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COMMODITY FUTURES TRADING COMMISSION

17 CFR Parts 1, 22, 30, and 39

RIN 3038-AF21

Regulations to Address Margin Adequacy and to Account for the Treatment of Separate Accounts by Futures Commission Merchants

AGENCY: Commodity Futures Trading Commission.

ACTION: Notice of proposed rulemaking; withdrawal.

SUMMARY: On April 14, 2023, the Commodity Futures Trading Commission (Commission or CFTC) published a notice of proposed rulemaking (First Proposal) that proposed to amend the derivatives clearing organization (DCO) risk management regulations adopted under the Commodity Exchange Act (CEA) to permit futures commission merchants (FCMs) that are clearing members of DCOs (clearing FCMs), subject to specified requirements, to treat separate accounts of a single customer as accounts of separate legal entities for purposes of certain Commission regulations. In light of comments received supporting direct application of separate account treatment requirements to FCMs in the Commission's regulations, the Commission has determined to withdraw the First Proposal. The Commission now proposes regulations to require an FCM to ensure that a customer does not withdraw funds from its account with the FCM if the balance in such account after such withdrawal would be insufficient to meet the customer's initial margin requirements, and relatedly, to permit an FCM, in certain circumstances and subject to certain conditions, to treat the separate accounts of a single customer as accounts of separate entities for purposes of certain Commission regulations (Second Proposal). The proposed amendments would establish the conditions under which an FCM may engage in such separate account treatment.

DATES: Comments must be received on or before April 22, 2024.

ADDRESSES: You may submit comments, identified by RIN 3038–AF21, by any of the following methods:

- *CFTC Comments Portal: https://comments.cftc.gov*. Select the "Submit Comments" link for this rulemaking and follow the instructions on the Public Comment Form.
- *Mail:* Send to Christopher Kirkpatrick, Secretary of the Commission, Commodity Futures Trading Commission, Three Lafayette Centre, 1155 21st Street NW, Washington, DC 20581.
- *Hand Delivery/Courier:* Follow the same instructions as for Mail, above.

Please submit your comments using only one of these methods. Submissions through the CFTC Comments Portal are encouraged. All comments must be submitted in English, or if not, accompanied by an English translation. Comments will be posted as received to *https://comments.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. 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 *https://comments.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 proposed determination and order 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 FOIA.

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I. Background

A. The Commission's Customer Funds Protection Regulations[1]

Two of the fundamental purposes of the CEA are the avoidance of systemic risk and the protection of market participants from misuses of customer assets.[2] The Commission has promulgated a number of regulations in furtherance of those objectives, including regulations designed to ensure that FCMs appropriately margin customer accounts, and are not induced to cover one customer's margin shortfall with another customer's funds. In addition to protecting customer assets, the current regulations serve the purpose of avoidance of systemic risk by mitigating the risk that a customer default in its obligations to a clearing FCM results in the clearing FCM in turn defaulting on its obligations to a DCO, which could adversely affect the stability of the broader financial system.

Section 4d(a)(2) of the CEA and Commission regulation § 1.20(a) require an FCM to separately account for and segregate from its own funds all money, securities, and property which it has received to margin, guarantee, or secure the trades or contracts of its commodity customers.[3] Additionally, section 4d(a)(2) of the CEA and Commission regulation § 1.22(a) prohibit an FCM from using the money, securities, or property of one customer to margin or settle the trades or contracts of another customer.[4] This requirement is designed to prevent disparate treatment of customers by an FCM and mitigate the risk that there will be insufficient funds in segregation to pay all customer claims if the FCM becomes insolvent.[5] Section 4d(a)(2) of the CEA and regulations §§ 1.20 and 1.22 effectively require an FCM to add its own funds into segregation in an amount equal to the sum of all customer undermargined amounts, including customer

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[1] For purposes of completeness and explanation of the basis for this Second Proposal, the Commission restates its explanation of its customer funds protection regulations, as stated in the First Proposal. *See* Derivatives Clearing Organization Risk Management Regulations to Account for the Treatment of Separate Accounts by Futures Commission Merchants, 88 FR 22934, 22935-22936 (Apr. 14, 2023) (First Proposal).
[2] Section 3(b) of the CEA, 7 U.S.C. 5(b).
[3] 7 U.S.C. 6d(a)(2); 17 CFR 1.20(a).
[4] 7 U.S.C. 6d(a)(2); 17 CFR 1.22(a).
[5] Prohibition of Guarantees Against Loss, 46 FR 11668, 11669 (Feb. 10, 1981).

account deficits, to prevent the FCM from being induced to use one customer's funds to margin or carry another customer's trades or contracts.[6]

Section 5b of the CEA,[7] as amended by the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010,[8] sets forth eighteen core principles with which DCOs must comply to register and maintain registration as DCOs with the Commission. In 2011, the Commission adopted regulations for DCOs to implement Core Principle D, which concerns risk management.[9] These regulations include a number of provisions that require a DCO to in turn require that its clearing members take certain steps to support their own risk management in order to mitigate the risk that such clearing members pose to the DCO.

Specifically, Commission regulation § 39.13(g)(8)(iii) provides that a DCO shall require an FCM clearing member to ensure that a customer does not withdraw funds from its account with such clearing member unless the net liquidating value plus the margin deposits remaining in the customer's account after the withdrawal would be sufficient to meet the customer initial margin requirements with respect to the products or portfolios in the customer's account, which are cleared by the DCO.[10] Regulation § 39.13(g)(8)(iii) thus establishes a "Margin Adequacy Requirement," designed to mitigate the risk that an FCM clearing member fails to hold, from a customer, funds sufficient to cover the required initial margin for the customer's cleared positions.[11] In light of the use of omnibus margin accounts, where the funds of multiple customers are held together, this

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[6] 7 U.S.C. 6d(a)(2); 17 CFR 1.20; 17 CFR 1.22; Prohibition of Guarantees Against Loss, 46 FR at 11669.
[7] 7 U.S.C. 7a-1(b).
[8] Dodd-Frank Wall Street Reform and Consumer Protection Act, Public Law 111-203, 124 Stat. 1376 (2010).
[9] Section 5b(c)(2)(D) of the CEA, 7 U.S.C. 7a-1(c)(2)(D); Derivatives Clearing Organization General Provisions and Core Principles, 76 FR 69334, 69335 (Nov. 8, 2011).
[10] 17 CFR 39.13(g)(8)(iii).
[11] For purposes of this proposed rulemaking, the Commission uses the term "Margin Adequacy Requirement" to refer to this requirement, which applies indirectly to clearing FCMs via the operation of DCO rules, and the analogous requirement set forth in proposed regulation § 1.44(b) which would apply directly to all FCMs.

safeguard is necessary to "avoid the misuse of customer funds"[12] by mitigating the likelihood that the clearing member will effectively cover one customer's margin shortfall using another customer's funds.

