant collateral. The Commission also proposes to permit each FCM and DCO to operationally hold (or "commingle") all relevant collateral in one account. The Commission further proposes that, in the event that an FCM defaults simultaneously with one or more cleared swaps customers, the DCO may access the collateral of the FCM's defaulting cleared swaps customers to cure the default, but not the collateral of the FCM's non-defaulting cleared swaps customers. However, the Commission is continuing to assess the benefits and costs of the proposal, and is considering whether to permit the DCO to access the collateral of non-defaulting cleared swaps customers, after the DCO attempts to cure the default by applying its own capital and the guaranty fund contributions of its non-defaulting FCM members. Moreover, the Commission is also continuing to assess the feasibility of permitting each DCO to choose the level of protection that it would accord to the cleared swaps customer collateral of its FCM members.

In deciding to propose the above requirements, the Commission looked to current practices for the protection of uncleared swaps collateral, as well as current practices for the protection of collateral supporting futures customer contracts. The Commission, through its staff, sought comment from a wide variety of stakeholders (*i.e.,* swaps customers, FCMs, and DCOs), through external meetings [4] and a public roundtable.[5] Further, the Commission issued an advanced notice of proposed rulemaking (the "ANPR").[6] After carefully considering all comments, the Commission has reached the conclusion that this proposal (i) protects cleared swaps customer collateral in the manner mandated by the Dodd-Frank Act, and (ii) provides the best balance between (A) the benefits of mitigating Fellow-Customer Risk, Investment Risk (as such terms are defined below) and systemic risk, inducing changes in behavior, and enhancing portability as well as potentially facilitating portfolio margining, and (B) the operational and

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

[3] *See* section 724 of the Dodd-Frank Act. There is some controversy with respect to section 4d(f)(6) of the CEA as applied to a DCO. *See* section II(C) herein.

[4] A list of external meetings is available at: *http://www.cftc.gov/LawRegulation/DoddFrankAct/Rulemakings/DF_6_SegBankruptcy/index.htm.*

[5] A transcript of the Staff Roundtable on Individual Customer Collateral Protection (the "Roundtable") is available at: *http://www.cftc.gov/ucm/groups/public/@swaps/documents/dfsubmission/dfsubmission6_102210-transcrip.pdf.*

[6] *See* Advance Notice of Proposed Rulemaking for Protection of Cleared Swaps Customers Before and After Commodity Broker Bankruptcies, 75 FR 75162, Dec. 2, 2010.

risk costs [7] associated with implementation. This notice of proposed rulemaking (the "NPRM") sets forth the rationale for such conclusion. The Commission requests comment on each element of its rationale, its conclusion, and any alternatives to the proposal that it is considering (such as, whether to permit the DCO to access the collateral of non-defaulting cleared swaps customers and whether to permit each DCO to choose the level of protection for such collateral).

II. Background

A. Segregation Requirements

On July 21, 2010, President Obama signed the Dodd-Frank Act. Title VII of the Dodd-Frank Act [8] amended the CEA [9] to establish a comprehensive new regulatory framework for swaps and certain security-based swaps. The legislation was enacted to reduce risk, increase transparency, and promote market integrity within the financial system by, among other things: (i) Providing for the registration and comprehensive regulation of swap dealers and major swap participants; [10] (ii) imposing mandatory clearing and trade execution requirements on clearable swap contracts; (iii) creating robust recordkeeping and real-time reporting regimes; and (iv) enhancing the rulemaking and enforcement authorities of the Commission with respect to, among others, all registered entities and intermediaries subject to the oversight of the Commission.

Section 724 of the Dodd-Frank Act prescribes the manner in which cleared swaps (and related collateral) [11] must be treated prior to and after bankruptcy. Section 724(a) of the Dodd-Frank Act amends section 4d of the CEA to add a new paragraph (f). New section 4d(f) imposes the following requirements on an FCM, as well as any depository thereof (including, without limitation, a DCO):

1. The FCM must treat and deal with all collateral (including accruals thereon) deposited by a customer [12] to margin its cleared swaps as belonging to such customer;

2. The FCM may not commingle such collateral with its own property and may not, with certain exceptions, use such collateral to margin the cleared swaps of any person other than the customer depositing such collateral;

3. A DCO may not hold or dispose of the collateral that an FCM receives from a customer to margin cleared swaps as belonging to the FCM or any person other than the customer; and

4. The FCM and the DCO may only invest such collateral in enumerated investments.

Section 724(b) of the Dodd-Frank Act governs bankruptcy treatment of cleared swaps by clarifying that cleared swaps are "commodity contracts" within the meaning of section 761(4)(F) of the Bankruptcy Code.[13] Therefore, in the event of an FCM or DCO insolvency, cleared swaps customers may invoke the protections of Subchapter IV of Chapter 7 of the Bankruptcy Code ("Subchapter IV"). Such protections include: (i) Protected transfers of cleared swaps and related collateral; [14] and (ii) if cleared swaps are subject to liquidation, preferential distribution of remaining collateral.[15]

B. Implementation Alternatives

The Commission considered several alternatives for implementing new section 4d(f) of the CEA. The first alternative that the Commission explored was legal segregation with operational commingling (the "Legal Segregation Model"). Under the Legal Segregation Model, each FCM and DCO would enter (or "segregate"), in its books and records, the cleared swaps of each individual customer and relevant collateral. Each FCM and DCO would ensure that such entries are separate from entries indicating (i) FCM or DCO obligations or (ii) the obligations of non-cleared swaps customers. Operationally, however, each FCM and DCO would be permitted to hold (or "commingle") the relevant collateral in one account. Each FCM and DCO would ensure that such account is separate from any account holding FCM or DCO property or holding property belonging to non-cleared swaps customers.

Under the Legal Segregation Model, the FCM, prior to default, would ensure that the DCO does not use the collateral of one cleared swaps customer to support the obligations of another customer by making certain that the value of the cleared swaps collateral that the DCO holds equals or exceeds the value of all cleared swaps collateral that it has received to secure the contracts of the FCM's customers. The Commission considered two possible scenarios after a simultaneous default of the FCM and of one or more cleared swaps customers. First, the Commission contemplated permitting the DCO to access the collateral of the defaulting cleared swaps customers, but not the collateral of the non-defaulting cleared swaps customers (the "Complete Legal Segregation Model").[16] Second, the Commission contemplated permitting the DCO to access the collateral of the non-defaulting cleared swaps customers, after the DCO applies its own capital to cure the default, as well as the guaranty fund contributions of its non-defaulting FCM members (the "Legal Segregation with Recourse Model").[17]

As its second alternative, the Commission explored full physical segregation (the "Physical Segregation Model").[18] Prior to FCM default, the Physical Segregation Model differs from the Legal Segregation Model only operationally. Like the Legal Segregation Model, each FCM and DCO would enter (or "segregate"), in its books and records, the cleared swaps of each individual customer and relevant collateral. However, unlike the Legal Segregation Model, each FCM and DCO would maintain separate individual accounts for the relevant collateral. Hence, prior to default, the FCM would ensure that the DCO does not use the collateral of one cleared swaps customer to support the obligations of another customer by making certain that the DCO does not mistakenly transfer collateral in (i) the account belonging to the former to (ii) the account belonging to the latter. After a simultaneous default of the FCM and of one or more cleared swaps customers, the Physical Segregation Model leads to the same result as the Complete Legal Segregation Model. Specifically, the DCO would be permitted to access the collateral of the defaulting cleared swaps customers, but not the collateral of the non-defaulting customers.

As its third alternative, the Commission explored replicating the

---

[7] *See* section II(C)(3) below.

[8] Pursuant to section 701 of the Dodd-Frank Act, Title VII may be cited as the "Wall Street Transparency and Accountability Act of 2010."

[9] 7 U.S.C. 1 *et seq.*

[10] In this release, the terms "swap dealer" and "major swap participant" shall have the meanings set forth in section 721(a) of the Dodd-Frank Act, which added sections 1a(49) and (33) of the CEA. However, section 721(c) of the Dodd-Frank Act directs the Commission to promulgate rules to further define, among other terms, "swap dealer" and "major swap participant." The Commission is in the process of this rulemaking. *See* 75 FR 80173, Dec. 21, 2010.

[11] Proposed regulation 22.1 defines "Cleared Swap" and "Cleared Swaps Customer Collateral."

[12] Proposed regulation 22.1 defines "Cleared Swaps Customer."

[13] 11 U.S.C. 761(4)(F).

[14] *See, e.g.,* 11 U.S.C. 764.

[15] *See, e.g.,* 11 U.S.C. 766(h) and (i).

[16] The Complete Legal Segregation Model was referred to as the Legal Segregation with Commingling model in the ANPR.

[17] The Legal Segregation with Recourse Model was known as the Moving Customers to the Back of the Waterfall model in the ANPR.

[18] In the ANPR, the Commission referred to this model as Full Physical Segregation.

segregation requirement currently applicable to futures (the "Futures Model").[19] Prior to default, the Futures Model shares certain similarities with the Legal Segregation Model. Specifically, each FCM would enter (or "segregate"), in its books and records, the cleared swaps of each individual customer and relevant collateral. Each DCO, however, would recognize, in its books and records, the cleared swaps that an FCM intermediates on a collective (or "omnibus") basis. Each FCM and DCO would be permitted to hold (or "commingle") all cleared swaps collateral in one account. After default, the Futures Model shares certain similarities with the Legal Segregation with Recourse Model. Specifically, the DCO would be permitted to access the collateral of the non-defaulting cleared swaps customers. However, under the Futures Model, the DCO would be permitted to access such collateral before applying its own capital or the guaranty fund contributions of non-defaulting FCM members.

Finally, the Commission explored permitting a DCO to choose between (i) the Legal Segregation Model (whether Complete or with Recourse), (ii) the Physical Segregation Model, and (iii) the Futures Model, rather than mandating any particular alternative.

C. Solicitation of Public Input Regarding the Alternatives

Throughout the fall and winter of 2010, the Commission sought public comment on the alternatives mentioned above, and on the advisability of permitting the DCO to choose between alternatives. First, the Commission, through its staff, held extensive external meetings with three segments of stakeholders (*i.e.,* DCOs, FCMs, and swaps customers).[20] Second, on October 22, 2010, the Commission, through its staff, held the Roundtable. Third, on November 19, 2010, the Commission issued the ANPR.

1. Roundtable

As the ANPR describes, the Roundtable revealed that stakeholders had countervailing concerns regarding the alternatives that the Commission set forth. On the one hand, a number of swaps customers argued that the Commission should focus on effectively eliminating fellow-customer risk[21] and investment risk.[22] Such swaps customers emphasized that (i) they currently transact in uncleared swaps, (ii) they are able to negotiate for individual segregation at independent third parties for collateral supporting such uncleared swaps, and therefore (iii) they are currently subject to neither Fellow-Customer Risk nor Investment Risk. Such customers found it inappropriate that, under certain alternatives that the Commission set forth, they should be subject to Fellow-Customer Risk and Investment Risk when they transact in cleared swaps. As the ANPR noted, pension funds were specifically concerned about whether Fellow-Customer Risk and Investment Risk would be incompatible with their obligations under the Employee Retirement Income Security Act.[23]

On the other hand, a number of FCMs and DCOs argued that the benefits of effectively eliminating Fellow-Customer Risk and Investment Risk are outweighed by the costs. With respect to benefits, these FCMs and DCOs noted that the Futures Model has served the futures industry well for many decades. With respect to costs, these FCMs and DCOs described two potential sources. First, FCMs and DCOs stated that, depending on the manner in which the Commission proposes to eliminate or mitigate Fellow-Customer Risk and Investment Risk, they may experience substantial increases to operational costs. Second, and more significantly, FCMs and DCOs stated that they may incur additional risk costs due to proposed financial resources requirements.[24] Specifically, the Commission has proposed to require each DCO to maintain a package of financial resources sufficient, at a minimum, to:

> [e]nable the derivatives clearing organization to meet its financial obligations to its clearing members notwithstanding a default by the clearing member creating the largest financial exposure for the derivatives clearing organization in extreme but plausible market conditions.[25]

Some DCOs may have anticipated including collateral from non-defaulting cleared swaps customers as an element in their financial resources packages. If DCOs no longer have access to such collateral, then those DCOs would need to obtain additional financial resources to meet proposed Commission requirements. As the ANPR noted, DCOs stated that they could obtain such financial resources in two ways (or a combination thereof). They can increase the amount of collateral that each cleared swaps customer must provide to margin its cleared swaps. Alternatively, they can increase the amount of capital that each FCM must contribute to the relevant DCO guaranty funds. Both FCMs and DCOs averred that the costs associated with obtaining such additional financial resources may be

[19] *See* sections 4d(a) and (b) of the CEA, as well as regulations 1.20 to 1.30. The Futures Model was referred to as the Baseline model in the ANPR.

[20] A list of external meetings is available at: *http://www.cftc.gov/LawRegulation/DoddFrankAct/Rulemakings/DF_6_SegBankruptcy/index.htm.*

[21] "Fellow-Customer Risk" is the risk that a DCO would access the collateral of non-defaulting cleared swaps customers to cure an FCM default. Basically, among other things, an FCM functions as a guarantor of customer transactions with a DCO. Section 4d(f) of the CEA prohibits an FCM from using the collateral deposited by one cleared swaps customer to support the transactions of another customer. Therefore, if one cleared swaps customer owes money to the FCM (*i.e.,* the customer has a debit balance), the FCM, acting as guarantor, must deposit its own capital with the DCO to settle obligations attributable to such customer. If such customer defaults to the FCM, and the obligations attributable to such customer are so significant that the FCM does not have sufficient capital to meet such obligations, then the FCM would default to the DCO.

In general, DCOs maintain packages of financial resources to cure the default. The first element of such packages is the property of the defaulting FCM (*i.e.,* collateral deposited to support FCM proprietary transactions and contributions to the DCO guaranty fund). As mentioned above, other elements of such packages may include: (i) The collateral that the FCM deposited to support the transactions of non-defaulting cleared swaps customers; (ii) a portion of the capital of the DCO; and (iii) contributions to the guaranty fund from other DCO members. Typically, a DCO would exhaust one element before moving onto the next element. Therefore, the risk that the DCO would use any one element depends on the position of that element in the package.

[22] "Investment Risk" is the risk that each cleared swaps customer would share *pro rata* in any decline in the value of FCM or DCO investments of cleared swaps customer collateral. Section 4d(f) of the CEA permits an FCM to invest cleared swaps customer collateral in certain enumerated instruments. The Commission is proposing to expand such instruments to include those referenced in regulation 1.25 (as it may be amended from time to time). Even though (i) such investments are "consistent with the objectives of preserving principal and maintaining liquidity," and (ii) both the FCM, as well as the DCO, value such investments conservatively (by, *e.g.,* applying haircuts), the value of such investments may decline to less than the value of the collateral originally deposited. *See* regulation 1.25(b) (as proposed to be amended in *Investment of Customer Funds and Funds Held in an Account for Foreign Futures and Foreign Options Transactions,* 75 FR 67642, Nov. 3, 2011). In such a situation, all customers would share in the decline *pro rata,* even if the invested collateral belonged to certain customers and not others.

[23] 75 FR at 75163.

[24] For a more detailed discussion regarding risk costs, see section II(C)(3)(b) infra.

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

The Commission has proposed to require systemically-important DCOs to maintain a financial resources package sufficient to cover a default by the two clearing members creating the largest combined financial exposure in extreme but plausible market conditions. *Id.* at 63119 (proposed regulation 39.29(a)).

substantial, and would ultimately be borne by cleared swaps customers.[26]

2. ANPR

a. Questions

Given the countervailing concerns that stakeholders expressed at the Roundtable, the Commission decided to seek further comment through the ANPR on the potential benefits and costs of (i) the Legal Segregation Model (whether Complete or with Recourse), (ii) the Physical Segregation Model, and (iii) the Futures Model. As the ANPR explicitly stated, "[t]he Commission [was] seeking to achieve two basic goals: Protection of customers and their collateral, and minimization of costs imposed on customers and on the industry as a whole."[27]

Although the ANPR sought comment on the abovementioned models from the general public, it addressed specific questions to the three segments of stakeholders (*i.e.,* DCOs, FCMs, and swaps customers). The Commission asked all three segments to identify the benefits of each model relative to the others. The Commission then asked all three segments to estimate the costs of implementing each model from their perspective. Specifically, for FCMs, the Commission asked for estimates of (i) FCM compliance costs for each model (other than the Futures Model) and (ii) FCM costs resulting from DCOs seeking additional financial resources to meet proposed Commission requirements. For DCOs, the Commission asked for estimates of: (i) DCO, as well as FCM, compliance costs for each model (other than the Futures Model); and (ii) DCO, as well as FCM, costs resulting from DCOs seeking additional financial resources to meet proposed Commission requirements. In addition to the above, the Commission requested comment on the impact of each model on behavior, as well as whether Congress evinced intent for the Commission to adopt any one or more of these models.

b. Comments: Background

The Commission received thirty-one comments from twenty-nine commenters.[28] Of the commenters, fifteen represented current or potential cleared swaps customers (*i.e.,* buy-side firms or groups),[29] eight represented FCMs or investment firms (or organizations thereof),[30] four were DCOs,[31] one was the National Futures Association ("NFA"), and one was from a legal practitioner.[32] The Commission invites further comment on any of the issues raised and the factual and analytical points made in the comments received in response to the ANPR.

The comments were generally divided by the nature of the commenter: most (though not all) of the buy-side commenters favored either the Legal Segregation Model (whether Complete or with Recourse) or the Physical Segregation Model, manifesting a willingness to bear the added costs. Most of the FCMs and DCOs favored the Futures Model. LCH favored the Complete Legal Segregation Model. Finally, ISDA, in its supplemental comment, opined that the most important factor that the Commission should consider is the extent to which a model fostered the portability[33] of cleared swaps belonging to non-defaulting customers. ISDA noted that the Physical Segregation Model and what is now referred to as the Complete Legal Segregation Model were most conducive to that goal.

c. Comments: Discussion

In general, comments to the ANPR addressed the following major issues: (i) Concerns with statutory interpretation; (ii) the appropriate basis for comparison of benefits and costs for each model; (iii) estimates of costs, and the assumptions underlying such estimates; (iv) the benefits of individual collateral protection (*e.g.,* on Fellow-Customer Risk, Investment Risk, systemic risk, induced changes in behavior, and portfolio margining); and (v) the appropriateness of optional models.

1. Statutory Issues

Section 4d(f)(6) of the CEA prohibits "any person, including any derivatives clearing organization * * *" from holding, disposing, or using cleared swaps customer collateral "for deposit in a separate account or accounts * * * as belonging to * * * any person other than the swaps customer of the futures commission merchant." The emphasis on "separate account or accounts" and the use of "customer" in the singular contrasts with section 4d(b) of the CEA (applicable to futures customer contracts and related collateral). In the ANPR, the Commission asked for comment as to whether Congress evinced intent to create a segregation regime that protects cleared swaps (and related customer collateral) on a more individualized basis than futures (and related customer collateral). In general, commenters presented opposing views. For example, one commenter viewed use of the singular term "customer" in section 4d(f)(6) of the CEA as a "critical difference."[34] Similarly, another commenter viewed such use "as direction to the * * * Commission to ensure that customer initial margin [for cleared swaps] is not put at risk on account of actions of other customers."[35] In contrast, a third commenter expressed doubt as to whether Congress would "adopt such a subtle method of moving away from [omnibus customer protection] and directing the use of individually segregated accounts for cleared swaps."[36] The commenter further observed that it would be anomalous to afford greater protection to cleared

[26] 75 FR at 75163. For example, one DCO estimated that it would have to increase the amount of collateral that each cleared swaps customer must provide by 60 percent, if it could no longer access the collateral of non-defaulting cleared swaps customers to cure certain defaults.

[27] *Id.*

[28] Federated Investors submitted two comments, both of which focused on the investment of cleared swaps customer collateral. ISDA submitted two comments, an original comment (the "ISDA Original") and, later, a supplemental comment (the "ISDA Supplemental").

[29] Buy-side firms or groups (collectively, the "buy-side") included the following: (i) Alternative Investment Management Association ("AIMA"); (ii) BlackRock, Inc. ("BlackRock"); (iii) California Public Employees Retirement System ("CALPERS"); (iv) Coalition for Derivatives End Users (by Gibson, Dunn & Crutcher); (v) Coalition for Energy End Users; (vi) Committee on Investment of Employee Benefit Assets ("CIEBA"); (vii) Federal Farm Credit Banks Funding Corp.; (viii) Federal Home Loan Banks ("FHLB"); (ix) Fidelity Investments ("Fidelity"); (x) Freddie Mac; (xi) Investment Company Institute; (xii) Managed Funds Association; (xiii) Securities Industry and Financial Markets Association Asset Management Group ("SIFMA–AMG"); (xiv) Tudor Investment Corporation; and (xv) Vanguard.

[30] FCMs or investment firms (or organizations thereof) (collectively, the "FCMs") included the following: (i) Citigroup Global Markets, Inc. ("Citigroup Capital Markets"); (ii) Federated Investors, Inc. (Freeman and Hawke); (iii) Futures Industry Association; (iv) International Swaps and Derivatives Association ("ISDA") (Original and Supplemental); (v) Newedge USA, LLC ("Newedge"); (vi) Norges Bank Investment Management; (vii) Securities Industry and Financial Markets Association ("SIFMA"); and (viii) State Street Corporation.

[31] DCOs (collectively, the "DCOs") included the following: (i) CME Group ("CME"); (ii) IntercontinentalExchange, Inc. ("ICE"); (iii) LCH Clearnet Group ("LCH"); and (iv) Minneapolis Grain Exchange, Inc.

[32] Jerrold Salzman.

[33] Portability refers to the ability to reliably transfer the swaps (and related collateral) of a non-defaulting customer from an insolvent FCM to a solvent FCM, without the necessity of liquidating and re-establishing the swaps.

[34] CIEBA at 4 at note 2.

[35] FHLB at 3 at note 3.

Additionally, some commenters maintained that the Futures Model depends on an interpretive statement issued by the Office of the General Counsel, which they describe as "dated and questionable" in relation to cleared swaps. *See* FHLB at 4, Federal Farm Credit Banks Funding Corporation at 3. *See also* Interpretative Statement, No. 85–3, *Regarding the Use of Segregated Funds by Clearing Organizations Upon Default by Member Firms* (OGC Aug. 12, 1985).

[36] CME at 5.

swaps customers, many of which are large and presumed to be sophisticated, than futures customers, some of whom might be individual or "retail" customers.[37]

2. What is the appropriate starting point?

In general, commenters presented opposing views on whether the Commission should consider the benefits and costs of each model in light of current swaps practice or current futures practice. Most buy-side commenters stated that benefits and costs of each model should be informed by current swaps practice. First, these commenters emphasized that they are currently able to negotiate for individual collateral protection at independent third parties, and are therefore exposed to neither Fellow-Customer Risk nor Investment Risk. Second, these commenters stated that they are accustomed to the costs associated with individual collateral protection and note that their counterparties enjoy profit from this business model. Finally, these commenters maintained that the Futures Model forms an inappropriate basis for the consideration of benefits and costs because:

(i) The Commission is contemplating the appropriate segregation regime for cleared swaps and related customer collateral; (ii) the Futures Model references industry conventions for futures contracts and related collateral; and (iii) the market for cleared swaps has developed and may continue to develop in a different manner than the market for futures contracts.[38]

In contrast, a number of commenters, primarily the FCMs and the DCOs, suggested that the benefits and costs of each model should be informed by current futures practice. In support of this position, these commenters note that the futures segregation requirement has served the futures industry well for many decades.

3. Costs

In general, commenters estimated the costs of implementing each model in light of the basis for consideration that they viewed most appropriate. For example, those commenters that argued that current swaps practice should inform the benefits and costs of each model emphasized that they have been willing to bear the costs for individual collateral protection. In contrast, those commenters that argued that current futures practice should inform the benefits and costs of each model emphasized that implementing either the Legal Segregation Model (whether Complete or with Recourse) or the Physical Segregation Model would lead to substantial costs. As mentioned above, they described two major sources for such costs: (i) Operational costs; and (ii) costs associated with obtaining additional financial resources to meet proposed Commission requirements (assuming that the Commission prohibits a DCO from accessing the collateral of non-defaulting cleared swaps customers to cure an FCM default) (the "Risk Costs").[39] Certain other commenters disagreed with the assumptions underlying estimates of Risk Costs, but not those underlying estimates of operational costs.

a. Operational Costs[40]

For the Physical Segregation Model, one commenter estimates that an FCM would incur upfront operational costs of $33 million and ongoing operational costs of $136 million.[41] Another commenter estimates that a DCO would incur upfront operational costs of $7.5 million and ongoing operational costs of $40 million.[42] In contrast, for the Legal Segregation Model (whether Complete or with Recourse), commenters have suggested that the operational costs would be more modest. For example, commenters estimate that an FCM would incur upfront operational costs of $1 million and ongoing operational costs of $700,000.[43]

b. The Risk Costs

i. The physical segregation model and the complete legal segregation model.

Both the Physical Segregation Model and the Complete Legal Segregation Model would result in Risk Costs,[44] because they both prohibit a DCO from accessing the collateral of non-defaulting cleared swaps customers. As mentioned above, a DCO may seek to cover Risk Costs in two different ways (or a combination thereof). First, the DCO may increase the amount of collateral that each cleared swaps customer must provide to margin its cleared swaps. One commenter estimated that this increase may equal 69.75 percent (*i.e.,* a total increase of $581 billion). Second, a DCO may increase the amount of resources that each FCM must contribute to the guaranty fund. The same commenter estimated that a DCO may double such contributions (*i.e.,* a total increase of $128 billion).[45] Another commenter—a DCO—agrees with such estimate, stating that it would double FCM contributions to its guaranty fund (*i.e.,* the guaranty fund would increase from $50 billion to $100 billion).[46]

ii. The legal segregation with recourse model and the futures model.

Based on the rationale articulated above, neither the Legal Segregation with Recourse Model nor the Futures Model would result in a need to obtain

[37] *See* CME at 5–6.

[38] For example, the swaps markets have historically been bespoke, whereas the futures markets have historically been more standardized. Such historical differences may persist while the swaps markets transition from the over-the-counter environment to a cleared and transparent environment. Specifically, while the swaps market "dwarf[s]" the futures market, "the tremendous diversity in products and trade parameters" in the swaps market "effectively results in a lower liquidity," thereby resulting in the risks that omnibus clearing poses for swaps customers to be significantly greater than they are for futures customers. *See* Fidelity at 6, Vanguard at 2–5.

[39] Additionally, induced changes in behavior may create a systemic cost. Such costs have been addressed under the rubric of moral hazard below.

[40] Some commenters claim that it may be difficult for FCMs and DCOs to maintain separate models for futures customer collateral and cleared swaps customer collateral.

[41] ISDA Original at 10.

[42] *See generally* ICE at 10–12.

As mentioned above, the Physical Segregation Model would require that each FCM and DCO maintain a separate account for each cleared swaps customer. Therefore, the costs that commenters identify include, among other things, (i) the costs to establish and maintain such accounts, (ii) the costs to effect separate fund transfers between such accounts, (iii) the costs of account reconciliation, and (iv) the costs to establish the information technology infrastructure for such accounts.

[43] *See* ISDA Supplemental at 7. This modifies the ongoing figure in ISDA Original at 10 (the upfront figure there is correct).

In contrast to the Physical Segregation Model, the Legal Segregation Model (whether Complete or with Recourse) would permit an FCM and a DCO to continue maintaining omnibus accounts, while requiring enhanced reporting. Therefore, the costs that commenters identify pertain mostly to such reporting.

[44] One should note that the dollar figures for Risk Costs presented by commenters and described in the text represent increased use of capital, not actual costs. The cost associated with these figures would reflect the opportunity cost of forgoing possible higher return from alternative uses of the capital in question.

[45] *See* ISDA Original at 12–13. One should note that this amount represents increased use of capital, and thus does not represent hundreds of billions in costs.

[46] *See* CME at 8–9. This commenter also would consider the use of "concentration margin" to cover such Risk Costs. According to such commenter, charging concentration margin would constitute a "more targeted approach," because a DCO would charge extra margin "to the customer cleared-swap accounts in the clearing system with the largest potential shortfalls," rather than increasing the overall size of the guaranty fund. The commenter acknowledges that it "currently lack[s] sufficient information to precisely assess an appropriate methodology to incorporate concentration margin in a potential financial-safeguards regime," but does state that "likely concentration charges would fall in the range of $50 billion to $250 billion." The commenter anticipates that customers using "cleared swaps to hedge exposures in other markets may bear the brunt of a concentration margin approach." The Commission notes that such an approach may arguably provide for better alignment of risk-creation and risk-assumption, which commenters from the buy-side have requested.

additional financial resources to meet proposed Commission requirements, since under these models DCOs would have access to the collateral of non-defaulting customers in the event of a simultaneous default by an FCM and one or more customers.[47] However, one commenter observed that the Legal Segregation with Recourse Model increases the likelihood that a DCO would access (i) its own contribution and (ii) the guaranty fund contributions of non-defaulting FCM members, in each case, to cure a default. The commenter stated that "[t]he increased risk to which the DCO and clearing members would be exposed represents a real wealth transfer from the clearing infrastructure (DCOs and clearing members), upon which systemic safety is to depend, to clients."[48]

c. Assumptions Underlying Risk Costs

Certain commenters disagreed with the assumptions underlying the estimates of Risk Costs for the Complete Legal Segregation Model and the Physical Segregation Model. Specifically, they questioned whether, upon an FCM default, a DCO would have any collateral of non-defaulting cleared swaps customers left to access. These commenters noted that, if an FCM declines over time, customers may begin transferring their cleared swaps collateral to more creditworthy FCMs.[49] Therefore, a DCO may choose not to rely on the collateral of non-defaulting cleared swaps customers for risk management reasons. If the DCO makes such a choice, it would incur no Risk Costs in adopting either the Complete Legal Segregation Model or the Physical Segregation Model. These commenters observed that certain DCOs experienced in clearing swaps have already made such a choice.[50]

4. Benefits

a. Fellow-Customer Risk and Investment Risk

In general, commenters agreed that the Physical Segregation Model would eliminate Investment Risk, and that such model, along with the Legal Segregation Model (whether Complete or with Recourse), would mitigate Fellow-Customer Risk. As mentioned above, commenters disagreed on whether such benefits would outweigh the operational costs and Risk Costs, as applicable, which would be incurred to implement such models.[51]

b. Portability

One commenter emphasized that the most important factor that the Commission should consider in deciding which model to propose is the effect of that model on the portability of the cleared swaps of non-defaulting customers in the event of an FCM default. The commenter stated that the Physical Segregation Model and the Complete Legal Segregation Model would most facilitate portability.[52]

c. Systemic Risk

A number of commenters described ways in which the Legal Segregation Model (whether Complete or with Recourse) or the Physical Segregation Model may mitigate systemic risk. The commenter that emphasized the importance of portability stated that the Complete Legal Segregation Model or the Physical Segregation Model would mitigate systemic risk by enhancing portability of the cleared swaps of non-defaulting customers in the event of FCM default.[53] However, this commenter did not believe that the Legal Segregation with Recourse Model would mitigate systemic risk to the same extent since it would not facilitate portability to the same extent as the Complete Legal Segregation Model.[54] Second, certain commenters suggested that the Legal Segregation Model (whether Complete or with Recourse) or the Physical Segregation Model may ameliorate certain pro-cyclical incentives under the Futures Model for bank-style "runs" on FCMs that are perceived to be weakening.[55]

d. Induced Changes in Behavior

In general, commenters offered different opinions on the appropriate focus of induced changes in behavior analysis. For example, certain commenters focused on the effects of the Futures Model on the motivations of the DCO. As mentioned above, under the Futures Model, a DCO may access the collateral of non-defaulting cleared swaps customers prior to its own capital in the event of an FCM default. Therefore, the above-mentioned commenters argued that under the Futures Model a DCO may be less motivated to ensure that each FCM member is managing the risks posed by cleared swaps customers properly than under Legal Segregation or Physical Segregation models.[56]

---

[47] *See* ISDA Original at 12–13. *See* ISDA Supplemental at 5–6. For a sense of scale, ISDA estimated that, under the Futures Model and the Legal Segregation with Recourse Model, industry-wide initial margin for cleared swaps customer contracts would total $833 billion, and DCO guaranty funds would total $128 billion.

[48] *See* ISDA Supplemental at 6.

[49] *See, e.g.,* Citigroup Capital Markets at 1–2 ("customers of a deteriorating, non-defaulted FCM have the ability pursuant to CFTC regulation and clearing house rules to move their positions to an alternative FCM"), Federal Farm Credit Banks Funding Corp. at 4 ("when faced with a clearing member's potential deterioration in credit * * * a customer [may] transfer its positions to another clearing member which could have the unintended effect of accelerating a clearing member's credit problems"), LCH at 2–3 (stating that while in a "shock event," a DCO may access collateral from non-defaulting cleared swaps customers, in the contrasting case of an FCM default following a gradual decline, "the assumption of access to non-defaulting client Initial Margin does not hold").

[50] For example, LCH stated that, in order for DCOs [to be] managed prudently * * * their risk waterfalls must cater for all events, not just 'shock' events. This requires that DCOs clearing swaps must always assume that no client Initial Margin is available at the point of a default, as this is the most conservative assumption from a risk management standpoint.

Id.

[51] Compare CME at 4 (" * * * adopting an individual segregation model for customer cleared swaps * * * would impose significantly higher costs on customers and clearing members * * * the increased costs may decrease participation in the CFTC-regulated cleared swaps market * * * .") with BlackRock at 2 ("We fail to understand why protecting collateral for segregation for the OTC Derivative Account Class when done at an FCM is associated with high costs when the OTC derivatives market has been able to function as a profitable business with collateral segregation as part of this business model").

[52] *See* ISDA Supplemental at 4.

[53] *See id.* at 4, 7. ISDA also noted that "[f]ellow customer risk, properly conceived, includes the cost incurred by non-defaulting clients as the result of a DCO closing out their positions following a client and FCM default." *See also id.* at 2 ("We believe that the client desire for continuance of transactions and the avoidance of systemic risk requires additional focus on the facilitation of trade portability and the re-prioritization of close-out procedures as the option of last resort. From a client point of view, the enforced close-out of positions could lead to significant losses, particularly for a financial entity hedging other rate exposures. The close-out of even a portion of a large derivative book, like that which is currently run by a GSE, for example, may create huge losses for the swap hedger, and ultimately significant costs to the taxpayer. Further, for clients that are subject to regulatory capital requirements, a reduction in the ability to port positions may lead to higher regulatory capital costs").

[54] *See id.* at 5. The commenter further observed that the Legal Segregation with Recourse Model represents a "wealth transfer" from the DCO and its FCM members to cleared swaps customers relative to the Futures Model, which may increase systemic risk to the extent that such transfer weakens the DCO and the FCMs.

[55] *See* FHLB at 7 ("the primary way for customers to manage their fellow-customer risk is to have advance arrangements in place that would allow them to quickly move their cleared trades from a defaulting clearing member to another clearing member * * * [this] may prompt the equivalent of a 'run on the bank' when information becomes available that suggests a clearing member may be facing financial stress" which may not "make[] sense from a systemic risk perspective"). *See also* AIMA at 1 (where "client collateral is inadequately protected, " "lack of confidence in the system * * * can cause customers to seek to avoid losses by liquidating or moving their positions in stressed market conditions, causing 'runs' on futures commission merchants, greatly exacerbating market stress and contributing to wider financial instability").

[56] *See, e.g.,* Freddie Mac at 3, 4; BlackRock at 5; Vanguard at 7.

Other commenters focused on the effect of the Legal Segregation Model (especially Complete) and the Physical Segregation Model on the motivations of cleared swaps customers and FCMs. First, these commenters argued that such models would cause changes in behavior, because cleared swaps customers benefitting from individual collateral protection would be less motivated to create market discipline by clearing thorough less risky firms.[57] Second, these commenters contended that FCMs would be less motivated to maintain substantial excess net capital in order to present a more attractive profile to customers.[58]

Finally, a number of commenters observed that an important consideration in selecting a model is the effect that the model would have on the willingness of cleared swaps customers to maintain excess margin. The more protective of cleared swaps customer collateral a model is, the more likely it is that cleared swaps customers would be willing to maintain excess margin.

e. Portfolio Margining

A number of commenters expressed concern that the use of models other than the Futures Model would create fragmented segregation requirements (whether across securities and commodities accounts, or between different classes of commodities accounts), which in turn would create barriers to the ability of cleared swaps customers to portfolio margin.[59]

5. The Optional Approach[60]

Finally, a number of commenters suggested that the Commission permit DCOs the option of offering different models for protecting cleared swaps customer contracts and related collateral (the "Optional Approach").[61] However, other commenters found the Optional Approach to be impracticable.[62] Still other commenters stated that the Optional Approach may not succeed in reducing costs for those cleared swaps customers that do not opt for greater protection, and that the Optional Approach, depending on the manner in which it is structured, may indeed increase the amount of funds such customers have at risk.[63]

III. The Proposed Rules

After carefully considering all comments, the Commission has decided to propose the Complete Legal Segregation Model in this NPRM for the following reasons.

First, as discussed in section III(A) herein, the Commission believes that section 4d(f) of the CEA provides it with authority to propose the Complete Legal Segregation Model. Further, the Commission believes that the language of section 4d(f) of the CEA supports strongly considering the current swaps practice.

Second, as discussed in section III(D) herein, the Commission believes that the Complete Legal Segregation Model provides the best balance between benefits and costs in order to protect market participants and the public. Section III(B) herein describes the Commission's evaluation of the costs of each model, whereas section III(C) herein describes the Commission's evaluation of the benefits of each model.

As mentioned in section I (*Introduction*) herein, the Commission is continuing to assess the benefits and costs of the Complete Legal Segregation Model. As part of such assessment, the Commission is considering whether to adopt, in the alternative, the Legal Segregation with Recourse Model. Further, the Commission is continuing to assess the feasibility of the Optional Approach and the Futures Model, and seeks comments thereon.

The Commission requests comments on (i) its proposal, (ii) whether it should adopt, in the alternative, the Legal Segregation with Recourse Model, and (iii) whether it should adopt the Optional Approach or the Futures Model. The Commission has set forth specific questions below.