In adopting the Margin Adequacy Requirement of regulation § 39.13(g)(8)(iii), the Commission stated[13] that the regulation was consistent with the definition of "Margin Funds Available for Disbursement" in the Margins Handbook[14] prepared by the Joint Audit Committee (JAC), a representative committee of U.S. futures exchanges and the National Futures Association (NFA).[15] The Commission noted that while designated self-regulatory organizations (DSROs) reviewed FCMs to determine whether they appropriately prohibited their customers from withdrawing funds from their futures accounts, it was unclear to what extent that requirement applied to cleared swap accounts when such swaps were executed on a designated contract market (DCM) that participated in the JAC.[16] The Commission also noted that clearing members that cleared only swaps that were executed on a swap execution facility were not subject to the requirements of the JAC Margins Handbook or review by a DSRO.[17]

Thus, regulation § 39.13(g)(8)(iii) was also designed to apply these risk mitigation and customer protection standards to futures and swap positions carried in customer accounts by clearing FCMs. However, Commission regulations do not apply a Margin Adequacy Requirement to non-clearing FCMs, and regulation § 39.13(g)(8)(iii) does not require DCOs to apply that requirement to the positions carried by a clearing

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[12] Section 3(b) of the CEA, 7 U.S.C. 5(b).
[13] Derivatives Clearing Organization General Provisions and Core Principles, 76 FR at 69379.
[14] JAC Margins Handbook, available at *http://www.jacfutures.com/jac/MarginHandBookWord.aspx*.
[15] Joint Audit Committee, JAC Members, available at *http://www.jacfutures.com/jac/Members.aspx*. Self-regulatory organizations, such as commodity exchanges and registered futures associations (*e.g.*, NFA), enforce minimum financial and reporting requirements, among other responsibilities, for their members. *See* Commission regulation § 1.3, 17 CFR 1.3. Pursuant to Commission regulation § 1.52(d), when an FCM is a member of more than one self-regulatory organization, the self-regulatory organizations may decide among themselves which of them will assume primary responsibility for these regulatory duties and, upon approval of such a plan by the Commission, the self-regulatory organization assuming such primary responsibility will be appointed the designated self-regulatory organization for the FCM. 17 CFR 1.52(d).
[16] Derivatives Clearing Organization General Provisions and Core Principles, 76 FR at 69379.
[17] *Id.*

FCM that are not cleared at a registered DCO (*e.g.*, most foreign futures and foreign option positions).[18]

B. The Divisions' No-Action Position[19]

On July 10, 2019, the Division of Swap Dealer and Intermediary Oversight (DSIO) (now Market Participants Division (MPD)) and the Division of Clearing and Risk (DCR) (collectively, the Divisions) published CFTC Letter No. 19-17, which, among other things, provides guidance with respect to the processing of margin withdrawals under regulation § 39.13(g)(8)(iii) and announced a conditional and time-limited no-action position for certain such withdrawals.[20] The advisory followed discussions with and written representations from the Asset Management Group of the Securities Industry and Financial Markets Association (SIFMA-AMG), the Chicago Mercantile Exchange (CME), the Futures Industry Association (FIA), the JAC, and several FCMs, regarding practices among FCMs and their customers related to the handling of separate accounts of the same customer.[21] CFTC Letter No. 19-17 used the term "beneficial owner" synonymously with the term "customer," as "beneficial owner" was, in this context, commonly used to refer to the customer that is financially responsible for an account. Additionally, as discussed further below, in the customer relationship context, FCMs often deal directly with a commodity trading advisor acting as an agent of the customer

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[18] The term "foreign futures" means any contract for the purchase or sale of any commodity for future delivery made, or to be made, on or subject to the rules of any foreign board of trade. 17 CFR 30.1(a). The term "foreign option" means any transaction or agreement which is or is held out to be of the character of, or is commonly known to the trade as, an "option", "privilege", "indemnity", "bid", "offer", "put", "call", "advance guaranty" or "decline guaranty", made or to be made on or subject to the rules of any foreign board of trade. 17 CFR 30.1(b).

[19] For purposes of completeness and explanation of the basis for this Second Proposal, the Commission restates its explanation of the no-action position contained in CFTC Letter No. 19-17, as stated in the First Proposal. *See* First Proposal, 88 FR 22936-22937.

[20] CFTC Letter No. 19-17, July 10, 2019, available at *https://www.cftc.gov/csl/19-17/download* as extended by CFTC Letter No. 20-28, Sept. 15, 2020, available at *https://www.cftc.gov/csl/20-28/download*; CFTC Letter No. 21-29, Dec. 21, 2021, available at *https://www.cftc.gov/csl/21-29/download*; and CFTC Letter No. 22-11, Sept. 15, 2022, available at https://www.cftc.gov/csl/22-11/download; CFTC Letter No. 23-13, Sept. 11, 2023, available at *https://www.cftc.gov/csl/23-13/download*.

[21] SIFMA-AMG letter dated June 7, 2019 to Brian A. Bussey and Matthew B. Kulkin (SIFMA-AMG Letter); CME letter dated June 14, 2019 to Brian A. Bussey and Matthew B. Kulkin (CME Letter); and FIA letter dated June 26, 2019 to Brian A. Bussey and Matthew B. Kulkin (First FIA Letter).

rather than the customer itself. For the avoidance of confusion (*e.g.*, with regard to the terms "owner" or "ownership," as those terms are used in Forms 40 and 102, or parts 17-20, or with regard to the term "beneficial owner," as that term may be used by other agencies), this proposed rulemaking uses only the term "customer," except where directly quoting or paraphrasing a source that uses "beneficial owner."

The written representations preceding the issuance of CFTC Letter No. 19-17 included letters filed separately by SIFMA-AMG, CME, and FIA (collectively, the "Industry Letters").[22] Citing regulation § 39.13(g)(8)(iii)'s requirements related to the withdrawal of customer initial margin, and JAC Regulatory Alert #19-02 reminding FCMs of those requirements,[23] SIFMA-AMG and FIA explained that provisions in certain FCM customer agreements provide that certain accounts carried by the FCM that have the same customer are treated as accounts for different legal entities (*i.e.*, "separate accounts").[24]

As FIA explained, there are a variety of reasons why a customer may want separate treatment for its accounts under such an agreement.[25] For instance, an institutional customer, such as an investment or pension fund, may allocate assets to investment managers under investment management agreements that require each investment manager to invest a specified portion of the customer's assets under management in accordance with an agreed trading strategy, independent of the trading that may be undertaken for the customer by the same or other investment managers acting on behalf of other accounts of the customer.[26] In such a situation, an investment manager

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[22] The Commission notes that while CME disagreed with certain aspects of FIA's letter that fall beyond the scope of this rulemaking, CME's letter noted that CME was "amenable to the Commission amending Rule 39.13(g)(8)(iii) to allow a DCO to permit a[n] FCM to release excess funds from a customer's separate account notwithstanding an outstanding margin call in another account of the same customer provided that certain specified risk-mitigating conditions … are satisfied." CME Letter.

[23] JAC, Regulatory Alert #19-02, May 14, 2019, available at *http://www.jacfutures.com/jac/jacupdates/2019/jac1902.pdf*.

[24] SIFMA-AMG Letter; First FIA Letter.

[25] First FIA Letter.

[26] *See id.*

may, in order to implement its trading strategy effectively, want assurance that the portion of funds it has been allocated to manage is entirely available to the investment manager, and will not be affected by the activities of other investment managers who manage other portions of the customer's assets and maintain separate accounts at the same FCM. Additionally, a commercial enterprise may establish separate agreements to leverage specific broker expertise on products or to diversify risk management strategies.[27] In such cases, each separate account may be subject to a separate customer agreement, which the FCM negotiates directly with, in many cases, the customer's agent, which often will be an investment manager.[28]

SIFMA-AMG and FIA asserted that, subject to appropriate FCM internal controls and procedures, separate accounts should be treated as separate legal entities for purposes of regulation § 39.13(g)(8)(iii); *i.e.*, separate accounts should not be combined when determining an account's margin funds available for disbursement.[29] SIFMA-AMG and FIA maintained that such separate account treatment should not be expected to expose an FCM to any greater regulatory or financial risk, and asserted that an FCM's internal controls and procedures could be designed to assure that the FCM does not undertake any additional risk as to the separate account.[30] The Industry Letters included a number of examples of such controls and procedures.[31]

In its letter, SIFMA-AMG suggested that it would be possible to allow for separate account treatment without undermining the risk mitigation and customer protection goals of regulation § 39.13(g)(8)(iii).[32] SIFMA-AMG recognized that there may be some instances, such as a customer default, in which separate account treatment

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[27] *Id.*
[28] *Cf. id.*
[29] SIFMA-AMG Letter; First FIA Letter.
[30] SIFMA-AMG Letter; First FIA Letter.
[31] SIFMA-AMG Letter; First FIA Letter; CME Letter.
[32] SIFMA-AMG Letter.

would no longer be appropriate.[33] SIFMA-AMG stated that an FCM could agree to first satisfy any amounts owed from agreed assets related to a separate account, and continue to release funds until the FCM provided the separate account with a notice of an event of default under the applicable clearing account agreement, and determined that it is no longer prudent to continue to separately margin the separate accounts, provided that such actions are consistent with the FCM's written internal controls and procedures.[34] SIFMA-AMG further stated that, in such instance, the FCM would retain the ability to ultimately look to funds in other accounts of the customer, including accounts under different control, and the right to call the customer for funds.[35] CME similarly asserted that disbursements on a separate account basis should not be permitted in certain circumstances, such as financial distress, that fall outside the "ordinary course of business."[36] While CME asserted that the plain language of regulation § 39.13(g)(8)(iii) unambiguously forbids disbursements on a separate account basis, CME noted that it would be amenable to the Commission amending the regulation to permit such disbursements, subject to certain such risk-mitigating conditions.[37]

SIFMA-AMG and FIA requested that DCR confirm that it would not recommend that the Commission initiate an enforcement action against a DCO that permits its clearing FCMs to treat certain separate accounts of a customer as accounts of separate entities for purposes of regulation § 39.13(g)(8)(iii),[38] and confirm that a clearing FCM may release excess funds from a separate customer account notwithstanding an outstanding margin call in another account of the same customer.[39]

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[33] *Id.*
[34] *Id.*
[35] *Id.*
[36] CME Letter.
[37] *Id.*
[38] FIA specifically noted that such a no-action position could be conditioned on the FCM maintaining certain internal controls and procedures.
[39] SIFMA-AMG Letter; First FIA Letter; *see also* CME Letter.

In CFTC Letter No. 19-17, DCR stated that, in the context of separate accounts, the risk management goals of regulation § 39.13(g)(8)(iii) may effectively be addressed if a clearing FCM carrying a customer with separate accounts meets certain conditions, which were derived from the Industry Letters and specified in CFTC Letter No. 19-17.[40] DCR stated that it would not recommend that the Commission take enforcement action against a DCO if the DCO permits its clearing FCMs to treat certain separate accounts as accounts of separate entities for purposes of regulation § 39.13(g)(8)(iii) subject to these conditions.[41] The no-action position extended until June 30, 2021, in order to provide staff with time to recommend, and the Commission with time to determine whether to conduct and, if so, conduct, a rulemaking to implement a permanent solution.[42] CFTC Letter No. 20-28, published on September 15, 2020, extended the no-action position until December 31, 2021 due to challenges presented by the COVID-19 pandemic.[43] CFTC Letter No. 20-28 stated that if the process to consider codifying the no-action position provided for by CFTC Letter No. 19-17 was not completed by that date, DSIO and DCR would consider further extending the no-action position.[44] The Divisions published CFTC Letter No. 21-29, further extending the no-action position until September 30, 2022.[45] On September 15, 2022, the Divisions published CFTC Letter No. 22-11, which further extended the no-action position until the earlier of September 30, 2023 or the effective date of any final Commission action relating to regulation § 39.13(g).[46] As with CFTC Letter No. 21-29, this extension was issued in order to provide additional time for the Commission to consider a rulemaking. As discussed further below, while the Commission proposed a rulemaking to codify the no-action position in CFTC Letter No.

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[40] CFTC Letter No. 19-17.
[41] *Id.*
[42] *Id.*
[43] CFTC Letter No. 20-28.
[44] *Id.*
[45] CFTC Letter No. 21-29.
[46] CFTC Letter No. 22-11.

19-17, the Commission has determined to withdraw that proposed rulemaking in light of comments received and propose a new rulemaking in part 1 of its regulations to both impose a Margin Adequacy Requirement (as discussed herein) and simultaneously provide for separate account treatment. On September 11, 2023, the Divisions published CFTC Letter No. 23-13, extending the no-action position until the earlier of June 30, 2024 or the effective date of any final Commission action relating to regulation § 39.13(g),[47] to provide further time for staff to develop and for the Commission to consider the Second Proposal, and to receive and consider comments thereon and consider and adopt a final rule.

C. The Commission's First Proposal and its Withdrawal

On April 14, 2023, the Commission published in the *Federal Register* a notice of proposed rulemaking – the First Proposal – designed to codify the no-action position in CFTC Letter No. 19-17.[48] The First Proposal proposed to amend regulation § 39.13 to add new paragraph (j) allowing a DCO to permit a clearing FCM to treat the separate accounts of customers as accounts of separate entities for purposes of regulation § 39.13(g)(8)(iii), if such clearing member's written internal controls and procedures permitted it to do so, and the DCO required its clearing members to comply with conditions specified in proposed regulation § 39.13(j).

The conditions for separate account treatment in proposed regulation § 39.13(j) were substantially similar to the conditions specified in CFTC Letter No. 19-17. However, certain conditions in proposed regulation § 39.13(j) reflected modification of the conditions in CFTC Letter No. 19-17 on which they were based. Such modifications included adding further reporting requirements for clearing members required to cease separate account treatment, an explicit process for clearing members to resume separate

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[47] The Commission notes that this Second Proposal amends § 39.13(g) to refer to proposed regulation § 1.44.

[48] First Proposal.

account treatment, and provisions designed to further clarify the requirement that separate accounts be on a one business day margin call.

The comment period for the First Proposal was extended once at the request of a commenter and closed on June 30, 2023.[49] The Commission received comments from twelve commenters.[50] While commenters generally supported codifying the no-action position in CFTC Letter No. 19-17, six commenters[51] contended that the Commission should codify the no-action position in its part 1 FCM regulations (where it would apply directly to all FCMs) rather than its part 39 DCO regulations (where it applies only to clearing FCMs, through the instrumentality of DCOs). Other commenters did not opine on whether the proposed codification should be in part 1 versus part 39.