A. Statutory Issues and the Appropriate Starting Point

Section 4d(f) of the CEA provides the Commission with the authority to afford individualized protection to cleared swaps customer collateral. As mentioned above, new section 4d(f)(6) of the CEA prohibits "any person, including any derivatives clearing organization * * *" from holding, disposing, or using customer collateral "for deposit in a separate account or accounts * * * as belonging to * * * any person other than the swaps customer of the futures commission merchant." The reference to "separate account or accounts" and the use of "customer" in the singular contrasts with section 4d(b) of the CEA, which governs the handling of customer collateral by DCOs in the futures market. Section 4d(b) prohibits a DCO from holding, disposing, or using customer collateral "for deposit in a separate account * * * as belonging to * * * any person other than the customers of such futures commission merchant," using the plural form "customers" to refer to the property of customers collectively. The contrast between sections 4d(b) and 4d(f)(6) of the CEA suggests that the Commission need not treat cleared swaps customer collateral in the same manner as futures customer collateral. This is particularly true because the reference to "separate account or accounts" and "customer" in section 4d(f)(6) of the CEA accords with the individual collateral protection currently available in the swaps markets and contrasts with the omnibus approach traditionally used in futures markets. For the same reason, the Commission is persuaded that the costs of and protections provided by current swaps practices are highly relevant to the evaluation of alternative models for implementing the statute.

B. Costs[64]

1. Rationale

As mentioned above, the Commission believes that current swaps practices

[57] *See, e.g.,* CME at 4, ISDA Supplemental at 6.

[58] *See, e.g.,* ISDA Supplemental at 6.

[59] *See* SIFMA at 3–4, Investment Company Institute at 5–6, Futures Industry Association at 6.

[60] The Optional Approach may be implemented in two ways. First, the Commission may permit each DCO to offer more than one model for protecting cleared swaps customer contracts and related collateral. For example, certain FCM members may choose the Complete Legal Segregation Model, whereas other FCM members may choose the Legal Segregation with Recourse Model. Second, the Commission may permit each DCO to offer a different model for protecting cleared swaps customer contracts and related collateral. For example, a DCO could choose to offer the Complete Legal Segregation Model to all of its FCM members, whereas another DCO could choose to offer the Futures Model.

[61] *See, e.g.,* Freddie Mac at 3 ("requiring DCOs to provide individual segregation on an optional basis is the best way to achieve the Commission's twin goals of maximizing customer protection and minimizing cost"), NFA at 2 (The "better mousetrap may involve * * * clearing organizations adopting one of the other models discussed by the Commission. The Commission's regulations should ensure that DCOs have the flexibility to offer those alternative structures * * *").

[62] *See, e.g.,* ICE at 12 ("ICE's general sense is that any bifurcated or optional model will further complicate the settlement process and lead to greater uncertainty during times of financial stress"), Investment Company Institute at 6 ("Due to the host of legal, regulatory, operational and other issues which would be presented, ICI does not believe that it would be appropriate to implement individual customer protection on an optional rather than a mandatory basis in connection with this rulemaking proceeding * * *").

[63] *See, e.g.,* ISDA Original at 13 ("if highly credit worthy customers choose the more expensive, higher protection option," pooling may be less effective from the point of view of the DCO, which may be required to increase initial margin for all customers, including those choosing to bear fellow customer risk, forcing the latter to bear both increased funding cost and a greater amount of funds at risk).

[64] For additional discussion of cost issues, with particular reference to the costs of the proposed Complete Legal Segregation Model and the Legal

Continued

forms an appropriate perspective for considering the costs of each model for protecting cleared swaps customer collateral. The Commission further believes that the operational costs and Risk Costs that commenters have identified for each model should be examined in light of the current practice of many swaps customers to incur costs to obtain individual collateral protection with independent third-parties.

With respect to operational costs, the Commission notes that commenters appeared to have relied upon appropriate assumptions in their estimates for the Legal Segregation Model (whether Complete or with Recourse) and the Physical Segregation Model.[65] With respect to Risk Costs, the Commission observes that commenters appeared to have relied upon appropriate assumptions in their estimates for the Legal Segregation with Recourse Model and the Futures Model.[66] In contrast, the Commission finds, at least initially, persuasive the comments questioning the estimates of Risk Costs for the Complete Legal Segregation Model and the Physical Segregation Model, to the extent that such estimates are based on the assumption that collateral from non-defaulting cleared swaps customers would be fully available to DCOs in practice.[67]

2. Questions

The Commission seeks comment on potential operational costs associated with implementing the Futures Model, and whether such costs could vary depending on the volume of swaps to be cleared.

Further, the Commission seeks comment on potential operational costs and Risk Costs for all models other than the Futures Model, especially with respect to (i) the extent to which such costs could be offset against the costs that swaps customers currently incur to obtain individual collateral protection, and (ii) the extent to which such costs may correspond to the implicit costs that customers may bear due to Fellow-Customer Risk.

The Commission also seeks comment on the assumptions underlying estimates of Risk Costs for the Complete Legal Segregation Model and the Physical Segregation Model.

- Specifically, is it plausible that an FCM might decline gradually over time rather than in a sudden event? If so, is it plausible that customers of such a declining FCM might transfer their cleared swaps and related collateral to another FCM?
- If the Commission were to permit a DCO to access collateral from non-defaulting cleared swaps customers to cure a default, would it be prudent, in light of answers to the foregoing questions, for the DCO to rely upon such collateral in calculating the financial resources package that it must hold? Why or why not, or to what extent? If not, or if only to a limited extent, how does that conclusion affect the Risk Costs for the Complete Legal Segregation Model (as well as the Physical Segregation Model)? Do DCOs account for potential differences between fellow customer collateral at the time of calculation and expected fellow-customer collateral at the time of default in their default resource calculations? If so, how?

In addition, as discussed above, a number of commenters on the ANPR suggested that consideration of the costs and benefits of all models should be informed by the protections for collateral obtained by customers in the existing swaps market and of the costs incurred for such protections.[68] The Commission invites additional comment on these subjects, including quantitative information. Specifically, the Commission invites the submission of additional information on the costs of each level of protection, as well as the submission of detailed quantitative information on the effects, if any, of the absence of Fellow-Customer Risk on guaranty fund levels, margin levels and other economic characteristics of the use of collateral in the cleared swaps market. Additionally, the Commission invites the submission of detailed quantitative information on the costs currently incurred to protect collateral in the cleared and uncleared swaps markets.

Finally, some commenters on the ANPR stated that swaps, including cleared swaps, have inherent characteristics that differentiate them from exchange-traded futures contracts and that affect the magnitude of the exposure that Cleared Swaps Customers have to Fellow-Customer Risk.[69] The Commission invites additional comment on the prevalence of such characteristics and their bearing on the costs and benefits of the proposed rule and potential alternatives.

C. Benefits[70]

1. Rationale

a. Fellow-Customer Risk and Investment Risk

The Commission agrees with commenters that the Legal Segregation Model (whether Complete or with Recourse) and the Physical Segregation Model would mitigate Fellow-Customer Risk and Investment Risk to differing extents. With respect to Fellow-Customer Risk, the Commission believes that: (i) The Physical Segregation Model would eliminate Fellow-Customer Risk, albeit only to the extent permitted under the Bankruptcy Code;[71] (ii) the Complete Legal Segregation Model would largely mitigate Fellow-Customer Risk in FCM defaults of all magnitudes;[72] and (iii) the Legal Segregation with Recourse Model would

---

Segregation with Recourse Model relative to the Futures Model, see the cost-benefit analysis at section VII(C) infra.

[65] The Commission is not persuaded by the claim that it may be difficult for FCMs and DCOs to maintain separate models for futures customer collateral and cleared swaps customer collateral. Many FCMs are part of organizations that currently (and in the future will) maintain separate models for futures and uncleared swaps, and there has been no evidence of problems with the ability of such FCMs to operate both business lines. Indeed, there are DCOs that currently maintain different guaranty funds for cleared swaps and futures contracts, and that apply materially different margin models to such contracts (*e.g.,* futures contracts vs. credit default swaps vs. interest rate swaps), again without reported trouble.

[66] Regarding the comment stating that the Legal Segregation with Recourse Model would result in a "wealth transfer" from the DCO and its FCM members to cleared swaps customers, the Commission notes that such comment did not include an estimate for any additional costs resulting from such "transfer." Moreover, such statement is simply the obverse of the observation by other commenters that the Futures Model would involve implicit costs to customers. *See, e.g.,* Federal Farm Credit Banks Funding Corp. at 3 ("Under the [futures] model, the hundreds of millions of dollars that the System Banks will likely post as initial margin and variation margin for cleared trades would be at economic risk").

[67] For example, the size of the customer account at Lehman declined substantially in the days before its bankruptcy filing and caused DCOs to declare it in default. For additional discussion of the relationship of estimates of Risk Costs to assumptions about the availability of the collateral of non-defaulting customers in the event of an FCM default, see the discussion of fellow-customer behavior and "diversification" effects in relation to the design of a DCO's financial resources package in the cost-benefit analysis at section VII(C)(2)(b) infra.

[68] *See* section II(C)(2)(c)(2) supra.

[69] *See, e.g.,* note 38, supra.

[70] For additional discussion of benefits issues, with particular reference to the benefits of the proposed Complete Legal Segregation Model and the Legal Segregation with Recourse Model relative to the Futures Model, see the cost-benefit analysis at section VII(C) infra.

[71] As discussed further below, section 766(h) of the Bankruptcy Code, 11 U.S.C. 766(h), requires that customer property be distributed "ratably to customers on the basis and to the extent of such customers' allowed net equity claims * * *."

[72] Because the DCO would allocate collateral between defaulting and non-defaulting cleared swaps customers based on information the FCM provided the day prior to default, such allocation would not reflect movement in the cleared swaps portfolio of such customers on the day of default.

largely mitigate Fellow-Customer Risk [73] in all but the most extreme FCM defaults.

The Commission agrees with commenters that the Physical Segregation Model would eliminate Investment Risk because the FCM and DCO would invest the collateral of one cleared swaps customer separately from the collateral of another such customer. Therefore, the FCM or DCO may attribute losses on such investments to one particular customer. The Commission believes that the Legal Segregation Model (whether Complete or with Recourse) and the Futures Model would not mitigate Investment Risk. Such models permit the FCM and DCO to hold the collateral of all cleared swaps customers in one account, and therefore neither the FCM nor the DCO would be able to attribute investments (and losses thereon) to one particular customer.

b. Portability

The Commission agrees with commenters that the Complete Legal Segregation Model and the Physical Segregation Model would enhance portability of the cleared swaps of non-defaulting customers in the event of an FCM default. The Commission notes that the Legal Segregation with Recourse Model would not likely facilitate portability to the same extent, because the DCO is unlikely to release the collateral of such non-defaulting customers until it has completed the process of liquidating the portfolio of the defaulting FCM and customers. Therefore, even if the DCO or trustee ports the cleared swaps of non-defaulting customers, such customers may need to post additional collateral at the non-defaulting FCM to support such swaps. Such customers may not be able to meet such increased capital demands, especially during a time of resource scarcity.

c. Systemic Risk

The Commission agrees with comments that the Complete Legal Segregation Model and the Physical Segregation Model would most mitigate systemic risk by enhancing portability of the cleared swaps of non-defaulting customers in the event that an FCM defaults. The Commission notes that certain international regulators also emphasize the importance of portability. For example, the Consultative Report on the Principles for Financial Market Infrastructures (the "CPSS–IOSCO Principles") [74] issued by the Committee on Payment and Settlement Systems ("CPSS") and the Technical Committee of the International Organization of Securities Commissions ("IOSCO," and together "CPSS–IOSCO") and the Proposal for a Regulation on OTC Derivatives, Central Counterparties and Trade Repositories by the European Parliament and Council (the "EU Proposal") [75] highlight the importance of portability of cleared swaps customer contracts and related collateral. As stated in the CPSS–IOSCO Principles, the "[e]fficient and complete portability of customer positions and collateral is important in both pre-default and post-default scenarios, but is particularly critical when a participant defaults or is undergoing insolvency proceedings".[76] The EU Proposal explains that segregation and portability are "critical to effectively reduc[ing] counterparty credit risk through the use of [central counterparties], to achiev[ing] a level playing field among European [central counterparties] and to protect the legitimate interests of clients of clearing members".[77]

d. Induced Changes in Behavior [78]

The Commission agrees with commenters that argued that the better the protection that a model affords to the collateral of non-defaulting cleared swaps customers, the more likely customers would leave excess margin at an FCM. In contrast, the Commission does not find persuasive arguments that the Legal Segregation Model (especially Complete) and the Physical Segregation Model would cause changes in behavior, by (i) discouraging cleared swaps customers from creating market discipline by clearing through less risky firms,[79] or (ii) discouraging FCMs from maintaining substantial excess net capital to present a more attractive profile to customers.[80]

With respect to (i), cleared swaps customers generally cannot exert material market discipline because they lack information to accurately assess the risk of their FCMs. For example, certain commenters noted that cleared swaps customers cannot obtain information about the risk profile of fellow customers.[81] Buy-side commenters reinforced such observation by stating that they would not want fellow customers learning of their own risk profiles.[82] Even if FCMs were to disclose general policies regarding the risk profiles of customers that they accept, it is not clear how cleared swaps customers would learn about exceptions to the FCM policies that may be granted. Given the foregoing, the Commission is interested in whether FCM disclosures to cleared swaps customers could be improved. What measures could FCMs take to provide more comprehensive and useful disclosures regarding their proprietary risks and the risk profiles of their customers? For example, one commenter suggested that the Commission could require FCM disclosures to include the following:

- The FCM's total equity, regulatory capital and net worth;
- The dollar value of the FCM's proprietary margin requirements as a percentage of its segregated and secured customer margin requirements;
- What number of the FCM's customers comprise an agreed significant percentage of its customer segregated funds;
- The aggregate notional value of non-hedged, principal OTC transactions into which the FCM has entered;
- The amount, generic source and purpose of any unsecured and uncommitted short-term funding the FCM is using;
- 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;
- The percentage of defaulting assets (debits and deficits) the FCM had during the prior year compared to its year-end segregated and secured customer funds; and
- A summary of the FCM's current risk practices, controls and procedures.[83]

The Commission requests comment as to whether it would make the FCM disclosure more useful to customers if such disclosure contained one or more of the elements above. Which elements would be most helpful to customers? What would be the cost to FCMs of generating such disclosures? What would be the costs and benefits to

[73] *Id.*

[74] *See* CPSS–IOSCO, CPSS–IOSCO Principles (March 10, 2011), available at *http://www.bis.org/publ/cpss94.pdf.*

[75] *See* European Commission, EU Proposal (Sept. 15, 2010), available at *http://ec.europa.eu/internal_market/financial-markets/docs/derivatives/20100915_proposal_en.pdf.*

[76] *See* CPSS–IOSCO Principles at 69.

[77] *See* EU Proposal at 10 (Sept. 15, 2010).

[78] *See* section VII(C)(2) herein for a description of induced changes in behavior for DCOs if the Commission adopts either the Complete Legal Segregation or the Legal Segregation with Recourse Models.

[79] *See, e.g.,* CME at 4, ISDA Supplemental at 6.

[80] See, *e.g.,* ISDA Supplemental at 6.

[81] *E.g.,* ADM at 3, BlackRock at 5, CIEBA at 2, 4–6, FFCB at 4, FHLB at 1, MFA at 8, Tudor at 2.

[82] *E.g.,* BlackRock at 5, FHLB at 2.

[83] *See* NewEdge at 3 to 5.

customers of receiving and reviewing such disclosures?

With respect to (ii), the Commission notes that FCMs have claimed in recent net capital rulemakings that Commission capital requirements are sufficient.[84] If such capital requirements are sufficient, it would appear that excess net capital is not necessary.[85]

e. Portfolio Margining.[86]

In response to concerns regarding the impact of models other than the Futures Model on portfolio margining,[87] the Commission believes that such impact would likely be positive. Specifically, a DCO could more easily justify to the Commission that issuing an order under section 4d(f) of the CEA (or approving rules permitting commingling pursuant to proposed regulation 39.15(b)(2))[88] is appropriate if the regulations under such section mitigate Fellow-Customer Risk, since the impact of any different risk from the product being brought into the portfolio would be limited to the customer who chooses to trade that product. This is in contrast to the Futures Model, where the risks that the product being brought into the portfolio affect customers who do not—and would not—trade that product.

2. Questions

The Commission seeks comment on the above analysis of benefits accorded by each model, including whether there are any additional benefits that the Commission should consider. What benefits would be realized by, alternatively, adopting the Futures Model?

D. Proposing the Complete Legal Segregation Model: Weighing of Costs and Benefits

As mentioned above, commenters generally agreed that customers would bear the costs of implementing any model. Therefore, the Commission believes that it is appropriate to give weight to the preference of customers. The Commission finds it compelling that most (although not all) buy-side commenters to the ANPR favored a model other than the Futures Model. The Commission notes that models other than the Futures Model would provide more individualized protection to cleared swaps customer collateral in accordance with section 4d(f) of the CEA. Any such model may provide substantial benefits in the form of (i) decreased Fellow-Customer Risk (as well as Investment Risk, in certain circumstances), (ii) increased likelihood of portability, (iii) decreased systemic risk, and (iv) positive impact on portfolio margining. The Commission seeks additional comments, in particular from customers, as to whether and why, in light of this NPRM, they favor or oppose adoption of the Futures Model. The Commission anticipates that, to the extent it decides to adopt the Futures Model, the proposed rule text from proposed regulation 22.2 to proposed regulation 22.10 would implement such model. The Commission notes that changes to the language of proposed regulation 22.15 may be necessary. Specifically, proposed regulation 22.15 would need to include an additional section to the effect that a DCO may, if its rules so provide, use the Cleared Swaps Customer Collateral of all Cleared Swaps Customers of a Depositing Futures Commission Merchant that has defaulted on a payment to the DCO with respect to its Cleared Swaps Customer Account.

In choosing between the Legal Segregation Model (whether Complete or with Recourse) and the Physical Segregation Model, the Commission notes that the operational costs for the Physical Segregation Model are substantially higher than the operational costs for the Legal Segregation Model (whether Complete or with Recourse).

With respect to benefits, the Commission believes that the Physical Segregation Model provides only incremental advantages over the Legal Segregation Model (whether Complete or with Recourse) with respect to the mitigation of Fellow-Customer Risk. The Physical Segregation Model, unlike the Legal Segregation Model (whether Complete or with Recourse), does eliminate Investment Risk. However, the Commission notes that (i) it is in the process of further addressing Investment Risk by proposing amendments to regulation 1.25, and (ii) each FCM and DCO already values investments conservatively. Finally, the Commission observes that the Physical Segregation Model generally enhances portability to the same extent as the Complete Legal Segregation Model, and therefore would have similar effects on systemic risk. The Physical Segregation Model and the Legal Segregation Model (whether Complete or with Recourse) would likely enhance portfolio margining to the same extent.

Consequently, after weighing the potential costs and benefits of the Physical Segregation Model, the Commission has decided that this model does not provide the best balance, in that it provides similar benefits as the Legal Segregation Model (whether Complete or with Recourse), but costs more to implement. Hence, the Commission has determined not to propose the Physical Segregation Model.

In choosing between the Complete Legal Segregation Model and the Legal Segregation with Recourse Model, the Commission notes that commenters have argued that implementing the former would result in significant Risk Costs, whereas implementing the latter would result in no Risk Costs. As mentioned above, the Commission finds, at least initially, persuasive comments that question the assumptions underlying the estimates of Risk Costs for the Complete Legal Segregation Model. Nevertheless, the Commission recognizes that such assumptions form an area of divergence between commenters, and therefore asks for additional comment on the Risk Costs for the Complete Legal Segregation Model. The Commission observes that operational costs for the Complete Legal Segregation Model and the Legal Segregation with Recourse Model are approximately the same.

With respect to benefits, the Commission notes that the Complete Legal Segregation Model would mitigate Fellow-Customer Risk even in extreme FCM defaults, unlike the Legal Segregation with Recourse Model. Further, the Complete Legal Segregation Model would enhance portability (and therefore mitigate systemic risk) to a significantly greater extent than the Legal Segregation with Recourse Model. Finally, the Complete Legal Segregation Model would have an incremental advantage over the Legal Segregation with Recourse Model with respect to impact on portfolio margining.

Consequently, after weighing the potential costs and benefits, the Commission has determined that the Complete Legal Segregation Model provides the best balance, and therefore has determined to propose the Complete Legal Segregation Model. Nevertheless, because the Commission is still evaluating the costs associated with such model, as well as with the Legal

[84] *See, e.g.,* Newedge Letter of June 8, 2009 at 2 ("increasing capital requirements does not necessarily ensure fiscal solvency."), *id.* at 4 (increasing capital requirements would be anti-competitive). (Attachment B to the Newedge comment to this rulemaking).

[85] *See* section VII(C)(2)(c) infra for additional discussion of induced changes in behavior for DCOs, including effects on monitoring of FCM risk, if the Commission adopts either the Complete Legal Segregation or the Legal Segregation with Recourse Models.

[86] *See* section IV(A)(2) herein for a more detailed description of Commission orders under section 4d(f) of the CEA.

[87] *See* SIFMA at 3–4, Investment Company Institute at 5–6, Futures Industry Association at 6.

[88] *See* Notice of Proposed Rulemaking on Risk Management Requirements for Derivatives Clearing Organizations, 76 FR 3698 (Jan. 20, 2011).

Segregation with Recourse Model, the Commission is also considering the Legal Segregation with Recourse Model.[89]

E. The Optional Approach

1. Rationale

As mentioned above, a number of commenters urged the Commission to propose the Optional Approach. The Commission has preliminarily declined to propose the Optional Approach because it may not be compatible with the Bankruptcy Code and regulation part 190 ("Part 190"). Specifically, if customer collateral cannot be transferred, section 766(h) of the Bankruptcy Code[90] requires that such collateral be distributed on a *pro rata* basis. In implementing this section of the Bankruptcy Code, the Commission has created in Part 190 the "account class" concept, which enables customer collateral to be separated into different categories for distribution depending on the type of customer (*i.e.,* futures customer, foreign futures customer, and cleared swaps customer) holding a claim. All customers belonging to one "account class" would share *pro rata* in the collateral attributed to that "account class." Therefore, all cleared swaps customers would belong to one "account class," and would share *pro rata* in the cleared swaps collateral remaining after their contracts are ported or liquidated. If, under the Optional Approach, certain cleared swaps customers had chosen a model that provided more individual collateral protection while others had not, the former would still share in any shortfalls in cleared swaps customer collateral resulting from the choices of the latter. The Commission notes that the "account class" concept, which has been tested and upheld in prior bankruptcy proceedings, has never permitted customers transacting in the same type of contracts, with two different segregation requirements, to be deemed participants in separate "account classes."[91]

Moreover, as a number of commenters have noted, optional models may cause legal, regulatory, operational and other complexities.[92]

2. Questions

It may be possible for the Commission to resolve the incompatibility between (i) the Optional Approach and (ii) the Bankruptcy Code and Part 190, by permitting DCOs to require that FCMs establish separate legal entities, each of which is limited to clearing at DCOs that use only one of (A) the Complete Legal Segregation Model or (B) the Legal Segregation with Recourse Model. The Commission notes, however, that this approach might cause concerns with respect to open access and competition. The Commission seeks comment on the practicability of this approach.

- What costs (including implementation, operational, and capital) would such DCOs and FCMs incur?
- Would FCMs be willing to establish such separate legal entities? What systemic risk impacts might there be, if any?
- Would such an approach create benefits or burdens in other contexts?
- What would be the effect of this approach on competition and on opening FCM access to clearing organizations?

In addition, the Commission seeks comment on whether the Optional Approach should be expanded to add the Futures Model as an option. If so, what would be the impact on (1) costs, (2) the protection of Cleared Swaps Customer Collateral, and (3) the existence of effective choice by customers?

The Commission also seeks comment on whether to implement a model that permits DCOs to offer the Physical Segregation Model for cleared swaps customer collateral for some set of customers of their FCM members, with the remaining cleared swaps customer collateral staying in an omnibus account under the Futures Model. (Under this model, the customers in question would hold claims with respect to the collateral placed in physical segregation directly against the DCO rather than against the FCM through which the customers clear.)[93]

- How would such a model work in the ordinary course of business (*i.e.,* pre-FCM member default)? For example, how would an FCM and a DCO structure their respective cash flows to accommodate such model? To the extent that an FCM or DCO may structure their cash flows in different ways, what are the issues, costs, or risks of each way?
- What changes to proposed Part 22 and Part 190 should the Commission make to accommodate this model?
- Who (*e.g.,* the cleared swaps customer, FCM member, and DCO) would have what rights in cleared swaps customer collateral at every stage of clearing (including with respect to initial margin and variation payments and collections)?
- In the event of an FCM bankruptcy, would such cleared swaps customer collateral constitute "customer property" subject to ratable distribution pursuant to section 766(h) of the Bankruptcy Code?
  - To what extent would the answer to this question depend on the manner in which the FCM and the DCO structured their respective cash flows in the ordinary course of business?
  - To the extent cleared swaps customer collateral is removed from "customer property":
    - What vulnerabilities might that raise for the protection of such collateral in an FCM or a DCO bankruptcy? For example, is there a risk that, in some circumstances, such property might be deemed to be part of a bankrupt FCM's or DCO's bankruptcy estate subject to the claims of creditors other than the relevant swaps customers?
    - What changes would need to be made to self-regulatory organization audit programs to ensure protection of

[89] *See* generally section IV(O) below.

[90] 11 U.S.C. 761(h).

[91] The Commission created the "account class" concept in adopting original part 190. *See* 46 FR 57535 (Nov. 24, 1981). The Commission noted that "the accounts held by a commodity broker would be divided into four types or classes: Futures accounts, foreign futures accounts, leverage accounts and commodity options accounts, which correspond to the four estates a commodity broker may have based upon the different types of transactions it handles for customers." *Id.* at 57536. These classes corresponded to different definitions of "customer" found in section 761(9) of the Bankruptcy Code: With respect to a "futures commission merchant," a "foreign futures commission merchant," a "leverage transaction merchant," and a "commodity options dealer." *See* 11 U.S.C. 761(9).

In making that proposal, the Commission cited to text in the House Report for the 1978 Bankruptcy Code concerning those definitions, which noted that:

It is anticipated that a debtor with multifaceted characteristics will have separate estates for each different kind of customer. Thus, a debtor that is a leverage transaction merchant and a commodity options dealer would have separate estates for the leverage transaction customers and for the options customers, and a general estate for other creditors.

See H.R. Rep. 95–595 at 355, 1978 U.S.C.C.A.N. 5963, 6346.

In the release adopting part 190, the Commission added another "account class," delivery accounts, for property related to the making or taking of physical delivery by a customer. Delivery accounts are not mentioned in section 761(9) of the Bankruptcy Code, but are, again, related to a "different kind of customer." *See* 48 FR 8716, 8731 (Mar. 1, 1983). Similarly, in April of 2010, the Commission added another "account class," for cleared OTC transactions. Once again, this represented a "separate estate" for a "different kind of customer." *See* 75 FR 17297 (Apr. 6, 2010). Separating cleared swaps customers by the type of model the DCO adopts does not fit this tested rubric: The customers are all of the same "kind," namely, all cleared swaps customers.

[92] *See, e.g.,* ICE at 12, Investment Company Institute at 6, LCH at 7.

[93] *See* comment from Jerrold Salzman, available at *http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=42253&SearchText=* (discussing the legal segregation of certain customer accounts as a way to minimize fellow customer risk).

cleared swaps customer collateral pre-bankruptcy?

- Should such a model be an option elected by cleared swaps customers, or mandatory for defined "high-risk" customers?
  - By whom would the definition of "high-risk" be set?
  - What criteria should be included in the definition of "high risk"?
  - Would the definition of "high risk" vary by asset class?
- To the extent the model is optional by a cleared swaps customer, to what extent might there be a tendency for cleared swaps customers posing greater risk to remain in the omnibus pool? What policy concerns, if any, might be raised by the inclusion of a larger concentration of cleared swaps customers posing greater risk in the omnibus pool?

Please provide a detailed quantitative analysis of the costs and benefits of this model relative to other models that are being considered in this NPRM, and relative to the existing uncleared swaps market. Please specify how each cost and benefit would be ultimately allocated to, or borne by, cleared swaps customers, FCMs and DCOs. Specifically, how would this type of model affect operational costs and Risk Costs?

F. Structure of These Proposed Regulations

Proposed regulation part 22 ("Part 22") establishes the basic architecture for protecting cleared swaps customer collateral through the promulgation of definitions and procedures for the segregation of cleared swaps pertaining to customers, as well as associated collateral. The Commission intends for proposed Part 22 to incorporate legal segregation, and to parallel, for the most part, the substance of corresponding provisions in part 1 to Title 17 (the "Part 1 Provisions"), in updated and clarified form, with respect to issues such as requirements for treatment of customer funds on a day-to-day basis, required amounts of collateral in customer accounts, and required qualifications for permitted depositories. While most of the proposed regulations in Part 22 will remain the same for the Complete Legal Segregation Model and the Legal Segregation with Recourse Model, proposed regulation 22.15 sets forth alternatives to take into account the fact that, under the Legal Segregation with Recourse Model, following an event of default a DCO would be able to access the collateral of non-defaulting cleared swaps customers after the DCO applied (i) its own capital to cure the default and (ii) the guaranty fund contributions of its non-defaulting FCM members.

The infrastructure supporting legal segregation is established in proposed regulations 22.11–22.16, including (i) the requirement that an FCM transmit to its DCO daily information regarding customers and their swaps, (ii) tools that the DCO may use to manage the risk it incurs with respect to individual customers, (iii) steps the FCM is required to take if it fails to meet a cleared swaps customer margin call in full, and (iv) an explicit requirement that cleared swaps customer collateral be treated on an individual basis. The Commission requests comment on whether Part 22 differs in substance from the Part 1 Provisions, other than in the specific instances described in this NPRM.

In addition, proposed revisions to Part 190 of the Commission's regulations generally implement changes wrought by the Dodd-Frank Act, including the inclusion of swaps cleared with a DCO as customer contracts for all commodity brokers, the inclusion of swaps execution facilities as a category of trading venue, and additional conforming changes to time periods. Additional proposed changes have been made to conform Part 190 to current market practices (*e.g.,* providing for auctions of swaps portfolios in the event of a commodity broker insolvency).

IV. Section by Section Analysis: Segregation of Cleared Swaps for Customers

A. Proposed Regulation 22.1: Definitions

Proposed regulation 22.1 establishes definitions for, *inter alia,* the following terms: "cleared swap," "cleared swaps customer," "cleared swaps customer account," "cleared swaps customer collateral," "cleared swaps proprietary account," "clearing member," [94] "collecting futures commission merchant," "commingle," "customer," "depositing futures commission merchant," "permitted depository," [95] and "segregate."

1. "Segregate" and "Commingle"

The Commission has never defined the terms "segregate" and "commingle," although the Part 1 Provisions make extensive use of these terms. Regulation 22.1 proposes definitions for these terms that are intended to codify the common meaning of such terms under the Part 1 Provisions. Pursuant to the proposal, to "segregate" two or more items means to keep them in separate accounts and to avoid combining them in the same transfer between accounts. In contrast, to "commingle" two or more items means to hold them in the same account, or to combine such items in a transfer between accounts. For purposes of these definitions, to keep items in separate accounts means: (i) To hold tangible items [96] physically separate within one's own organization; (ii) to deposit tangible or intangible items [97] with a Permitted Depository (as discussed further below) in separate accounts; and (iii) to reflect tangible or intangible items in separate entries in books and records. To hold items in the same account means exactly the opposite—namely, (i) to hold tangible items physically together within one's own organization; (ii) to deposit tangible or intangible items with a Permitted Depository in the same account; and (iii) to reflect tangible or intangible items in the same entries in books and records.

2. "Cleared Swap"

The term "Cleared Swap" has no analog in the Part 1 Provisions. Regulation 22.1 proposes a definition that incorporates section 1a(7) of the CEA,[98] as added by section 721 of the Dodd-Frank Act. This definition then excludes, for purposes of Part 22 only, cleared swaps (and related collateral) that, pursuant to Commission order under section 4d(a) of the CEA,[99] are

---

[94] Under the Commission's proposal, the term "clearing member" means "any person that has clearing privileges such that it can process, clear and settle trades through a derivatives clearing organization on behalf of itself or others. The derivatives clearing organization need not be organized as a membership organization."

[95] The Commission is proposing to define "permitted depository" as a depository that meets the following conditions:

(a) The depository must (subject to proposed regulation 22.9) be one of the following types of entities:

(1) A bank located in the United States;

(2) a trust company located in the United States;

(3) a Collecting Futures Commission Merchant registered with the Commission (but only with respect to a Depositing Futures Commission Merchant providing Cleared Swaps Customer Collateral); or

(4) a derivatives clearing organization registered with the Commission; and

(b) the FCM or the DCO must hold a written acknowledgment letter from the depository as required by proposed regulation 22.5. *See* also the discussion under section IV(D).

[96] Tangible items may include, *e.g.,* gold ingots or warehouse receipts, as discussed further below.

[97] Intangible items may include, *e.g.,* wire transfers or dematerialized securities, as discussed further below.

[98] 7 U.S.C. 1a(7). The Commission is working on regulations, along with the Securities and Exchange Commission, that would further define certain key terms of the Dodd-Frank Act, including "swaps." *See Definitions Contained in Title VII of Dodd-Frank Wall Street Reform and Consumer Protection Act,* 75 FR 51429 (Aug. 20, 2010). Such regulations, when finalized, would automatically be incorporated in the definition of "cleared swap" cited herein.

[99] 7 U.S.C. 6d(a).

commingled with futures contracts (and related collateral) in an account established for the futures contracts. The definition conversely includes, for purposes of Part 22 only, futures contracts or foreign futures contracts (and, in each case, related collateral) that, pursuant to Commission order under section 4d(f) of the CEA,[100] are commingled with cleared swaps (and related collateral) in an account established for the cleared swaps. The rationale for such exclusion and inclusion is that, under Commission precedent,[101] once cleared swaps (and related collateral) are commingled with futures contracts (and related collateral) in a futures account, the Part 1 Provisions and the Bankruptcy Rules would apply to the cleared swaps (and related collateral) as if such swaps constituted futures contracts (and related collateral). Similarly, once futures contracts or foreign futures contracts (and, in each case, related collateral) are commingled with cleared swaps (and related collateral) in a cleared swaps account, the proposed definition of "Cleared Swap" would apply Part 22 and the Bankruptcy Rules to the former contracts as if they constituted cleared swaps (and related collateral). Therefore, the proposed definition of "Cleared Swap," with such exclusion and inclusion, simply extends Commission precedent.

3. "Cleared Swaps Customer" and "Customer"

Regulation 22.1 proposes a definition of "Cleared Swaps Customer" that has two elements. First, an entity holding a Cleared Swaps Proprietary Account (as discussed further below) is not a "Cleared Swaps Customer" with respect to the Cleared Swaps (and related collateral) in that account. Such exclusion is consistent with regulation 1.3,[102] which defines "customer" and "commodity customer" for futures contracts. Second, an entity is only a "Cleared Swaps Customer" with respect to its Cleared Swaps (and related collateral). Additionally, the same entity may be a "customer" or "commodity customer" (as regulation 1.3 defines such terms) with respect to its futures contracts, and a "foreign futures or foreign options customer" (as regulation 30.1(c) [103] defines such term) with respect to its foreign futures contracts.[104] Because certain provisions of Part 22 distinguish the status of such entity (i) as a "Cleared Swaps Customer" and (ii) as a "customer" or "commodity customer" or "foreign futures or options customer," regulation 22.1 proposes a definition for "Customer" that includes any customer of an FCM other than a "Cleared Swaps Customer."

4. "Cleared Swaps Customer Collateral"

Regulation 22.1 proposes to define "Cleared Swaps Customer Collateral" to include money, securities, or other property that an FCM or a DCO receives, from, for, or on behalf of a Cleared Swaps Customer, which (i) is intended to or does margin, guarantee, or secure a Cleared Swap,[105] or (ii) if the Cleared Swap is in the form or nature of an option, constitutes the settlement value of such option. Additionally, regulation 22.1 proposes to define "Cleared Swaps Customer Collateral" to include "accruals," which are the money, securities, or other property that an FCM or DCO receives, either directly or indirectly, as incident to or resulting from a Cleared Swap that the FCM intermediates for a Cleared Swaps Customer.[106]

In general, the proposed definition parallels regulation 1.3,[107] which defines "customer funds" for futures contracts. However, the proposed definition differs from regulation 1.3 in three instances.[108] First, the proposed definition explicitly includes a Cleared Swap in the form or nature of an option as "Cleared Swaps Customer Collateral." The Commission believes that such change appropriately clarifies that a Cleared Swap functioning as an option, but not labeled as one, falls within the scope of the proposed definition. Second, the proposed definition does not explicitly include option premiums as "Cleared Swaps Customer Collateral." The Commission believes that such amounts are already incorporated in the settlement value of the option, and that listing such amounts separately may cause unnecessary confusion. Third, the proposed definition explicitly includes in "accruals" the money, securities, or other property that a DCO may receive relating to the Cleared Swap that an FCM intermediates for a Cleared Swap Customer. The Commission believes that such inclusion is appropriate since proposed regulation 22.3 permits a DCO to invest the "Cleared Swaps Customer Collateral" that it receives from the FCM in accordance with regulation 1.25.[109] Therefore, any increases in value

[100] 7 U.S.C. 6d(f).

[101] For example, current regulation 190.01(a) states: "* * * if positions in commodity contracts that would otherwise belong to one account class (and the money, securities, and/or other property margining, guaranteeing, or securing such positions), are, pursuant to a Commission order, commingled with positions in commodity contracts of the futures account class (and the money, securities, and/or other property margining, guaranteeing, or securing such positions), then the former positions (and the relevant money, securities, and/or other property) shall be treated, for purposes of this part, as being held in an account of the futures account class." 17 CFR 190.01(a). In the notice proposing current regulation 190.01(a), 74 FR 40794 (Aug. 13, 2009), the Commission stated that the regulation codified two previous interpretative statements: (i) The Interpretative Statement Regarding Funds Related to Cleared-Only Contracts Determined To Be Included in a Customer's Net Equity, 73 FR 65514 (Nov. 4, 2008); and (ii) the Interpretative Statement Regarding Funds Determined to be Held in the Futures Account Type of Customer Account Class, 69 FR 69510 (Nov. 30, 2004).

[102] 17 CFR 1.3.

[103] 17 CFR 30.1(c).

[104] The contracts (and related collateral) of such entity would be subject to three different segregation regimes. Specifically, the entity would be entitled to the protections of (i) the Corresponding Provisions with respect to its futures contracts (and related collateral), (ii) regulation 30.7 with respect to its foreign futures contracts (and related collateral), and (iii) Part 22 with respect to its Cleared Swaps (and related collateral).

[105] Proposed regulation 22.1 provides that "Cleared Swaps Customer Collateral" includes collateral that an FCM or a DCO receives from, for, or on behalf of a Cleared Swaps Customer that either (i) is actually margining, guaranteeing, or securing a Cleared Swap or (ii) is intended to margin, guarantee, or secure a Cleared Swap. This provision is a clarification of "customer funds" as defined in regulation 1.3, which includes "all money, securities, and property received by a futures commission merchant or by a clearing organization from, for, or on behalf of, customers or option customers * * * to margin, guarantee, or secure futures contracts."

[106] The Commission does not intend to include in Part 22 a parallel to regulation 1.21, given that (i) regulation 22.1 proposes to broadly include "accruals" in the definition of "Cleared Swaps Customer Collateral" and (ii) regulation 22.2(c) proposes to permit an FCM to commingle the "Cleared Swaps Customer Collateral" of multiple "Cleared Swaps Customers."

Regulation 1.21 states: "All money received directly or indirectly by, and all money and equities accruing to, a futures commission merchant from any clearing organization or from any clearing member or from any member of a contract market incident to or resulting from any trade, contract or commodity option made by or through such futures commission merchant on behalf of any commodity or option customer shall be considered as accruing to such commodity or option customer within the meaning of the Act and these regulations. Such money and equities shall be treated and dealt with as belonging to such commodity or option customer in accordance with the provisions of the Act and these regulations. Money and equities accruing in connection with commodity or option customers' open trades, contracts, or commodity options need not be separately credited to individual accounts but may be treated and dealt with as belonging undivided to all commodity or option customers having open trades, contracts, or commodity option positions which if closed would result in a credit to such commodity or option customers." 17 CFR 1.21.

The Commission requests comment on whether it should include in Part 22 a parallel to regulation 1.21.

[107] 17 CFR 1.3.

[108] In addition to these three instances, the proposed definition does not incorporate certain parallels to regulation 1.3 (exclusion from "customer funds" of collateral to secure security futures products in a securities account) because such parallels are not applicable to the context of Cleared Swaps (and related collateral).

[109] 17 CFR 1.25.

resulting from the investment would properly belong to the Cleared Swaps Customer, and would constitute another form of "Cleared Swaps Customer Collateral."

5. "Cleared Swaps Customer Account" and "Cleared Swaps Proprietary Account"

Regulation 22.1 proposes to define "Cleared Swaps Customer Account" as (i) an account that an FCM maintains at a Permitted Depository (as such term is discussed below) for the Cleared Swaps (and related collateral) of its Cleared Swaps Customers, or (ii) an account that a DCO maintains at a Permitted Depository, for collateral related to Cleared Swaps that the FCM members intermediate for their Cleared Swaps Customers. The proposed definition does not include any physical locations in which an FCM or a DCO may itself hold tangible Cleared Swaps Customer Collateral. As described below, regulations 22.2 and 22.3 propose to define such physical locations as the "FCM Physical Location" and the "DCO Physical Location," respectively. The proposed definition is consistent with regulation 1.3,[110] which defines "futures account." However, the proposed definition provides greater specificity than regulation 1.3 regarding (i) the entities maintaining the "Cleared Swaps Customer Account" (*i.e.,* the FCM or DCO) and (ii) the Permitted Depositories for a "Cleared Swaps Customer Account."

Regulation 22.1 proposes a definition for "Cleared Swaps Proprietary Account" that is substantially similar to regulation 1.3, which defines "Proprietary Account" for futures contracts.[111] The proposed definition contains a proviso, in paragraph (b)(8), that states "an account owned by any shareholder or member of a cooperative association of producers, within the meaning of section 6a of the Act, which association is registered as an FCM and carries such account on its records, shall be deemed to be a Cleared Swaps Customer Account and not a Cleared Swaps Proprietary Account of such association, unless the shareholder or member is an officer, director, or manager of the association." This proviso parallels paragraph viii in the definition of "Proprietary Account" in regulation 1.3. The Commission requests comment on whether this proviso remains relevant, and, in particular, with respect to Cleared Swaps.

[110] 17 CFR 1.3.

[111] *Id.*

6. "Collecting Futures Commission Merchant" and "Depositing Futures Commission Merchant"

The terms "Collecting Futures Commission Merchant" and "Depositing Futures Commission Merchant" have no analogs in the Part 1 Provisions. Regulation 22.1 proposes to define a "Collecting Futures Commission Merchant" as one that carries Cleared Swaps on behalf of another FCM and the Cleared Swaps Customers of that other FCM and, as part of doing so, collects Cleared Swaps Customer Collateral. In contrast, regulation 22.1 proposes to define a "Depositing Futures Commission Merchant" as one that carries Cleared Swaps on behalf of its Cleared Swaps Customers through a Collecting Futures Commission Merchant, and, as part of doing so, deposits Cleared Swaps Customer Collateral with such Collecting Futures Commission Merchant. Regulation 22.7, as described below, proposes to employ the terms "Collecting Futures Commission Merchant" and "Depositing Futures Commission Merchant" to delineate the circumstances in which one FCM may serve as a Permitted Depository to another.

B. Proposed Regulation 22.2—Futures Commission Merchants: Treatment of Cleared Swaps Customer Collateral

Regulation 22.2 proposes requirements for an FCM's treatment of Cleared Swaps Customer Collateral, as well as the associated Cleared Swaps.

1. In General

Regulation 22.2(a) proposes to require an FCM to treat and deal with the Cleared Swaps of Cleared Swaps Customers, as well as associated Cleared Swaps Customer Collateral, as belonging to the Cleared Swaps Customers. In other words, the FCM may not use Cleared Swaps Customer Collateral to cover or support (i) its own obligations or (ii) the obligations of Customers (*e.g.,* entities transacting in futures or equities contracts). Such proposal parallels regulations 1.20(a) and 1.26(a), which apply to "customer funds," and obligations purchased with customer funds, for futures contracts.[112]

2. Location of Collateral

Regulation 22.2(b) proposes to require that an FCM segregate all Cleared Swaps Customer Collateral that it receives. Such proposal parallels regulations 1.20(a) and 1.26(a).[113] Additionally, regulation 22.2(b) proposes to require that an FCM adopt one of two methods to hold segregated Cleared Swaps Customer Collateral, which parallel either implicit assumptions or explicit provisions of regulation 1.20(a).

a. The First Method

Paralleling an implicit assumption of regulations 1.20(a) and 1.26(a), the first method permits the FCM to hold Cleared Swaps Customer Collateral itself.[114] Continuing such parallel, the first method limits the FCM to holding tangible collateral (*e.g.,* gold ingots or warehouse receipts) because no FCM currently serves as a depository registered with domestic or foreign banking regulators, and because of uncertainty regarding the effectiveness of such segregation if an FCM that was so registered held intangible collateral in its own accounts. Finally, the first method requires the FCM, in holding such Cleared Swaps Customer Collateral, to:

- Physically separate the collateral from FCM property (*e.g.,* in a box or vault);
- Clearly identify each physical location (an "FCM Physical Location") in which it holds such collateral as a "Location of Cleared Swaps Customer Collateral" (*e.g.,* by affixing a label or sign to the box or vault);
- Ensure that the FCM Physical Location provides appropriate protection for such collateral (*e.g.,* by confirming that the box or vault has locks and is fire resistant); and
- Record in its books and records the amount of such collateral separately from FCM funds (*i.e.,* to reflect the reality of physical separation in books and records).

[112] Regulation 1.20(a) states: "Under no circumstances shall any portion of customer funds be obligated to a clearing organization, any member of a contract market, a futures commission merchant, or any depository except to purchase, margin, guarantee, secure, transfer, adjust or settle trades, contracts or commodity option transactions of commodity or option customers." 17 CFR 1.20(a).

[113] Regulation 1.20(a) states: "All customer funds shall be separately accounted for and segregated as belonging to commodity or option customers." *Id.*

Regulation 1.26(a) states: "Each futures commission merchant who invests customer funds in instruments described in Sec. 1.25 shall separately account for such instruments and segregate such instruments as belonging to such commodity or option customers." 17 CFR 1.26.

[114] Regulation 1.20(a) does not require that an FCM hold "customer funds" in a depository. Rather, it applies certain requirements to the holding of "customer funds *when* deposited with any bank, trust company, clearing organization or another futures commission merchant * * *" (emphasis added). In the absence of a requirement to use a depository, regulation 1.20(a) must implicitly permit the FCM to hold "customer funds" itself. *Id.* Regulation 1.26(a) contains similar language regarding the use of a depository. *Id.*

b. The Second Method

Paralleling an explicit provision of regulations 1.20(a) and 1.26(a),[115] the second method permits the FCM to hold Cleared Swaps Customer Collateral outside of itself, *i.e.,* at a depository.[116] Continuing that parallel, the second method limits the FCM to certain Permitted Depositories (as further discussed below), and requires that the FCM deposit such collateral in a Cleared Swaps Customer Account.

3. Commingling

Regulation 22.2(c) proposes to permit an FCM to commingle the Cleared Swaps Customer Collateral of multiple Cleared Swaps Customers, while prohibiting the FCM from commingling Cleared Swaps Customer Collateral with:

- FCM property, except as permitted under proposed regulation 22.2(e) (as discussed below); or
- "Customer funds" for futures contracts (as regulation 1.3 defines such term) or the "foreign futures or foreign options secured amount" (as regulation 1.3 defines such term), except as permitted by a Commission rule, regulation or order (or a derivatives clearing organization rule approved pursuant to regulation 39.15(b)(2)).[117]

Proposed regulation 22.2(c) parallels regulations 1.20(a), 1.20(c), and 1.26(a).[118]

4. Limitations on Use

Regulation 22.2(d) proposes certain limitations on the use that an FCM may make of Cleared Swaps Customer Collateral. First, regulation 22.2(d)(1) proposes to prohibit an FCM from using, or permitting the use of, the Cleared Swaps Customer Collateral or one Cleared Swaps Customer to purchase, margin, or settle the Cleared Swaps, or any other transaction, of a person other than the Cleared Swaps Customer. Such proposal parallels regulation 1.20(c) and 1.22.[119] Second, regulation 22.2(d)(2) proposes to prohibit an FCM from using Cleared Swaps Customer Collateral to margin, guarantee, or secure the non-Cleared Swap contracts (*e.g.,* futures or foreign futures contracts) of the entity constituting the Cleared Swaps Customer.[120] Such proposal parallels regulation 1.22.[121]

Regulation 22.2(d)(2) proposes to prohibit an FCM from imposing, or permitting the imposition of, a lien on Cleared Swaps Customer Collateral, including on any FCM residual financial interest therein (as regulation 22.2(e)(3) discusses further). The Commission believes that such a prohibition, in the event that an FCM becomes insolvent, would preempt the claim of an FCM creditor against any portion of the Cleared Swaps Customer Collateral, and would thereby prevent the FCM creditor from interfering with the porting of such collateral to a solvent FCM.

Regulation 22.2(d)(3) proposes to prohibit an FCM from claiming that any of the following constitutes Cleared Swaps Customer Collateral:

- Money invested in the securities, memberships, or obligations of any DCO, DCM, SEF, or SDR; or
- Money, securities, or other property that any DCO holds and may use for a purpose other than to margin, guarantee, secure, transfer, adjust or settle the obligations incurred by the FCM on behalf of its Cleared Swaps Customers.

Such proposal parallels regulation 1.24.[122]

5. Exceptions

Regulation 22.2(e) proposes certain exceptions to the abovementioned requirements and limitations.

a. Permitted Investments

Proposed regulation 22.2(e)(1) constitutes an exception to regulation 22.2(d) (Limitations on Use). Regulation 22.2(e)(1) proposes to allow an FCM to

[115] Regulation 1.20(a) states: "All customer funds shall be separately accounted for and segregated as belonging to commodity or option customers. Such customer funds when deposited with any bank, trust company, clearing organization or another futures commission merchant shall be deposited under an account name which clearly identifies them as such and shows that they are segregated as required by the Act and this part." *Id.* Regulation 1.26(a) contains similar language. *Id.*

[116] If an FCM chooses to accept intangible Cleared Swaps Customer Collateral, then the proposal effectively requires the FCM to maintain such collateral outside of itself. If the FCM accepts tangible Cleared Swaps Customer Collateral (*e.g.,* a gold ingot) and transfers such collateral to a depository (*e.g.,* a DCO), the FCM will be considered to be depositing such collateral rather than maintaining the collateral itself.

[117] As the discussion on the proposed definition of "Cleared Swaps" highlights, if the Commission adopts a rule or regulation or issues an order pursuant to section 4d(a) of the CEA, or if the Commission approves DCO rules pursuant to proposed regulation 39.15(b)(2) permitting such commingling, the Commission would apply the Corresponding Provisions and Part 190 to the Cleared Swap (and related collateral) as if the swap constituted a futures contract (and related collateral).

In contrast, if the Commission adopts a rule or regulation or issues an order pursuant to section 4d(f) of the CEA, or if the Commission approves DCO rules pursuant to proposed regulation 39.15(b)(2) permitting such commingling, the proposed definition of "Cleared Swap" would operate to apply Part 22 and Part 190 to (i) the futures contract (and related collateral) or (ii) the foreign futures contract (and related collateral) as if such contracts constituted Cleared Swaps (and related collateral).

[118] Regulations 1.20(a) and 1.26(a) implicitly (i) permit the FCM to commingle "customer funds" from multiple futures customers and (ii) prohibit the FCM from commingling "customer funds" with either FCM funds or funds supporting customer transactions in non-futures contracts. Specifically, regulation 1.20(a) states: "All customer funds shall be separately accounted for and segregated as belonging to commodity or option customers." Similarly, regulation 1.26(a) states: "Each futures commission merchant who invests customer funds in instruments described in Sec. 1.25 shall separately account for such instruments and segregate such instruments as belonging to such commodity or option customers." 17 CFR 1.20(a) and 1.26(a).

Regulation 1.20(c), in contrast, first explicitly prohibits an FCM from commingling the "customer funds" of one futures customer with (i) "customer funds" of another futures customer, (ii) funds supporting customer transactions in non-futures contracts (*e.g.,* the "foreign futures and options secured amount," as defined in regulation 1.3), and (iii) FCM funds. Specifically, regulation 1.20(c) states: "Each futures commission merchant shall treat and deal with the customer funds of a commodity customer or of an option customer as belonging to such commodity or option customer. All customer funds shall be separately accounted for, and shall not be commingled with the money, securities, or property of a futures commission merchant or of any other person. * * *" Notwithstanding the foregoing, however, regulation 1.20(c) then permits an FCM to commingle "customer funds" of multiple futures customers for convenience. Specifically, regulation 1.20(c) contains the following proviso: "*Provided, however,* that customer funds treated as belonging to the commodity or option customers of a futures commission merchant may for convenience be commingled and deposited in the same account or accounts with any bank or trust company, with another person registered as a futures commission merchant, or with a clearing organization. * * *" Regulation 1.20(c) does not contain a similar exception for (i) funds supporting customer transactions in non-futures contracts or (ii) FCM funds. 17 CFR 1.20(c).

[119] Regulation 1.20(c) states: "All customer funds shall be separately accounted for, and shall not * * * 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." *Id.*

Regulation 1.22 states: "No futures commission merchant shall use, or permit the use of, the customer funds of one commodity and/or option customer to purchase, margin, or settle the trades, contracts, or commodity options of, or to secure or extend the credit of, any person other than such customer or option customer." 17 CFR 1.22.

[120] As mentioned above, an entity may simultaneously transact (i) futures contracts, (ii) foreign futures contracts, and (iii) Cleared Swaps. Such entity would constitute a Cleared Swaps Customer only with respect to its Cleared Swaps.

[121] Regulation 1.22 further states: "Customer funds shall not be used to carry trades or positions of the same commodity and/or option customer other than in commodities or commodity options traded through the facilities of a contract market." 17 CFR 1.22.

[122] Regulation 1.24 states: "Money held in a segregated account by a futures commission merchant shall not include: (a) Money invested in obligations or stocks of any clearing organization or in memberships in or obligations of any contract market; or (b) money held by any clearing organization which it may use for any purpose other than to purchase, margin, guarantee, secure, transfer, adjust, or settle the contracts, trades, or commodity options of the commodity or option customers of such futures commission merchant." 17 CFR 1.24.

invest Cleared Swaps Customer Collateral in accordance with regulation 1.25, as such regulation may be amended from time to time. Regulation 1.25 delineates permitted investments of "customer funds" (as regulation 1.3 defines such term) for futures contracts.[123]

By allowing certain investments of Cleared Swaps Customer Collateral, proposed regulation 22.2(e)(1) parallels regulation 1.20(c).[124]

b. Permitted Withdrawals

Proposed regulation 22.2(e)(2) permits an FCM to withdraw Cleared Swaps Customer Collateral for such purposes as meeting margin calls at a DCO or a Collecting FCM, or to meet charges lawfully accruing in connection with a cleared swap, such as brokerage or storage charges. Regulation 22.2(e)(2) parallels regulation 1.20(c) and implements section 4d(f)(3)(A)(ii).

c. Deposits of Own Money, Securities, or Other Property

Proposed regulation 22.2(e)(3) constitutes an exception to regulations 22.2(b) (Location of Cleared Swaps Customer Collateral) and (c) (Commingling). Regulation 22.2(e)(3) proposes to permit an FCM: (i) To place its own property in an FCM Physical Location or (ii) to deposit its own property in a Cleared Swaps Customer Account.[125] As further explained below, proposed regulation 22.2(f) (Requirements as to Amount) mandates an FCM to use its own capital to cover the negative account balance of any Cleared Swaps Customer. To avoid the possibility of a deficiency,[126] an FCM may choose to place or deposit, in advance, its own property in an FCM Physical Location or a Cleared Swaps Customer Account, as applicable. By permitting such placement or deposit, proposed regulation 22.2(e)(3) parallels regulation 1.23.[127]

d. Residual Financial Interest

Proposed regulation 22.2(e)(4) clarifies that, if an FCM places or deposits its own property in an FCM Physical Location or a Cleared Swaps Customer Account, as applicable, then that property becomes Cleared Swaps Customer Collateral. This regulation would permit an FCM to retain a residual financial interest in property in excess of that necessary to comport with proposed regulation 22.2(f) (Requirements as to Amount). It allows the FCM to make withdrawals from the FCM Physical Location or the Cleared Swaps Customer Account, as applicable, so long as the FCM first ascertains that such withdrawals do not surpass its residual financial interest. In general, proposed regulation 22.2(e)(4) parallels regulation 1.23.[128]

e. Requirements as to Amount

i. Background

Proposed regulation 22.2(f) sets forth an explicit calculation for the value of Cleared Swaps Customer Collateral that each FCM must hold, which parallels the implicit calculation in the Part 1 Provisions. The Part 1 Provisions clearly require an FCM to segregate "customer funds" (as regulation 1.3 defines such term) for futures contracts.[129] However, the Part 1 Provisions also consider "customer funds" to be fungible. Specifically, because the Part 1 Provisions permit FCM commingling of "customer funds" from multiple futures customers[130] and FCM investment of such funds,[131] the Part 1 Provisions implicitly allow an FCM to meet its obligations without maintaining the exact property that each futures customer conveys. The Part 1 Provisions do require an FCM to maintain, at a minimum, an overall amount of "customer funds" in segregation.[132] Nevertheless, the Part 1 Provisions do not set forth an explicit calculation for such amount. Instead, the Part 1 Provisions imply that an FCM must maintain an amount in segregation that would prevent the FCM from using the "customer funds" of one futures customer 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."[133] Form 1–FR–FCM builds upon this implicit calculation.

ii. Proposed Requirement

Consistent with the intention of the Commission to incorporate updated and clarified versions of the Part 1 Provisions in Part 22, the Commission proposes an explicit calculation for the amount of Cleared Swaps Customer Collateral that an FCM must maintain in segregation. As such this calculation is intended only to make explicit what the Part 1 Provisions left implicit, the

---

[123] One commenter, Federated Investors, Inc. (Freeman and Hawke), argues that limitations on the investment of customer collateral in money market mutual funds are inappropriate for futures, and even more inappropriate for swaps. As mentioned above, the Commission has proposed amendments to regulation 1.25. *See Investment of Customer Funds and Funds Held in an Account for Foreign Futures and Foreign Options Transactions,* 75 FR 67642 (Nov. 3, 2010). With respect to limitations on investment of cleared swaps customer collateral, the Dodd-Frank Act provides, in newly-enacted section 4d(f)(4) of the CEA, that such collateral

* * * may be invested in obligations of the United States, in general obligations of any State or of any political subdivision of a State, and in obligations fully guaranteed as to principal and interest by the United States, or in any other investment that the Commission may by rule or regulation prescribe * * *.

Thus, with the exception of the specified government obligations, Congress chose not to mandate any specific acceptable customer investments. In exercising the power granted under section 4d(f)(4) to expand the universe of acceptable customer investments, the Commission is seeking the same goals as in regulation 1.25—namely, preserving principal and maintaining liquidity. *See* 75 FR at 67646. Accordingly, the Commission is proposing to incorporate the provisions of regulation 1.25 (as amended from time to time) by reference.

[124] Regulation 1.20(c) states: "* * * customer funds may be invested in instruments described in Sec. 1.25." 17 CFR 1.20(c).

[125] Regulation 22.2(e)(3) proposes to permit an FCM to deposit only those securities that are unencumbered and are of the types specified in regulation 1.25. Such proposal accords with regulation 1.23. *See* infra note 127. The Commission notes, however, that this proposal does not, and is not meant to, require a DCO to accept all of the types of securities or other property specified in regulation 1.25.

[126] *See* regulation 1.12(h) (requiring an FCM that learns of a deficiency in segregated funds to notify the Commission and the FCM's designated self-regulatory organization of that deficiency).

[127] Regulation 1.23 states: "The provision in section 4d(a)(2) of the Act and the provision in § 1.20(c), which prohibit the commingling of customer funds with the funds of a futures commission merchant, shall not be * * * construed to prevent a futures commission merchant from adding to such segregated 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, as it may deem necessary to ensure any and all commodity or option customers' accounts from becoming under segregated at any time." 17 CFR 1.23.

[128] Regulation 1.23 states, in addition to the text in note 127 supra: "The provision in section 4d(a)(2) of the Act and the provision in § 1.20(c), which prohibit the commingling of 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 customer funds, segregated as required by the Act and the rules in this part and set apart for the benefit of commodity or option customers * * * The books and records of a futures commission merchant shall at all times accurately reflect its interest in the segregated funds. A futures commission merchant may draw upon such segregated funds to its own order, to the extent of its actual interest therein, including the withdrawal of securities held in segregated safekeeping accounts held by a bank, trust company, contract market, clearing organization or other futures commission merchant. Such withdrawal shall not result in the funds of one commodity and/or option customer being used to purchase, margin or carry the trades, contracts or commodity options, or extend the credit of any other commodity customer, option customer or other customer." *Id.*

[129] *See* regulations 1.20(a) and (c) and 1.26(a).

[130] *See* regulation 1.20(c).

[131] *See* regulations 1.20(c) and 1.25.

[132] Regulation 1.32 states: "Each futures commission merchant must compute as of the close of each business day, on a currency-by-currency basis * * * (2) the amount of such customer funds required by the Act and these regulations to be on deposit in segregated accounts on behalf of such commodity and option customers. * * *" 17 CFR 1.32.

[133] Regulation 1.20.

calculation does not materially differ in the Form 1–FR–FCM from the calculation for "customer funds" of futures customers.

First, regulation 22.2(f) proposes to define "account" to reference FCM's books and records pertaining to the Cleared Swaps Customer Collateral of a particular Cleared Swaps Customer.

Second, regulation 22.2(f) proposes to require an FCM to reflect in its account for each Cleared Swaps Customer the market value of any Cleared Swaps Collateral that it receives from such customer, as adjusted for:

- Any uses that proposed regulation 22.2(d) permits;
- Any accruals or losses on investments permitted by proposed regulation 22.2(e) that, pursuant to the applicable FCM customer agreement, are creditable or chargeable to such Cleared Swaps Customer;
- Any charges lawfully accruing to the Cleared Swaps Customer, including any commission, brokerage fee, interest, tax, or storage fee; and
- Any appropriately authorized distribution or transfer of the Cleared Swaps Collateral.

Third, regulation 22.2(f) proposes to categorize accounts of Cleared Swaps Customers as having credit or debit balances. Accounts where the market value of Cleared Swaps Customer Collateral is positive after adjustments have credit balances. Conversely, accounts where the market value of Cleared Swaps Customer Collateral is negative after adjustments have debit balances.

Fourth, regulation 22.2(f) proposes to require an FCM to maintain in segregation, in its FCM Physical Location and/or its Cleared Swaps Customer Accounts at Permitted Depositories, an amount equal to the sum of any credit balances that Cleared Swaps Customers have in their accounts, excluding from such sum any debit balances that Cleared Swaps Customers have in their accounts (the "Collateral Requirement").

Finally, regulation 22.2(f) proposes an exception to the exclusion of debit balances, which parallels regulation 1.32(b).[134] Specifically, to the extent that a Cleared Swaps Customer deposited "readily marketable securities" with the FCM to secure a debit balance in its account, then the FCM must include such balance in the Collateral Requirement. "Readily marketable" is proposed to be defined as having a "ready market" as such latter term is defined in rule 15c3–1(c)(11) of the Securities and Exchange Commission (§ 241.15c3–1(c)(11) of this title). Regulation 22.2(f) proposes to deem a debit balance "secured" only if the FCM maintains a security interest in the "readily marketable securities," and holds a written authorization to liquidate such securities in its discretion. To determine the amount of the debit balance that the FCM must include in the Collateral Requirement, regulation 22.2(f) proposes to require the FCM: (i) To determine the market value of such securities, and (ii) to 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. The FCM would include in the Collateral Requirement that portion of the debit balance, not exceeding 100 percent, which is secured by such reduced market value.

iii. Question

The Commission requests comment on the Collateral Requirement proposed in regulation 22.2(f). Specifically, the Commission requests comment on whether the explicit calculation of such Collateral Requirement materially differs from the implicit calculation in the Part 1 Provisions for segregated "customer funds" of futures customers.

f. Segregated Account; Daily Computation and Record

Regulation 22.2(g), paralleling regulation 1.32,[135] proposes to require an FCM to compute, as of the close of each business day, on a currency-by-currency basis:

- The aggregate market value of the Cleared Swaps Customer Collateral in all FCM Physical Locations and all Cleared Swaps Customer Accounts at Permitted Depositories (the "Collateral Value");
- The Collateral Requirement; and
- The amount of the residual financial interest that the FCM holds in such Cleared Swaps Customer Collateral (*i.e.,* the difference between the Collateral Value and the Collateral Requirement).

Regulation 22.2(g), further paralleling regulation 1.32,[136] proposes to require the FCM to complete the abovementioned computation prior to noon on the next business day, and to keep all computations, together with supporting data, in accordance with regulation 1.31. "Noon" refers to noon in the time zone where the FCM's principal office is located.

C. Proposed Regulation 22.3—Derivatives Clearing Organizations: Treatment of Cleared Swaps Customer Collateral

Regulation 22.3 proposes requirements for DCO treatment of Cleared Swaps Customer Collateral from FCMs, as well as the associated Cleared Swaps. Such requirements generally parallel the Part 1 Provisions.

1. In General

Regulation 22.3(a) proposes to require a DCO to treat and deal with the Cleared Swaps Customer Collateral deposited by an FCM as belonging to the Cleared Swaps Customers of such FCM and not other persons, including, without limitation, the FCM. In other words, the DCO may not use Cleared Swaps Customer Collateral to cover or support (i) the obligations of the FCM depositing the Cleared Swaps Customer Collateral, (ii) the obligations of any other FCM, or (iii) the obligations of Customers (*e.g.,* entities transacting in futures or equities contracts) of any FCM. Such proposal parallels regulation 1.20(a), which applies to "customer funds" for futures contracts.[137]

2. Location of Collateral

Regulation 22.3(b) proposes to require that a DCO segregate all Cleared Swaps Customer Collateral that it receives from

[134] Regulation 1.32(b) states: "In computing the amount of funds required to be in segregated accounts, a futures commission merchant may offset any net deficit in a particular customer's account against the current market value of readily marketable securities, less applicable percentage deductions (*i.e.,* "securities haircuts") as set forth in rule 15c3–1(c)(2)(vi) of the Securities and Exchange Commission (17 CFR 241.15c3–1(c)(2)(vi)), held for the same customer's account. The futures commission merchant must maintain a security interest in the securities, including 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, clearing organization of a contract market, or another futures commission merchant. For purposes of this section, a security will be considered readily marketable if it is traded on a "ready market" as defined in rule 15c3–1(c)(11)(i) of the Securities and Exchange Commission (17 CFR 240.15c3–1(c)(11)(i))." 17 CFR 1.32(b).

[135] Regulation 1.32(a) states: "Each futures commission merchant must compute as of the close of each business day, on a currency-by-currency basis: (1) The total amount of customer funds on deposit in segregated accounts on behalf of commodity and option customers; (2) the amount of such customer funds required by the Act and these regulations to be on deposit in segregated accounts on behalf of such commodity and option customers; and (3) the amount of the futures commission merchant's residual interest in such customer funds." 17 CFR 1.32(a).

[136] Regulation 1.32(c) states: "The daily computations required by this section must be completed by the futures commission merchant prior to noon on the next business day and must be kept, together with all supporting data, in accordance with the requirements of § 1.31." 17 CFR 1.32(c).

[137] *See* note 112 supra.

FCMs. Such proposal parallels regulations 1.20(b) and 1.26(b).[138] Additionally, regulation 22.2(b) proposes to require that a DCO adopt one of two methods to hold segregated Cleared Swaps Customer Collateral, which parallel either implicit assumptions or explicit provisions of regulation 1.20(b).

a. The First Method

Paralleling an implicit assumption of regulations 1.20(b) and 1.26(b), the first method permits the DCO to hold Cleared Swaps Customer Collateral itself.[139] Continuing such parallel, the first method limits the DCO to holding tangible collateral (*e.g.,* gold ingots or warehouse receipts) because no DCO serves as a depository for intangible collateral. Finally, the first method requires the FCM, in holding such Cleared Swaps Customer Collateral, to:

- Physically separate (*e.g.,* in a box or vault) such collateral from its own property, the property of any FCM, and the property of any other person that is not a Cleared Swaps Customer of an FCM;
- Clearly identify each physical location (the "DCO Physical Location") in which it holds such collateral as a "Location of Cleared Swaps Customer Collateral" (*e.g.,* by affixing a label or sign to the box or vault);
- Ensure that each such DCO Physical Location provides appropriate protection for such collateral (*e.g.,* by confirming that the box or vault has locks and is fire resistant); and
- Record in its books and records the amount of such collateral separately from its own funds, the funds of any FCM, and the funds of any other person that is not a Cleared Swaps Customer of an FCM (*i.e.,* to reflect the reality of physical separation in books and records).

b. The Second Method

Paralleling explicit provisions of regulations 1.20(b) and 1.26(b),[140] the second method permits the DCO to hold Cleared Swaps Customer Collateral from FCMs outside of itself.[141] Continuing such parallel, the second method limits the DCO to certain Permitted Depositories (as further discussed below), and requires that the DCO maintain a Cleared Swaps Customer Account with each Permitted Depository.

c. Questions

As described above, both the first and second methods incorporate assumptions with respect to DCO structure that were true when regulations 1.20(b) and 1.26(b) were first adopted and remain true currently. However, the Commission recognizes that DCO structure may change after the Dodd-Frank Act and the regulations thereunder become effective. Notably, the Commission recognizes that a depository registered with either domestic or foreign banking regulators may seek to become a DCO, and that such depository may seek to hold Cleared Swaps Customer Collateral, as well as other forms of customer property. The Commission therefore requests comment on what, if any, changes to proposed regulation 22.3 may be appropriate to accommodate such possibility. Specifically, the Commission requests comment on whether a DCO that is also a registered depository should be permitted to hold both tangible and intangible forms of Cleared Swaps Customer Collateral from FCMs itself. What challenges might this arrangement pose to protection (including effective segregation) of Cleared Swaps Customer Collateral (as well as other forms of customer property)? How might these challenges be addressed?

3. Commingling

Regulation 22.3(c) proposes to permit a DCO to commingle the Cleared Swaps Customer Collateral that it receives from multiple FCMs on behalf of their Cleared Swaps Customers, while prohibiting the DCO from commingling Cleared Swaps Customer Collateral with:

- The money, securities, or other property belonging to the DCO;
- The money, securities, or other property belonging to any FCM; or
- Other categories of funds that it receives from an FCM on behalf of Customers, including "customer funds" for futures contracts (as regulation 1.3 defines such term) or the "foreign futures or foreign options secured amount" (as regulation 1.3 defines such term), except as permitted by a Commission rule, regulation or order (or by a derivatives clearing organization rule approved pursuant to regulation 39.15(b)(2)).[142]

Proposed regulation 22.3(c) parallels regulations 1.20(a), 1.20(b), and 1.26(b).[143]

4. Exceptions

Regulations 22.3(d) and (e) propose certain exceptions to the abovementioned requirements and limitations.

a. FCM Deposits and Withdrawals

Regulation 22.3(d) constitutes an exception to regulation 22.3(c) (Commingling). Regulation 22.3(d) proposes to allow a DCO to place money, securities, or other property belonging to an FCM in a DCO Physical Location, or deposit such money, securities, or other property in the relevant Cleared Swaps Customer Account, pursuant to an instruction

[138] Regulation 1.20(b) states: "All customer funds received by a clearing organization from a member of the clearing organization to purchase, margin, guarantee, secure or settle the trades, contracts or commodity options of the clearing member's commodity or option customers and all money accruing to such commodity or option customers as the result of trades, contracts or commodity options so carried shall be separately accounted for and segregated as belonging to such commodity or option customers. * * *" 17 CFR 1.20(b).

Regulation 1.26(b) states: "Each clearing organization which invests money belonging or accruing to commodity or option customers of its clearing members in instruments described in § 1.25 shall separately account for such instruments and segregate such instruments as belonging to such commodity or option customers." 17 CFR 1.26(b).

[139] Regulation 1.20(b) does not require that a DCO hold "customer funds" from FCMs in a depository. Rather, it applies certain requirements to the holding of "customer funds *when* deposited in a bank or trust company * * *" (emphasis added). In the absence of a requirement to use a depository, regulation 1.20(b) must implicitly permit the DCO to hold "customer funds" from FCMs itself. *Id.* Regulation 1.26(b) contains similar language regarding the use of a depository. *Id.*

[140] Regulation 1.20(b) states: "All customer funds received by a clearing organization from a member of the clearing organization to purchase, margin, guarantee, secure or settle the trades, contracts or commodity options of the clearing member's commodity or option customers and all money accruing to such commodity or option customers as the result of trades, contracts or commodity options so carried shall be separately accounted for and segregated as belonging to such commodity or option customers, and a clearing organization shall not hold, use or dispose of such customer funds except as belonging to such commodity or option customers. Such customer funds when deposited in a bank or trust company shall be deposited under an account name which clearly shows that they are the customer funds of the commodity or option customers of clearing members, segregated as required by the Act and these regulations." *Id.* Regulation 1.26(b) contains similar language. *Id.*

[141] If a DCO chooses to accept intangible Cleared Swaps Customer Collateral from an FCM, then the proposal effectively requires the DCO to maintain such collateral outside of itself.

[142] *See* note 117 supra.

[143] Regulations 1.20(a), 1.20(b), and 1.26(b) implicitly (i) permit the DCO to commingle the "customer funds" that it receives from multiple FCMs and (ii) prohibit the DCO from commingling "customer funds" with DCO funds, FCM funds, or funds supporting customer transactions in non-futures contracts. Specifically, regulation 1.20(a) states: "All customer funds shall be separately accounted for and segregated as belonging to commodity or option customers." Regulation 1.20(b) further develops such language, as detailed in note 140 supra. Similarly, regulation 1.26(b) states: "Each clearing organization which invests money belonging or accruing to commodity or option customers of its clearing members in instruments described in § 1.25 shall separately account for such instruments and segregate such instruments as belonging to such commodity or option customers." 17 CFR 1.20(a), 1.20(b), and 1.26(a).

from the FCM. Regulation 22.3(d) further proposes to permit FCM withdrawals of money, securities, or other property from a DCO Physical Location or Cleared Swaps Customer Account. As discussed below, a DCO functions as a Permitted Depository for an FCM. Proposed regulation 22.3 enables such function, by facilitating (i) FCM deposits of its own money, securities, or other property in its Cleared Swaps Customer Account at the DCO,[144] and (ii) FCM withdrawals of its residual financial interest in the Cleared Swaps Customer Collateral.[145]

b. Permitted Investments

Regulation 22.3(e) constitutes an exception to regulation 22.3(b)(1) (Location of Cleared Swaps Collateral) and regulation 22.15 (Treatment of Cleared Swaps Collateral on an Individual Basis). Regulation 22.3(e) proposes to allow a DCO to invest Cleared Swaps Customer Collateral in accordance with regulation 1.25, which delineates permitted investments of "customer funds" (as regulation 1.3 defines such term) for futures contracts.

D. Proposed Regulation 22.4—Futures Commission Merchants and Derivatives Clearing Organizations: Permitted Depositories

1. The Permitted Depositories

Regulation 22.4 proposes a list of depositories permitted to hold Cleared Swaps Customer Collateral (the "Permitted Depositories"). For a DCO or an FCM, a Permitted Depository must (subject to regulation 22.9) be: (i) A bank located in the United States; (ii) a trust company located in the United States; or (iii) a DCO. As discussed further below, regulation 22.9 incorporates regulation 1.49 with respect to Permitted Depositories located outside the United States.[146] An FCM may also serve as a Permitted Depository, but only if it is a "Collecting Futures Commission Merchant" carrying the Cleared Swaps (and related Cleared Swaps Customer Collateral) of a "Depositing Futures Commission Merchant" (as regulation 22.1 proposes to define each such term). Before an entity may serve as a Permitted Depository, the DCO or FCM seeking to maintain a Cleared Swaps Customer Account must obtain a written acknowledgement letter, as discussed further below.