The Commission originally proposed to codify the no-action position in CFTC Letter No. 19-17 in part 39 in order to hew closely to the operation of the no-action position: DCOs could choose to permit clearing FCMs to engage in separate account treatment, provided such clearing FCMs complied with certain conditions.

In its comment responding to the First Proposal, CME recommended codification in part 1 to extend the benefits of separate account treatment to all FCMs equally, whether or not they are clearing members of one or more DCOs.[52] CME asserted that codification in part 1 would eliminate the risk that a current or future DCO chooses not to permit separate account treatment, noting that CME's own clearing members have invested significant time and effort in conforming their policies, systems, and practices to comply with the no-action conditions and related JAC advisory notices.[53] As CME further contended, under the First Proposal, if one DCO chose not to permit separate

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[49] Derivatives Clearing Organization Risk Management Regulations to Account for the Treatment of Separate Accounts by Futures Commission Merchants, 88 FR 39205 (June 15, 2023).
[50] American Council of Life Insurers (ACLI), CME, FIA, Intercontinental Exchange, Inc. (ICE), JAC, Managed Funds Association (MFA), NFA, SIFMA-AMG, Symphony Communications Services, LLC, and three individuals.
[51] CME, FIA, ICE, JAC, NFA, and SIFMA-AMG.
[52] CME Comment Letter.
[53] *Id.* (citing regulations §§ 1.17, 1.20 and 22.2).

account treatment, then an FCM would have to exclude contracts cleared through that DCO from its customers' separate accounts.[54] CME argued that this would likely make separate margining operationally infeasible, noting that the First Proposal acknowledged that an FCM's futures account for a customer includes all futures products that the FCM clears for the customer, and the initial margin requirement for the account would be the total of the initial margin the FCM charges the customer for each contract in the account, in each case regardless of the DCO at which the contracts are cleared.[55]

CME also asserted that the First Proposal would effectively create two sets of reporting requirements applicable only to those FCM clearing members who choose to implement separate account margining at one or more DCOs, with new reporting requirements that conflict with regulations in part 1 that require calculation of deficits across all accounts of a single beneficial owner.[56]

CME further asserted that codification in part 39 would create new burdens for DCOs related to conducting examinations for compliance and the composition of DCO Chief Compliance Officer (CCO) reports, and would allow for disparate implementation by DCOs.[57] CME additionally opined that certain proposed requirements in the First Proposal were outside the scope of DCOs' risk management responsibilities and instead should be applied directly to FCMs.[58]

In its comment, FIA contended that rules that affect the obligations of FCMs should be set out in part 1, and, similar to CME, argued that, if the no-action position is codified in part 1, then non-clearing FCMs and FCMs that maintain 30.7 accounts for 30.7 customers pursuant to part 30 of the Commission's regulations would be able to provide consistent treatment to customers with the same enhanced risk management

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[54] *Id.*
[55] *Id.*
[56] *Id.*
[57] *Id.*
[58] *Id.*

standards set forth in the no-action position.[59] FIA also asserted that codification in part 1 would allow an FCM to control whether enhanced standards and separate account treatment are offered to a specific customer, rather than requiring each DCO to manage and control whether separate account treatment is permitted.[60] FIA additionally contended that the terms and conditions under which separate account treatment should be permitted or prohibited is a decision that the Commission, rather than individual DCOs, should make.[61]

In its comment, ICE supported part 1 codification on the basis that the no-action conditions are mainly relevant to the operation of an FCM and its relationship with its customers, rather than the operation of a DCO.[62] ICE also argued that supervision of FCM compliance with requirements related to separate accounts would be more consistently applied if not done at the individual DCO level.[63] ICE noted that functions of supervision, examination, and surveillance of the relationship between FCMs and customers are typically performed by an FCM's DSRO under Commission regulation § 1.52, rather than by DCOs.[64] ICE further contended that it would be more efficient for an FCM to address issues related to separate account treatment with a single DSRO rather than each DCO of which it is a member, and that imposing on DCOs additional burden

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[59] FIA Comment letter. As set forth in Commission regulations, the term "30.7 account" means any account maintained by an FCM for or on behalf of 30.7 customers to hold money, securities, or other property to margin, guarantee, or secure foreign futures or foreign option positions. 17 CFR 30.1(g). The term "30.7 customer" means any person who trades foreign futures or foreign options through an FCM, except for the owner or holder of a proprietary account as defined in regulation § 1.3. 17 CFR 30.1(f).

[60] *Id.*

[61] *Id.* FIA noted that FCMs collect customer margin across DCOs and, if a DCO was to deny its clearing FCMs the right to provide separate account treatment, or establish different standards, such FCMs would effectively be denied the right to provide separate account treatment for their customers. *Id.*

[62] ICE Comment Letter. For instance, ICE contended that DCOs would not be well-placed to administer or enforce ensuring FCMs verify the identity of authorized representatives of clients, and recommended that if the Commission believes it necessary to establish steps clearing FCMs must take to identify such representatives, that it applies those requirements directly to such FCMs. *Id.* ICE also contended that a DSRO would be better placed than a DCO to readily assess whether an FCM is applying separate account treatment consistently. *Id.*

[63] *Id.*

[64] *Id.*

and costs of supervising separate account treatment conditions may disincentivize DCOs from permitting FCMs to engage in separate account treatment.[65]

In its comment, the JAC opined that conditions for separate account treatment should be stringent enough to mitigate to the maximum extent possible the additional risks to other customers of an FCM that separate account treatment presents, but noted that, in any case, part 39 DCO regulations do not fall under the JAC's self-regulatory organization surveillance authority.[66] Similar to CME, the JAC also asserted that the First Proposal lacked clarity regarding whether it contemplated bifurcated reporting requirements, because the First Proposal provided that a clearing FCM would need to calculate certain separate account customer balances for capital and segregation differently than under parts 1, 22, or 30, but did not include amendments to those regulations.[67] Thus, the JAC argued, it was unclear whether the JAC would continue to review and monitor an FCM's financial statements prepared in accordance with those regulations, while a DCO would monitor the FCM's different computations prepared in accordance with proposed regulation § 39.13(j).[68] The JAC also noted that the First Proposal did not provide for separate account treatment for non-clearing FCMs and Commission regulation § 30.7 customers.[69]

Like other commenters, NFA argued that codification in part 1 would provide a clear path for an FCM's DSRO to examine it for compliance with separate account treatment requirements, and would provide greater clarity to non-clearing FCMs regarding whether they are permitted to engage in separate account treatment.[70]

SIFMA-AMG recommended incorporating the First Proposal's conditions, with modifications, in Commission regulations §§ 1.11 and 1.56, and argued that codification

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[65] *Id.*
[66] JAC Comment Letter.
[67] *Id.*
[68] *Id.*
[69] *Id.*
[70] NFA Comment Letter.

in part 1 would directly establish obligations for the FCM, rather than indirect obligations applied through the DCO, with respect to separate treatment of customer accounts within the CFTC's regulatory framework.[71] SIFMA-AMG also argued that codification in part 1 would clarify that the regulatory obligations of the proposed regulation are the FCM's, and not the DCO's obligation to evaluate and determine if the FCM's behavior was appropriate.[72]

In light of these comments, the Commission has determined to propose codification of the underlying Margin Adequacy Requirement (*i.e.*, that an FCM should not permit a customer to withdraw margin funds from that customer's accounts with the FCM if the net liquidating value plus the margin deposits remaining in such accounts after such withdrawal would be insufficient to meet the customer's initial margin requirements)[73] along with the conditional modification of that requirement embodied in CFTC Letter No. 19-17, in part 1 of its regulations. The Commission believes codification in part 1 can be effectuated in a manner that provides appropriate flexibility for market participants, enhanced risk management and protection of customer funds along with appropriate flexibility for a larger number of FCMs, and more efficient supervision of compliance with the no-action conditions proposed to be codified, while maintaining the effectiveness of those conditions. Therefore, the Commission formally withdraws its First Proposal, and proposes this new rulemaking to provide for separate account treatment through part 1 of its regulations.