In general, proposed regulation 22.4 parallels regulations 1.20, 1.26 and 1.49(d)(2), with the exception of allowing an FCM to serve as a Permitted Depository only if the FCM is a "Collecting Futures Commission Merchant."[147] The Commission believes that such a limitation is appropriate, because the purpose for allowing an FCM to serve as a Permitted Depository is to facilitate the clearing of swaps carried by an FCM that is not a member of a particular DCO (*i.e.,* the Depositing Futures Commission Merchant) through another FCM that is a member of that DCO (*i.e.,* the Collecting Futures Commission Merchant).[148]

2. Question

The Commission seeks public comment on whether the limitation that it is proposing for an FCM serving as a Permitted Depository is appropriate.

E. Proposed Regulation 22.5—Futures Commission Merchants and Derivatives Clearing Organizations: Written Acknowledgement

1. Substantive Requirements

As mentioned above, a DCO or FCM must obtain a written acknowledgement letter from a potential Permitted Depository before opening a Cleared Swaps Customer Account.[149] Regulation 22.5 proposes substantive requirements for such letter. First, regulation 22.5 proposes to mandate that the FCM or DCO obtain a written acknowledgement letter in accordance with regulations 1.20 and 1.26, which shall apply to Cleared Swaps Customer Collateral as if such collateral constituted "customer funds" (as regulation 1.3 defines such term). The Commission seeks comment as to whether such incorporation by reference is the most appropriate way to proceed, or whether the Commission should publish a separate form acknowledgement letter for swaps. In what way should such separate form letter differ from the form letter previously published for futures customer funds?[150]

Second, regulation 22.5 proposes to exempt the FCM or DCO from the requirement to obtain a written acknowledgement letter, if the potential Permitted Depository is a DCO that has adopted rules providing for the segregation of Cleared Swaps Customer Collateral. This proposed exemption is consistent with regulation 1.20.[151]

2. Question

The Commission is currently considering a notice of proposed rulemaking amending regulation 1.20 with respect to requirements for written acknowledgement letters from depositories of "customer funds" (as regulation 1.3 defines such term) for futures contracts. The Commission seeks comment on whether the following are appropriate: (i) The incorporation of regulation 1.20 (as the Commission may choose to amend such

[144] *See* proposed regulation 22.2(d)(2).

[145] *See* proposed regulation 22.2(d)(3).

[146] While there is some ambiguity as to whether regulation 1.49 currently applies to DCOs given the provisions of current regulation 39.2, the Commission has proposed amendments that would remove regulation 39.2. *See Risk Management Requirements for Derivatives Clearing Organizations,* 76 FR 3698, 3714 (Jan. 20, 2011). Thus, if the proposed amendments are finalized as written, DCOs would be subject to the requirements set forth in regulation 1.49. In addition, notwithstanding regulation 39.2, the Commission and industry have proceeded on the basis that the requirements of regulation 1.49 apply to DCOs.

[147] Regulations 1.20(a) and (c) imply that an FCM may deposit "customer funds" with "any bank, trust company, clearing organization or another futures commission merchant." Regulation 1.20(b) implies than a DCO may deposit "customer funds" from FCMs with "a bank or trust company." Regulations 1.26(a) and (b) contain similar language. Regulation 1.49(d)(2) clarifies that an FCM or DCO may deposit "customer funds" in the United States only with "(i) A bank or trust company; (ii) A futures commission merchant registered as such with the Commission; or (iii) A derivatives clearing organization." 17 CFR 1.20, 1.26, and 1.49(d)(2).

[148] *See* section 4d(f)(3)(A)(ii) of the CEA, as amended by section 724 of the Dodd-Frank Act (explicitly stating that Cleared Swaps Customer Collateral may be withdrawn to margin, guarantee, secure, transfer, adjust, or settle a Cleared Swap with a DCO, or any member of a DCO, and not explicitly allowing withdrawals for any other purpose (except for permitted investments)).

[149] The function of a written acknowledgment letter is to ensure that a potential Permitted Depository is aware that (i) the FCM or DCO is opening a Cleared Swaps Customer Account, (ii) the funds deposited in such account constitute Cleared Swaps Customer Collateral, and (iii) such Cleared Swaps Customer Collateral is subject to the requirements of section 4d(f) of the CEA and Part 22 (when finalized).

[150] *See* 75 FR 47738 (Aug. 9, 2010) (proposing form acknowledgment letters for customer funds and secured amount funds).

[151] Currently, with respect to an FCM, regulation 1.20(a) states: "Each registrant shall obtain and retain in its files for the period provided in § 1.31 a written acknowledgment from such bank, trust company, clearing organization, or futures commission merchant, that it was informed that the customer funds deposited therein are those of commodity or option customers and are being held in accordance with the provisions of the Act and this part: *Provided, however,* that an acknowledgment need not be obtained from a clearing organization that has adopted and submitted to the Commission rules that provide for the segregation as customer funds, in accordance with all relevant provisions of the Act and the rules and orders promulgated thereunder, of all funds held on behalf of customers." 17 CFR 1.20(a).

Currently, with respect to a DCO, regulation 1.20(b) states: "The clearing organization shall obtain and retain in its files for the period provided by § 1.31 an acknowledgment from such bank or trust company that it was informed that the customer funds deposited therein are those of commodity or option customers of its clearing members and are being held in accordance with the provisions of the Act and these regulations." 17 CFR 1.20(b).

However, as noted above, the Commission is currently considering a notice of proposed rulemaking amending regulation 1.20. *See* 75 FR 47740 (Aug. 9, 2010).

regulation) in proposed regulation 22.5, and (ii) the adaptation of any form letter that the Commission may choose to promulgate under regulation 1.20 to accommodate Cleared Swaps Customer Collateral under regulation 22.5.

F. Proposed Regulation 22.6—Futures Commission Merchants and Derivatives Clearing Organizations: Naming of Cleared Swaps Customer Accounts

Regulation 22.6 proposes to require an FCM or DCO to ensure that the name of each Cleared Swaps Customer Account that it maintains with a Permitted Depository (i) clearly identifies the account as a "Cleared Swaps Customer Account," and (ii) clearly indicates that the collateral therein is "Cleared Swaps Customer Collateral" subject to segregation in accordance with section 4d(f) of the CEA and Part 22 (as final). Proposed regulation 22.6 parallels regulation 1.20(a), 1.20(b), 1.26(a), and 1.26(b).[152]

G. Proposed Regulation 22.7—Permitted Depositories: Treatment of Cleared Swaps Customer Collateral

Regulation 22.7 proposes to require a Permitted Depository to treat all funds in a Cleared Swaps Customer Account as Cleared Swaps Customer Collateral. Regulation 22.7 further proposes to prohibit a Permitted Depository from holding, disposing of, or using any Cleared Swaps Customer Collateral as belonging to any person other than (i) the Cleared Swaps Customers of the FCM maintaining such Cleared Swaps Customer Account or (b) the Cleared Swaps Customers of the FCMs for which the DCO maintains such Cleared Swaps Customer Account. In other words, no Permitted Depository may use Cleared Swaps Customer Collateral to cover or support the obligations of the FCM or DCO maintaining the Cleared Swaps Customer Account. Proposed regulation 22.7 parallels section 4d(f)(6) of the CEA, as added by section 724 of the Dodd-Frank Act.[153] Proposed regulation 22.7 also parallels regulation 1.20.[154]

H. Proposed Regulation 22.8—Situs of Cleared Swaps Accounts

1. Proposed Requirements

Proposed regulation 22.8 has no analog in the Part 1 Provisions. Regulation 22.8 proposes to require (i) each FCM to designate the United States as the site (*i.e.,* the legal situs) of the FCM Physical Location and the "account" (as regulation 22.2(f)(1) defines such term) that the FCM maintains for each Cleared Swaps Customer, and (ii) each DCO to designate the United States as the site (*i.e.,* the legal situs) of the DCO Physical Location and the Cleared Swaps Customer Account that the DCO maintains on its books and records for the Cleared Swaps Customers of each FCM. In light of increased cross-border activity,[155] the Commission believes that proposed regulation 22.8 is appropriate, as it is intended to ensure that, in the event of an FCM or DCO insolvency, Cleared Swaps Customer Collateral, whether received by an FCM or DCO, would be treated in accordance with the United States Bankruptcy Code. The Commission does not intend for proposed regulation 22.8 to affect the actual locations in which an FCM or DCO may hold Cleared Swaps Customer Collateral. As discussed further below, an FCM or DCO may hold Cleared Swaps Customer Collateral (i) in denominations other than the United States dollar and (ii) at depositories within or outside of the United States. Additionally, the Commission does not intend for proposed regulation 22.8 to affect choice of law provisions that a DCO might set forth in its rules or an FCM might set forth in its agreement with a Cleared Swaps Customer.

2. Questions

The Commission requests comment on whether proposed regulation 22.8 achieves the purpose of the Commission—namely, to ensure that Cleared Swaps Customer Collateral be treated in accordance with the United States Bankruptcy Code, to the extent possible. If proposed regulation 22.8 does not achieve such purpose, what alternatives should the Commission consider to achieve such purpose? Additionally, the Commission requests comment on the benefits and costs of proposed regulation 22.8, as well as any alternatives.

I. Proposed Regulation 22.9—Denomination of Cleared Swaps Customer Collateral and Location of Depositories

Regulation 22.9 proposes to incorporate regulation 1.49 by reference, as applicable to Cleared Swaps Customer Collateral. Regulation 1.49 sets forth, for futures contracts, rules determining the permitted denominations of customer funds (*i.e.,* permitted currencies and amounts in each currency), permitted locations of customer funds (*i.e.,* permitted countries and amounts in each country), and qualifications that entities outside of the United States must meet to become Permitted Depositories (*e.g.,* minimum regulatory capital). However, regulation 22.9 proposes to allow an FCM to serve as a Permitted Depository only if that FCM is a "Collecting Futures Commission Merchant" carrying the Cleared Swaps, and associated Cleared Swaps Customer Collateral, for the Cleared Swaps Customers of a "Depositing Futures Commission Merchant." Such proposal accords with proposed regulation 22.4.

J. Proposed Regulation 22.10—Incorporation by Reference

Regulation 22.10 proposes to incorporate by reference regulations 1.27 (Record of investments), 1.28 (Appraisal of obligations purchased with customer funds), 1.29 (Increment or interest resulting from investment of customer funds), and 1.30 (Loans by futures commission merchants; treatment of proceeds), as applicable to Cleared Swaps Customers and Cleared Swaps Customer Collateral. Regulation 1.27 requires FCMs and DCOs investing "customer funds" (as regulation 1.3 defines such term) to maintain specified records concerning such investments. Regulation 1.28 requires FCMs investing "customer funds" to record and report such investment at no greater than market value. Regulation 1.29 permits

[152] With respect to the responsibilities of an FCM, regulation 1.20(a) states: "Such customer funds when deposited with any bank, trust company, clearing organization or another futures commission merchant shall be deposited under an account name which clearly identifies them as such and shows that they are segregated as required by the Act and this part." 17 CFR 1.20(a). With respect to the responsibilities of a DCO, regulation 1.20(b) states: "Such customer funds when deposited in a bank or trust company shall be deposited under an account name which clearly shows that they are the customer funds of the commodity or option customers of clearing members, segregated as required by the Act and these regulations." 17 CFR 1.20(b). Regulations 1.26(a) and (b) contain similar language.

[153] Section 4d(f)(6) of the CEA states: "It shall be unlawful for any person, including any derivatives clearing organization and any depository institution, that has received any money, securities, or property for deposit in a separate account or accounts as provided in paragraph (2) to hold, dispose of, or use any such money, securities, or property as belonging to the depositing futures commission merchant or any person other than the swaps customer of the futures commission merchant." 7 U.S.C. 6d.

[154] Regulation 1.20 states: "No person, including any clearing organization or any depository, that has received 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 option or commodity customers of the futures commission merchant which deposited such funds." 17 CFR 1.20.

[155] For example, the Commission currently regulates certain entities based outside of the United States (*e.g.,* LCH.Clearnet Limited and ICE Clear Europe, each of which is based in the United Kingdom).

FCMs and DCOs investing "customer funds" to receive and retain any increment or interest thereon. Regulation 1.30 permits FCMs to loan their own funds to customers on a secured basis, and to repledge or sell such security pursuant to agreement with such customers. Regulation 1.30 does make clear, however, that the proceeds of such loans, when used to purchase, margin, guarantee, or secure futures contracts, shall be treated as "customer funds."

K. Proposed Regulation 22.11—Information To Be Provided Regarding Customers and Their Cleared Swaps

1. Proposed Requirements

In order to implement the Complete Legal Segregation Model, regulations 22.11 to 22.16 propose, among other things, requirements that ensure that each DCO and FCM: (i) Obtains, on a daily basis, information necessary for risk management; (ii) performs, on a daily basis, risk management calculations and records the results; (iii) receives on the day of default, any residual Cleared Swaps Customer Collateral; and (iv) allocates, on the day of default, the value of Cleared Swaps Customer Collateral that it owes to each individual customer. Regulations 22.11 to 22.16 recognize that swaps may be cleared through a multi-tier system, with certain FCMs clearing swaps for customers directly with the DCO and other FCMs clearing swaps for customers indirectly through another FCM. Therefore, Part 22 recognizes the concepts of "Depositing Futures Commission Merchant" and "Collecting Futures Commission Merchant," each of which is described above. Regulations 22.11 to 22.16 extend their requirements through each potential tier of clearing, from the Depositing Futures Commission Merchant through the Collecting Futures Commission Merchant and finally to the DCO.

Regulation 22.11 proposes to require that (i) each Depositing Futures Commission Merchant provide to its Collecting Futures Commission Merchant and (ii) each FCM member provide to its DCO, in each case, information sufficient to identify Cleared Swaps Customers on a one-time basis, and information sufficient to identify the portfolio of rights and obligations belonging to such customers with respect to their Cleared Swaps on a daily basis. If a Depositing Futures Commission Merchant or FCM member also serves as a Collecting Futures Commission Merchant, then it must provide the specified information with respect to each individual Cleared Swaps Customer for which it acts (on behalf of a Depositing Futures Commission Merchant) as a Collecting Futures Commission Merchant.

The abovementioned information should aid Collecting Futures Commission Merchants and DCOs in their daily risk management programs by (i) revealing ownership of cleared swaps customer contracts (in contrast to currently available Large Trader information, which is based on control of futures contracts) and (ii) permitting DCOs to aggregate the positions of Cleared Swaps Customers clearing through multiple FCMs, and Collecting Futures Commission Merchants to aggregate the contracts of Cleared Swaps Customers clearing through multiple Depositing Futures Commission Merchants. The abovementioned information will also enable Collecting Futures Commission Merchants and DCOs to conform to their obligations to allocate Cleared Swaps Customer Collateral, in the event of an FCM default, pursuant to proposed regulation 22.15.

The DCO is at the apex of the reporting structure that regulation 22.11 establishes, as it receives all information for each individual Cleared Swaps Customer that FCMs, Collecting Futures Commission Merchants, and Depositing Futures Commission Merchants serve. Therefore, regulation 22.11 proposes to hold the DCO responsible for taking appropriate steps to confirm that the information that it receives is accurate and complete, and ensure that the information is being produced on a timely basis. However, because the DCO may not have a direct relationship with, *e.g.,* a Depositing Futures Commission Merchant, the Commission intends for the DCO to take "appropriate steps" to ensure that its FCM members enter into suitable arrangements with, *e.g.,* a Depositing Futures Commission Merchant to verify the accuracy and timeliness of information. In this manner, the Commission intends for the verification requirement to be applied through each potential tier of clearing.

2. Questions

Does the proposed requirement in regulation 22.11 for a Depositing Futures Commission Merchant to provide a Collecting Futures Commission Merchant with information sufficient to identify its Cleared Swaps Customers raise any, *e.g.,* competitive concerns? Could such concerns be resolved if the identities of such Cleared Swaps Customers are coded, with the DCO, but not the Collecting Futures Commission Merchant, receiving a copy of such code? What other methods would resolve such concerns?

L. Proposed Regulation 22.12—Information To Be Maintained Regarding Cleared Swaps Customer Collateral

Regulation 22.12 proposes to require DCOs and Collecting Futures Commission Merchants to use the information provided pursuant to proposed regulation 22.11 to calculate, no less frequently than once each business day, the amount of collateral required (i) for each relevant Cleared Swaps Customer (including each such customer of a Depositing Futures Commission Merchant), based on the portfolio of rights and obligations arising from its Cleared Swaps; and (ii) for all relevant Cleared Swaps Customers. It is not the responsibility of a DCO or a Collecting Futures Commission Merchant to monitor or to calculate the extent to which a Cleared Swaps Customer has, in fact, posted excess or insufficient collateral. In the latter case, the relevant FCM will have, in effect, made a loan to the Cleared Swaps Customer and will have a claim against that customer, outside of the relationship with the DCO or the Collecting Futures Commission Merchant.

M. Proposed Regulation 22.13—Additions to Cleared Swaps Customer Collateral

Regulation 22.13 proposes two tools that DCOs or Collecting Futures Commission Merchants may use to manage the risk they incur with respect to individual Cleared Swaps Customers. These tools are not intended to be mandatory or exclusive, and the Commission seeks comment on how the Commission may enable DCOs or Collecting Futures Commission Merchants to use other tools to manage such risk.

Regulation 22.13(a) proposes to clarify that a DCO or Collecting Futures Commission Merchant may increase the collateral required of a particular Cleared Swaps Customer or group of such customers, based on an evaluation of the credit risk posed by such customer(s), in which case such higher amount shall be calculated and recorded as provided in proposed regulation 22.12, and would (on an individual basis) be available in the event of a default by any such Cleared Swaps Customer. This proposed clarification is not intended to interfere with the right of any FCM to increase the collateral requirements with respect to any of its customers. The Commission requests comment regarding whether a DCO or a

Collecting Futures Commission Merchant may wish to increase the collateral required, in the manner described above, for any reason other than credit risk.

Similarly, proposed regulation 22.13(b) clarifies that any collateral deposited by an FCM out of its own funds pursuant to proposed regulation 22.2(e)(3), in which the FCM has a residual financial interest pursuant to proposed regulation 22.2(e)(4), may, to the extent of such residual interest, be used by a DCO or Collecting Futures Commission Merchant to margin the cleared swaps of any or all of such customers. Thus, if a DCO chooses to require an FCM member, or if a Collecting Futures Commission Merchant chooses to require a Depositing Futures Commission Merchant, in each case, to post such additional collateral out of its own funds, the collateral would be available, to the extent specified above, on an omnibus basis, in the event of default of any relevant Cleared Swaps Customer.

N. Proposed Regulation 22.14—Futures Commission Merchant Failure To Meet a Customer Margin Call in Full

The structure of proposed regulations 22.14(a) through (d) is intended to ensure that each tier of clearing receives the requisite transmissions of Cleared Swaps Customer Collateral and information to attribute such collateral on the date of an FCM default. Starting from the lowest tier, regulation 22.14(a) proposes to require a Depositing Futures Commission Merchant that fails to meet a margin call with respect to a Cleared Swaps Customer Account, in full, to (i) transmit to its Collecting Futures Commission Merchant, with respect to each Cleared Swaps Customer of the Depositing Futures Commission Merchant whose contracts contribute to that margin call, the lesser of the amount called for or the remaining collateral for that customer on deposit at such Depositing Futures Commission Merchant, and (ii) advise the Collecting Futures Commission Merchant of the identity of the Cleared Swaps Customer and the amount transmitted on behalf of such customer. Moving towards the middle tier, regulation 22.14(b) proposes to parallel the above requirement for a Depositing Futures Commission Merchant that also serves as a Collecting Futures Commission Merchant. Moving towards the apex, regulations 22.14(c) and (d) propose to parallel the above requirement for an FCM member of a DCO, including if the FCM member is also a Collecting Futures Commission Merchant.

Regulations 22.14(e) and (f) propose to address a situation involving investment risk, the loss of value of collateral, despite the application of haircuts. Specifically, if (i) the collateral collected by a DCO or Collecting Futures Commission Merchant is sufficient to meet the amount of collateral required by regulation 22.12 on the business day before the failure to meet the margin call (with sufficiency measured including the application of haircuts specified by the rules and procedures of the DCO or the policies applied by the Collecting Futures Commission Merchant), and (ii) as of the close of business on the business day of the failure to meet the margin call, the value of such collateral is, due to changes in market value, less than the amount required by regulation 22.12 on the business day before the failure to meet the margin call, then that loss of value will be shared among the customers *pro rata:* The amount of collateral attributable to each customer will be reduced by the percentage difference between the amount specified in regulation 22.12 on that previous business day and the market value of the collateral on the day of the failure to meet the margin call. The Commission believes that investment risk, unlike fellow-customer risk, should not be borne by the DCO. The Commission seeks comment on this allocation of investment risk.

O. Proposed Regulation 22.15—Treatment of Cleared Swaps Customer Collateral on an Individual Basis

Proposed regulation 22.15 sets forth the basic principle of individual collateral protection. It requires each DCO and each Collecting Futures Commission Merchant to treat the amount of collateral required with respect to the portfolio of rights and obligations arising out of the Cleared Swaps intermediated for each Cleared Swaps Customer as belonging to that customer. That amount may not be used to margin, guarantee or secure the cleared swaps, or any other obligations, of an FCM, or of any other customer.

It should be noted that what is protected is an amount (*i.e.,* a value) of collateral, rather than any specific item of collateral.

As discussed above, the Commission is proposing herein the Complete Legal Segregation Model, but is seeking comment as to whether the Legal Segregation with Recourse Model would be more appropriate. Under the Legal Segregation with Recourse Model, this regulation would be modified to permit the use of the Cleared Swaps Customer Collateral of non-defaulting customers after the exhaustion of both the DCO's contribution to default resources from its own capital, and the guaranty fund contributions of clearing members.

Specifically, an additional section would be added to the effect that

> a derivatives clearing organization may, if its rules so provide, and if the derivatives clearing organization has first exhausted the resources described in §§ 39.11(b)(1)(ii) [the derivatives clearing organization's own capital], (iii) [Guaranty fund deposits], and (iv) [other financial resources deemed acceptable by the Commission], use the Cleared Swaps Customer Collateral of all Cleared Swaps Customers of a depositing futures commission merchant that has defaulted in a payment to the derivatives clearing organization with respect to its Cleared Swaps Customer Account.

Under such a proposal, the Commission does not contemplate requiring the use of a DCO's assessment powers before permitting the use of the collateral of non-defaulting customers under the Legal Segregation with Recourse Model.

P. Proposed Regulation 22.16—Disclosures to Customers

In order to make Cleared Swaps Customers aware of the limits of protection under the Complete Legal Segregation Model, proposed regulations 22.16(a) and (b) require FCMs to disclose to their Cleared Swaps Customers the governing provisions relating to use of customer collateral, transfer of Cleared Swaps and related collateral, neutralization of the risks of customer positions, or liquidation of cleared swaps, in each case in the event of a default by its FCM related to the Cleared Swaps Customer Account, either to a Collecting Futures Commission Merchant or directly to a DCO. Proposed regulation 22.16(c) specifies that the governing provisions are the rules of the DCO, or the provisions of the customer agreement between the Depositing Futures Commission Merchant and the Collecting Futures Commission Merchant, on or through which the Depositing Futures Commission Merchant clears swaps for Cleared Swaps Customers.

The Commission is particularly interested in further discussion of the benefits and costs of each model in light of the proposed regulations (*i.e.,* the Complete Legal Segregation Model that is proposed and the Legal Segregation with Recourse Model that is being considered). In particular, the Commission seeks comment on (1) Operational costs: The incremental activities commenters would be required to perform, with respect to

cleared swaps and cleared swaps collateral under each model that they are not currently required to perform with respect to futures and futures collateral, and the initial and annualized costs of such activities. How can these costs be estimated industry-wide? Please provide a detailed basis for these estimates; and (2) Risk Environment Costs: How do you see the industry adapting to the risk changes attendant to each model? What types of costs would you expect your institution to incur if the industry adapts to the model in the most efficient manner feasible? How are those costs different from the costs your institution incurs relative to futures and futures collateral? What is a reasonable estimate of the initial and annualized ongoing incremental costs incurred by your institution, and how can such costs be estimated industry wide? Please provide a detailed basis for your estimates.

V. Section by Section Analysis: Amendments to Regulation Part 190

A. Background

In April of 2010, prior to the enactment of the Dodd-Frank Act, the Commission promulgated rules to establish an account class for cleared OTC derivatives (and related collateral).[156] At that time, there were questions concerning the authority of the Commission to require the segregation of cleared OTC derivatives (and related collateral), or to establish the account class for the insolvency of a DCO. As a result, protection for cleared OTC derivatives (and related) collateral was limited to those cases where such derivatives and collateral were required to be segregated pursuant to the rules of a DCO, and the reach of the account class was limited to cases of the bankruptcy of a commodity broker that is an FCM. Moreover, while section 4d(a)(2) of the CEA permitted the inclusion in the domestic futures account class of transactions and related collateral from outside that class, there was no similar provision permitting the inclusion in the cleared OTC account class of transactions and related collateral from outside that latter class.

Section 724 of the Dodd-Frank Act has resolved these questions. As mentioned above, section 4d(f) of the Dodd-Frank Act requires, among other things, segregation of Cleared Swaps and Cleared Swaps Customer Collateral. Section 4d(f)(3)(B) of the CEA permits the inclusion of positions in other contracts (such as exchange-traded futures) and related collateral with Cleared Swaps and Cleared Swaps Customer Collateral. Section 724(b) of the Dodd-Frank Act amends the Bankruptcy Code to include in the definition of "commodity contracts" Cleared Swaps with respect to both FCMs and DCOs. Thus, this section V proposes amendments to regulation Part 190, pursuant to Commission authority under section 20 of the CEA, in order to give effect to section 724 of the Dodd-Frank Act. Such amendments conform to proposed Part 22.

B. Definitions

The Commission proposes certain technical amendments to regulation 190.01 to remove the reference to the definition of "Opt-out customer" from the definition of "Non-Public Customer," and to include or exclude Cleared Swaps and Cleared Swaps Collateral in the definitions of "Clearing Organization," "Non-Public Customer," and "Principal Contract," as appropriate. The Commission also proposes substantive changes to the definitions of "Account Class" and "Cleared Swaps."

1. Proposed Amendment to Regulation 190.01(a)—Account Class

The Commission proposes amending regulation 190.01(a) to change the definition of account class to include a class for cleared swaps accounts, without limiting that definition to commodity brokers that are FCMs (as is currently the case). In addition, commodity option accounts would be deleted from the definition because the term commodity options, as defined in section 1.3, includes options on futures (which are regulated as futures) and options on commodities (which under the Dodd-Frank Act are swaps). The additions of subsections (a)(2)(i) and (a)(2)(ii) are meant to make clear that options on futures and options on commodities should not be grouped into one account class; rather options on futures should be deemed part of the futures account class and options on commodities should deemed part of the cleared swaps account class. Another proposed amendment, subsection (a)(3), is intended to clarify that Commission orders putting futures contracts and related collateral in the cleared swaps account class (pursuant to new section 4d(f)(3)(B) of the CEA) are treated, for bankruptcy purposes, in a manner analogous to orders putting cleared swaps and related collateral in the futures account class (pursuant to CEA section 4d(a)(2)). The proposed amended § 190.01(a) would clarify that if, pursuant to a Commission rule, regulation or order (or a derivatives clearing organization rule approved pursuant to regulation 39.15(b)(2)), positions or transactions that would otherwise belong to one class are associated with positions and related collateral in commodity contracts another account class, then the former positions and related collateral shall be treated as part of the latter account class.

2. Proposed New Regulation 190.01(e)—Calendar Day

The Commission proposes defining the term "calendar day" to include the time from midnight to midnight.

3. Proposed Amendment to Regulation 190.01(f)—Clearing Organization

The Commission proposes to amend the definition of clearing organization to remove, as unnecessary, the reference to commodity options traded on or subject to the rules of a contract market or board of trade.

4. Proposed Amendment to Regulation 190.01(cc)—Non-Public Customer

The Commission proposes to amend the definition of non-public customer to include references to non-public customers under regulation 30.1(c) (with respect to foreign futures and options customers) and in the definition of cleared swaps proprietary account.

5. Proposed Amendment to Regulation 190.01(hh)—Principal Contract

The Commission proposes to amend the definition of principal contract to include an exclusion for cleared swaps contracts.

6. Proposed Amendment to Regulation 190.01(ll)—Specifically Identifiable Property

The Commission proposes to amend the definition of specifically identifiable property to change, in subsection (ll)(2)(ii), an anachronistic reference to section 5a(a)(12) of the CEA to a reference to 5c(c) of the CEA, and to change references to "business days" in subsections (ll)(4) and (ll)(5) to references to "calendar days," to conform to other proposed changes to Part 190 implementing Public Law 111–16, the Statutory Time-Periods Technical Amendments Act of 2009, which (in relevant part) changed the time period in 11 U.S.C. 764(b) from five (business) days to seven (calendar) days.[157] Because the pace of recent commodity broker bankruptcies has included work on weekends, references to four or fewer "business days" have

[156] *See* Account Class, 75 FR 17297 (Apr. 6, 2010).

[157] *See generally* 75 FR 75432, 75435 (Dec. 3, 2010).

been changed to the same number of calendar days; while references to five business days have been changed to six calendar days.

7. Proposed Amendment to Regulation 190.01 (pp)—Cleared Swap

Proposed new § 190.01(pp) replaces the definition of "Cleared OTC Derivative" that the Commission previously adopted with a definition of cleared swap that incorporates by reference the definition of that term in § 22.1.

C. Proposed Amendments to Regulation 190.02—Operation of the Debtor's Estate Subsequent to the Filing Date and Prior to the Primary Liquidation Date

The Commission is proposing certain technical amendments to (1) expand regulation 190.02 to apply to cleared swaps (and related collateral) and (2) change references to "business days" to references to "calendar days," and require transfer instructions by the sixth calendar day after the order for relief and instructed transfers to be completed by the seventh calendar day after the order for relief, in order to fall within the protection of section 764(b) of the Bankruptcy Code. Other proposed amendments to § 190.02(g)(1)(i) are intended to clarify that maintenance margin refers to the maintenance margin requirements of the applicable designated contract market or swap execution facility. Inclusion of the words "if any" reflects Commission recognition that there may be situations where there is no applicable designated contract market or swap execution facility.

D. Proposed Amendments to Regulation 190.03—Operation of the Debtor's Estate Subsequent to the Primary Liquidation Date

In addition to certain technical amendments to (1) expand regulation 190.03 to apply to cleared swaps (and related collateral) and (2) change references to "business days" to references to "calendar days," proposed amendments to § 190.03(a)(3) are intended to clarify that maintenance margin refers to the maintenance margin requirements of the applicable designated contract market or swap execution facility. Inclusion of the words "if any" reflects Commission recognition that there may be situations where there is no applicable designated contract market or swap execution facility.

E. Proposed Amendments to Regulation 190.04—Operation of the Debtor's Estate—General

Proposed amendments to regulation 190.04 would extend the liquidation of open commodity contracts held for a house account or a customer account by or on behalf of a commodity broker that is a debtor to commodity contracts traded on swap execution facilities.[158] These commodity contracts would be liquidated in accordance with the rules of the relevant swap execution facility or designated contract market, under a liquidation process that, to the extent possible under market conditions at the time of liquidation, results in competitive pricing. In addition, in order to conform to current market practice, the amendments would allow open commodity contracts that are liquidated by book entry to be offset using the settlement price as calculated by the relevant clearing organization pursuant to its rules, which rules would also be required to promote competitive pricing to the extent feasible under market conditions at the time of liquidation. Such rules are required to be submitted to the Commission for approval pursuant to section 5c(c) of the CEA, or approved by the Commission (or its delegate) pursuant to regulation 190.10(d).

F. Proposed Amendments to Regulation 190.05—Making and Taking Delivery on Commodity Contracts

Proposed amendments to regulation 190.05 are technical in nature, changing a reference to "contract market" to "designated contract market, swap execution facility, or clearing organization," and requiring the submission of rules for approval subject to section 5c(c) of the CEA.

G. Proposed Amendments to Regulation 190.06—Transfers

Proposed amendments to regulation 190.06(a) are intended to clarify that nothing in paragraph (a) would constrain the contractual right of the DCO to liquidate open commodity contracts, even those pertaining to customers (whether transacting in futures, cleared swaps, or other products).

Proposed amendments to regulation 190.06(e) would permit the trustee to transfer accounts with no open commodity contracts. In past commodity broker bankruptcies, the Commission has permitted the transfer of such accounts. Moreover, section 761(9)(A)(ii)(I) and (II) of the Bankruptcy Code define a "customer" to include an entity that holds a claim against the FCM arising out of: (i) the liquidation of a commodity contract and (ii) a deposit or payment of property with such FCM for the purpose of making or margining a commodity contract, either of which might occur after or before the customer holds a commodity contract. Further, section 764 of the Bankruptcy Code prohibits the trustee from avoiding post-petition transfers: (i) facilitating the liquidation of a commodity contract, and presumably claims attendant thereto, and (ii) of any cash, securities, or other property margining or securing a commodity contract, and presumably claims thereto.

Proposed amendments to regulation 190.06(g) would prohibit the trustee from avoiding pre-petition transfers made by a clearing organization on behalf of customers of the debtor of accounts held for or on behalf of customers of the debtor as long as the money, securities, or other property accompanying such transfer would not exceed the funded balance of such accounts based on information available as of the close of business on the business day immediately preceding such transfer minus the value on the date of return or transfer of any property previously returned or transferred thereto. The Commission believes that this change promotes portability by allowing clearing organizations to efficiently manage the customer accounts of the debtor in a default scenario.

In light of the importance of transfers to swaps markets, the Commission observes that certain portions of regulation 190.06 are not being changed. Specifically, regulation 190.06(f)(3) addresses partial transfers, whether with respect to fewer than all customers (subsection (i)), or with respect to fewer than all contracts cleared on behalf of a particular customer (subsection (ii)). Moreover, regulation 190.06(e)(2) limits the amount of equity that may be transferred in respect of any account to the funded balance of that account, subject to certain adjustments, "based on available information as of the calendar day immediately preceding transfer" (emphasis supplied).

While a transfer of all contracts in all accounts may be preferable, it may, in certain circumstances, be impracticable. If so, the regulations described above accommodate partial transfers.

In addition, technical amendments have been made to change "business day" to "calendar day."

[158] Open commodity contracts traded on a designated contract market would continue to be liquidated in accordance with the rules of the relevant designated contract market.

H. Proposed Amendments to Regulation 190.07—Calculation of Allowed Net Equity

Proposed amendments to regulation 190.07(b) clarify that individual cleared swaps customer accounts within an omnibus account are to be treated individually. A proposed amendment to regulation 190.07(c) corrects a typographical error. Proposed amendments to regulation 190.07(e) would change the valuation of an open commodity contract so that the value of the commodity contract would be derived from the settlement price as calculated by the relevant clearing organization pursuant to its rules, provided that such rules have been submitted to the Commission for approval pursuant to section 5c(c)(4) of the CEA and have received such approval, or have been approved pursuant to regulation 190.10(d). This change is intended to conform the valuation of an open commodity contract to current market practices. Another proposed amendment to regulation 190.07(e) would change references to securities traded over-the-counter pursuant to the National Association of Securities Dealers Automated Quotation System to securities not traded on an exchange, again to conform to current market practices.

I. Proposed Amendments to Regulation 190.09—Member Property

Proposed amendments to regulation 190.09(b) have been made to include references to an account excluded pursuant to the proviso in regulation 30.1(c) (with respect to proprietary foreign futures and options customers) and to the cleared swaps proprietary account.

J. Proposed Amendments to Regulation 190.10—General

Proposed amendments to regulation 190.10 (a) have been made to remove references to providing notice by telegram or ordinary postal mail and to require notice by e-mail and overnight mail.

K. Proposed Amendments to Appendix A to Part 190—Bankruptcy Forms, Bankruptcy

Proposed changes to appendix A, form 1 would remove references to "bulk transfers" and replace the term with the word "transfers." While the Commission believes that the trustee should transfer as much of a customer account as possible for each account class [159] to one non-defaulting FCM, the Commission recognizes that there may be situations where a bulk transfer may not be possible.[160]

Technical amendments also are being proposed for appendix A to Part 190. These amendments would include revisions to reflect the addition of section 4d(f) by section 724 of the Dodd-Frank Act. In addition, amendments have been made to clarify that Commission approval with respect to the rules of a registered entity that require Commission approval means Commission approval under section 5c(c) of the CEA. Additional technical amendments to appendix A to Part 190 have been proposed to conform certain time periods to the proposed changes made by the Commission to implement Public Law 111–16, the Statutory Time-Periods Technical Amendments Act of 2009.

L. Proposed Amendments to Appendix B to Part 190—Special Bankruptcy Distributions

Proposed amendments to appendix B would clarify that the cross margining program is intended to apply only to futures customers and futures customer funds.

VI. Effective Date

The Commission requests comment on the appropriate timing of effectiveness for the final rules for Part 22.[161] Specifically, is six months after the promulgation of final rules sufficient? If not, please specify a recommended time period, and explain in detail the reasons why no shorter period will be sufficient.

VII. Administrative Compliance

A. Regulatory Flexibility Act

The Regulatory Flexibility Act ("RFA")[162] requires that agencies, in proposing rules, consider whether the rules they propose will have a significant economic impact on a substantial number of small entities and, if so, provide a regulatory flexibility analysis addressing the impact. The proposed rules will affect DCOs and FCMs. The Commission has previously determined that DCOs and FCMs are not small entities for purposes of the RFA.[163]

Accordingly, pursuant to section 605(b) of the RFA, 5 U.S.C. 605(b), the Chairman, on behalf of the Commission, certifies that these proposed rule amendments will not have a significant economic impact on a substantial number of small entities. The Commission invites the public to comment on this finding.

B. Paperwork Reduction Act

1. Introduction

Provisions of proposed new Part 22 of the Commission's rules include new information disclosure and recordkeeping requirements that constitute the collection of information within the meaning of the Paperwork Reduction Act of 1995 ("PRA").[164] The Commission therefore is submitting this proposed collection of information to the Office of Management and Budget ("OMB") for review in accordance with 44 U.S.C. 3507(d) and 5 CFR 1320.11. Under the PRA, an 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.[165] The title for this collection of information is "Disclosure and Retention of Certain Information Relating to Cleared Swaps Customer Collateral," OMB Control Number 3038–NEW. This collection of information will be mandatory. The information in question will be held by private entities and, to the extent it involves consumer financial information, may be protected under Title V of the Gramm-Leach-Bliley Act as amended by the Dodd-Frank Act.[166] This collection of information has not yet been assigned an OMB control number.

2. Information Provided by Reporting Entities

Proposed section 22.2(g) requires each FCM with Cleared Swaps Customer Accounts to compute daily the amount of Cleared Swaps Customer Collateral on deposit in Cleared Swaps Customer Accounts, the amount of such collateral

[159] Account class means each of the following types of customer accounts that must be recognized as a separate class of account by the trustee: futures accounts, foreign futures accounts, leverage accounts, delivery accounts as defined in § 190.05(a)(2) of this part, and cleared swaps accounts.

[160] For example, when evaluating the creditworthiness of various FCMs, the trustee may conclude that it would be preferable to transfer portions of a customer account to several different non-defaulting FCMs who have high credit ratings instead of one non-defaulting futures commission merchant with lower credit quality.

[161] The amendments to Part 190 appear to be self-executing, but commenters are invited to suggest why an implementation period for these amendments might be necessary.

[162] 5 U.S.C. 601 *et seq.*

[163] *See* 66 FR 45605, 45609 (Aug. 29, 2001) (DCOs); 47 FR 18618, 18619–20 (Apr. 30, 1982) (FCMs).

[164] 44 U.S.C. 3501 *et seq.*

[165] *Id.*

[166] *See generally* Notice of Proposed Rulemaking, Privacy of Consumer Financial Information; Conforming Amendments Under Dodd-Frank Act, 75 FR 66014 (Oct. 27, 2010).

required to be on deposit in such accounts and the amount of the FCM's residual financial interest in such accounts. The computations and supporting data must be kept in accordance with the CFTC regulation 1.31, which establishes generally applicable rules for recordkeeping under the CEA. The purpose of this collection of information is to help ensure that FCMs' Cleared Swaps Customer Accounts are in compliance at all times with statutory and regulatory requirements for such accounts.

Proposed section 22.5(a) requires an FCM or DCO to obtain, from each depository with which it deposits cleared swaps customer funds,[167] a letter acknowledging that such funds belong to the cleared swaps customers of the FCM, and not the FCM itself or any other person. The purpose of this collection of information is to confirm that the depository understands its responsibilities with respect to protection of cleared swaps customer funds.

Proposed section 22.11 requires each FCM that intermediates cleared swaps for customers on or subject to the rules of a DCO, whether directly as a clearing member or indirectly through a Collecting Futures Commission Merchant, to provide the DCO or the Collecting Futures Commission Merchant, as appropriate, with information sufficient to identify each customer of the FCM whose swaps are cleared by the FCM. Section 22.11 also requires the FCM, at least once daily, to provide the DCO or the Collecting Futures Commission Merchant, as appropriate, with information sufficient to identify each customer's portfolio of rights and obligations arising out of cleared swaps intermediated by the FCM. The purpose of this collection of information is to facilitate risk management by DCOs and Collecting Futures Commission Merchants, and, in the event of default by the FCM, to enable DCOs and Collecting Futures Commission Merchants to perform their duty, pursuant to section 22.15, to treat the collateral attributed to each customer of the FCM on an individual basis.

Proposed section 22.12 requires that each Collecting Futures Commission Merchant and DCO, on a daily basis, calculate, based on information received pursuant to proposed section 22.11 and on information generated and used in the ordinary course of business by the Collecting Futures Commission Merchant or DCO, and record certain information about the amount of collateral required for each Cleared Swaps Customer and the sum of these amounts.

Proposed section 22.16 requires that each FCM who has cleared swaps customers disclose to each of such customers the governing provisions, as established by DCO rules or customer agreements between collecting and depositing FCMs, relating to use of customer collateral, transfer, neutralization of the risks, or liquidation of cleared swaps in the event of a default by a depositing FCM relating to a cleared swaps customer account. The purpose of this collection of information is to ensure that cleared swaps customers are informed of the procedures to which accounts containing their swaps collateral may be subject in the event of a default by their FCM.

The recordkeeping and disclosure requirements of sections 22.2(g) and 22.11 are expected to apply to approximately 100 entities on a daily basis.[168] The recordkeeping requirement of section 22.5 is expected to apply to approximately 100 entities on an approximately annual basis. Based on experience with analogous recordkeeping and disclosure requirements for FCMs in futures transactions, the recordkeeping and disclosure required by section 22.2(g) is expected to require about 100 hours annually per entity, for a total burden of approximately 20,000 hours. At an hourly rate of $25 per hour, the cost burden would be approximately $2500 per entity per year for a total of $250,000. Also based on experience with analogous recordkeeping requirements for FCMs in futures transactions, the recordkeeping requirement of section 22.5 is expected to require about 5 hours per entity per year, for a total burden of approximately 500 hours per year. At an hourly rate of $25 per hour, the cost burden would be approximately $125 annually per entity, for a total of $12,500.

The disclosure required by section 22.11 involves information that FCMs that intermediate swaps generate and use in the usual and customary ordinary course of their business. It is expected that the required disclosure will be performed using automated data systems that FCMs maintain and use in the usual and customary ordinary course of their business but that certain additional functionality will need to be added to these systems to perform the required disclosure. Because of the novel character of proposed section 22.11, it is not possible to make a precise estimate of the paperwork burden. We estimate that the necessary modifications to, and maintenance of, systems may require a range of between 20 and 40 hours of work annually at a salary of approximately $75 per hour.[169] The total annual burden for section 22.11 therefore is estimated at 2,000 to 4,000 hours and $150,000 to $300,000.

The recordkeeping required by proposed section 22.12 involves information that Collecting Futures Commission Merchants and DCOs will receive pursuant to proposed section 22.11 or that they generate and use in the usual and customary ordinary course of their business. It is expected that the required recordkeeping will be performed using automated data systems that Collecting Futures Commission Merchants and DCOs maintain and use in the usual and customary ordinary course of their business but that certain additional functionality will need to be added to these systems to perform the required disclosure. Because of the novel character of proposed section 22.12, it is not possible to make a precise estimate of the paperwork burden. We estimate that the necessary modifications to, and maintenance of, systems may require a range of between 20 and 40 hours of work annually at a salary of approximately $75 per hour.[170] It is expected that the required recordkeeping will be performed by approximately 100 entities. The total annual burden for section 22.11

[167] Proposed section 22.5(c) provides an exception for a DCO serving as a depository where such DCO has made effective rules that provide for the segregation of Cleared Swaps Customer Collateral in accordance with all relevant provisions of the CEA and the regulations thereunder.

[168] This estimate is based on the following: there are currently approximately 125 FCMs registered with the Commission. However, it is expected that only FCMs with substantial capital will be capable of clearing swaps. There are approximately 75 FCMs with adjusted net capital in excess of $25 million, accordingly, and allowing room for growth, it is estimated that there will be 100 FCMs subject to these requirements.

[169] The range of estimates of hours is influenced by the fact that FCMs commonly use similar or identical data systems produced by a small number of vendors, so there may be significant economies of scale in making the system modifications required for the section 22.11 disclosure. The estimates also are based on the assumption that half of the time required to modify systems will be expended on a one-time basis and annualized over five years.

[170] The range of estimates of hours is influenced by the fact that FCMs and DCOs commonly use similar or identical data systems produced by a small number of vendors, so there may be significant economies of scale in making the system modifications required for the section 22.12 recordkeeping. The estimates also are based on the assumption that half of the time required to modify systems will be expended on a one-time basis and annualized over five years.

therefore is estimated at 2,000 to 4,000 hours and $150,000 to $300,000.

Proposed section 22.16 would apply to the same estimated 100 entities as sections 22.2(g), 22.5(a) and 22.11. The required disclosure would have to be made once each time a swaps customer begins to be cleared through a particular DCO or collecting FCM and each time a DCO or collecting FCM through which a customer's swaps are cleared changes it polices on the matters covered by the disclosure. It is expected that each disclosure would require about 0.2 hours of staff time by staff with a salary level of about $25 per hour. It is uncertain what average number of swaps customers FCMs will have, and what average number of disclosures will be required for each customer annually. Assuming an average of 500 customers per FCM and two disclosures per customer per year, the estimated total annual burden would be 200 hours and $5000 per entity, for an overall burden of $500,000.

3. Information Collection Comments

The Commission requests comment on all aspects of this proposed mandatory collection of information and document retention. Specifically, the Commission requests comment on whether the Commission has provided sufficient clarity concerning the types of information that would be required to be disclosed and retained.

C. Cost-Benefit Analysis

1. Introduction

a. Requirement Under Section 15(a) of the CEA

Section 15(a) of the CEA [171] requires the Commission to consider the costs and benefits of its actions before issuing a rulemaking under the CEA. Section 15(a) further specifies that the costs and benefits shall be evaluated in light of five broad areas of market and public concern: (i) Protection of market participants and the public; (ii) efficiency, competitiveness, and financial integrity of futures markets; (iii) price discovery; (iv) sound risk management practices; and (v) other public interest considerations. The Commission may in its discretion give greater weight to any one of the five enumerated areas and could in its discretion determine that, notwithstanding its costs, a particular rule is necessary or appropriate to protect the public interest or to effectuate any of the provisions or accomplish any of the purposes of the CEA.

b. Structure of the Analysis

As mentioned above, the Commission has decided to propose the Complete Legal Segregation Model. A number of commenters to the ANPR suggested that the costs and benefits of the Complete Legal Segregation Model should be informed by the Futures Model. Such commenters provided quantitative estimates of such costs (but not such benefits). Using these quantitative estimates of cost, the Commission discusses the costs and benefits of the Complete Legal Segregation Model (as well as the Legal Segregation with Recourse Model) in relation to a common baseline—namely, the Futures Model.

The Commission notes that other commenters suggested that the costs and benefits of the Complete Legal Segregation Model should be informed by the protections for collateral obtained by customers in the existing swaps markets and of the costs incurred for such protections. While this alternative is not part of the formal analysis, it can inform us of the costs of the various models. Therefore, the Commission has asked for additional comment on such protections, including quantitative estimates of costs, in section III(B) herein.

Finally, as mentioned above, the Commission is considering the Legal Segregation with Recourse Model. The Commission has asked for additional comment on the Legal Segregation with Recourse Model, as well as (i) the Futures Model and (ii) the Optional Approach.

2. Costs of the Complete Legal Segregation Model, the Legal Segregation With Recourse Model, and the Futures Model

There are several kinds of costs associated with the Complete Legal Segregation and the Legal Segregation with Recourse Models, relative to the Futures Model. These can be categorized as operational costs, Risk Costs (as section II(C)(3) defines such term), and costs associated with induced changes in behavior. The Complete Legal Segregation, the Legal Segregation with Recourse, and the Futures Models will require different payments from various parties in the event that there is a simultaneous default of one or more Cleared Swaps Customers and their FCMs. The direct effect of the Complete Legal Segregation and the Legal Segregation with Recourse Models, in contrast to the Futures Model, would be to protect the Cleared Swaps Customer Collateral of non-defaulting customers against claims by the relevant DCO.[172] In general, this protection of non-defaulting customers makes it more likely, relative to the Futures Model, that the financial resource package of the DCO (including, *e.g.,* the DCO's own capital contribution and the guaranty funds contributed by member FCMs) would need to be applied to the liability of the defaulting Cleared Swaps Customer(s).

a. Operational Costs

Operational costs associated with the Complete Legal Segregation and the Legal Segregation with Recourse Models result from a greater need, relative to the Futures Model, to transfer information about individual Cleared Swaps Customer Contracts between FCMs and DCOs, an increased amount of account information kept by DCOs, potential increases in compliance costs, and related kinds of costs. Some of these costs will be one-time set-up costs, and other costs will be recurring. Operational costs associated with the Complete Legal Segregation and the Legal Segregation with Recourse Models can be expected to be identical or close to identical because the informational and other operational requirements of both models are substantially similar—where the two models differ is in the scope of DCO's claim to Cleared Swaps Customer Collateral in the event of the simultaneous default of one or more Cleared Swaps Customers and their FCMs.

Precise determination of the extent of operational costs associated with the Complete Legal Segregation and the Legal Segregation with Recourse Models depends on the number of Cleared Swaps Customers at each FCM, the number and types of Cleared Swaps Customer Accounts held by each customer, and other factors. Some estimates of the typical FCM's costs were provided by ISDA. As discussed above, in comments on the ANPR, ISDA estimates that the Complete Legal Segregation and the Legal Segregation with Recourse Models would involve a one-time cost increase of $0.8 million to $1 million per FCM, plus a recurring

[171] 7 U.S.C. 19(a).

[172] According to comments on the ANPR, the direct benefit to customers in the form of reduced risk of loss of collateral stemming from the activities of fellow customers may generate indirect benefits. For example, commenters indicated that increased security for collateral could increase their ability to use swaps for business purposes, although this effect could be counterbalanced by increased dollar costs. Commenters also stated that the increased protection against Fellow-Customer Risk would reduce their need to incur costs to protect against the effects of loss of Cleared Swaps Customer Collateral.

annual cost with a median estimate of roughly $0.7 million.[173] In addition, there would be costs faced by each DCO, which would likely be of a similar magnitude, unless the DCO already possesses the information required to implement the Complete Legal Segregation and the Legal Segregation with Recourse Models. A DCO with such information may find the operational costs associated with the Complete Legal Segregation and the Legal Segregation with Recourse Models to be negligible.

b. Risk Costs

Risk Costs refer to the costs associated with reassigning liability in the event of a customer default (*i.e.,* the Complete Legal Segregation Model or the Legal Segregation with Recourse Model compared to the Futures Model). This can usefully be divided into direct and indirect costs (and associated benefits). The direct costs of the Complete Legal Segregation and the Legal Segregation with Recourse Models are the increased risk the DCO will face when one or more Cleared Swaps Customers and their FCMs default. Under the Complete Legal Segregation Model, this is equal to the probability of a default by a Cleared Swaps Customer and its FCM, times the expected contribution that fellow customers would have provided toward the uncovered loss. The gain to Cleared Swaps Customers under this model is the value they place on avoiding this same cost (*i.e.,* owning insurance against Fellow-Customer Risk). The Legal Segregation with Recourse Model is fundamentally similar, except that the Cleared Swaps Customers may ultimately be responsible for some of that deficiency, should the capital of the DCO and the guaranty fund contributions of non-defaulting FCM members be exhausted.[174]

Thus, the Complete Legal Segregation Model will potentially result in a decrease in the financial resources package available to the DCO in the event of default. Hence, maintaining the same assurance of performance requires the DCO to raise additional financial resources. While the Legal Segregation with Recourse Model does not directly reduce DCO financial resources, it restructures them so as to likely lead a DCO to change its default management structure. The exact nature of the Risk Costs will depend on how each DCO structures its default management structure if the Complete Legal Segregation or the Legal Segregation with Recourse Models is chosen over the Futures Model. The comments sent to the Commission have suggested two possible ways by which the DCO may vary its default management structure: (i) By increasing the amount of collateral that each Cleared Swaps Customer must provide; or (ii) by increasing the amount of resources that each FCM must contribute to the guaranty fund.

Focusing on (i) (an increase in the amount of collateral that each Cleared Swaps Customer must provide), estimates of the size of the increase vary, and in principle depend on whether the Complete Legal Segregation Model or the Legal Segregation with Recourse Model is under consideration. In comments on the ANPR, both CME and ISDA suggest that the Complete Legal Segregation Model would require an increase of approximately 70% in Cleared Swaps Customer Collateral, or an increase of roughly $500–600 billion in total required Cleared Swaps Customer Collateral relative to the Futures Model. The organizations had somewhat different views of the Legal Segregation with Recourse Model. ISDA noted that the total pool of capital available to a DCO under this model would not be changed, although there would be "a real wealth transfer" from the FCMs and DCO to the customers, while CME suggested that the increase would be of a similar magnitude to the effect of the Complete Legal Segregation Model.

If instead the capital structure is restored though (ii) (an increase in the amount of resources that each FCM would contribute to the guaranty fund), what were described as "conservative" estimates suggest an increase of $50 billion (CME) to $128 billion (ISDA) in guaranty funds for the Complete Legal Segregation Model.[175] By contrast, LCH, in its comment, stated that there would be no need for additions to the guaranty fund under either the Complete Legal Segregation Model or the Legal Segregation with Recourse Model because the manner in which it currently calculates the size of its guaranty fund provides adequate resources against default risk under the Complete Legal Segregation Model and the Legal Segregation with Recourse Model and because, in the view of LCH, a guaranty fund of similar size would be required to provide adequate security under the Futures Model.

The wide divergence in these figures is due in large part to different implicit assumptions about fellow customer behavior, and how such behavior should affect a DCO's prudent design of its financial resources package. Specifically, Core Principle B for DCOs, section 5b(c)(2)(B) of the CEA, requires the sufficiency of a DCO's financial resources package to be judged relative to the "worst" exposure, in a probabilistic sense, created by a member or participant in extreme but plausible market conditions. In the Complete Legal Segregation Model, such an approach likely requires an assessment of the largest stressed loss on a to-be-specified number of the largest customers to the given FCM since, in this instance, the DCO would not have access to the collateral of non-defaulting customers in such an event. By contrast, the Futures and the Legal Segregation with Recourse Models allow (to a degree) for the sufficiency of the DCO financial resources package to be judged relative to the "worst" loss that an FCM suffers in its omnibus customer account, recognizing that account as a diversified pool and taking advantage of the diversification benefit realized by the DCO across the customers within that pool. This is so because the Futures Model (and, at a later point, the Legal Segregation with Recourse Model) would allow the DCO to use the collateral of non-defaulting customers to cover losses the DCO would otherwise face as a result of a simultaneous default of one or more Cleared Swaps Customers and their FCMs.[176]

However, the extent of the diversification effect arising from the DCO's access to the entire omnibus customer account allowed by the Futures Model (and, at a later point in the process, the Legal Segregation with Recourse Model) depends on how much

[173] *See* note 43 supra.

[174] Implicitly then, unless there are offsetting changes, the resources available to the DCO to cover its obligations to counterparties in the event of the default of one or more Cleared Swaps Customers and their FCMs would potentially be smaller under the Complete Legal Segregation Model than under the Legal Segregation with Recourse Model, and hence the guarantee offered to Cleared Swaps counterparties by the DCO would potentially be less secure under the Complete Legal Segregation Model. Such offsetting changes, however, are required by proposed Commission requirements regarding DCO financial resource packages. *See* section II(C)(1) herein. As the following discussion indicates, the DCO may take steps, in terms of enhanced resources and use of risk-management tools to insure the security that it offers to Cleared Swaps counterparties.

[175] Presumably, some of the cost to the FCMs would be offset by enhanced charges to customers. Buy-side commenters to the ANPR have indicated that they would be willing to bear such charges.

[176] While the Legal Segregation with Recourse Model permits the DCO to take into account the omnibus customer account, as a diversified pool, in calculating the total resources available to cover the DCO's obligations resulting from a combined customer/FCM default, as explained above, it would expose the DCO to a higher risk of having to use the DCO's own capital and the guaranty fund contributions of non-defaulting FCM members than the Futures Model.

of the resources supplied by non-defaulting Cleared Swaps Customers (via initial margin) will be present in the account following a default. If all Cleared Swaps Customer Contracts remained with the defaulting FCM through the default, then the DCO could potentially measure the adequacy of the guaranty fund based on a fully diversified pool of customer positions. Conversely, if all Cleared Swaps Customers would transfer their positions to a different FCM in anticipation of the default, then the diversification (and its consequence for the DCO's financial resources package) would be eliminated.[177]

More generally, the extent to which the Complete Legal Segregation or the Legal Segregation with Recourse Models really requires a larger guaranty fund or higher levels of collateral per Cleared Swaps Customer (relative to the Futures Model) depends on the extent to which Cleared Swaps Customer Contracts can be expected to remain with the defaulting FCM during the time period immediately before the default.[178] Since the circumstances of particular FCM defaults will vary, DCOs, in determining their financial resources package, can be expected to take into consideration the possibility that, at least for some FCM defaults, there will be warning signs, resulting in a portion of Cleared Swaps Customer Collateral being transferred out of the Cleared Swaps Customer Account maintained by the defaulting FCM. And while determining the appropriate assumptions regarding customer behavior under either the Futures or the Legal Segregation with Recourse Models is central to the issue of capital adequacy, it may prove less central to the consideration of costs and benefits under this rule, since both those costs and benefits depend on the extent to which Cleared Swaps Customers will transfer their Cleared Swaps Contracts.

A distinct question in evaluating Risk Cost is how to translate a Cleared Swaps Customer Collateral or guaranty fund increase to a cost increase. A customer required to post an additional $100 of Cleared Swaps Customer Collateral is not made worse off by $100. Moreover, the cost to the customer is, at least in part, offset by the benefit to the DCO. The cost to the customer of a Cleared Swaps Customer Collateral increase of $100 is the difference between the gain he or she would have received by retaining that $100, and the return he or she will receive on the asset while it is on deposit with the FCM or DCO. For example, the customer might invest the $100 in buying and holding grain over the pendency of the swap if the level of Cleared Swaps Customer Collateral were not increased, while he or she is limited to the return on assets the DCO will accept as margin payment (*e.g.,* the t-bill rate) under the new, higher margins. While an exact figure for this difference is difficult to calculate precisely, it is likely to be in a range of 1–4% per year over the life of the swap. Offsetting this cost is the gain to the DCO of having additional assets available in the event of the simultaneous default of one or more Cleared Swaps Customers and their FCMs, which may enable it to obtain a higher rate of return on some of its other assets.[179] Similarly, the cost to an FCM of a guaranty fund contribution increase is equal to the difference in return between acceptable instruments for deposit to the guaranty fund and the FCM's potential return on that $100 if it were not deposited to the guaranty fund.

The benefit to customers of greater protection for customer margin provided by the Complete Legal Segregation Model and the Legal Segregation with Recourse Model also depends, to some extent, on assumptions about customers' behavior in advance of a fellow-customer default. Under the extreme assumption that all customers costlessly anticipate the default and move their positions to a different FCM, then neither the Complete Legal Segregation Model nor the Legal Segregation with Recourse Model provides any benefit to customers (since their Cleared Swaps Customer Accounts would not have been at risk under the benchmark). More generally, the greater the extent to which customers will move their positions, the lower the benefits of the Complete Legal Segregation Model and the Legal Segregation with Recourse Model relative to the Futures Model. Of course, under the Futures Model there exists uncertainty surrounding a customer's ability to anticipate an FCM default, and this uncertainty is either wholly or mostly eliminated under the Complete Legal Segregation and the Legal Segregation with Recourse Models. However, this benefit afforded the customer needs to be balanced against the cost to the DCO of insuring against this uncertainty, a portion of which can be anticipated to be passed along to the customer. Thus, both the capital costs and the benefits of the Complete Legal Segregation and the Legal Segregation with Recourse Models, relative to the Futures Model, will tend to be lower to the extent customers are likely to move their positions in advance of an FCM default and higher to the extent customers are unlikely to be able to move their positions. As a result, differing assumptions about customer mobility in advance of default are likely to have smaller implications for the relative costs and benefits of differing approaches than they do for Risk Cost considered in isolation.

c. Induced Changes in Behavior

Finally, in the category of costs and benefits associated with induced changes in behavior, several issues are worth noting. CME has argued that the Complete Legal Segregation and the Legal Segregation with Recourse Models could potentially reduce the incentives of individual customers to exercise due diligence when choosing an FCM. In effect, they argue that because the financial condition of the FCM, and of the FCM's other customers, will be less relevant to the customer's liability in the event of fellow customer default, the customer will devote less effort to monitoring the FCM and its customers. While this is likely to be true, these liability regimes have offsetting increased monitoring incentives on the part of FCMs and the DCO. That is, because the Complete Legal Segregation and the Legal Segregation with Recourse Models increase the likelihood that a customer default would impact the guaranty fund, increased incentives exist to protect that fund through more careful monitoring by the suppliers of the guaranty fund and their agent (the

[177] LCH states that a methodology in which no diversification is assumed represents their current practice, and is the most "conservative" in terms of capital adequacy. It argues that it is imprudent to assume that any funds in the omnibus Cleared Swaps Customer Account will remain at the time of default because that default may plausibly occur not as a sudden shock but, rather, as the end of a process of credit deterioration taking place over a number of days (potentially a number of weeks), during which time the Cleared Swaps Customers have time to port their Cleared Swaps Contracts and associated collateral away from the defaulting FCM. Thus, according to the logic of LCH's approach, the size of the guaranty fund and/or initial margin levels would need to be as high under the Futures Model as under either the Complete Legal Segregation or the Legal Segregation with Recourse Models.

[178] The LCH's observation also impacts the requisite change in Cleared Swaps Customer Collateral. The question of how to appropriately evaluate the omnibus customer account is a question of financial resources and is beyond the scope of this rulemaking. We note, however, that to the extent that immediate history may provide some guidance, the aggregate amount of segregated funds in Lehman's omnibus customer account dropped by roughly 75% during the week prior to its filing for bankruptcy.

[179] An additional offset to this cost is the value that customers assign to the increased safety of their collateral from fellow customer risk, a point which is discussed further below.

DCO). Indeed, as discussed above,[180] other commenters (BlackRock, Freddie Mac, and Vanguard) observe that the availability of fellow-customer collateral as a buffer reduces the incentives of DCOs to provide vigorous oversight. The net effect of these incentive changes on the incentive to monitor is difficult to quantify. However, the basic economics of monitoring suggest that there are efficiency gains to centralizing monitoring in a small number of parties.[181] This is because there are "free rider" effects associated with diffuse liability; when liability is spread upon a large number of agents, each gains little from devoting resources to monitoring the firm.[182] This effect is compounded by an information effect; even if the incentive exists, it is difficult for individual customers to gain access to information about the financial condition of the FCM, and even more so about the financial condition of their fellow customers. In contrast, the DCO will, especially under the Complete Legal Segregation Model and the Legal Segregation with Recourse Model, have good information about the financial condition of both FCMs and customers.

d. Portability

Another issue is the ease of moving Cleared Swaps Customer Contracts to new FCMs following an FCM default. Following a default by an FCM, the Cleared Swaps Contracts of the FCM's customers either have to be moved to another FCM, or closed. Moving a position to another FCM allows the DCO to maintain its net position in that contract at zero, which is generally a goal of a DCO. It also prevents a customer from needing to reestablish a position, which potentially can be costly, especially in a stressed economic state.[183] As discussed above, the various models result in different amounts of customer-specific information residing with the DCO under the various models. While it is difficult to quantify the effects of the alternatives on the cost of moving positions between FCMs, it would seem that both the Complete Legal Segregation and the Legal Segregation with Recourse models do not decrease portability, especially given the increases in capital requirements that many commenters view as a likely consequence of either model. In fact, ISDA emphasizes that the Complete Legal Segregation Model likely increases portability.

e. Potential Preferences of Cleared Swaps Customers

Overall, evaluating the costs and benefits of the Complete Legal Segregation Model and the Legal Segregation with Recourse Model relative to the Futures Model requires one to know the inherently-subjective valuation end-users place on the lower likelihood of losing their initial margin, as well as more precise estimates of the cost. Given the constraints on such knowledge, and the likelihood that the benefits to customers will, to some extent, vary with the cost to DCOs (that is, both are related to the same underlying factors), the best indirect evidence of the likely effect is the comments provided by the buy-side. While the Commission has not canvassed all buy-side members, most of those that chose to comment on the ANPR support the change. It is not knowable if these commenters fully internalized all of the potential costs outlined above (*e.g.,* potentially higher margins, increased costs imposed by FCMs). However, these commenters generally told the Commission that they understood that more protection for customer collateral was likely to come at a cost and that they nevertheless favored more protective approaches.

f. The Optional Approach

A final option is giving DCOs the choice of which segregation model to employ. If all DCOs would adopt the same model when given a choice, then the foregoing analysis would apply. In contrast, if different DCOs might adopt different models, then the analysis of the system-wide costs and benefits would need to account for the choices made by the extant DCOs. The Commission seeks comment on the likely alternatives that would emerge if DCOs had the option of choosing their segregation model, and the likely costs and benefits of having alternative default models available.[184]

3. Summary of Benefits of Legal Segregation Models

Based on the discussion in the previous section, the primary expected benefits of adopting the Complete Legal Segregation or the Legal Segregation with Recourse Models to implementing section 724 of the Dodd-Frank Act can be summarized as follows.

a. Fellow-Customer Risk

The primary direct benefit from either the Complete Legal Segregation or the Legal Segregation with Recourse Models is to reduce the risk to Cleared Swaps Customers of losing the value of their collateral in a scenario in which an FCM and one or more of its customers defaults on its obligations in connection with Cleared Swaps transactions. The Complete Legal Segregation Model would largely eliminate this risk.[185] The Legal Segregation with Recourse Model would limit this risk to defaults in which the magnitude of the Cleared Swaps Customer component of the default exceeds the aggregate of the DCO's own capital and the guaranty fund contributions of non-defaulting FCM members.

As discussed in the previous section, the value of this reduced risk of loss to Cleared Swaps Customers will, to some degree, depend on the extent to which such customers are able to anticipate FCM defaults and voluntarily transfer their Cleared Swaps Contracts, and associated collateral, to other FCMs before the default occurs. In practice, some FCM defaults may be anticipated by a substantial proportion of Cleared Swaps Customers, while others may occur suddenly with few or no customers able to transfer their collateral.[186] For this reason, an important benefit of the Legal Segregation Model (particularly the Complete Legal Segregation Model) is greater certainty. By providing post-default protection against Fellow-Customer Risk (as such term is defined above), the Legal Segregation Model provides Cleared Swaps Customers with a degree of certainty that they will not lose their collateral due to the actions of other customers regardless of whether they are able to anticipate an FCM default. Swaps customers who commented on the ANPR indicated that such certainty was critical to their business model. The direct benefit to Cleared Swaps Customers of reduced Fellow-Customer Risk and reduced

[180] *See* note 56 supra.

[181] In the banking literature, this argument supports capital requirements as effective disincentives to excessive risk-taking.

[182] *See, e.g.,* Andrei Shleifer and Robert W. Vishny, A Survey of Corporate Governance, 52 J. Fin. 737, 753 (1997) (discussing effect of "free rider" issues on monitoring in context of corporate governance).

[183] *See* ISDA Supplemental at 2.

[184] Section III(E) describes certain concerns with adopting the Optional Approach.

[185] As noted above, this model would leave some residual fellow-customer risk because the DCO would allocate collateral between defaulting and non-defaulting customers based on information the FCM provided the day prior to default, so the allocation would not reflect movement in the cleared swaps portfolio of customers on the day of default.

[186] *See* footnote 178 supra (regarding recent experience with Lehman). *Cf. e.g.,* Inskeep v. Griffin, 440 B.R. 148, 151–52 (Beginning on Monday, December 21, 1998 and continuing into the morning of Tuesday, December 22, 1998 * * * Park * * * a trader who operated out of Griffin Trading Company's London office, substantially exceeded his trading limits and suffered losses * * * As a result of Park's losses, Griffin Trading became insolvent.").

uncertainty may generate a variety of indirect benefits, for example an increased ability by some businesses to use cleared swaps as a risk management tool or a reduced need by Cleared Swaps Customers to incur costs to protect against the consequences of Fellow-Customer Risk in the event of an FCM default.

b. Portability and Systemic Risk

An additional benefit of the Complete Legal Segregation Model is to foster portability. By preserving the collateral of non-defaulting Cleared Swaps Customers, this model increases the likelihood that the Cleared Swaps Contracts of these customers can be successfully transferred. Fostering such transfer, as opposed to the liquidation of these Cleared Swaps Contracts, will carry benefits both for the Cleared Swaps Customers and for the financial system as a whole (the latter by reducing the likelihood that markets would be roiled by a mass liquidation).

c. Induced Changes in Behavior

Further benefits are expected to result from changes in behavior induced by the direct costs and benefits of the Complete Legal Segregation or Legal Segregation with Recourse Models. Because DCOs will not be able to rely on the collateral of non-defaulting Cleared Swaps Customers, they will have incentives to increase the extent of their monitoring of the risk posed by their FCM members and the major customers of those FCMs. This will have a tendency to reduce the incidence of FCM and major customer defaults. Some commenters on the ANPR suggested that the greater protection provided by the Legal Segregation Model (particularly the Complete Legal Segregation Model) will mean that Cleared Swaps Customers have less incentive to monitor the riskiness of their FCMs than under the Futures Model in which customers are exposed to greater risk of loss. However, for reasons explained in the previous section, DCOs are in a better position than Cleared Swaps Customers to monitor FCMs, and the customers thereof, so the benefits from increased monitoring by DCOs can be expected to outweigh any reduced monitoring by customers.[187]

4. Relevance to Section 15(a)(2) Considerations

The costs and benefits discussed in the previous sections bear on a number of the considerations listed in section 15(a)(2) of the CEA:

a. Protection of market participants and the public. The primary benefit of the Complete Legal Segregation Model, reduction in the risk of loss of Cleared Swaps Customer Collateral, advances this interest. The Commission notes that the Legal Segregation with Recourse Model, which the Commission is considering, also achieves such benefit, but to a lesser extent.

b. Efficiency, competitiveness, and financial integrity of markets. As mentioned above, the Complete Legal Segregation Model would increase the likelihood that, in the event of a simultaneous FCM and Cleared Swaps Customer default, the DCO would be able to transfer the Cleared Swaps of non-defaulting Cleared Swaps Customers. Therefore, to the extent that the Complete Legal Segregation Model would enable Cleared Swaps Customers to avoid liquidation of their existing Cleared Swaps, this model would avoid what one commenter described as "major market disruption with significant adverse economic impact." [188] Such avoidance would therefore promote the financial integrity of the markets.

Additionally, behavioral responses to the Complete Legal Segregation Model discussed above may also affect the financial integrity of markets. To the extent that the Complete Legal Segregation Model creates incentives for DCOs to employ higher levels of monitoring of FCMs and their Cleared Swaps Customers, it will enhance the financial integrity of markets.

The Commission notes that, in contrast to the Complete Legal Segregation Model, the Legal Segregation with Recourse Model increases the likelihood of the transfer of Cleared Swaps Customer Contracts to a lesser extent. Therefore, the Legal Segregation with Recourse Model does not enhance the financial integrity of markets as much as the Complete Legal Segregation Model.

As mentioned above, the Complete Legal Segregation Model arguably entails greater Risk Costs, although not operational costs, than the Legal Segregation with Recourse Model. Both such models arguably entail greater operational costs than the Futures Model. However:

- As discussed above, commenters exhibited considerable divergence in their estimates of Risk Costs.
- As discussed above, ANPR commenters suggested that the incremental operational costs of the Complete Legal Segregation or the Legal Segregation with Recourse Models, as compared with the Futures Model, would be relatively modest against the size of the market for cleared swaps.
- Despite the possibility of increased Risk Costs and operational costs, most buy-side commenters to the ANPR suggested that they valued the degree of certainty that they will not lose Cleared Swaps Customer Collateral, and several such commenters indicated that the absence of this level of certainty would impair their ability to use cleared swaps for risk management purposes. To the extent that these commenters represented the perspective of swaps users generally, then, notwithstanding the possibility of increased Risk Costs and operational costs, adoption of either the Complete Legal Segregation or the Legal Segregation with Recourse Models may increase the efficiency and competitiveness of markets, because they may encourage buy-side use of such markets in the management of risk.

Because the Complete Legal Segregation Model would eliminate the ability of DCOs to access the collateral of non-defaulting Cleared Swaps Customers in the event of an FCM default accompanied by the default of one or more customers, other things held constant, there could potentially be negative effects on a DCO's financial integrity. Such potential negative effects would not be present for the Legal Segregation with Recourse Model, because DCOs would still have the ability to access the collateral of non-defaulting Cleared Swaps Customers. To the extent that negative effects may exist, Core Principle B for DCOs, section 5b(c)(2)(B) of the CEA would require a DCO to have available alternative resources to protect the DCO from the consequences of a major FCM default, such as higher margin levels or larger guaranty funds. Consistent with this requirement, commenters on the ANPR who considered access to the collateral of non-defaulting Cleared Swaps Customers to be important generally assumed that DCOs would procure alternative financial resources if the Complete Legal Segregation Model is adopted. As a result, any potential negative effect of the Complete Legal Segregation Model on market integrity will be reflected in higher capital costs rather than an actual reduction in market integrity.

c. Price discovery. The effect of the Complete Legal Segregation Model (or the Legal Segregation with Recourse Model), as proposed, on price discovery will depend on the value that Cleared Swaps Customers assign to the additional protection that they will

[187] Moreover, any reduced monitoring by customers would also imply a reduced monitoring cost.

[188] *See* ISDA Supplemental at 3.

receive for Cleared Swaps Collateral against the cost that they will pay for such protection. If the former would exceed the latter, as buy-side commenters to the ANPR suggested, then Cleared Swaps Customers may be encouraged to participate in the markets, which could have a positive impact on price discovery

d. Sound risk management practices. To the extent that the Complete Legal Segregation Model or the Legal Segregation with Recourse Model creates incentives for higher levels of monitoring of FCMs and their Cleared Swaps Customers by DCOs, it will enhance sound risk management practices. As discussed above, some commenters suggested that the Complete Legal Segregation Model or the Legal Segregation with Recourse Model would reduce incentives for Cleared Swaps Customers to "risk manage" their FCMs. As noted above, there are significant questions about the ability of customers to "risk manage" their FCMs effectively. Moreover, the Commission expects that any such effect would be outweighed by enhanced risk management on the part of DCOs.

e. Other public interest considerations. As discussed above, some commenters suggested that the Complete Legal Segregation Model would increase market stability in times of stress facilitating the prompt transfer of customer positions without the need for liquidation when an FCM defaults.

5. Public Comment

The Commission invites public comment on its cost-benefit considerations, including the costs and benefits of the Complete Segregation Model (as proposed), the Legal Segregation with Recourse Model (which is under consideration), the Futures Model, and giving DCOs a choice of such approaches. Commenters are also invited to submit any data or other information that they may have quantifying or qualifying the costs and benefits with their comment letters.