Separate from the question of whether the proposed codification should be in part 1 versus part 39, commenters provided feedback related to the proposed codification of individual no-action conditions. These comments are discussed below. The Commission

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[71] SIFMA-AMG Comment Letter.

[72] *Id.*

[73] As discussed further below, this requirement, which currently is effectively applied only to clearing FCMs, and predominately to part 1 (futures customer) and part 22 (Cleared Swaps Customer) accounts, would through codification in part 1 effectively apply to all FCMs, including those that are not members of a DCO, and would apply to all FCMs' 30.7 accounts.

notes that, with some exceptions that it believes are helpful to understanding differences between the First Proposal and this Second Proposal, certain comments that appear to be premised specifically on the First Proposal's proposed codification in part 39 in contrast to part 1 are not discussed, as the Commission no longer proposes to codify the no-action position in part 39.

In addition to the comments noted above, FIA supported amending regulation § 1.56 to add a new paragraph recognizing (i) the right of an FCM to allow a customer to withdraw excess funds from a separate account while there is an outstanding margin call in another separate account, and (ii) that an FCM may agree that, in the absence of certain conditions, it will not use excess funds from one account to meet an obligation in another account without the customer's consent.[74] ACLI, MFA, and SIFMA-AMG additionally supported codification of interpretation of regulation § 1.56.[75]

While appreciating those comments, the Commission seeks in this Second Proposal to engage in a narrower task: to directly apply the Margin Adequacy Requirement to all FCMs, while enacting a narrow codification (with respect to all FCMs) of the no-action position in CFTC Letter No. 19-17 with respect to the current Margin Adequacy Requirement embodied in regulation § 39.13(g)(8)(iii). Amendments to regulation § 1.56 are outside the scope of the proposed rulemaking.

As such, where an FCM elects to apply separate account treatment, such treatment shall apply only for purposes of proposed regulation § 1.44 (inclusive of the Margin Adequacy Requirement of proposed regulation § 1.44(b)), including requirements that flow through to, *e.g.*, Commission regulations §§ 1.17, 1.20, 1.32, 1.58, 1.73, 22.2, 30.7,

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[74] FIA Comment Letter. The Commission also received comments from two individuals generally supportive of the First Proposal. Additionally, the Commission received a comment from Symphony Communication Services, LLC, describing ways in which the commenter's technological capabilities could facilitate compliance with certain components of the First Proposal. Lastly, the Commission received a comment from an individual requesting that the Commission provide a chart explaining to what extent and subject to what conditions portfolio-based margining is available across specific products and scenarios. The Commission considers this request outside the scope of this Second Proposal.

[75] ACLI Comment Letter; MFA Comment Letter; SIFMA-AMG Comment Letter.

the gross margining requirement of regulation § 39.13(g)(8)(i), and the Margin Adequacy Requirement of proposed regulation § 39.13(g)(8)(iii). Nothing in this rulemaking is intended to affect the requirements of regulation § 1.56 or, unless otherwise expressly indicated, any other Commission regulation.

D. The Commission's Second Proposal

For the reasons discussed above, the Commission proposes to codify the Margin Adequacy Requirement, along with the no-action position in CFTC Letter No. 19-17, in part 1. The bulk of the proposed regulation will be contained in new Commission regulation § 1.44, which is presently reserved. However, as explained below, the Commission also proposes supporting amendments in Commission regulations §§ 1.3, 1.17, 1.20, 1.32, 1.58, 1.73, 22.2, 30.2, 30.7, and 39.13 to facilitate implementation of proposed regulation § 1.44. The Commission is also proposing a number of amendments to address inadvertent inconsistencies in existing regulations.[76]

The Commission's Second Proposal represents in part a reorganization of the First Proposal. The First Proposal largely mirrored the organization of the no-action position in CFTC Letter No. 19-17, first providing that a DCO could allow a clearing FCM to engage in separate account treatment (so long as such clearing FCM complied with certain conditions), then explaining specific circumstances that would disqualify a clearing FCM from engaging in separate account treatment, and finally providing the

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[76] These are proposed changes to regulation § 1.3 (to clarify that Saturday is not a business day), regulation § 1.17(b) (to reorganize the wording of the definition of the term "business day" for capital purposes to be consistent with the wording in the proposed amendments to regulation § 1.3, to clarify that the definition of the term "risk margin" includes both customer and noncustomer accounts, and to change the term "FCM" to read "futures commission merchant"), regulations §§ 1.20(i), 30.7(f)(2), and 22.2(f) to revise the regulatory description of the calculation of the total amount of funds that an FCM must hold in segregation for futures customers, Cleared Swaps Customers, and 30.7 customers, respectively, to align such description with the Commission's financial forms and the instructions to such forms, reorganizing regulations § 22.2(f)), § 1.58(a) and (b) (to clarify that gross margining requirements for omnibus accounts carried for one FCM at another FCM apply to cleared swaps as well as to futures and options and futures), and § 30.2(b) (to clarify, in the context of the exclusion for applying certain regulations to persons and transactions subject to the requirements of part 30, existing regulations §§ 1.41, 1.42, and 1.43 (which were added in the 2021 part 190 bankruptcy rulemaking) are not excluded). These proposed changes are discussed in more detail in the relevant sections below.

specific risk-mitigating conditions with which the clearing FCM would be required to comply in order to provide separate account treatment.

Proposed regulation § 1.44 is comprised of eight paragraphs. First, proposed regulation § 1.44(a) defines key terms solely for purposes of proposed regulation § 1.44. Second, proposed regulation § 1.44(b) incorporates for all FCMs, and for all accounts,[77] the same Margin Adequacy Requirement that DCOs are obligated in regulation § 39.13(g)(8)(iii) to require their clearing FCMs to apply. Third, proposed regulation § 1.44(c) makes clear that an FCM can engage in separate account treatment only during the "ordinary course of business," a term that is defined in proposed regulation § 1.44. Fourth, proposed regulation § 1.44(d) explains how FCMs may elect to engage in separate account treatment for one or more customers. Fifth, proposed regulation § 1.44(e) enumerates events inconsistent with the ordinary course of business and contains requirements for FCMs related to cessation of separate account treatment upon the occurrence of such events, and resumption of separate account treatment upon the cure of such events. Sixth, proposed regulation § 1.44(f) contains the requirement that each separate account be on a "one business day margin call" and sets out regulations designed to explain the meaning of a one business day margin call for purposes of proposed regulation § 1.44. Seventh, proposed regulation § 1.44(g) sets forth capital, risk management, and segregation calculation requirements with which FCMs would be required to comply with respect to accounts for which the FCM has elected separate treatment. Eighth, proposed regulation § 1.44(h) sets out information and disclosure requirements for FCMs that engage in separate account treatment.