List of Subjects

17 CFR Part 22

Brokers, Clearing, Consumer protection, Reporting and recordkeeping requirements, Swaps.

17 CFR Part 190

Bankruptcy, Brokers, Commodity futures, Reporting and recordkeeping requirements, Swaps.

VIII. Text of Proposed Rules

For the reasons stated in this release, the Commission hereby proposes to amend Chapter as follows:

1. Add Part 22 to read as follows:

PART 22—CLEARED SWAPS

Sec.

Authority: 7 U.S.C. 1a, 6d, 7a–1 as amended by Pub. L. 111–203, 124 Stat. 1376.

§ 22.1 Definitions.

For the purposes of this part:

Cleared Swap. This term refers to a transaction constituting a "cleared swap" within the meaning of section 1a(7) of the Act.

(1) This term shall exclude any swap (along with money, securities, or other property received to margin, guarantee, or secure such a swap) that, 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), is (along with such money, securities, or other property) commingled with a commodity future or option (along with money, securities, or other property received to margin, guarantee, or secure such a future or option) that is segregated pursuant to section 4d(a) of the Act.

(2) This term shall include any trade or contract (along with money, securities or other property received to margin, guarantee, or secure such a trade or contract), that (i) Would be required to be segregated pursuant to section 4d(a) 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 swap (along with money, securities, or other property received to margin, guarantee, or secure such a swap) in an account segregated pursuant to section 4d(f) of the Act.

Cleared Swaps Customer. This term refers to any person entering into a Cleared Swap, but shall exclude any owner or holder of a Cleared Swaps Proprietary Account with respect to the Cleared Swaps in such account. A person shall be a Cleared Swaps Customer only with respect to its Cleared Swaps.

Cleared Swaps Customer Account. This term refers to any account for the Cleared Swaps of Cleared Swaps Customers and associated Cleared Swaps Customer Collateral that:

(1) A futures commission merchant maintains on behalf of Cleared Swaps Customers (including, in the case of a Collecting Futures Commission Merchant, the Cleared Swaps Customers of a Depositing Futures Commission Merchant) or

(2) A derivatives clearing organization maintains for futures commission merchants on behalf of Cleared Swaps Customers thereof.

Cleared Swaps Customer Collateral. (1) This term means all money, securities, or other property received by a futures commission merchant or by a derivatives clearing organization from, for, or on behalf of a Cleared Swaps Customer, which money, securities, or other property:

(i) Is intended to or does margin, guarantee, or secure a Cleared Swap; or

(ii) Constitutes, if a Cleared Swap is in the form or nature of an option, the settlement value of such option.

(2) This term shall also include accruals, *i.e.,* all money, securities, or other property that a futures commission merchant or derivatives clearing organization receives, directly or indirectly, which is incident to or results from a Cleared Swap that a futures commission merchant intermediates for a Cleared Swaps Customer.

Cleared Swaps Proprietary Account. (1) This term means an account for Cleared Swaps and associated collateral that is carried on the books and records of a futures commission merchant for persons with certain relationships with

that futures commission merchant, specifically:

(i) Where such account is carried for a person falling within one of the categories specified in paragraph (2) of this definition, or

(ii) Where ten percent or more of such account is owned by a person falling within one of the categories specified in paragraph (2) of this definition, or

(iii) Where an aggregate of ten percent or more of such account is owned by more than one person falling within one or more of the categories specified in paragraph (2) of this definition.

(2) The relationships to the futures commission merchant referred to in paragraph (1) of this definition are as follows:

(i) Such individual himself, or such partnership, corporation or association itself;

(ii) In the case of a partnership, a general partner in such partnership;

(iii) In the case of a limited partnership, a limited or special partner in such partnership whose duties include:

(*A*) The management of the partnership business or any part thereof;

(*B*) The handling, on behalf of such partnership, of (i) the Cleared Swaps of Cleared Swaps Customers or (ii) the Cleared Swaps Customer Collateral;

(*C*) The keeping, on behalf of such partnership, of records pertaining to (i) the Cleared Swaps of Cleared Swaps Customers or (ii) the Cleared Swaps Customer Collateral; or

(*D*) The signing or co-signing of checks or drafts on behalf of such partnership;

(iv) In the case of a corporation or association, an officer, director, or owner of ten percent or more of the capital stock of such organization;

(v) An employee of such individual, partnership, corporation or association whose duties include:

(*A*) The management of the business of such individual, partnership, corporation or association or any part thereof;

(*B*) The handling, on behalf of such individual, partnership, corporation, or association, of the Cleared Swaps of Cleared Swaps Customers or the Cleared Swaps Customer Collateral;

(*C*) The keeping of records, on behalf of such individual, partnership, corporation, or association, pertaining to the Cleared Swaps of Cleared Swaps Customers or the Cleared Swaps Customer Collateral; or

(*D*) The signing or co-signing of checks or drafts on behalf of such individual, partnership, corporation, or association;

(vi) A spouse or minor dependent living in the same household of any of the foregoing persons;

(vii) A business affiliate that, directly or indirectly, controls such individual, partnership, corporation, or association; or

(viii) A business affiliate that, directly or indirectly, is controlled by or is under common control with, such individual, partnership, corporation or association. *Provided, however,* that an account owned by any shareholder or member of a cooperative association of producers, within the meaning of section 6a of the Act, which association is registered as a futures commission merchant and carries such account on its records, shall be deemed to be a Cleared Swaps Customer Account and not a Cleared Swaps Proprietary Account of such association, unless the shareholder or member is an officer, director, or manager of the association.

Clearing Member. This term means any person that has clearing privileges such that it can process, clear and settle trades through a derivatives clearing organization on behalf of itself or others. The derivatives clearing organization need not be organized as a membership organization.

Collecting Futures Commission Merchant. A futures commission merchant that carries Cleared Swaps on behalf of another futures commission merchant and the Cleared Swaps Customers of the latter futures commission merchant, and as part of carrying such Cleared Swaps, collects Cleared Swaps Customer Collateral.

Commingle. To commingle two or more items means to hold such items in the same account, or to combine such items in a transfer between accounts.

Customer. This term means any customer of a futures commission merchant, other than a Cleared Swaps Customer, including, without limitation:

(1) Any "customer" or "commodity customer" within the meaning of § 1.3 of this chapter; and

(2) Any "foreign futures or foreign options customer" within the meaning of § 30.1(c) of this chapter.

Depositing Futures Commission Merchant. A futures commission merchant that carries Cleared Swaps on behalf of its Cleared Swaps Customers through another futures commission merchant and, as part of carrying such Cleared Swaps, deposits Cleared Swaps Customer Collateral with such futures commission merchant.

Permitted Depository. This term shall have the meaning set forth in § 22.4 of this part.

Segregate. To segregate two or more items is to keep them in separate accounts, and to avoid combining them in the same transfer between two accounts.

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

(a) *General.* A futures commission merchant shall treat and deal with the Cleared Swaps of Cleared Swaps Customers and associated Cleared Swaps Customer Collateral as belonging to Cleared Swaps Customers.

(b) *Location of Cleared Swaps Customer Collateral.* (1) A futures commission merchant must segregate all Cleared Swaps Customer Collateral that it receives, and must either hold such Cleared Swaps Customer Collateral itself as set forth in subparagraph (b)(2) of this section, or deposit such collateral into one or more Cleared Swaps Customer Accounts held at a Permitted Depository, as set forth in subparagraph (b)(3) of this section.

(2) If a futures commission merchant holds Cleared Swaps Customer Collateral itself, then the futures commission merchant must:

(i) Physically separate such collateral from its own property;

(ii) Clearly identify each physical location in which it holds such collateral as a "Location of Cleared Swaps Customer Collateral" (the "FCM Physical Location");

(iii) Ensure that the FCM Physical Location provides appropriate protection for such collateral; and

(iv) Record in its books and records the amount of such Cleared Swaps Customer Collateral separately from its own funds.

(3) If a futures commission merchant holds Cleared Swaps Customer Collateral in a Permitted Depository, then:

(i) The Permitted Depository must qualify pursuant to the requirements set forth in § 22.4 of this part, and

(ii) The futures commission merchant must maintain a Cleared Swaps Customer Account with each such Permitted Depository.

(c) *Commingling.* (1) A futures commission merchant may commingle the Cleared Swaps Customer Collateral that it receives from, for, or on behalf of multiple Cleared Swaps Customers.

(2) A futures commission merchant shall not commingle Cleared Swaps Customer Collateral with either of the following:

(i) Funds belonging to the futures commission merchant, except as expressly permitted in paragraph (e)(3) of this section; or

(ii) Other categories of funds belonging to Customers of the futures

commission merchant, including customer funds (as § 1.3 of this chapter defines such term) and the foreign futures or foreign options secured amount (as § 1.3 of this chapter defines such term), except as expressly permitted by Commission rule, regulation, or order, or by a derivatives clearing organization rule approved in accordance with § 39.15(b)(2) of this chapter.

(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, or by a derivatives clearing organization rule approved in accordance with § 39.15(b)(2) of this chapter.

(2) A futures commission merchant may not impose or permit the imposition of a lien on Cleared Swaps Customer Collateral, including any residual financial interest of the futures commission merchant in such collateral, as described in paragraph (e)(4) of this section.

(3) A futures commission merchant may not include, as Cleared Swaps Customer Collateral,

(i) Money invested in the securities, memberships, or obligations of any derivatives clearing organization, designated contract market, swap execution facility, or swap data repository, or

(ii) Money, securities, or other property that any derivatives clearing organization holds and may use for a purpose other than those set forth in § 22.3 of this part.

(e) *Exceptions.* Notwithstanding the foregoing:

(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 section 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.

(2) *Permitted Withdrawals.* Such share of Cleared Swaps Customer Collateral as in the normal course of business shall be necessary to margin, guarantee, secure, transfer, adjust, or settle a Cleared Swaps Customer's cleared swaps with a derivatives clearing organization, or with a Collecting Futures Commission Merchant, may be withdrawn and applied to such purposes, including the payment of commissions, brokerage, interest, taxes, storage, and other charges, lawfully accruing in connection with such cleared swaps.

(3) *Deposits of Own Money, Securities, or Other Property.* In order to ensure that it is always in compliance with paragraph (f) of this section, a futures commission merchant may place in an FCM Physical Location or deposit in a Cleared Swaps Customer Account its own money, securities, or other property (*provided, that* such securities or other property are unencumbered and are of the types specified in § 1.25 of this chapter).

(4) *Residual Financial Interest.* (i) If, in accordance with paragraph (e)(3) of this section, a futures commission merchant places in an FCM Physical Location or deposits in a Cleared Swaps Customer Account its own money, securities, or other property, then such money, securities, or other property (including accruals thereon) shall constitute Cleared Swaps Customer Collateral.

(ii) The futures commission merchant shall have a residual financial interest in any portion of such money, securities, or other property in excess of that necessary for compliance with paragraph (f)(4) of this section.

(iii) The futures commission merchant may withdraw money, securities, or other property from the FCM Physical Location or Cleared Swaps Customer Account, to the extent of its residual financial interest therein. At the time of such withdrawal, the futures commission merchant shall ensure that the withdrawal does not cause its residual financial interest to become less than zero.

(f) *Requirements as to Amount.* (1) For purposes of this section 22.2(f), the term "account" shall reference the entries on the books and records of a futures commission merchant pertaining to the Cleared Swaps Customer Collateral of a particular Cleared Swaps Customer.

(2) The futures commission merchant must reflect in the account that it maintains for each Cleared Swaps Customer the market value of any Cleared Swaps Customer Collateral that it receives from such customer, as adjusted by:

(i) Any uses permitted under § 22.2(d) of this part;

(ii) Any accruals or losses on permitted investments of such collateral under § 22.2(e) of this part that, pursuant to the futures commission merchant's customer agreement with that customer, are creditable or chargeable to such customer;

(iii) Any charges lawfully accruing to the Cleared Swaps Customer, including any commission, brokerage fee, interest, tax, or storage fee; and

(iv) Any appropriately authorized distribution or transfer of such collateral.

(3) If the market value of Cleared Swaps Customer Collateral in the account of a Cleared Swaps Customer is positive after adjustments, then that account has a credit balance. If the market value of Cleared Swaps Customer Collateral in the account of a Cleared Swaps Customer is negative after adjustments, then that account has a debit balance.

(4) The futures commission merchant must maintain in segregation, in its FCM Physical Locations and/or its Cleared Swaps Customer Accounts at Permitted Depositories, an amount equal to the sum of any credit balances that the Cleared Swaps Customers of the futures commission merchant have in their accounts, excluding from such sum any debit balances that the Cleared Swaps Customers of the futures commission merchant have in their accounts.

(5) Notwithstanding the foregoing, the futures commission merchant must include, in calculating the sum referenced in paragraph (f)(4) of this section, any debit balance that a Cleared Swaps Customer may have in its account, to the extent that such balance is secured by "readily marketable securities" that the Cleared Swaps Customer deposited with the futures commission merchant.

(i) For purposes of this section, "readily marketable" shall be defined as having a "ready market" as such latter term is defined in Rule 15c3–1(c)(11) of the Securities and Exchange Commission (§ 241.15c3–1(c)(11) of this title).

(ii) In order for a debit balance to be deemed secured by "readily marketable securities," the futures commission merchant must maintain a security interest in such securities, and must hold a written authorization to liquidate the securities at the discretion of the futures commission merchant.

(iii) To determine the amount secured by "readily marketable securities," the futures commission merchant shall: (A) determine the market value of such securities; and (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). The portion of the debit balance, not exceeding 100 per cent, 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.

(g) *Segregated Account; Daily Computation and Record.* (1) Each futures commission merchant must compute as of the close of each business day, on a currency-by-currency basis:

(i) The aggregate market value of the Cleared Swaps Customer Collateral in all FCM Physical Locations and all Cleared Swaps Customer Accounts held at Permitted Depositories (the "Collateral Value");

(ii) The sum referenced in paragraph (f)(4) of this section (the "Collateral Requirement"); and

(iii) The amount of the residual financial interest that the futures commission merchant holds in such Cleared Swaps Customer Collateral, which shall equal the difference between the Collateral Value and the Collateral Requirement.

(2) The futures commission merchant must complete the daily computations required by this section prior to noon on the next business day and must keep such computations, together with all supporting data, in accordance with the requirements of § 1.31 of this chapter.

§ 22.3 Derivatives Clearing Organizations: Treatment of Cleared Swaps Customer Collateral.

(a) *General.* A derivatives clearing organization shall treat and deal with the Cleared Swaps Customer Collateral deposited by a futures commission merchant as belonging to the Cleared Swaps Customers of such futures commission merchant and not other persons, including, without limitation, the futures commission merchant.

(b) *Location of Cleared Swaps Customer Collateral.* (1) The derivatives clearing organization must segregate all Cleared Swaps Customer Collateral that it receives from futures commission merchants, and must either hold such Cleared Swaps Customer Collateral itself as set forth in paragraph (b)(2) of this section, or deposit such collateral into one or more Cleared Swaps Customer Accounts held at a Permitted Depository, as set forth in paragraph (b)(3) of this section.

(2) If a derivatives clearing organization holds Cleared Swaps Customer Collateral itself, then the derivatives clearing organization must:

(i) Physically separate such collateral from its own property, the property of any futures commission merchant, and the property of any other person that is not a Cleared Swaps Customer of a futures commission merchant;

(ii) Clearly identify each physical location in which it holds such collateral as "Location of Cleared Swaps Customer Collateral" (the "DCO Physical Location");

(iii) Ensure that the DCO Physical Location provides appropriate protection for such collateral; and

(iv) Record in its books and records the amount of such Cleared Swaps Customer Collateral separately from its own funds, the funds of any futures commission merchant, and the funds of any other person that is not a Cleared Swaps Customer of a futures commission merchant.

(3) If a derivatives clearing organization holds Cleared Swaps Customer Collateral in a Permitted Depository, then:

(i) The Permitted Depository must qualify pursuant to the requirements set forth in § 22.4 of this part; and

(ii) The derivatives clearing organization must maintain a Cleared Swaps Customer Account with each such Permitted Depository.

(c) *Commingling.* (1) A derivatives clearing organization may commingle the Cleared Swaps Customer Collateral that it receives from multiple futures commission merchants on behalf of their Cleared Swaps Customers.

(2) A derivatives clearing organization shall not commingle the Cleared Swaps Customer Collateral that it receives from a futures commission merchant on behalf of Cleared Swaps Customers with any of the following:

(i) The money, securities, or other property belonging to the derivatives clearing organization;

(ii) The money, securities, or other property belonging to any futures commission merchant; or

(iii) Other categories of funds that it receives from a futures commission merchant on behalf of Customers, including customer funds (as § 1.3 of this chapter defines such term) and the foreign futures or foreign options secured amount (as § 1.3 of this chapter defines such term), except as expressly permitted by Commission rule, regulation or order, (or a derivatives clearing organization rule approved in accordance with § 39.15(b)(2) of this chapter).

(d) *Exceptions; Deposits and Withdrawals from Futures Commission Merchants.* Notwithstanding the foregoing, pursuant to an instruction from a futures commission merchant, a derivatives clearing organization may place money, securities, or other property belonging to the futures commission merchant in a DCO Physical Location, or deposit such money, securities, or other property in the Cleared Swaps Customer Accounts that the derivatives clearing organization maintains. The derivatives clearing organization may permit the futures commission merchant to withdraw such money, securities, or other property from a DCO Physical Location or Cleared Swaps Customer Account.

(e) *Exceptions; Permitted Investments.* Notwithstanding the foregoing and § 22.15 of this part, a derivatives clearing organization may invest the money, securities, or other property constituting Cleared Swaps Customer Collateral in accordance with § 1.25 of this chapter, which section 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.

§ 22.4 Futures Commission Merchants and Derivatives Clearing Organizations: Permitted Depositories.

In order for a depository to be a Permitted Depository:

(a) The depository must (subject to § 22.9) be one of the following types of entities:

(1) A bank located in the United States;

(2) A trust company located in the United States;

(3) A Collecting Futures Commission Merchant registered with the Commission (but only with respect to a Depositing Futures Commission Merchant providing Cleared Swaps Customer Collateral); or

(4) A derivatives clearing organization registered with the Commission; and

(b) The futures commission merchant or the derivatives clearing organization must hold a written acknowledgment letter from the depository as required by § 22.5 of this part.

§ 22.5 Futures Commission Merchants and Derivatives Clearing Organizations: Written Acknowledgement.

(a) Before depositing Cleared Swaps Customer Collateral, the futures commission merchant or derivatives clearing organization shall obtain and retain in its files a separate written acknowledgment letter from each depository in accordance with §§ 1.20 and 1.26 of this chapter, with all references to "customer funds" modified to apply to Cleared Swaps Customer Collateral, and with all references to section 4d(a) or 4d(b) of the Act and the regulations thereunder modified to apply to section 4d(f) of the Act and the regulations thereunder.

(b) The futures commission merchant or derivatives clearing organization shall adhere to all requirements specified in §§ 1.20 and 1.26 of this chapter regarding retaining, permitting access to, filing, or amending the written acknowledgment letter, in all cases as if the Cleared Swaps Customer Collateral comprised customer funds subject to segregation pursuant to section 4d(a) or 4d(b) of the Act and the regulations thereunder.

(c) Notwithstanding paragraph (a) of this section, an acknowledgement letter need not be obtained from a derivatives clearing organization that has made effective, pursuant to section 5c(c) of the Act and the regulations thereunder, rules that provide for the segregation of Cleared Swaps Customer Collateral, in accordance with all relevant provisions of the Act and the regulations thereunder.

§ 22.6 Futures Commission Merchants and Derivatives Clearing Organizations: Naming of Cleared Swaps Customer Accounts.

The name of each Cleared Swaps Customer Account that a futures commission merchant or a derivatives clearing organization maintains with a Permitted Depository shall (a) clearly identify the account as a "Cleared Swaps Customer Account" and (b) clearly indicate that the collateral therein is "Cleared Swaps Customer Collateral" subject to segregation in accordance with the Act and this part.

§ 22.7 Permitted Depositories: Treatment of Cleared Swaps Customer Collateral.

A Permitted Depository shall treat all funds in a Cleared Swaps Customer Account as Cleared Swaps Customer Collateral. A Permitted Depository shall not hold, dispose of, or use any such Cleared Swaps Customer Collateral as belonging to any person other than:

(a) The Cleared Swaps Customers of the futures commission merchant maintaining such Cleared Swaps Customer Account or;

(b) The Cleared Swaps Customers of the futures commission merchants for which the derivatives clearing organization maintains such Cleared Swaps Customer Account.

§ 22.8 Situs of Cleared Swaps Accounts.

The situs of each of the following shall be located in the United States:

(a) Each FCM Physical Location or DCO Physical Location;

(b) Each "account," within the meaning of § 22.2(f)(1), that a futures commission merchant maintains for each Cleared Swaps Customer; and

(c) Each Cleared Swaps Customer Account on the books and records of a derivatives clearing organization with respect to the Cleared Swaps Customers of a futures commission merchant.

§ 22.9 Denomination of Cleared Swaps Customer Collateral and Location of Depositories.

(a) Futures commission merchants and derivatives clearing organizations may hold Cleared Swaps Customer Collateral in the denominations, at the locations and depositories, and subject to the same segregation requirements specified in § 1.49 of this chapter, which section shall apply to such Cleared Swaps Customer Collateral as if it comprised customer funds subject to segregation pursuant to section 4d(a) of the Act.

(b) Each depository referenced in paragraph (a) of this section shall be considered a Permitted Depository for purposes of this part. *Provided, however,* that a futures commission merchant shall only be considered a Permitted Depository to the extent that it is acting as a Collecting Futures Commission Merchant (as § 22.1 of this part defines such term).

§ 22.10 Incorporation by Reference.

Sections 1.27, 1.28, 1.29, and 1.30 of this chapter shall apply to the Cleared Swaps Customer Collateral held by futures commission merchants and derivatives clearing organizations to the same extent as if such sections referred to:

(a) "Cleared Swaps Customer Collateral" in place of "customer funds;"

(b) "Cleared Swaps Customers" instead of "commodity or option customers" or "customers or option customers;"

(c) "Cleared Swaps Contracts" instead of "trades, contracts, or commodity options;" and

(d) "Section 4d(f) of the Act" instead of "section 4d(a)(2) of the Act."

§ 22.11 Information to be Provided Regarding Customers and their Cleared Swaps.

(a) Each Depositing Futures Commission Merchant shall provide to its Collecting Futures Commission Merchant the following information:

(1) The first time that the Depositing Futures Commission Merchant intermediates a Cleared Swap for a Cleared Swaps Customer, information sufficient to identify such customer; and

(2) At least once each business day thereafter, information sufficient to identify, for each Cleared Swaps Customer, the portfolio of rights and obligations arising from the Cleared Swaps that the Depositing Futures Commission Merchant intermediates for such customer.

(b) If an entity serves as both a Depositing Futures Commission Merchant and a Collecting Futures Commission Merchant, then:

(1) The information that such entity must provide to its Collecting Futures Commission Merchant pursuant to paragraph (a)(1) of this section shall also include information sufficient to identify each Cleared Swaps Customer of the Depositing Futures Commission Merchant for which such entity serves as a Collecting Futures Commission Merchant; and

(2) The information that such entity must provide to its Collecting Futures Commission Merchant pursuant to paragraph (a)(2) of this section shall also include information sufficient to identify, for each Cleared Swaps Customer referenced in paragraph (b)(1) of this section, the portfolio of rights and obligations arising from the Cleared Swaps that such entity intermediates as a Collecting Futures Commission Merchant, on behalf of its Depositing Futures Commission Merchant, for such customer.

(c) Each futures commission merchant that intermediates a Cleared Swap for a Cleared Swaps Customer, on or subject to the rules of a derivatives clearing organization, directly as a Clearing Member shall provide to such derivatives clearing organization the following information:

(1) The first time that such futures commission merchant intermediates a Cleared Swap for a Cleared Swaps Customer, information sufficient to identify such customer; and

(2) At least once each business day thereafter, information sufficient to identify, for each Cleared Swaps Customer, the portfolio of rights and obligations arising from the Cleared Swaps that such futures commission merchant intermediates for such customer.

(d) If the futures commission merchant referenced in paragraph (c) of this section is a Collecting Futures Commission Merchant, then:

(1) The information that it must provide to the derivatives clearing organization pursuant to paragraph (c)(1) of this section shall also include information sufficient to identify each Cleared Swaps Customer of any entity that acts as a Depositing Futures Commission Merchant in relation to the Collecting Futures Commission Merchant (including, without limitation, each Cleared Swaps Customer of any Depositing Futures Commission Merchant for which such entity also serves as a Collecting Futures Commission Merchant); and

(2) The information that it must provide to the derivatives clearing organization pursuant to paragraph (c)(2) of this section shall also include information sufficient to identify, for each Cleared Swaps Customer referenced in paragraph (d)(1) of this section, the portfolio of rights and obligations arising from the Cleared Swaps that the Collecting Futures Commission Merchant intermediates, on behalf of the Depositing Futures Commission Merchant, for such customer.

(e) Each derivatives clearing organization shall (1) take appropriate steps to confirm that the information it receives pursuant to paragraphs (c)(1) or (c)(2) of this section is accurate and complete, and (2) ensure that the futures commission merchant is providing the derivatives clearing organization the information required by paragraphs (c)(1) or (c)(2) of this section on a timely basis.

§ 22.12 Information to be Maintained Regarding Cleared Swaps Customer Collateral.

(a) Each Collecting Futures Commission Merchant receiving Cleared Swaps Customer Funds from an entity serving as a Depositing Futures Commission Merchant shall, no less frequently than once each business day, calculate and record:

(1) the amount of collateral required at such Collecting Futures Commission Merchant for each Cleared Swaps Customer of the entity acting as Depositing Futures Commission Merchant (including, without limitation, each Cleared Swaps Customer of any Depositing Futures Commission Merchant for which such entity also serves as a Collecting Futures Commission Merchant); and

(2) the sum of the individual collateral amounts referenced in paragraph (a)(1) of this section.

(b) Each Collecting Futures Commission Merchant shall calculate the collateral amounts referenced in paragraph (a) of this section with respect to the portfolio of rights and obligations arising from the Cleared Swaps that the Collecting Futures Commission Merchant intermediates, on behalf of the Depositing Futures Commission Merchant, for each Cleared Swaps Customer referenced in paragraph (a)(1).

(c) Each derivatives clearing organization receiving Cleared Swaps Customer Funds from a futures commission merchant shall, no less frequently than once each business day, calculate and record:

(1) The amount of collateral required at such derivatives clearing organization for each Cleared Swaps Customer of the futures commission merchant; and

(2) the sum of the individual collateral amounts referenced in paragraph (c)(1) of this section.

(d) If the futures commission merchant referenced in paragraph (c) of this section is a Collecting Futures Commission Merchant, then the derivatives clearing organization shall also perform and record the results of the calculation required in paragraph (c) of this section for each Cleared Swaps Customer of an entity acting as a Depositing Futures Commission Merchant in relation to the Collecting Futures Commission Merchant (including, without limitation, any Cleared Swaps Customer for which such entity is also acting as a Collecting Futures Commission Merchant).

(e) Each futures commission merchant shall calculate the collateral amounts referenced in paragraph (c) of this section with respect to the portfolio of rights and obligations arising from the Cleared Swaps that the futures commission merchant intermediates (including, without limitation, as a Collecting Futures Commission Merchant on behalf of a Depositing Futures Commission Merchant), for each Cleared Swaps Customer referenced in paragraphs (c)(1) and (d).

(f) The collateral requirement referenced in paragraph (a) of this section with respect to a Collecting Futures Commission Merchant shall be no less than that imposed by the relevant derivatives clearing organization with respect to the same portfolio of rights and obligations for each relevant Cleared Swaps Customer.

§ 22.13 Additions to Cleared Swaps Customer Collateral.

(a)(1) At the election of the derivatives clearing organization or Collecting Futures Commission Merchant, the collateral requirement referred to in § 22.12(a), (c), and (d) of this part applicable to a particular Cleared Swaps Customer or group of Cleared Swaps Customers may be increased based on an evaluation of the credit risk posed by such customer or group, in which case the derivatives clearing organization or Collecting Futures Commission Merchant shall collect and record such higher amount as provided in section 22.12 of this part.

(2) Nothing in paragraph (a)(1) of this section is intended to interfere with the right of a futures commission merchant to increase the collateral requirements at such futures commission merchant with respect to any of its Cleared Swaps Customers or Customers.

(b) Any collateral deposited by a futures commission merchant (including a Depositing Futures Commission Merchant) pursuant to § 22.2(e)(3) of this part, which collateral is identified as funds or securities in which such futures commission merchant has a residual financial interest pursuant to § 22.2(e)(4) of this part, may, to the extent of such residual financial interest, be used by the derivatives clearing organization or Collecting Futures Commission Merchant, as applicable, to margin, guarantee or secure the cleared swaps of any or all of such Cleared Swaps Customers.

§ 22.14 Futures Commission Merchant Failure to Meet a Customer Margin Call in Full.

(a) A Depositing Futures Commission Merchant which receives a call for either initial margin or variation margin with respect to a Cleared Swaps Customer Account from a Collecting Futures Commission Merchant, which call such Depositing Futures Commission Merchant does not meet in full, shall, with respect to each Cleared Swaps Customer of such Depositing Futures Commission Merchant whose Cleared Swaps contribute to such margin call,

(1) Transmit to the Collecting Futures Commission Merchant an amount equal to the lesser of

(i) The amount called for; or

(ii) The remaining Cleared Swaps Collateral on deposit at such Depositing Futures Commission Merchant for that Cleared Swaps Customer; and

(2) Advise the Collecting Futures Commission Merchant of the identity of each such Cleared Swaps Customer, and the amount transmitted on behalf of each such customer.

(b) If the entity acting as Depositing Futures Commission Merchant referenced in paragraph (a) of this section is also a Collecting Futures Commission Merchant, then:

(1) Such entity shall include in the transmission required in paragraph (a)(1) of this section any amount that it receives, pursuant to paragraph (a)(1) of this section, from a Depositing Futures Commission Merchant for which such entity acts as a Collecting Futures Commission Merchant; and

(2) Such entity shall present its Collecting Futures Commission Merchant with the information that it receives, pursuant to paragraph (a)(2) of this section, from a Depositing Futures Commission Merchant for which such

entity acts as a Collecting Futures Commission Merchant.

(c) A futures commission merchant which receives a call for margin (whether initial or variation) with respect to a Cleared Swaps Customer Account from a derivatives clearing organization, which call such futures commission merchant does not meet in full, shall, with respect to each Cleared Swaps Customer of such futures commission merchant whose Cleared Swaps contribute to such margin call:

(1) Transmit to the derivatives clearing organization an amount equal to the lesser of

(i) The amount called for; or

(ii) The remaining Cleared Swaps Collateral on deposit at such futures commission merchant for each such Cleared Swaps Customer; and

(2) advise the derivatives clearing organization of the identity of each such Cleared Swaps Customer, and the amount transmitted on behalf of each such customer.

(d) If the futures commission merchant referenced in paragraph (c) is a Collecting Futures Commission Merchant, then:

(1) Such Collecting Futures Commission Merchant shall include in the transmission required in paragraph (c)(1) of this section any amount that it receives from a Depositing Futures Commission Merchant pursuant to paragraph (a)(1) of this section; and

(2) Such Collecting Futures Commission shall present the derivatives clearing organization with the information that it receives from a Depositing Futures Commission Merchant pursuant to paragraph (a)(2) of this section.

(e) If,

(1) On the business day prior to the business day on which the Depositing Futures Commission Merchant fails to meet a margin call with respect to a Cleared Swaps Customer Account, such Collecting Futures Commission Merchant referenced in paragraph (a) of this section held, with respect to such account, Cleared Swaps Collateral of a value no less than the amount specified in § 22.12(a)(2) of this part, after the application of haircuts specified by policies applied by such Collecting Futures Commission Merchant in its relationship with the Depositing Futures Commission Merchant, and

(2) As of the close of business on the business day on which the margin call is not met, the market value of the Cleared Swaps Collateral held by the derivatives clearing organization or Collecting Futures Commission Merchant is, due to changes in such market value, less than the amount specified in § 22.12(a)(2) of this part, then the amount of such collateral attributable to each Cleared Swaps Customer pursuant to § 22.12(a)(1) of this part shall be reduced by the percentage difference between the amount specified in § 22.12(a)(2) of this part and such market value.

(f) If:

(1) On the business day prior to the business day on which the futures commission merchant fails to meet a margin call with respect to a Cleared Swaps Customer Account, the derivatives clearing organization referenced in paragraph (c) of this section held, with respect to such account, Cleared Swaps Collateral of a value no less than the amount specified in § 22.12(c)(2) of this part, after the application of haircuts specified by the rules and procedures of such derivatives clearing organization, and

(2) As of the close of business on the business day on which the margin call is not met, the market value of the Cleared Swaps Collateral held by the derivatives clearing organization is, due to changes in such market value, less than the amount specified in § 22.12(c)(2) of this part, then the amount of collateral attributable to each Cleared Swaps Customer pursuant to § 22.12(c)(1) of this part shall be reduced by the percentage difference between the amount specified in § 22.12(c)(2) and such market value.

§ 22.15 Treatment of Cleared Swaps Customer Collateral on an Individual Basis.

Subject to § 22.3(e) of this part, each derivatives clearing organization and each Collecting Futures Commission Merchant receiving Cleared Swaps Customer Collateral from a Depositing Futures Commission Merchant shall treat the value of collateral required with respect to the portfolio of rights and obligations arising out of the Cleared Swaps intermediated for each Cleared Swaps Customer, and collected from the Depositing Futures Commission Merchant, as belonging to such customer, and such amount shall not be used to margin, guarantee, or secure the Cleared Swaps or other obligations of the Depositing Futures Commission Merchant or of any other Cleared Swaps Customer or Customer.

§ 22.16 Disclosures to Customers.

(a) A futures commission merchant shall disclose, to each of its Cleared Swaps Customers, the governing provisions, as described in paragraph (c) of this section, relating to use of Cleared Swaps Customer Collateral, transfer, neutralization of the risks, or liquidation of Cleared Swaps in the event of a default by the futures commission merchant relating to the Cleared Swaps Customer Account, as well as any change in such governing provisions.

(b) If the futures commission merchant referenced in paragraph (a) of this section is a Depositing Futures Commission Merchant, then such futures commission merchant shall disclose, to each of its Cleared Swaps Customers, the governing provisions, as described in paragraph (c) of this section, relating to use of Cleared Swaps Customer Collateral, transfer, neutralization of the risks, or liquidation of Cleared Swaps in the event of a default by:

(1) Such futures commission merchant or

(2) Any relevant Collecting Futures Commission Merchant relating to the Cleared Swaps Customer Account, as well as any change in such governing provisions.

(c) The governing provisions referred to in paragraphs (a) and (b) of this section are the rules of each derivatives clearing organization, or the provisions of the customer agreement between the Collecting Futures Commission Merchant and the Depositing Futures Commission Merchant, on or through which the Depositing Futures Commission Merchant will intermediate Cleared Swaps for such Cleared Swaps Customer.

PART 190—BANKRUPTCY

2. The authority citation for part 190 continues to read as follows:

Authority: 7 U.S.C. 1a, 2, 4a, 6c, 6d, 6g, 7a, 12, 19, and 24, and 11 U.S.C. 362, 546, 548, 556, and 761–766, unless otherwise noted.

3. In 17 CFR Part 190:

A. Remove the words "commodity account" and "commodity futures account" and add, in their place, the words "commodity contract account" in:

i. Sections 190.01(w), (y), and (kk)(6),

ii. Sections 190.02(d)(1), (6), and (7),

iii. Section 190.03(a)(2),

iv. Sections 190.06(g)(1)(i), (ii), and (3),

v. Sections 190.10(d)(1) and (h),

B. Remove the words "commodity futures contract" and add, in their place, the words "commodity contract" in § 190.05(a)(1) and (b)(1).

C. *Remove the words "contract market" and "board of trade" and add, in their place, the words "designated contract market" in:*

i. Sections 190.01(gg), (kk)(2)(i), (4) and (5),

ii. Section 190.04(d)(1)(i), and

iii. Section 190.07(e)(2)(ii)(B) Remove the words "commodity transaction" and

add, in their place, the words "commodity contract transaction" in § 190.02(d)(3).

4. In § 190.01, redesignate paragraphs (e) through (oo) as (f) through (pp), add a new paragraph (e) and revise paragraphs (a), (f), and newly redesignated paragraphs (cc), (hh), (ll)(2)(ii), (ll)(4), (ll)(5), and (pp) to read as follows:

§ 190.01 Definitions.

* * * * *

(a)(1) *Account class* means each of the following types of customer accounts which must be recognized as a separate class of account by the trustee: futures accounts, foreign futures accounts, leverage accounts, delivery accounts as defined in § 190.05(a)(2) of this part, and cleared swaps accounts.

(2)(i) To the extent that the equity balance, as defined in § 190.07 of this part, of a customer in a commodity option, as defined in § 1.3 of this chapter, may be commingled with the equity balance of such customer in any domestic commodity futures contract pursuant to regulations under the Act, the aggregate shall be treated for purposes of this part as being held in a futures account.

(ii) To the extent that such equity balance of a customer in a commodity option may be commingled with the equity balance of such customer in any cleared swaps account pursuant to regulations under this act, the aggregate shall be treated for purposes of this part as being held in a cleared swaps account.

(iii) If positions or transactions in commodity contracts that would otherwise belong to one account class (and the money, securities, or other property margining, guaranteeing, or securing such positions or transactions), are, 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), held separately from other positions and transactions in that account class, and are commingled with positions or transactions in commodity contracts of another account class (and the money, securities, or other property margining, guaranteeing, or securing such positions or transactions), then the former positions (and the relevant money, securities, or other property) shall be treated, for purposes of this part, as being held in an account of the latter account class.

* * * * *

(e) *Calendar day.* A calendar day includes the time from midnight to midnight.

(f) *Clearing organization* shall have the same meaning as that set forth in section 761(2) of the Bankruptcy Code.