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[77] Proposed regulation § 1.44(a) defines "account" to include futures accounts and Cleared Swaps Customer Accounts, both of which terms are defined in regulation § 1.3, and 30.7 accounts. A 30.7 account means any account maintained by an FCM for or on behalf of 30.7 customers to hold money, securities, or other property to margin, guarantee, or secure foreign futures or foreign options. 17 CFR 30.1(g).

In its comment responding to the First Proposal, the JAC recommended adding two additional conditions for separate account treatment. First, the JAC supported adding a condition requiring a clearing FCM's risk-based capital requirement to be adjusted to capture the risk of accounts receiving separate treatment.[78] As discussed below, the Commission is proposing to amend regulation § 1.17 to revise an FCM's risk-based capital requirement to capture the risks of separate accounts. Second, the JAC supported adding a condition requiring accounts treated as separate accounts to be identified as such in an FCM's books and records, including on customer statements.[79] The Commission's proposed regulation § 1.44(d)(1), as discussed below, would provide that an FCM must include each separate account customer on a list of separate account customers maintained in its books and records. While an FCM may elect to specifically identify separate accounts as such in customer statements, the Commission expects that FCMs will be able to readily identify all of their customer accounts receiving separate treatment.

II. Proposed Regulations

Section 8a(5) of the CEA[80] authorizes the Commission "to make and promulgate such rules and regulation as, in the judgment of the Commission, are reasonably necessary to effectuate any of the provisions, or to accomplish any of the purposes, of" the CEA. The Commission is proposing these rules pursuant to section 8a(5) as reasonably necessary to effectuate sections 4d(a)(2) and 4d(f)(2),[81] providing for the segregation and protection of, respectively, futures customer funds and Cleared Swaps Customer Collateral, and 4(b)(2)(A),[82] providing for the safeguarding of customers' funds in connection with foreign futures and foreign option transactions. As additional authority, the Commission is also proposing these rules as reasonably necessary to

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[78] JAC Comment Letter.
[79] *Id.*
[80] 7 U.S.C. 12a(5).
[81] 7 U.S.C. 6d(a)(2) and (f)(2).
[82] 7 U.S.C. 6(b)(2)(A).

effectuate section 4f(b), which requires an FCM to meet minimum financial requirements prescribed by the Commission as necessary to ensure that the firm meets its obligations.[83] Moreover, as further additional authority, the Commission is also proposing these rules as reasonably necessary to accomplish the purposes of the CEA as set forth in section 3(b);[84] specifically, "the avoidance of systemic risk" and "protect[ing] all market participants from … misuses of customer assets."

Accordingly, the Commission preliminarily believes that the amendments proposed herein relating to the Margin Adequacy Requirement, and the modification of this requirement to permit, subject to certain prescribed conditions, separate account treatment in connection with the withdrawal of customer initial margin, support the customer funds protection and risk management provisions and purposes of the CEA. As further described below, the Commission also preliminarily believes that preventing the under-margining of customer accounts and mitigating the risk of a clearing member default, or the default of a non-clearing FCM, and the potential for systemic risk in either scenario, is effectively addressed by the standards set forth in the proposed regulation.

All FCMs are currently subject to a detailed set of requirements designed to provide effective protection for customer funds. These include, for futures accounts, regulations §§ 1.20 (requiring segregation), 1.22 (requiring, *inter alia*, residual interest to cover undermargined amounts), and 1.23 (requiring FCMs to maintain residual interest in segregated accounts up to a targeted amount that they determine based on specified considerations), as well as similar requirements with respect to Cleared Swaps Customer Accounts (respectively, regulations §§ 22.2(d) and (f), and 22.17), and 30.7 accounts (regulation § 30.7).

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[83] 7 U.S.C. 6f(b).
[84] 7 U.S.C. 5(b).

Regulation § 39.13(g)(8)(iii) provides an additional layer of protection, but only with respect to FCMs that are clearing members of DCOs. There is no analogous Margin Adequacy Requirement applicable to FCMs that are not clearing members of DCOs. As discussed above, regulation § 39.13(g)(8)(iii) is designed to mitigate the risk that a clearing member fails to hold, from a customer, funds sufficient to cover the required initial margin for the customer's cleared positions and, in light of the use of omnibus margin accounts, "avoid the misuse of customer funds" by mitigating the likelihood that the clearing member will effectively cover one customer's margin shortfall using another customer's funds.[85] Regulation § 39.13(g)(8)(iii) provides a risk mitigation provision for DCOs, clearing FCMs, and customers. The effect of the staff no-action position is to allow DCOs to permit clearing FCMs to engage in separate account treatment for purposes of that provision, but subject to conditions designed to maintain the provision's risk mitigating effects.

Where it is now proposing to establish requirements for separate account treatment for all FCMs by adding a similar Margin Adequacy Requirement to part 1, the Commission seeks to replicate the same regulatory structure on an all-FCM basis, and furthers the customer fund protection and risk mitigation purposes of the CEA[86] by implementing measures designed to further ensure that all FCMs, whether clearing or non-clearing, do not create or exacerbate an under-margining scenario.

Similar to the First Proposal, the requirements for separate account treatment proposed herein are designed to ensure that FCMs carry out separate account treatment in a consistent and documented manner, monitor customer accounts on a separate and combined basis, identify and act upon instances of financial or operational distress that

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[85] Section 3(b) of the CEA, 7 U.S.C. 5(b).

[86] Section 3(b) of the CEA, 7 U.S.C. 5(b) (It is the purpose of this Act to ensure the financial integrity of all transactions subject to this Act and the avoidance of systemic risk and to protect all market participants from misuses of customer assets)

necessitate a cessation of separate account treatment, provide appropriate disclosures to customers[87] regarding separate account treatment, and apprise their DSROs when they apply separate account treatment or an event has occurred that would necessitate cessation of separate account treatment.[88]

The Second Proposal is designed to extend the customer protection and risk management benefits of regulation § 39.13(g)(8)(iii) to all FCMs and all of their customer accounts, and to provide an alternative means of achieving those risk management goals if the FCM elects to permit customers to maintain separate accounts under the proposal.[89] Additionally, as discussed further below in the cost benefit considerations, because a number of clearing FCMs have already implemented the conditions set forth in CFTC Letter No. 19-17, a number of FCMs will have already implemented, in significant part, the requirements proposed herein.

Request for Comment

Question 1: The Commission requests comment regarding whether, in light of changes made in this Second Proposal relative to the First Proposal, it should consider any conditions additional to those contained in proposed regulation § 1.44 below, or modify or remove any of the conditions proposed herein.

Question 2: The Commission requests comment regarding whether the interaction between proposed regulation § 1.44(g) through (h) and other regulations under parts 1, 22, and 30 affected by the proposed requirements therein (*e.g.*, regulations §§ 1.17, 1.20, 1.22, 1.23, 1.32, 1.55, 1.58, 1.73, 22.2, 30.2, and 30.7) is sufficiently clear.