* * * * *

(cc) *Non-public customer* means any person enumerated in the definition of *Proprietary Account* in sections 1.3 or 31.4(e) of this chapter, any person excluded from the definition of "foreign futures or foreign options customer" in the proviso to section 30.1(c) of this chapter, or any person enumerated in the definition of *Cleared Swaps Proprietary Account* in section 22.1 of this chapter, in each case, if such person is defined as a "customer" under paragraph (k) of this section.

* * * * *

(hh) *Principal contract* means a contract which is not traded on a designated contract market, and includes leverage contracts and dealer options, but does not include:

(1) Transactions executed off the floor of a designated contract market pursuant to rules approved by the Commission or rules which the designated contract market is required to enforce, or pursuant to rules of a foreign board of trade located outside the United States, its territories or possessions; or (2) cleared swaps contracts.

* * * * *

(ll) * * *

(2) * * *

(ii) Is a bona fide hedging position or transaction as defined in § 1.3 of this chapter or is a commodity option transaction which has been determined by the registered entity to be economically appropriate to the reduction of risks in the conduct and management of a commercial enterprise pursuant to rules which have been approved by the Commission pursuant to section 5c(c) of the Commodity Exchange Act; and

* * * * *

(4) Any cash or other property deposited prior to the entry of the order for relief to pay for the taking of physical delivery on a long commodity contract or for payment of the strike price upon exercise of a short put or a long call option contract on a physical commodity, which cannot be settled in cash, in excess of the amount necessary to margin such commodity contract prior to the notice date or exercise date, which cash or other property is identified on the books and records of the debtor as received from or for the account of a particular customer on or after three calendar days before the first notice date or three calendar days before the exercise date specifically for the purpose of payment of the notice price upon taking delivery or the strike price upon exercise, respectively, and such customer takes delivery or exercises the option in accordance with the applicable contract market rules.

(5) The cash price tendered for any property deposited prior to the entry of the order for relief to make physical delivery on a short commodity contract or for exercise of a long put or a short call option contract on a physical commodity, which cannot be settled in cash, to the extent it exceeds the amount necessary to margin such contract prior to the notice date or exercise date, which property is identified on the books and records of the debtor as received from or for the account of a particular customer on or after three calendar days before the first notice date or three calendar days before the exercise date specifically for the purpose of a delivery or exercise, respectively, and such customer makes delivery or exercises the option in accordance with the applicable contract market rules.

* * * * *

(pp) *Cleared Swap.* This term shall have the same meaning as set forth in § 22.1 of this chapter.

* * * * *

5. In § 190.02, revise paragraphs (a), (b)(1), (b)(2), (d)(11), (e), (f)(1), and (g)(2)(i) to read as follows:

§ 190.02 Operation of the debtor's estate subsequent to the filing date and prior to the primary liquidation date.

* * * * *

(a) *Notices to the Commission and Designated Self-Regulatory Organizations—*

(1) *General.* Each commodity broker which files a petition in bankruptcy shall, at or before the time of such filing, and each commodity broker against which such a petition is filed shall, as soon as possible, but no later than one calendar day after the receipt of notice of such filing, notify the Commission and such broker's designated self-regulatory organization, if any, in accordance with § 190.10(a) of the filing date, the court in which the proceeding has been filed, and the docket number assigned to that proceeding by the court.

(2) *Of transfers under section 764(b) of the Bankruptcy Code.* As soon as possible, but in no event later than the close of business on third calendar day after the order for relief, the trustee, the applicable self-regulatory organization, or the commodity broker must notify the Commission in accordance with § 190.10(a) whether such entity or organization intends to transfer or to apply to transfer open commodity contracts on behalf of the commodity

broker in accordance with section 764(b) of the Bankruptcy Code and § 190.06(e) or (f).

(b) *Notices to customers.* (1) *Specifically identifiable property other than commodity contracts.* The trustee must use its best efforts to promptly, but in no event later than two calendar days after entry of the order for relief, commence to publish in a daily newspaper or newspapers of general circulation approved by the court serving the location of each branch office of the commodity broker, for two consecutive days a notice to customers stating that all specifically identifiable property of customers other than open commodity contracts which has not otherwise been liquidated will be liquidated commencing on the sixth calendar day after the second publication date if the customer has not instructed the trustee in writing on or before the fifth calendar day after the second publication date to return such property pursuant to the terms for distribution of specifically identifiable property contained in § 190.08(d)(1) and, on the seventh calendar day after such second publication date, if such property has not been returned in accordance with such terms on or prior to that date. Such notice must describe specifically identifiable property in accordance with the definition in this part and must specify the terms upon which that property may be returned. Publication of the form of notice set forth in the appendix to this part will constitute sufficient notice for purposes of this paragraph (b)(1).

(2) *Request for instructions regarding transfer of open commodity contracts.* The trustee must use its best efforts to request promptly, but in no event later than two calendar days after entry of an order for relief, customer instructions concerning the transfer or liquidation of the specifically identifiable open commodity contracts, if any, not required to be liquidated under paragraph (f)(1) of this section. The request for customer instructions required by this paragraph (b)(2) must state that the trustee is required to liquidate any such commodity contract for which transfer instructions have not been received on or before the sixth calendar day after entry of the order for relief, and any such commodity contract for which instructions have been received which has not been transferred in accordance with § 190.08(d)(2) on or before the seventh calendar day after entry of the order for relief. A form of notice is set forth in the appendix to this part.

* * * * *

(d) * * *

(11) Whether the claimant's positions in security futures products are held in a futures account or a securities account, as these terms are defined in § 1.3 of this chapter;

(e) *Transfers*—(1) *All cases.* The trustee for a commodity broker must immediately use its best efforts to effect a transfer in accordance with § 190.06(e) and (f) no later than the seventh calendar day after the order for relief of the open commodity contracts and equity held by the commodity broker for or on behalf of its customers.

(2) *Involuntary cases.* A commodity broker against which an involuntary petition in bankruptcy is filed, or the trustee if a trustee has been appointed in such case, must use its best efforts to effect a transfer in accordance with § 190.06(e) and (f) of all open commodity contracts and equity held by the commodity broker for or on behalf of its customers and such other property as the Commission in its discretion may authorize, on or before the seventh calendar day after the filing date, and immediately cease doing business: *Provided, however,* That the commodity broker may trade for liquidation only, unless otherwise directed by the Commission, by any applicable self-regulatory organization or by the court: And, *Provided further,* That if the commodity broker demonstrates to the Commission within such period that it was in compliance with the segregation and financial requirements of this chapter on the filing date, and the Commission determines, in its sole discretion, that such transfer or liquidation is neither appropriate nor in the public interest, the commodity broker may continue in business subject to applicable provisions of the Bankruptcy Code and of this chapter.

(f) * * *

(1) *Open commodity contracts.* All open commodity contracts except:

(i) Dealer option contracts, if the dealer option grantor is not the debtor, which cannot be transferred on or before the seventh calendar day after the order for relief; and

(ii) Specifically identifiable commodity contracts as defined in § 190.01(kk)(2) for which an instruction prohibiting liquidation is noted prominently in the accounting records of the debtor and timely received under paragraph (b)(2) of this section. Notwithstanding the foregoing, an open commodity contract must be offset if: such contract is a futures contract or a cleared swaps contract which cannot be settled in cash and which would otherwise remain open either beyond the last day of trading (if applicable), or the first day on which notice of intent to deliver may be tendered with respect thereto, whichever occurs first; such contract is a long option on a physical commodity which cannot be settled in cash and would be automatically exercised, has value and would remain open beyond the last day for exercise; such contract is a short option on a physical commodity which cannot be settled in cash; or, as otherwise specified in these rules.

* * * * *

(g) * * *

(2) * * *

(i) 100% of the maintenance margin requirements of the applicable designated contact market or swap execution facility, if any, with respect to the open commodity contracts in such account; or

* * * * *

6. In § 190.03, revise paragraphs (a)(3), (b)(3), (b)(4), (b)(5), and (c) to read as follows:

§ 190.03 Operation of the debtor's estate subsequent to the primary liquidation date.

* * * * *

(a) * * *

(3) *Margin calls.* The trustee must promptly issue margin calls with respect to any account referred to under paragraph (a)(1) of this section in which the balance does not equal or exceed 100% of the maintenance margin requirements of the applicable designated contact market or swap execution facility, if any, with respect to the open commodity contracts in such account, or if there are no such maintenance margin requirements, 100% of the clearing organization's initial margin requirements applicable to the open commodity contracts in such account, or if there are no such maintenance margin requirements or clearing organization initial margin requirements, then 50% of the customer initial margin applicable to the commodity contracts in such account: *Provided,* That no margin calls need be made to restore customer initial margin.

* * * * *

(b) * * *

(3) The trustee has received no customer instructions with respect to such contract by the sixth calendar day after entry of the order for relief;

(4) The commodity contract has not been transferred in accordance with § 190.08(d)(2) on or before the seventh calendar day after entry of the order for relief; or

(5) The commodity contract would otherwise remain open (*e.g.,* because it cannot be settled in cash) beyond the last day of trading in such contract (if

applicable) or the first day on which notice of delivery may be tendered with respect to such contract, whichever occurs first.

(c) *Liquidation of specifically identifiable property other than open commodity contracts.*

All specifically identifiable property other than open commodity contracts which have not been liquidated prior to the primary liquidation date, and for which no customer instructions have been timely received must be liquidated, to the extent reasonably possible, no later than the sixth calendar day after final publication of the notice referred to in § 190.02(b)(1). All other specifically identifiable property must be liquidated or returned, to the extent reasonably possible, no later than the seventh calendar day after final publication of such notice.

7. In § 190.04, revise paragraph (d)(1) to read as follows:

§ 190.04 Operation of the debtor's estate—general.

* * * * *

(d) *Liquidation*—(1) *Order of Liquidation.* (i) *In the Market.* Liquidation of open commodity contracts held for a house account or customer account by or on behalf of a commodity broker which is a debtor shall be accomplished pursuant to the rules of a clearing organization, a designated contract market, or a swap execution facility, as applicable. Such rules shall ensure that the process for liquidating open commodity contracts, whether for the house account or the customer account, results in competitive pricing, to the extent feasible under market conditions at the time of liquidation. Such rules must be submitted to the Commission for approval, pursuant to section 5c(c) of the Act, and be approved by the Commission. Alternatively, such rules must otherwise be submitted to and approved by the Commission (or its delegate pursuant to § 190.10(d) of this part) prior to their application.

(ii) *Book entry.* Notwithstanding paragraph (d)(1) of this section, in appropriate cases, upon application by the trustee or the affected clearing organization, the Commission may permit open commodity contracts to be liquidated, or settlement on such contracts to be made, by book entry. Such book entry shall offset open commodity contracts, whether matched or not matched on the books of the commodity broker, using the settlement price for such commodity contracts as determined by the clearing organization. Such settlement price shall be determined by the rules of the clearing organization, which shall ensure that such settlement price is established in a competitive manner, to the extent feasible under market conditions at the time of liquidation. Such rules must be submitted to the Commission for approval pursuant to section 5c(c) of the Act, and be approved by the Commission. Alternatively, such rules must otherwise be approved by the Commission (or its delegate pursuant to § 190.10(d) of this part) prior to their application.

* * * * *

8. In § 190.05, revise paragraph (b) introductory text to read as follows:

§ 190.05 Making and taking delivery on commodity contracts.

* * * * *

(b) Rules for deliveries on behalf of a customer of a debtor. Except in the case of a commodity contract which is settled in cash, each designated contract market, swap execution facility, or clearing organization shall adopt, maintain in effect and enforce rules which have been submitted in accordance with section 5c(c) of the Act for approval by the Commission, which:

* * * * *

9. In § 190.06, remove paragraph (e)(1)(iv) and redesignate paragraph (e)(1)(v) as (e)(1)(iv), revise paragraphs (a), (e)(1)(iii), (e)(2), (f)(3)(i) and (g)(2), and add paragraph (g)(1)(iii) to read as follows:

§ 190.06 Transfers.

(a) *Transfer rules.* No clearing organization or other self-regulatory organization may adopt, maintain in effect or enforce rules which:

(1) Are inconsistent with the provisions of this part;

(2) Interfere with the acceptance by its members of open commodity contracts and the equity margining or securing such contracts from futures commission merchants, or persons which are required to be registered as futures commission merchants, which are required to transfer accounts pursuant to § 1.17(a)(4) of this chapter; or

(3) Prevent the acceptance by its members of transfers of open commodity contracts and the equity margining or securing such contracts from futures commission merchants with respect to which a petition in bankruptcy has been filed, if such transfers have been approved by the Commission. *Provided, however,* that this paragraph shall not limit the exercise of any contractual right of a clearing organization or other registered entity to liquidate open commodity contracts.

* * * * *

(e) * * *

(1) * * *

(iii) Dealer option accounts, if the debtor is the dealer option grantor with respect to such accounts; or

* * * * *

(2) Amount of equity which may be transferred. In no case may money, securities or property be transferred in respect of any eligible account if the value of such money, securities or property would exceed the funded balance of such account based on available information as of the calendar day immediately preceding transfer less the value on the date of return or transfer of any property previously returned or transferred with respect thereto.

(f) * * *

(3) * * *

(i) If all eligible customer accounts held by a debtor cannot be transferred under this section, a partial transfer may nonetheless be made. The Commission will not disapprove such a transfer for the sole reason that it was a partial transfer if it would prefer the transfer of accounts, the liquidation of which could adversely affect the market or the bankrupt estate. Any dealer option contract held by or for the account of a debtor which is a futures commission merchant from or for the account of a customer which has not previously been transferred, and is eligible for transfer, must be transferred on or before the seventh calendar day after entry of the order for relief.

* * * * *

(g) * * *

(1) * * *

(iii) The transfer prior to the order for relief by a clearing organization of one or more accounts held for or on behalf of customers of the debtor, provided that (I) the money, securities, or other property accompanying such transfer did not exceed the funded balance of each account based on available information as of the close of business on the business day immediately preceding such transfer less the value on the date of return or transfer of any property previously returned or transferred thereto, and (II) the transfer is not disapproved by the Commission.

(2) *Post-relief transfers.* On or after the entry of the order for relief, the following transfers to one or more transferees may not be avoided by the trustee:

(i) The transfer of a customer account eligible to be transferred under paragraph (e) or (f) of this section made by the trustee of the commodity broker or by any self-regulatory organization of the commodity broker:

(A) On or before the seventh calendar day after the entry of the order for relief; and

(B) The Commission is notified in accordance with § 190.02(a)(2) prior to the transfer and does not disapprove the transfer; or

(ii) The transfer of a customer account at the direction of the Commission on or before the seventh calendar day after the order for relief upon such terms and conditions as the Commission may deem appropriate and in the public interest.

* * * * *

10. In § 190.07, redesignate paragraph (b)(2)(xiii) as paragraph (b)(2)(xiv), add a new paragraph (b)(2)(xiii), and revise paragraphs (b)(2)(viii), (b)(2)(ix), (b)(3)(v), (c)(1)(i), (e) introductory text, (e)(1) and (e)(4) to read as follows:

§ 190.07 Calculation of allowed net equity.

* * * * *

(b) * * *

(2) * * *

(viii) Subject to paragraph (b)(2)(ix) of this section, the futures accounts, leverage accounts, options accounts, foreign futures accounts, delivery accounts (as defined in § 190.05(a)(2)), and cleared swaps accounts of the same person shall not be deemed to be held in separate capacities: *Provided, however,* that such accounts may be aggregated only in accordance with paragraph (b)(3) of this section.

(ix) an omnibus customer account of a futures commission merchant maintained with a debtor shall be deemed to be held in a separate capacity from the house account and any other omnibus customer account of such futures commission merchant.

* * * * *

(xiii) with respect to the cleared swaps customer account class, each individual customer account within each omnibus customer account referred to in paragraph (ix) of this section shall be deemed to be held in a separate capacity from each other such individual customer account; subject to the provisions of paragraphs (i) through (xii) of this paragraph (b)(2).

* * * * *

(3) * * *

(v) The rules pertaining to separate capacities and permitted setoffs contained in this section must be applied subsequent to the entry of an order for relief; prior to the filing date, the provisions of § 1.22 of this chapter and of sections 4d(a)(2) and 4d(f) of the Act shall govern what setoffs are permitted.

* * * * *

(c) * * *

(1) * * *

(i) Multiplying the ratio of the amount of the net equity claim less the amounts referred to in (c)(1)(ii) of this section of such customer for any account class bears to the sum of the net equity claims less the amounts referred to in (c)(1)(ii) of this section of all customers for accounts of that class by the sum of:

(A) The value of the money, securities or property segregated on behalf of all accounts of the same class less the amounts referred to in (1)(ii) of this section;

(B) The value of any money, securities or property which must be allocated under § 190.08 to customer accounts of the same class; and

(C) The amount of any add-back required under paragraph (b)(4) of this section; and

* * * * *

(e) *Valuation.* In computing net equity, commodity contracts and other property held by or for a commodity broker must be valued as provided in this paragraph (e): *Provided, however,* that for all commodity contracts other than those listed in paragraph (e)(1) of this section, if identical commodity contracts, securities, or other property are liquidated on the same date, but cannot be liquidated at the same price, the trustee may use the weighted average of the liquidation prices in computing the net equity of each customer holding such contracts, securities, or property.

(1) *Commodity Contracts.* Unless otherwise specified in this paragraph (e), the value of an open commodity contract shall be equal to the settlement price as calculated by the clearing organization pursuant to its rules: *Provided,* that such rules must either be submitted to the Commission, pursuant to section 5c(c)(4) of the Act and be approved by the Commission, or such rules must be otherwise approved by the Commission (or its delegate pursuant to § 190.10(d) of this part) prior to their application; *Provided, further,* that if such contract is transferred its value shall be determined as of the end of the settlement cycle in which it is transferred; and *Provided, finally,* that if such contract is liquidated, its value shall be equal to the net proceeds of liquidation.

* * * * *

(4) *Securities.* The value of a listed security shall be equal to the closing price for such security on the exchange upon which it is traded. The value of all securities not traded on an exchange shall be equal in the case of a long position, to the average of the bid prices for long positions, and in the case of a short position, to the average of the asking prices for the short positions. If liquidated prior to the primary liquidation date, the value of such security shall be equal to the net proceeds of its liquidation. Securities which are not publicly traded shall be valued by the trustee, subject to approval of the court, using such professional assistance as the trustee deems necessary in its sole discretion under the circumstances.

* * * * *

11. In § 190.09, revise paragraph (b) to read as follows:

§ 190.09 Member property.

* * * * *

(b) *Scope of Member Property.* Member property shall include all money, securities and property received, acquired, or held by a clearing organization to margin, guarantee or secure, on behalf of a clearing member, the proprietary account, as defined in § 1.3 of this chapter, any account not belonging to a foreign futures or foreign options customer pursuant to the proviso in § 30.1(c), and any Cleared Swaps Proprietary Account, as defined in § 22.1: *Provided, however,* that any guaranty deposit or similar payment or deposit made by such member and any capital stock, or membership of such member in the clearing organization shall also be included in member property after payment in full of that portion of the net equity claim of the member based on its customer account and of any obligations due to the clearing organization which may be paid therefrom in accordance with the by-laws or rules of the clearing organization, including obligations due from the clearing organization to customers or other members.

12. In § 190.10, revise paragraph (a) to read as follows:

§ 190.10 General.

(a) *Notices.* Unless instructed otherwise by the Commission, all mandatory or discretionary notices to be given to the Commission under this part shall be directed by electronic mail to *bankruptcyfilings@cftc.gov*, with a copy sent by overnight mail to Director, Division of Clearing and Intermediary Oversight, Commodity Futures Trading Commission, Three Lafayette Centre, 1155 21st Street, NW., Washington, DC 20581. For purposes of this part, notice to the Commission shall be deemed to be given only upon actual receipt.

* * * * *

13. Revise Appendix A to Part 190 to read as follows:

Appendix A to Part 190—Bankruptcy Forms

Bankruptcy Appendix Form 1—Operation of the Debtor's Estate—Schedule of Trustee's Duties

For the convenience of a prospective trustee, the Commission has constructed an approximate schedule of important duties which the trustee should perform during the early stages of a commodity broker bankruptcy proceeding. The schedule includes duties required by this part, subchapter IV of chapter 7 of the Bankruptcy Code as well as certain practical suggestions, but it is only intended to highlight the more significant duties and is not an exhaustive description of all the trustee's responsibilities. It also assumes that the commodity broker being liquidated is an FCM. Moreover, it is important to note that the operating facts in a particular bankruptcy proceeding may vary the schedule or obviate the need for any of the particular activities.

All Cases

Date of Order for Relief

1. Assure that the commodity broker has notified the Commission, its designated self-regulatory organization ("DSRO") (if any), and all applicable clearing organizations of which it is a member that a petition or order for relief has been filed (§ 190.02(a)(1)).

2. Attempt to effectuate the transfer of entire customer accounts wherein the commodity contracts are transferred together with the money, securities, or other property margining, guaranteeing, or securing the commodity contracts (hereinafter the "transfer").

3. Attempt to estimate shortfall of customer funds segregated pursuant to sections 4d(a) and (b) of the Act; customer funds segregated pursuant to section 4f of the Act; and the foreign futures or foreign options secured amount, as defined in § 1.3 of this chapter.

a. The trustee should:

i. Contact the DSRO (if any) and the clearing organizations and attempt to effectuate a transfer with such shortfall under section 764(b) of the Code; notify the Commission for assistance (§ 190.02(a)(2) and (e)(1), § 190.06(b)(2), (e), (f)(3), (g)(2), and (h)) but recognize that if there is a substantial shortfall, a transfer of such funds or amounts is highly unlikely.

ii. If a transfer cannot be effectuated, liquidate all customer commodity contracts that are margined, guaranteed, or secured by funds or amounts with such shortfall, except dealer options and specifically identifiable commodity contracts which are bona fide hedging positions (as defined in § 190.01(kk)(2)) with instructions not to be liquidated. (See §§ 190.02(f) and 190.06(d)(1)). (In this connection, depending upon the size of the debtor and other complications of liquidation, the trustee should be aware of special liquidation rules, and in particular the availability under certain circumstances of book-entry liquidation (§ 190.04(d)(1)(ii)).

b. If there is a small shortfall in any of the funds or amounts listed in paragraph 2, negotiate with the clearing organization to effect a transfer; notify the Commission (§§ 190.02(a)(2) and (e)(1), 190.06(b)(2), (e), (f)(3), (g)(2), and (h)).

4. Whether or not a transfer has occurred, liquidate or offset open commodity contracts not eligible for transfer (*i.e.,* deficit accounts, accounts with no open positions) (§ 190.06(e)(1)).

5. Offset all futures contracts and cleared swaps contracts which cannot be settled in cash and which would otherwise remain open either beyond the last day of trading (if applicable) or the first day on which notice of intent to deliver may be tendered with respect thereto, whichever occurs first; offset all long options on a physical commodity which cannot be settled in cash, have value and would be automatically exercised or would remain open beyond the last day of exercise; and offset all short options on a physical commodity which cannot be settled in cash (§ 190.02(f)(1)).

6. Compute estimated funded balance for each customer commodity account containing open commodity contracts (§ 190.04(b)) (daily thereafter).

7. Make margin calls if necessary (§ 190.02(g)(1)) (daily thereafter).

8. Liquidate or offset any open commodity account for which a customer has failed to meet a margin call (§ 190.02(f)(1)) (daily thereafter).

9. Commence liquidation or offset of specifically identifiable property described in § 190.02(f)(2)(i) (property which has lost 10% or more of value) (and as appropriate thereafter).

10. Commence liquidation or offset of property described in § 190.02(f)(3) ("all other property").

11. Be aware of any contracts in delivery position and rules pertaining to such contracts (§ 190.05).

First Calendar Day After the Entry of an Order for Relief

1. If a transfer occurred on the date of entry of the order for relief:

a. Liquidate any remaining open commodity contracts, except any dealer option or specifically identifiable commodity contract [hedge] (See § 190.01(kk)(2) and § 190.02(f)(1)), and not otherwise transferred in the transfer.

b. Primary liquidation date for transferred or liquidated commodity contracts (§ 190.01(ff)).

2. If no transfer has yet been effected, continue attempt to negotiate transfer of open commodity contracts and dealer options (§ 190.02(c)(1)).

3. Provide the clearing house or carrying broker with assurances to prevent liquidation of open commodity contract accounts available for transfer at the customer's instruction or liquidate all open commodity contracts except those available for transfer at a customer's instruction and dealer options.

Second Calendar Day After the Entry of an Order for Relief

If no transfer has yet been effected, request directly customer instructions regarding transfer of open commodity contracts and publish notice for customer instructions regarding the return of specifically identifiable property other than commodity contracts (§§ 190.02(b) (1) and (2)).

Third Calendar Day After the Entry of an Order for Relief

1. Second publication date for customer instructions (§ 190.02(b)(1)) (publication is to be made on two consecutive days, whether or not the second day is a business day).

2. Last day on which to notify the Commission with regard to whether a transfer in accordance with section 764(b) of the Bankruptcy Code will take place (§ 190.02(a)(2) and § 190.06(e)).

Sixth Calendar Day After the Entry of an Order for Relief

Last day for customers to instruct the trustee concerning open commodity contracts (§ 190.02(b)(2)).

Seventh Calendar Day After the Entry of an Order for Relief

1. If not previously concluded, conclude transfers under § 190.06(e) and (f). (See § 190.02(e)(1) and § 190.06(g)(2)(i)(A)).

2. Transfer all open dealer option contracts which have not previously been transferred (§ 190.06(f)(3)(i)).

3. Primary liquidation date (§ 190.01(ff)) (assuming no transfers and liquidation effected for all open commodity contracts for which no customer instructions were received by the sixth calendar day).

4. Establishment of transfer accounts (§ 190.03(a)(1)) (assuming this is the primary liquidation date); mark such accounts to market (§ 190.03(a)(2)) (daily thereafter until closed).

5. Liquidate or offset all remaining open commodity contracts (§ 190.02(b)(2)).

6. If not done previously, notify customers of bankruptcy and request customer proof of claim (§ 190.02(b)(4)).

Eighth Calendar Day After the Entry of an Order for Relief

Customer instructions due to trustee concerning specifically identifiable property (§ 190.02(b)(1)).

Ninth Calendar Day After the Entry of an Order for Relief

Commence liquidation of specifically identifiable property for which no arrangements for return have been made in accordance with customer instructions (§§ 190.02(b)(1), 190.03(c)).

Tenth Calendar Day After the Entry of an Order for Relief

Complete liquidation to the extent reasonably possible of specifically identifiable property which has yet to be liquidated and for which no customer instructions have been received (§ 190.03(c)).

Separate Procedures for Involuntary Petitions for Bankruptcy

1. Within one business day after notice of receipt of filing of the petition in bankruptcy, the trustee should assure that proper notification has been given to the Commission, the commodity broker's designated self-regulatory organization (*§ 190.02(a)(1)*) (if any), and all applicable clearing organizations; margin calls should be issued if necessary (*§ 190.02(g)(2)*).

2. On or before the seventh calendar day after the filing of a petition in bankruptcy,

the trustee should use his best efforts to effect a transfer in accordance with *§ 190.06(e)* and (*f*) of all open commodity contracts and equity held for or on behalf of customers of the commodity broker (*§ 190.02(e)(2)*) unless the debtor can provide certain assurances to the trustee.

Bankruptcy Appendix Form 2—Request for Instructions Concerning Non-Cash Property Deposited With (Commodity Broker)

Please take notice: On (date), a petition in bankruptcy was filed by [against] (commodity broker). Those customers of (commodity broker) who deposited certain kinds of non-cash property (see below) with (commodity broker) may instruct the trustee of the estate to return their property to them as provided below.

As no customer may obtain more than his or her proportionate share of the property available to satisfy customer claims, if you instruct the trustee to return your property to you, you will be required to pay the estate, as a condition to the return of your property, an amount determined by the trustee. If your property is not margining an open contract, this amount will approximate the difference between the market value of your property and your *pro rata* share of the estate, as estimated by the trustee. If your property is margining an open commodity contract, this amount will be approximately the full fair market value of the property on the date of its return.

Kinds of Property to Which This Notice Applies

1. Any security deposited as margin which, as of (date petition was filed), was securing an open commodity contract and is:

—Registered in your name,
—Not transferrable by delivery, and
—Not a short-term obligation.

2. Any fully-paid, non-exempt security held for your account in which there were no open commodity contracts as of (date petition was filed). (Rather than the return, at this time, of the specific securities you deposited with (commodity broker), you may instead request now, or at any later time, that the trustee purchase "like-kind" securities of a fair market value which does not exceed your proportionate share of the estate).

3. Any warehouse receipt, bill of lading or other document of title deposited as margin which, as of (date petition was filed), was securing an open commodity contract and—can be identified in (commodity broker)'s records as being held for your account, and—is neither in bearer form nor otherwise transferable by delivery.

4. Any warehouse receipt bill of lading or other document of title, or any commodity received, acquired or held by (commodity broker) to make or take delivery or exercise from or for your account and which—can be identified in (commodity broker)'s records as received from or for your account as held specifically for the purpose of delivery or exercise.

5. Any cash or other property deposited to make or take delivery on a commodity contract may be eligible to be returned. The trustee should be contacted directly for further information if you have deposited such property with (commodity broker) and desire its return.

Instructions must be received by (the 5th calendar day after 2d publication date) or the trustee will liquidate your property. (If you own such property but fail to provide the trustee with instructions, you will still have a claim against (commodity broker) but you will not be able to have your specific property returned to you).

Note: Prior to receipt of your instructions, circumstances may require the trustee to liquidate your property, or transfer your property to another broker if it is margining open commodity contracts. If your property is transferred and your instructions were received within the required time, your instructions will be forwarded to the new broker.

Instructions should be directed to: (Trustee's name, address, and/or telephone).

Even if you request the return of your property, you must also pay the trustee the amount he specifies and provide the trustee with proof of your claim before (the 7th calendar day after 2d publication date) or your property will be liquidated. (Upon receipt of customer instructions to return property, the trustee will mail the sender a form which describes the information he must provide to substantiate his claim).

Note: The trustee is required to liquidate your property despite the timely receipt of your instructions, money, and proof of claim if, for any reason, your property cannot be returned by (close of business on the 7th business day after 2d publication date).

Bankruptcy Appendix Form 3—Request For Instructions Concerning Transfer of Your Hedge Contracts Held by (Commodity Broker)

United States Bankruptcy Court __District of _____In re _____, Debtor, No. _____.

Please take notice: On (date), a petition in bankruptcy was filed by [against] (commodity broker).

You indicated when your hedge account was opened that the commodity contracts in your hedge account should not be liquidated automatically in the event of the bankruptcy of (commodity broker), and that you wished to provide instructions at this time concerning their disposition.

Instructions to transfer your commodity contracts and a cash deposit (as described below) must be received by the trustee by (the 6th calendar day after entry of order for relief) or your commodity contracts will be liquidated.

If you request the transfer of your commodity contracts, prior to their transfer, you must pay the trustee in cash an amount determined by the trustee which will approximate the difference between the value of the equity margining your commodity contracts and your *pro rata* share of the estate plus an amount constituting security for the nonrecovery of any overpayments. In your instructions, you should specify the broker to which you wish your commodity contracts transferred.

Be further advised that prior to receipt of your instructions, circumstances may, in any event, require the trustee to liquidate or transfer your commodity contracts. If your commodity contracts are so transferred and your instructions are received, your instructions will be forwarded to the new broker.

Note also that the trustee is required to liquidate your positions despite the timely receipt of your instructions and money if, for any reason, you have not made arrangements to transfer and/or your contracts are not transferred by (7 calendar days after entry of order for relief).

Instructions should be sent to: (Trustee's or designee's name, address, and/or telephone). [Instructions may also be provided by phone].

Bankruptcy Appendix Form 4—Proof of Claim

[Note to trustee: As indicated in § 190.02(d), this form is provided as a guide to the trustee and should be modified as necessary depending upon the information which the trustee needs at the time a proof of claim is requested and the time provided for a response.]

Proof of Claim

United States Bankruptcy Court __District of _____In re _____, Debtor, No. _____. Return this form by _____ or your claim will be barred (unless extended, for good cause only).

I. [If claimant is an individual claiming for himself] The undersigned, who is the claimant herein, resides at _____.

[If claimant is a partnership claiming through a member] The undersigned, who resides at __, is a member of _____, a partnership, composed of the undersigned and _____, of _____, and doing business at __, and is duly authorized to make this proof of claim on behalf of the partnership.

[If claimant is a corporation claiming though a duly authorized officer] The undersigned, who resides at __ is the _____ of __, a corporation organized under the laws of __ and doing business at _____, and is duly authorized to make this proof of claim on behalf of the corporation.

[If claim is made by agent] The undersigned, who resides at _____, is the agent of _____, and is duly authorized to make this proof of claim on behalf of the claimant.

II. The debtor was, at the time of the filing of the petition initiating this case, and still is, indebted to this claimant for the total sum of $ _____.

III. List EACH account on behalf of which a claim is being made by number and name of account holder[s], and for EACH account, specify the following information:

a. Whether the account is a futures, foreign futures, leverage, option (if an option account, specify whether exchange-traded, dealer or cleared swap), "delivery" account, or a cleared swaps account. A "delivery" account is one which contains only documents of title, commodities, cash, or other property identified to the claimant and deposited for the purposes of making or taking delivery on a commodity underlying a commodity contract or for payment of the strike price upon exercise of an option.

b. The capacity in which the account is held, as follows (and if more than one is applicable, so state):

1. [The account is held in the name of the undersigned in his individual capacity];

2. [The account is held by the undersigned as guardian, custodian, or conservator for the benefit of a ward or a minor under the Uniform Gift to Minors Act];

3. [The account is held by the undersigned as executor or administrator of an estate];

4. [The account is held by the undersigned as trustee for the trust beneficiary];

5. [The account is held by the undersigned in the name of a corporation, partnership, or unincorporated association];

6. [The account is held as an omnibus customer account of the undersigned futures commission merchant];

7. [The account is held by the undersigned as part owner of a joint account];

8. [The account is held by the undersigned in the name of a plan which, on the date the petition in bankruptcy was filed, had in effect a registration statement in accordance with the requirements of § 1031 of the Employee Retirement Income Security Act of 1974 and the regulations thereunder]; or

9. [The account is held by the undersigned as agent or nominee for a principal or beneficial owner (and not described above in items 1–8 of this II, b)].

10. [The account is held in any other capacity not described above in items 1–9 of this II, b. Specify the capacity].

c. The equity, as of the date the petition in bankruptcy was filed, based on the commodity contracts in the account.

d. Whether the person[s] (including a general partnership, limited partnership, corporation, or other type of association) on whose behalf the account is held is one of the following persons OR whether one of the following persons, alone or jointly, owns 10% or more of the account:

1. [If the debtor is an individual—

A. Such individual;

B. Relative (as defined below in item 8 of this III,d) of the debtor or of a general partner of the debtor;

C. Partnership in which the debtor is a general partner;

D. General partner of the debtor; or

E. Corporation of which the debtor is a director, officer, or person in control];

2. [If the debtor is a partnership—

A. Such partnership;

B. General partner in the debtor;

C. Relative (as defined in item 8 of this III,d) of a general partner in, general partner of, or person in control of the debtor;

D. Partnership in which the debtor is a general partner;

E. General partner of the debtor; or

F. Person in control of the debtor];

3. [If the debtor is a limited partnership—

A. Such limited partnership;

B. A limited or special partner in such partnership whose duties include:

i. The management of the partnership business or any part thereof;

ii. The handling of the trades or customer funds of customers of such partnership;

iii. The keeping of records pertaining to the trades or customer funds of customers of such partnership; or

iv. The signing or co-signing of checks or drafts on behalf of such partnership];

4. [If the debtor is a corporation or association (except a debtor which is a futures commission merchant and is also a cooperative association of producers)—

A. Such corporation or association;

B. Director of the debtor;

C. Officer of the debtor;

D. Person in control of the debtor;

E. Partnership in which the debtor is a general partner;

F. General partner of the debtor;

G. Relative (as defined in item 8 of this III,d) of a general partner, director, officer, or person in control of the debtor;

H. An officer, director or owner of ten percent or more of the capital stock of such organization];

5. [If the debtor is a futures commission merchant which is a cooperative association of producers—

Shareholder or member of the debtor which is an officer, director or manager];

6. [An employee of such individual, partnership, limited partnership, corporation or association whose duties include:

A. The management of the business of such individual, partnership, limited partnership, corporation or association or any part thereof;

B. The handling of the trades or customer funds of customers of such individual, partnership, limited partnership, corporation or association;

C. The keeping of records pertaining to the trades or funds of customers of such individual, partnership, limited partnership, corporation or association; or

D. The signing or co-signing of checks or drafts on behalf of such individual, partnership, limited partnership, corporation or association];

7. [Managing agent of the debtor];

8. [A spouse or minor dependent living in the same household of ANY OF THE FOREGOING PERSONS, or any other relative, regardless of residency, (unless previously described in items 1–B, 2–C, or 4–G of this III, d) defined as an individual related by affinity or consanguinity within the third degree as determined by the common law, or individual in a step or adoptive relationship within such degree];

9. ["Affiliate" of the debtor, defined as:

A. Entity that directly or indirectly owns, controls, or holds with power to vote, 20 percent or more of the outstanding voting securities of the debtor, other than an entity that holds such securities—

i. In a fiduciary or agency capacity without sole discretionary power to vote such securities; or

ii. Solely to secure a debt, if such entity has not in fact exercised such power to vote;

B. Corporation 20 percent or more of whose outstanding voting securities are directly or indirectly owned, controlled, or held with power to vote, by the debtor, or by an entity that directly or indirectly owns, controls, or holds with power to vote, 20 percent or more of the outstanding voting securities of the debtor, other than an entity that holds such securities—

i. In a fiduciary or agency capacity without sole discretionary power to vote such securities; or

ii. Solely to secure a debt, if such entity has not in fact exercised such power to vote;

C. Person whose business is operated under a lease or operating agreement by the debtor, or person substantially all of whose property is operated under an operating agreement with the debtor;

D. Entity that otherwise, directly or indirectly, is controlled by or is under common control with the debtor];

E. Entity that operates the business or all or substantially all of the property of the debtor under a lease or operating agreement; or

F. Entity that otherwise, directly or indirectly, controls the debtor; or

10. [Any of the persons listed in items 1–7 above of this III, d if such person is associated with an affiliate (see item 9 above) of the debtor as if the affiliate were the debtor].

e. Whether the account is a discretionary account. (If it is, the name in which the "attorney in fact" is held).

f. If the account is a joint account, the amount of the claimant's percentage interest in the account. (Also specify whether participants in a joint account are claiming separately or jointly).

g. Whether the claimant's positions in security futures products are held in a futures account or securities account, as those terms are defined in § 1.3 of this chapter.

IV. Describe all claims against the debtor not based upon a commodity contract account of the claimant (*e.g.,* if landlord, for rent; if customer, for misrepresentation or fraud).

V. Describe all claims of the DEBTOR against the CLAIMANT not already included in the equity of a commodity contract account[s] of the claimant (see III, c above).

VI. Describe any deposits of money, securities or other property held by or for the debtor from or for the claimant, and indicate if any of this property was included in your answer to III, c above.

VII. Of the money, securities, or other property described in VI above, identify any which consists of the following:

a. With respect to property received, acquired, or held by or for the account of the debtor from or for the account of the claimant to margin, guarantee or secure an open commodity contract, the following:

1. Any security which as of the filing date is:

A. Held for the claimant's account;

B. Registered in the claimant's name;

C. Not transferable by delivery; and

D. Not a short term obligation; or

2. Any warehouse receipt, bill of lading or other document of title which as of the filing date:

A. Can be identified on the books and records of the debtor as held for the account of the claimant; and

B. Is not in bearer form and is not otherwise transferable by delivery.

b. With respect to open commodity contracts, and except as otherwise provided below in item g of this VII, any such contract which:

1. As of the date the petition in bankruptcy was filed, is identified on the books and records of the debtor as held for the account of the claimant;

2. Is a bona fide hedging position or transaction as defined in Rule 1.3 of the Commodity Futures Trading Commission ("CFTC") or is a commodity option transaction which has been determined by a registered entity to be economically appropriate to the reduction of risks in the conduct and management of a commercial enterprise pursuant to rules which have been approved by the CFTC pursuant to section 5c(c) of the Commodity Exchange Act;

3. Is in an account designated in the accounting records of the debtor as a hedging account.

c. With respect to warehouse receipts, bills of lading or other documents of title, or physical commodities received, acquired, or held by or for the account of the debtor for the purpose of making or taking delivery or exercise from or for the claimant's account, any such document of title or commodity which as of the filing date can be identified on the books and records of the debtor as received from or for the account of the claimant specifically for the purpose of delivery or exercise.

d. Any cash or other property deposited prior to bankruptcy to pay for the taking of physical delivery on a long commodity contract or for payment of the strike price upon exercise of a short put or a long call option contract on a physical commodity, which cannot be settled in cash, in excess of the amount necessary to margin such commodity contract prior to the notice date or exercise date which cash or other property is identified on the books and records of the debtor as received from or for the account of the claimant within three or less days of the notice date or three or less days of the exercise date specifically for the purpose of payment of the notice price upon taking delivery or the strike price upon exercise.

e. The cash price tendered for any property deposited prior to bankruptcy to make physical delivery on a short commodity contract or for exercise of a long put or a short call option contract on a physical commodity, which cannot be settled in cash, to the extent it exceeds the amount necessary to margin such contract prior to the notice exercise date which property is identified on the books and records of the debtor as received from or for the account of the claimant within three or less days of the notice date or of the exercise date specifically for the purpose of a delivery or exercise.

f. Fully paid, non-exempt securities identified on the books and records of the debtor as held by the debtor for or on behalf of the commodity contract account of the claimant for which, according to such books and records as of the filing date, no open commodity contracts were held in the same capacity.

g. Open commodity contracts transferred to another futures commission merchant by the trustee.

VIII. Specify whether the claimant wishes to receive payment in kind, to the extent possible, for any claim for securities.

IX. Attach copies of any documents which support the information provided in this proof of claim, including but not limited to customer confirmations, account statements, and statements of purchase or sale.

This proof of claim must be filed with the trustee no later than _____, or your claim will be barred unless an extension has been granted, available only for good cause.

Return this form to:

(Trustee's name (or designee's) and address)

_____

Dated: _____

(Signed) _____

Penalty for Presenting Fraudulent Claim. Fine of not more than $5,000 or imprisonment for not more than five years or both—Title 18, U.S.C. 152.

(Approved by the Office of Management and Budget under control number 3038–0021)

14. Revise Appendix B to Part 190 to read as follows:

Appendix B to Part 190—Bankruptcy Forms

Special Bankruptcy Distributions Framework 1—Special Distribution of Futures Customer Funds When FCM Participated in Cross-Margining

The Commission has established the following distributional convention with respect to "futures customer funds" (as § 1.3 of this chapter defines such term) held by a futures commission merchant (FCM) that participated in a cross-margining (XM) program which shall apply if participating market professionals sign an agreement that makes reference to this distributional rule and the form of such agreement has been approved by the Commission by rule, regulation or order:

All futures customer funds held in respect of XM accounts, regardless of the product that customers holding such accounts are trading, are required by Commission order to be segregated separately from all other customer segregated funds. For purposes of this distributional rule, XM accounts will be deemed to be commodity interest accounts and securities held in XM accounts will be deemed to be received by the FCM to margin, guarantee or secure commodity interest contracts. The maintenance of property in an XM account will result in subordination of the claim for such property to certain non-XM customer claims and thereby will operate to cause such XM claim not to be treated as a customer claim for purposes of the Securities Investors Protection Act and the XM securities to be excluded from the securities estate. This creates subclasses of futures customer accounts, an XM account and a non-XM account (a person could hold each type of account), and results in two pools of segregated funds belonging to futures customers: An XM pool and a non-XM pool. In the event that there is a shortfall in the non-XM pool of customer class segregated funds and there is no shortfall in the XM pool of customer segregated funds, all futures customer net equity claims, whether or not they arise out of the XM subclass of accounts, will be combined and will be paid *pro rata* out of the total pool of available XM and non-XM futures customer funds. In the event that there is a shortfall in the XM pool of customer segregated funds and there is no shortfall in the non-XM pool of customer segregated funds, then futures customer net equity claims arising from the XM subclass of accounts shall be satisfied first from the XM pool of customer segregated funds, and futures customer net equity claims arising from the non-XM subclass of accounts shall be satisfied first from the non-XM customer segregated funds. Furthermore, in the event that there is a shortfall in both the non-XM and XM pools of customer segregated funds: (1) If the non-XM shortfall as a percentage of the segregation requirement in the non-XM pool is greater than or equal to the XM shortfall as a percentage of the segregation requirement in the XM pool, all futures customer net equity claims will be paid *pro rata;* and (2) if the XM shortfall as a percentage of the segregation requirement in the XM pool is greater than the non-XM shortfall as a percentage of the segregation requirement of the non-XM pool, non-XM futures customer net equity claims will be paid *pro rata* out of the available non-XM segregated funds, and XM futures customer net equity claims will be paid *pro rata* out of the available XM segregated funds. In this way, non-XM customers will never be adversely affected by an XM shortfall.

The following examples illustrate the operation of this convention. The examples assume that the FCM has two customers, one with exclusively XM accounts and one with exclusively non-XM accounts. However, the examples would apply equally if there were only one customer, with both an XM account and a non-XM account.

1. Sufficient Funds to Meet Non-XM and XM Customer Claims:

	Non-XM	XM	Total
Funds in 4d(a) segregation	150	150	300
4d(a) Segregation requirement	150	150	300
Shortfall (dollars)	0	0	.....
Shortfall (percent)	0	0	.....
Distribution	150	150	300

There are adequate funds available and both the non-XM and the XM customer claims will be paid in full.

2. Shortfall in Non-XM Only:

	Non-XM	XM	Total
Funds in 4d(a) segregation	100	150	250
4d(a) Segregation requirement	150	150	300
Shortfall (dollars)	50	0	
Shortfall (percent)	50/150 = 33.3	0	
Pro rata (percent)	150/300 = 50	150/300 = 50	
Pro rata (dollars)	125	125	
Distribution	125	125	250

Due to the non-XM account, there are insufficient funds available to meet both the non-XM and the XM customer claims in full. Each customer will receive his *pro rata* share of the funds available, or 50% of the $250 available, or $125.

3. Shortfall in XM Only:

	Non-XM	XM	Total
Funds in 4d(a) segregation	150	100	250
4d(a) Segregation requirement	150	150	300
Shortfall (dollars)	0	50	
Shortfall (percent)	0	50/150 = 33.3	
Pro rata (percent)	150/300 = 50	150/300 = 50	
Pro rata (dollars)	125	125	
Distribution	150	100	250

Due to the XM account, there are insufficient funds available to meet both the non-XM and the XM customer claims in full. Accordingly, the XM funds and non-XM funds are treated as separate pools, and the non-XM customer will be paid in full, receiving $ 150 while the XM customer will receive the remaining $100.

4. Shortfall in Both, With XM Shortfall Exceeding Non-XM Shortfall:

	Non-XM	XM	Total
Funds in 4d(a) segregation	125	100	225
4d(a) Segregation requirement	150	150	300
Shortfall (dollars)	25	50	
Shortfall (percent)	25/150 = 16.7	50/150 = 33.3	
Pro rata (percent)	150/300 = 50	150/300 = 50	
Pro rata (dollars)	112.50	112.50	
Distribution	125	100	225

There are insufficient funds available to meet both the non-XM and the XM customer claims in full, and the XM shortfall exceeds the non-XM shortfall. The non-XM customer will receive the $125 available with respect to non-XM claims while the XM customer will receive the $100 available with respect to XM claims.

5. Shortfall in Both, With Non-XM Shortfall Exceeding XM Shortfall:

	Non-XM	XM	Total
Funds in 4d(a) segregation	100	125	225
4d(a) Segregation requirement	150	150	300
Shortfall (dollars)	50	25	
Shortfall (percent)	50/150 = 33.3	25/150 = 16.7	
Pro rata (percent)	150/300 = 50	150/300 = 50	
Pro rata (dollars)	112.50	112.50	
Distribution	112.50	112.50	225

There are insufficient funds available to meet both the non-XM and the XM customer claims in full, and the non-XM shortfall exceeds the XM shortfall. Each customer will receive 50% of the $225 available, or $112.50.

6. Shortfall in Both, Non-XM Shortfall = XM Shortfall:

	Non-XM	XM	Total
Funds in 4d(a) segregation	100	100	200
4d(a) Segregation requirement	150	150	300
Shortfall (dollars)	50	50	
Shortfall (percent)	50/150 = 33.3	50/150 = 33.3	
Pro rata (percent)	150/300 = 50	150/300 = 50	

	Non-XM	XM	Total
Pro rata (dollars)	100	100	
Distribution	100	100	200

There are insufficient funds available to meet both the non-XM and the XM customer claims in full, and the non-XM shortfall equals the XM shortfall. Each customer will receive 50% of the $200 available, or $100.

These examples illustrate the principle that *pro rata* distribution across both accounts is the preferable approach except when a shortfall in the XM account could harm non-XM customers. Thus, *pro rata* distribution occurs in Examples 1, 2, 5 and 6. Separate treatment of the XM and non-XM accounts occurs in Examples 3 and 4.

Special Bankruptcy Distributions Framework 2—Special Allocation of Shortfall to Customer Claims When Futures Customer Funds and Cleared Swaps Customer Collateral Are Held in a Depository Outside of the United States or in a Foreign Currency

The Commission has established the following allocation convention with respect to futures customer funds (as § 1.3 of this chapter defines such term) and Cleared Swaps Customer Collateral (as § 22.1 of this chapter defines such term) segregated pursuant to the Act and Commission rules thereunder held by a futures commission merchant ("FCM") or derivatives clearing organization ("DCO") in a depository outside the United States ("U.S.") or in a foreign currency. The maintenance of futures customer funds or Cleared Swaps Customer Collateral in a depository outside the U.S. or denominated in a foreign currency will result, in certain circumstances, in the reduction of customer claims for such funds. For purposes of this proposed bankruptcy convention, sovereign action of a foreign government or court would include, but not be limited to, the application or enforcement of statutes, rules, regulations, interpretations, advisories, decisions, or orders, formal or informal, by a Federal, state, or provincial executive, legislature, judiciary, or government agency. If an FCM enters into bankruptcy and maintains futures customer funds or Cleared Swaps Customer Collateral in a depository located in the U.S. in a currency other than U.S. dollars or in a depository outside the U.S., the following allocation procedures shall be used to calculate the claim of each futures customer or Cleared Swaps Customer (as § 22.1 of this chapter defines such term). The allocation procedures should be performed separately with respect to each futures customer or Cleared Swaps Customer.

I. Reduction in Claims for General Shortfall

A. Determination of Losses not Attributable to Sovereign Action

1. Convert the claim of each futures customer or Cleared Swaps Customer in each currency to U.S. Dollars at the exchange rate in effect on the Final Net Equity Determination Date, as defined in § 190.01(s) (the "Exchange Rate").

2. Determine the amount of assets available for distribution to futures customers or Cleared Swaps Customers. In making this calculation, *include* futures customer funds and Cleared Swaps Customer Collateral that would be available for distribution but for the sovereign action.

3. Convert the amount of futures customer funds and Cleared Swaps Customer Collateral available for distribution to U.S. Dollars at the Exchange Rate.

4. Determine the Shortfall Percentage that is *not* attributable to sovereign action, as follows:

$$Shortfall\ \text{Percentage} = \left(1 - \left[\frac{Total\ \text{Customer Assets}}{Total\ \text{Customer Claims}}\right]\right)$$

B. Allocation of Losses Not Attributable to Sovereign Action

1. Reduce the claim of each futures customer or Cleared Swaps Customer by the Shortfall Percentage.

II. Reduction in Claims for Sovereign Loss

A. Determination of Losses Attributable to Sovereign Action ("Sovereign Loss")

1. If any portion of the claim of a futures customer or Cleared Swaps Customer is required to be kept in U.S. dollars in the U.S., that portion of the claim is not exposed to Sovereign Loss.

2. If any portion of the claim of a futures customer or Cleared Swaps Customer is authorized to be kept in only one location and that location is:

a. The U.S. or a location in which there is no Sovereign Loss, then that portion of the claim is not exposed to Sovereign Loss.

b. A location in which there is Sovereign Loss, then that entire portion of the claim is exposed to Sovereign Loss.

3. If any portion of the claim of a futures customer or Cleared Swaps Customer is authorized to be kept in only one currency and that currency is:

a. U.S. dollars or a currency in which there is no Sovereign Loss, then that portion of the claim is not exposed to Sovereign Loss.

b. A currency in which there is Sovereign Loss, then that entire portion of the claim is exposed to Sovereign Loss.

4. If any portion of the claim of a futures customer or Cleared Swaps Customer is authorized to be kept in more than one location and:

a. There is no Sovereign Loss in any of those locations, then that portion of the claim is not exposed to Sovereign Loss.

b. There is Sovereign Loss in one of those locations, then that entire portion of the claim is exposed to Sovereign Loss.

c. There is Sovereign Loss in more than one of those locations, then an equal share of that portion of the claim will be exposed to Sovereign Loss in each such location.

5. If any portion of the claim of a futures customer or Cleared Swaps Customer is authorized to be kept in more than one currency and:

a. There is no Sovereign Loss in any of those currencies, then that portion of the claim is not exposed to Sovereign Loss.

b. There is Sovereign Loss in one of those currencies, then that entire portion of the claim is exposed to Sovereign Loss.

c. There is Sovereign Loss in more than one of those currencies, then an equal share of that portion of the claim will be exposed to Sovereign Loss.

B. Calculation of Sovereign Loss

1. The total Sovereign Loss for each location is the difference between:

a. The total futures customer funds or Cleared Swaps Customer Collateral deposited in depositories in that location and

b. The amount of futures customer funds or Cleared Swaps Customer Collateral in that location that is available to be distributed to futures customers or Cleared Swaps Customers, after taking into account any sovereign action.

2. The total Sovereign Loss for each currency is the difference between:

a. The value, in U.S. dollars, of the futures customer funds or Cleared Swaps Customer Collateral held in that currency on the day before the sovereign action took place and

b. The value, in U.S. dollars, of the futures customer funds or Cleared Swaps Customer Collateral held in that currency on the Final Net Equity Determination Date.

C. Allocation of Sovereign Loss

1. Each portion of the claim of a futures customer or Cleared Swaps Customer exposed to Sovereign Loss in a location will be reduced by:

$$\textit{Total}\ \text{Sovereign Loss} \times \frac{\text{Portion of the customer's claim exposed to loss in that location}}{\textit{All}\ \text{portions of customer claims exposed to loss in that location}}$$

2. Each portion of the claim of a futures customer or Cleared Swaps Customer exposed to Sovereign Loss in a currency will be reduced by:

$$\textit{Total}\ \text{Sovereign Loss} \times \frac{\text{Portion of the customer's claim exposed to loss in that currency}}{\textit{All}\ \text{portions of customer claims exposed to loss in that currency}}$$

3. A portion of the claim of a futures customer or Cleared Swaps Customer exposed to Sovereign Loss in a location or currency will not be reduced below zero. (The above calculations might yield a result below zero where the FCM kept more futures customer funds or Cleared Swaps Customer Funds in a location or currency than it was authorized to keep.)

4. Any amount of Sovereign Loss from a location or currency in excess of the total amount of futures customer funds or Cleared Swaps Customer Funds authorized to be kept in that location or currency (calculated in accord with section II.1 above) ("Total Excess Sovereign Loss") will be divided among all futures customers or Cleared Swaps Customer who have authorized funds to be kept outside the U.S., or in currencies other than U.S. dollars, with each such futures customer or Cleared Swaps Customer claim reduced by the following amount:

$$\textit{Total}\ \text{Excess Sovereign Loss} \times \left[\frac{\left(\begin{array}{c}\text{This customer's total claim} - \text{The portion of this Customer's claim}\\ \text{required to be kept in U.S. dollars, in the U.S.}\end{array}\right)}{\begin{array}{c}\textit{Total}\ \text{customer claims} - \text{Total of all customer claims}\\ \text{required to be kept in U.S. dollars, in the U.S.}\end{array}}\right]$$

The following examples illustrate the operation of this convention.

Example 1. No shortfall in any location.

Customer	Claim	Location(s) customer has consented to having funds held
A	$50	U.S.
B	€50	U.K.
C	€50	Germany.
D	£300	U.K.

Location	Actual asset balance
U.S.	$50.
U.K.	£300.
U.K.	€50.
Germany	€50.

Note: Conversion Rates: £1 = $1; £1=$1.5.

Convert the claim of each futures customer or Cleared Swaps Customer in each currency to U.S. Dollars:

Customer	Claim	Conversion rate	Claim in U.S. dollars
A	$50	1.0	$50
B	€50	1.0	50
C	€50	1.0	50
D	£300	1.5	450
Total			600.00

Determine assets available for distribution to futures customers or Cleared Swaps Customers, converting to U.S. dollars:

Location	Assets	Conversion rate	Assets in U.S. dollars	Shortfall due to sovereign action percentage	Actual shortfall due to sovereign action	Amount actually available
U.S.	$50	1.0	$50			$50
U.K.	£300	1.5	450			450
U.K.	€50	1.0	50			50
Germany	€50	1.0	50			50
Total			600.00		0	600.00

There are no shortfalls in funds held in any location. Accordingly, there will be no reduction of futures customer or Cleared Swaps Customer claims.

Claims:

Customer	Claim in U.S. dollars after allocated non-sovereign shortfall	Allocation of shortfall due to sovereign action	Claim after all reductions
A	$50	$0	$50
B	50	0	50
C	50	0	50
D	450	0	450
Total	600.00	0.00	600.00

Example 2. Shortfall in funds held in the U.S.

Customer	Claim	Location(s) customer has consented to having funds held
A	$100	U.S.
B	€50	U.K.
C	€100	U.K., Germany, or Japan.

Location	Actual asset balance
U.S.	$50
U.K.	€100
Germany	€50

Note: Conversion Rates: €1 = $1.

Reduction in Claims for General Shortfall

There is a shortfall in the funds held in the U.S. such that only ½ of the funds are available. Convert the claim of each futures customer or Cleared Swaps Customer in each currency to U.S. Dollars:

Convert each customer's claim in each currency to U.S. Dollars:

Customer	Claim	Conversion rate	Claim in US$
A	$100	1.0	$100
B	€50	1.0	50
C	€100	1.0	100
Total			250.00

Determine assets available for distribution to futures customers or Cleared Swaps Customers, converting to U.S. dollars:

Location	Assets	Conversion rate	Assets in U.S. dollars	Shortfall due to sovereign action percentage	Actual shortfall due to sovereign action	Amount actually available
U.S.	$50	1.0	$50.00			$50
U.K.	€100	1.0	100			100
Germany	€50	1.0	50			50

Location	Assets	Conversion rate	Assets in U.S. dollars	Shortfall due to sovereign action percentage	Actual shortfall due to sovereign action	Amount actually available
Total			200.00			200.00

Determine the percentage of shortfall that is not attributable to sovereign action:

Shortfall Percentage = (1 − (200/250)) = (1 − 80%) = 20%.

Reduce each futures customer or Cleared Swaps Customer claim by the Shortfall Percentage:

Customer	Claim in US$	Allocated shortfall (non-sovereign)	Claim in U.S. dollars after allocated shortfall
A	$100	$20.00	$80.00
B	50	10.00	40.00
C	100	20.00	80.00
Total	250.00	50.00	200.00

Reduction in Claims for Shortfall Due to Sovereign Action

There is no shortfall due to sovereign action. Accordingly, the futures customer or Cleared Swaps Customer claims will not be further reduced.

Claims After Reductions

Customer	Claim in U.S. dollars after allocated non-sovereign shortfall	Allocation of shortfall due to sovereign action	Claim after all reductions
A	$80		$80.00
B	40		40.00
C	80		80.00
Total	200.00	0	200.00

Example 3. Shortfall in funds held outside the U.S., or in a currency other than U.S. dollars, not due to sovereign action.

Customer	Claim	Location(s) customer has consented to having funds held
A	$150	U.S.
B	€100	U.K.
C	€50	Germany.
D	$100	U.S.
D	€100	U.K. or Germany.

Location	Actual asset balance
U.S.	$250
U.K.	€50
Germany	€100

Note: Conversion Rates: €1 = $1.

Reduction in Claims for General Shortfall

Convert the claim of each futures customer or Cleared Swaps Customer in each currency to U.S. Dollars:

Customer	Claim	Conversion rate	Claim in US$
A	$150	1.0	150
B	€100	1.0	100
C	€50	1.0	50
D	$100	1.0	100
D	€100	1.0	100
Total			500.00

Determine assets available for distribution to futures customers or Cleared Swaps Customers, converting to U.S. dollars:

Location	Assets	Conversion rate	Assets in U.S. dollars	Shortfall due to sovereign action percentage	Actual shortfall due to sovereign action	Amount actually available
U.S.	$250	1.0	$250	.....	.....	$250
U.K.	€50	1.0	50	.....	.....	50
Germany	€100	1.0	100	.....	.....	100
Total	.....	.....	400.00	.....	0	400.00

Determine the percentage of shortfall that is not attributable to sovereign action:

Shortfall Percentage = (1 − 400/500) = (1 − 80%) = 20%.

Reduce each futures customer or Cleared Swaps Customer by the shortfall percentage:

Customer	Claim in US$	Allocated shortfall (non-sovereign)	Claim in U.S. dollars after allocated shortfall
A	$150	$30.00	120.00
B	100	20.00	80.00
C	50	10.00	40.00
D	200	40.00	160.00
Total	500.00	100.00	400.00

Reduction in Claims for Shortfall Due to Sovereign Action

There is no shortfall due to sovereign action. Accordingly, the claims will not be further reduced.

Claims After Reductions

Customer	Claim in U.S. dollars after allocated non-sovereign shortfall	Allocation of shortfall due to sovereign action	Claim after all reductions
A	$120.00	.....	$120
B	80.00	.....	80
C	40.00	.....	40
D	160.00	0	160
Total	400.00	0	400

Example 4. Shortfall in funds held outside the U.S., or in a currency other than U.S. dollars, due to sovereign action.

Customer	Claim	Location(s) where customer has consented to have funds held
A	$50	U.S.
B	€50	U.K.
C	€50	Germany.
D	$100	U.S.
D	€100	U.K. or Germany.

Location	Actual asset balance
U.S.	$150
U.K.	100
Germany	100

Notice: Conversion Rates: €1 = $1; ¥1 = $0.01, £1= $1.5.

Reduction in Claims for General Shortfall

Convert each futures customer or Cleared Swaps Customer claim in each currency to U.S. Dollars:

Customer	Claim	Conversion rate	Claim in US$
A	$50	1.0	$50
B	€50	1.0	50
C	€50	1.0	50
D	$100	1.0	100
D	€100	1.0	100
Total			350.00

Determine assets available for distribution to futures customers or Cleared Swaps Customers, converting to U.S. dollars:

Location	Assets	Conversion rate	Assets in U.S. dollars	Shortfall due to sovereign action percentage	Actual shortfall due to sovereign action	Amount actually available
U.S	$150	1.0	$150			$150
U.K	€100	1.0	100			100
Germany	€100	1.0	100	50%	50	50
Total			350.00		50.00	300.00

Determine the percentage of shortfall that is not attributable to sovereign action:

Shortfall Percentage = (1 − 350/350) = (1 − 100%) = 0%.

Reduce each futures customer or Cleared Swaps Customer claim by the shortfall percentage:

Customer	Claim in US$	Allocated shortfall (non-sovereign)	Claim in U.S. dollars after allocated shortfall
A	$50	0	$50.00
B	50	0	50.00
C	50	0	50.00
D	200	0	200.00
Total	350.00	0.00	350.00

Reduction in Claims for Shortfall Due to Sovereign Action

Due to sovereign action, only ½ of the funds in Germany are available.

Customer	Presumed location of funds		
	U.S.	U.K.	Germany
A	$50		
B		$50	
C			$50
D	100		100
Total	150.00	50.00	150.00

Calculation of the allocation of the shortfall due to sovereign action—Germany ($50 shortfall to be allocated):

Customer	Allocation share	Allocation share of actual shortfall	Actual shortfall allocated
C	$50/$150	33.3% of $50	$16.67
D	$100/$150	66.7% of $50	33.33
Total			50.00

Claims After Reductions:

Customer	Claim in U.S. dollars after allocated non-sovereign shortfall	Allocation of shortfall due to sovereign action from Germany	Claim after all reductions
A	$50	.....	$50
B	50	.....	50
C	50	$16.67	33.33
D	200	33.33	166.67
Total	350.00	50.00	300.00

Example 5. Shortfall in funds held outside the U.S., or in a currency other than U.S. dollars, due to sovereign action and a shortfall in funds held in the U.S.

Customer	Claim	Location(s) customer has consented to having funds held
A	$100	U.S.
B	€50	U.K.
C	€150	Germany.
D	$100	U.S.
D	£300	U.K.
D	€150	U.K. or Germany.

Location	Actual asset balance
U.S.	$100
U.K.	£300
U.K.	€200
Germany	€150

Conversion Rates: €1 = $1; £1 = $1.5.

Reduction in Claims for General Shortfall

Convert each futures customer or Cleared Swaps Customer claim in each currency to U.S. Dollars:

Customer	Claim	Conversion rate	Claim in U.S.$
A	$100	1.0	$100
B	€50	1.0	50
C	€150	1.0	150
D	$100	1.0	100
D	£300	1.5	450
D	€150	1.0	150
Total	.....	.....	1,000.00

Determine assets available for distribution to futures customers or Cleared Swaps.

Customers, converting to U.S. dollars:

Location	Assets	Conversion rate	Assets in U.S. dollars	Shortfall due to sovereign action percentage	Actual shortfall due to sovereign action	Amount actually available
U.S.	$100	1.0	$100	.....	.....	$100
U.K.	£300	1.5	450	.....	.....	450
U.K.	€200	1.0	200	.....	.....	200
Germany	€150	1.0	150	100%	$150	0
Total	.....	.....	900.00	.....	150.00	750.00

Determine the percentage of shortfall that is not attributable to sovereign action:

Shortfall Percentage = (1 − 900/1000) = (1 − 90%) = 10%. Reduce each futures customer or Cleared Swaps Customer claim by the shortfall percentage:

Customer	Claim in U.S.$	Allocated shortfall (non-sovereign)	Claim in U.S. dollars after allocated shortfall
A	$100	$10.00	$90.00
B	50	5.00	45.00
C	150	15.00	135.00
D	700	70.00	63.00
Total	1,000.00	100.00	900.00

Reduction in Claims for Shortfall Due to Sovereign Action

Due to sovereign action, none of the money in Germany is available.

Customer	Presumed location of funds		
	U.S.	U.K.	Germany
A	$100		
B		$50	
C			$150
D	100	450	150
Total	200.00	500.00	300.00

Calculation of the allocation of the shortfall due to sovereign action Germany ($150 shortfall to be allocated):

Customer	Allocation share	Allocation share of actual shortfall	Actual shortfall allocated
C	$150/$300	50% of $150	$75
D	150/300	50% of $150	75
Total			150.00

Claims After Reductions

Customer	Claim in U.S. dollars after allocated non-sovereign shortfall	Allocation of shortfall due to sovereign action from Germany	Claim after all reductions
A	$90		$90
B	45		45
C	135	$75	60
D	630	75	555
Total	900.00	150.00	750.00

Example 6. Shortfall in funds held outside the U.S., or in a currency other than U.S. dollars, due to sovereign action, shortfall in funds held outside the U.S., or in a currency other than U.S. dollars, not due to sovereign action, and a shortfall in funds held in the U.S.

Customer	Claim	Location(s) customer has consented to having funds held
A	$50	U.S.
B	€50	U.K.
C	$20	U.S.
C	€50	Germany.
D	$100	U.S.
D	£300	U.K.
D	€100	U.K., Germany, or Japan.
E	$80	U.S.
E	¥10,000	Japan.

Customer	Claim	Location(s) customer has consented to having funds held
Location		Actual asset balance
U.S.		$200
U.K.		£200
U.K.		€100
Germany		€50
Japan		¥10,000

Conversion Rates: £1 = $1; ¥1=$0.01, £1=$1.5.

Reduction in Claims for General Shortfall

Convert each futures customer or Cleared Swaps Customer claim in each currency to U.S. Dollars:

Customer	Claim	Conversion rate	Claim in U.S.$
A	$50	1.0	$50
B	€50	1.0	50
C	$20	1.0	20
C	€50	1.0	50
D	$100	1.0	100
D	€300	1.5	450
D	£100	1.0	100
E	$80	1.0	80
E	¥10,000	0.01	100
Total			1,000.00

Determine assets available for distribution to futures customers or Cleared Swaps Customers, converting to U.S. dollars:

Location	Assets	Conversion rate	Assets in U.S. dollars	Shortfall due to sovereign action percentage	Actual shortfall due to sovereign action	Amount actually available
U.S.	$200	1.0	$200			$200
U.K.	£200	1.5	300			300
U.K.	€100	1.0	100			100
Germany	€50	1.0	50	100%	$50	0
Japan	¥10,000	0.01	100	50%	50	50
Total			750		100.00	650.00

Determine the percentage of shortfall that is not attributable to sovereign action:

Shortfall Percentage = (1–750/1000) = (1–75%) = 25%.

Reduce each futures customer or Cleared Swaps Customer claim by the shortfall percentage:

Customer	Claim in U.S.$	Allocated shortfall (non-sovereign)	Claim in U.S. dollars after allocated shortfall
A	$50	$12.50	$37.50
B	50	12.50	37.50
C	70	17.50	52.50
D	650	162.50	487.50
E	180	45.00	135.00
Total	1,000.00	250.00	750.00

Reduction in Claims for Shortfall Due to Sovereign Action

Due to sovereign action, none of the money in Germany and only ½ of the funds in Japan are available.

Customer	Presumed location of funds			
	U.S.	U.K.	Germany	Japan
A	$50			
B		$50		
C	20		$50	
D	100	450	50	$50
E	80			100
Total	250.00	500.00	100.00	150.00

Calculation of the allocation of the shortfall due to sovereign action—Germany ($50 shortfall to be allocated):

Customer allocation	Allocation share	Allocation share of actual shortfall	Actual shortfall allocated
C	$50/$100	50% of $50	$25
D	50/100	50% of 50	25
Total			50

Japan ($50 shortfall to be allocated):

Customer	Allocation share	Allocation share of actual shortfall	Actual shortfall allocated
D	$50/$150	33.3% of $50	$16.67
E	100/150	66.6% of 50	33.33
Total			50.00

Claims After Reductions

Customer	Claim in US dollars after allocated non-sovereign shortfall	Allocation of shortfall due to sovereign action from Germany	Allocation of shortfall due to sovereign action from Japan	Claim after all reductions
A	$37.50			37.50
B	37.50			37.50
C	52.50	$25		27.50
D	487.50	25	16.67	445.83
E	135.00		33.33	101.67
Total	750.00	50.00	50.00	650.00

Example 7. Shortfall in funds held outside the U.S., or in a currency other than U.S. dollars, due to sovereign action, where the FCM kept more funds than permitted in such location or currency.

Customer	Claim	Location(s) customer has consented to having funds held
A	$50	U.S.
B	50	U.S.
B	€50	U.K.
C	€50	Germany.
D	100	U.S.
D	€100	U.K. or Germany.
E	50	U.S.
E	€50	U.K.

Location	Actual asset balance
U.S.	$250
U.K.	€50
Germany	€200

Conversion Rates: 1 = $1.

Reduction in Claims for General Shortfall

Convert each futures customer or Cleared Swaps Customer claim in each currency to U.S. dollars:

Customer	Claim	Conversion rate	Claim in U.S.$
A	$50	1.0	50
B	50	1.0	50
B	€50	1.0	50
C	€50	1.0	50
D	€100	1.0	100
D	€100	1.0	100
E	50	1.0	50
E	€50	1.0	50
Total			500.00

Determine assets available for distribution to futures customers or Cleared Swaps Customers, converting to U.S. dollars:

Location	Assets	Conversion rate	Assets in U.S. dollars	Shortfall due to sovereign action percentage	Actual shortfall due to sovereign action	Amount actually available
U.S.	$250	1.0	$250			$250
U.K.	€50	1.0	50			50
Germany	€200	1.0	200	100%	200	0
Total			500.00		200	300.00

Determine the percentage of shortfall that is not attributable to sovereign action.

Shortfall Percentage = (1 − 500/500) = (1 − 100%) = 0%.

Reduce each futures customer or Cleared Swaps Customer claim by the shortfall percentage:

Customer	Claim in U.S.$	Allocated shortfall (non-sovereign)	Claim in U.S. dollars after allocated shortfall
A	$50	$0	$50.00
B	100	0	100.00
C	50	0	50.00
D	200	0	200.00
E	100	0	100.00
Total	500.00	0.00	500.00

Reduction in Claims for Shortfall Due to Sovereign Action

Due to sovereign action, none of the money in Germany is available.

Customer	Presumed location of funds		
	U.S.	U.K.	Germany
A	$50		
B	50	50	
C			50
D	100		100
E	50	50	
Total	250.00	100.00	150.00

Calculation of the allocation of the shortfall due to sovereign action—Germany ($200 shortfall to be allocated):

Customer	Allocation share	Allocation share of actual shortfall	Actual shortfall allocated
C	$50/$150	33.3% of $200	$66.67
D	$100/$150	66.7% of $200	133.33
Total	.....	.....	200.000

This would result in the claims of customers C and D being reduced below zero.

Accordingly, the claims of customer C and D will only be reduced to zero, or $50 for C and $100 for D. This results in a Total Excess Shortfall of $50.

Actual shortfall	Allocation of shortfall for customer C	Allocation of shortfall for customer D	Total excess shortfall
$200	$50	$100	$50

This shortfall will be divided among the remaining futures customers or Cleared Swaps Customers who have authorized funds to be held outside the U.S. or in a currency other than U.S. dollars.

Customer	Total claims of customers permitting funds to be held outside the U.S.	Portion of claim required to be in the U.S.	Allocation share (column B–C/column B Total—all customer claims in U.S.)	Allocation share of actual total excess shortfall	Actual total excess shortfall allocated
B	$100	$50	$50/$200	25% of $50	$12.50
C	50	0	([1])	.....	0
D	200	100	100/200	50% of $50	25
E	100	50	50/100	25% of $50	12.50
Total	450.00	.....	.....	.....	50.00

[1] Claim already reduced to $0.

Claims After Reductions

Customer	Claim in U.S. dollars after allocated non-sovereign shortfall	Allocation of shortfall due to sovereign action Germany	Allocation of total excess shortfall	Claim after all reductions
A	$50	.....	.....	$50.00
B	100	.....	12.50	87.50
C	50	50	.....	0
D	200	100	25	75.00
E	100	.....	12.50	87.50
Total	500.00	150.00	50.00	300.00

Issued in Washington, DC, on April 27, 2011, by the Commission.

David A. Stawick,

Secretary of the Commission.

Appendices to Protection of Cleared Swaps Customer Contracts and Collateral; Conforming Amendments to the Commodity Broker Bankruptcy Provisions—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 Dunn, Chilton and O'Malia voted in the affirmative; Commissioner Sommers voted in the negative.

Appendix 2—Statement of Chairman Gary Gensler

I support the proposed rule on protection of cleared swaps customer contracts and collateral and the associated conforming amendments. The proposal carries out the Dodd-Frank Act's mandate that futures commission merchants (FCMs) and derivatives clearing organizations (DCOs) segregate customer collateral supporting cleared swaps. FCMs and DCOs must hold customer collateral in an account that is separate from that belonging to the FCMs or DCOs.

Under the Dodd-Frank Act, an FCM or DCO must not use the collateral of one swaps customer to cover the obligations of another swaps customer or itself. Under the proposed rule, in the event that an FCM defaults simultaneously with one or more of its cleared swaps customers, the DCO may access the collateral of the FCM's defaulting cleared swaps customers to cure the default, but not the collateral of the FCM's non-defaulting cleared swaps customers. The

proposal also asks a variety of questions regarding alternative means of implementing protection of customer collateral.

This proposed rulemaking benefited from public input received during the CFTC staff roundtable on segregation and in other meetings and from the 32 comments received in response the Commission's advanced notice of proposed rulemaking. I look forward to further hearing from the public on this proposed rulemaking.

[FR Doc. 2011–10737 Filed 6–2–11; 11:15 am]

BILLING CODE 6351–01–P