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[87] In this proposal, references to a "customer" are to a direct customer of the FCM in question. Thus, where non-clearing FCM *N* clears through clearing FCM *C*, a customer (including a separate account customer) of *N* is not considered a customer of *C*.

[88] For the avoidance of doubt, the Second Proposal permits an FCM to elect to engage in separate account treatment. It neither requires an FCM to engage in such treatment nor requires a customer of an FCM that elects to engage in separate account treatment to elect to have its accounts with such FCM treated as separate accounts of separate entities. Thus, separate account treatment requires an affirmative election of both the FCM and the customer.

[89] As a result, proposed regulation § 1.44 would prohibit the application of portfolio margining or cross-margining treatment *between* separate accounts of the same customer, but would not prohibit the application of such treatments *within* a particular separate account of a customer.

A. Proposed Amendments to Regulation § 1.3

The definitions contained in Commission regulation § 1.3 are key to understanding and interpreting the Commission's regulations, including part 1 FCM regulations. The Commission believes the provisions of proposed regulation § 1.44 necessitate an amendment to regulation § 1.3.

The Commission proposes to amend the definition of "business day" in regulation § 1.3. Current regulation § 1.3 provides, in relevant part, that "business day" means any day other than a Sunday or holiday. The Commission proposes to expand this definition to confirm that the term encompasses any day other than a *Saturday*, Sunday, or holiday. This term, which is applicable to proposed regulation § 1.44(f), setting forth the requirement that separate accounts be on a one business day margin call, is similar to the proposed definition of "United States business day," which appeared in the First Proposal.[90] As in the First Proposal, however, the term is intended to encompass days on which banks and custodians are open in the United States to facilitate payment of margin. Thus, for the avoidance of doubt, "holiday" in this context refers to holidays in the United States.

The Commission notes that, notwithstanding the current definition of the term in regulation § 1.3, which is used in a variety of regulations, in actual practice, Saturdays are generally not treated as business days in the markets,[91] by market participants, or for regulatory purposes.[92] The Commission is thus proposing to change the definition of "business day" in regulation § 1.3 to conform to that reality.

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[90] Under the First Proposal, the term "United States business day" referred to weekdays not including federal holidays as established by 5 U.S.C. 6103.

[91] It is true that some markets are moving toward 24/7 operation. The Commission will continue to monitor these developments, and consider further rulemaking in this area as appropriate. Nonetheless, a definition of business days that includes Saturday, but not Sunday, does not reflect present or plausible future reality.

[92] For instance, Saturdays are treated as non-business days for purposes of swaps reporting under parts 43 and 45 of the Commission's regulations, 17 CFR 43.1; 17 CFR 45.2, execution of confirmations by swap dealers, 17 CFR 23.501(c)(5)(ii), and under the Commission's part 39 DCO regulations, 17 CFR 39.2 (defining an intraday business day period). *See also, e.g.*, CFTC, Guidebook for Part 17.00: Reports by

Request for Comment

Question 3: The Commission requests comment regarding whether its proposal to revise the definition of "business day" in regulation § 1.3 would result in any adverse consequences for any market participants.

B. Proposed Amendments to Regulation § 1.17

Regulation § 1.17 currently establishes minimum financial requirements for FCMs. In this regard, regulation § 1.17(a)(1)(i) provides that each person registered as an FCM must maintain adjusted net capital equal to, or in excess of, the greatest of: (1) $1 million (or $20 million if the FCM is also registered as a swap dealer); (2) eight percent of the total "risk margin" required on the positions in customer and noncustomer accounts[93] carried by the FCM; (3) the amount of adjusted net capital required by NFA as a registered futures association; or (4) for an FCM registered as a securities broker or dealer with the Securities and Exchange Commission (SEC), the amount of net capital required by SEC rule § 15c3-1.[94] For purposes of regulation § 1.17(a)(1)(i), the term "risk margin" is defined by paragraph (b)(8) of regulation § 1.17 to generally mean the level of maintenance margin or performance bond required for customer and noncustomer positions established by the applicable exchanges or clearing organizations.

The Commission is proposing several amendments to regulation § 1.17 to reflect the regulatory capital treatment of separate accounts that would result from the implementation of proposed regulation § 1.44, including the conditions contained in proposed regulation § 1.44(g)(3) discussed below. These proposed amendments were not part of the First Proposal. As a general matter, the proposed amendments to regulation § 1.17 are designed to ensure that FCMs risk manage separate accounts consistently, and

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Reporting Markets, Futures Commission Merchants, Clearing Members, and Foreign Brokers, at 18, May 30, 2023 (noting that for purposes of part 17.00 reports, "reporting entities may elect to not consider Saturdays to be a business day, as Saturday is not commonly known as such").

[93] The term "noncustomer account" generally means the accounts of affiliates of an FCM or employees of an FCM. *See* 17 CFR 1.17(b)(4).

[94] 17 CFR 240.15c3-1.

cannot revert to calculating minimum financial requirements on a combined account basis where such calculations would tend to reflect less risk and reduced financial requirements for a customer than if each of the customer's separate accounts were treated as an account of a distinct customer without regard to the same customer's other separate accounts.

Consistent with the above intent, the Commission is proposing to expand the list of modifiers to the definition of the term "risk margin" for an account by adding proposed paragraph (b)(8)(v) to regulation § 1.17, providing that if an FCM carries separate accounts for separate account customers pursuant to proposed regulation § 1.44, then the FCM shall calculate the risk margin pursuant to regulation § 1.17(a)(1)(i)(B)(*1*) as if each separate account is owned by a separate entity. The Commission notes that, under the proposed regulation, risk margin would be calculated on an individual basis for each separate account. Calculating risk margin separately for each separate account would eliminate the potential for portfolio margining offsets based on positions between separate accounts of the same separate account customer.[95] Therefore, the proposal to treat separate accounts as accounts of separate entities would either increase, or leave unchanged, the total risk margin requirement, and thus the minimum adjusted net capital requirement, for an FCM providing separate account treatment.[96] The proposed addition

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[95] As noted in regulation § 39.13(g)(4), a DCO may allow reduction in initial margin requirements for related positions if the price risks with respect to such positions are significantly and reliably correlated. This includes cases where (A) The products on which the positions are based are complements of, or substitutes for, each other. An example might be long versus short positions in oil and natural gas, both of which may be used for generating energy. However, portfolio margining is applicable only to accounts for the same customer. *See* regulation § 39.13(g)(8)(i) (requiring collection of initial margin on a gross basis for each clearing member's customer accounts). So, if a customer has, in a single account, both long oil positions and short natural gas positions, they may benefit from a reduction in initial margin requirements for the two risk-offsetting positions. However, if those positions are in different separate accounts of the customer under this proposal, the positions would not lead to an initial margin reduction as the positions would not be margined on a combined or portfolio basis.

[96] As noted above, per regulation § 1.17(a)(1)(i), the adjusted net capital requirement for an FCM is the greatest of a number of calculations, one of which is eight percent of the total risk margin requirement as defined in regulation § 1.17(b)(8). Thus, a calculation that would increase, or leave the same, the risk margin requirement would correspondingly increase, or leave the same, the adjusted net capital requirement.

of paragraph (b)(8)(v) to regulation § 1.17 is intended to further clarify that, pursuant to the Commission's FCM capital rule, an FCM that elects to permit separate account treatment must compute the risk margin amount for separate accounts as if each account is an account of a separate entity.

The Commission further notes that the proposed amendment to the definition of the term "risk margin" in regulation § 1.17(b)(8) to reflect separate accounts, and the resulting potential increase in an FCM's minimum adjusted net capital requirement under regulation § 1.17(a)(1)(i), would also impact other regulations that impose obligations on FCMs based on their level of adjusted net capital. For example, regulation § 1.17(h) conditions an FCM's ability to repay or prepay subordinated debt obligations on the FCM maintaining an amount of adjusted net capital that, after taking into effect the amount of the subordinated debt payment and other subordinate debt payments maturing within a set time period, exceeds the FCM's minimum adjusted net capital requirement by 120 percent to 125 percent, as specified in the applicable provision of regulation § 1.17(h).[97] The proposed amendments to the minimum capital requirements would also impact an FCM's obligation to provide certain notices to the Commission and to the FCM's DSRO under Commission regulation § 1.12.[98]

The Commission additionally notes that, as discussed further below, it is additionally proposing to amend regulation § 1.58 to provide that, where a clearing FCM carries an omnibus customer account for a non-clearing FCM, and the non-clearing FCM applies separate account treatment, then such non-clearing FCM must calculate initial and maintenance margin for purposes of regulation § 1.58(a) separately for each separate account. These proposed amendments to regulation § 1.58 are discussed further below.

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[97] *See, e.g.,* 17 CFR 1.17(h)(2)(vii) which generally provides, subject to certain conditions, that an FCM may not make a prepayment on an outstanding subordinated debt obligation if such payment would result in the FCM maintaining less than 120 percent of its minimum adjusted net capital requirement.

[98] *See, e.g.,* 17 CFR 1.12(a), which requires an FCM to provide notice to the Commission and the firm's DSRO if the FCM's adjusted net capital at any time is less than the minimum required by regulation § 1.17.

Second, the Commission proposes to amend regulation § 1.17(c)(2), which defines "current assets" that an FCM may recognize and include in computing its net capital. Regulation § 1.17(c)(2) currently defines "current assets" to include cash and other assets or resources commonly identified as those that are reasonably expected to be realized in cash or sold during the next 12 months. Regulation § 1.17(c)(2)(i), however, provides that an FCM must exclude from current assets any unsecured receivables resulting from futures, Cleared Swaps, or 30.7 accounts that liquidate to a deficit or contain a debit ledger balance only, provided, however, that the FCM may include a deficit or debit ledger balance in current assets until the close of business on the business day following the date on which the deficit or debit ledger balance originated (provided, in turn, that the account had timely satisfied the previous day's deficits or debit ledger balances).

The Commission is proposing to amend regulation § 1.17(c)(2)(i) to provide explicitly that if an FCM carries separate accounts for separate account customers pursuant to proposed regulation § 1.44, then the FCM must treat each separate account as an account of a separate entity. Accordingly, the FCM must exclude each unsecured separate account that liquidates to a deficit or contains a debit ledger balance only from current assets in its calculation of net capital, provided, however, that if the separate account is subject to a call for margin by the FCM it may be included in current assets until the close of business on the business day following the date on which the deficit or debit ledger balance originated, provided that the separate account timely satisfied previous day's debit or deficits in its entirety. If the separate account does not satisfy a previous day's deficit in its entirety, then the deficit for the separate account, and any other deficits of the separate account customer in other separate accounts carried by the FCM, shall not be included in current assets until all such calls are satisfied in their entirety. The proposed amendment to regulation § 1.17(c)(2)(i) would provide the same

capital treatment to separate accounts as is currently provided customer accounts that liquidate to deficits or contain debit ledger balances, and is consistent with corresponding conditions to the no-action position in CFTC Letter No. 19-17.[99]

Third, the Commission proposes to amend regulation § 1.17(c)(4), which defines the term "liabilities" for purposes of an FCM calculating its net capital. Regulation § 1.17(c)(4) generally defines the term "liabilities" to mean the total money liabilities of an FCM arising in connection with any transaction whatsoever, including economic obligations of an FCM that are recognized and measured in conformity with generally accepted accounting principles. Regulation § 1.17(c)(4) also provides that for purposes of computing net capital, an FCM may exclude from its liabilities funds held in segregation for futures customers, Cleared Swaps Customers, and 30.7 customers, provided that such segregated funds are also excluded from the FCM's current assets in computing the firm's net capital. The Commission is proposing to amend regulation § 1.17(c)(4)(ii) to explicitly provide that an FCM that carries the separate accounts of separate account customers pursuant to proposed regulation § 1.44 must compute the amount of money, securities, and property due to a separate account customer as if each separate account of the separate account customer is a distinct customer. The Commission is further proposing to amend regulation § 1.17(c)(4)(ii) to provide that an FCM, in computing its net capital, may exclude funds held in segregation for separate account customers from the FCM's liabilities, provided that funds held in segregation for separate account customers are also excluded from the FCM's current assets. The purpose of the proposed amendment is to ensure that an FCM, in computing its net

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[99] CFTC Letter No. 19-17. CFTC Letter No. 19-17 provides that an "FCM shall record each separate account independently in the FCM's books and records, *i.e.*, the FCM shall record separate accounts as a receivable (debit/deficit) or payable with no offsets between the other separate accounts of the same customer." *Id.* (Condition 6.) CFTC Letter No. 19-17 also provides that "the receivable from a separate account shall only be considered secured (a current/allowable asset) based on the assets of that separate account, not on the assets held in another separate account of the same customer." *Id.* (Condition 7.)

capital, reflects separate accounts in a consistent manner in determining its total current assets and liabilities.

Fourth, the Commission proposes to amend regulation § 1.17(c)(5), which defines the term "adjusted net capital." Regulation § 1.17(c)(5)(viii) provides, in relevant part, that adjusted net capital means net capital minus, among other items detailed in regulation § 1.17(c)(5), the amount of funds required in each customer account to meet maintenance margin requirements of the applicable board of trade or, if there are no such maintenance margin requirements, clearing organization margin requirements applicable to the account's positions. FCMs are allowed to apply (that is, to reduce the amount of this deduction from capital by) "calls for margin or other required deposits which are outstanding no more than one business day." However, once a customer fails to meet a margin call within one business day, the FCM loses the one business day "grace period" for receiving any of that customer's future margin calls, until the point in time at which the customer is no longer undermargined.

Thus, if, due to activity on Monday, Customer A is undermargined by $150, and the FCM calls Customer A for that margin on Tuesday, the FCM does not need to deduct that $150 from its net capital in computing its adjusted net capital, so long as the margin call is met by the close of business on Wednesday. Moreover, if Customer A, due to activity on Tuesday, is undermargined by an additional $100, and the FCM calls for that additional $100 on Wednesday, the FCM does not need to deduct that additional $100 on Wednesday. If Customer A meets the $150 call by close of business Wednesday, and the $100 call by close of business on Thursday, then no deduction need be taken for either the $150 or the $100 margin calls. However, if Customer A fails to meet Tuesday's $150 call by close of business on Wednesday, then the FCM must deduct *both* the $150 from Tuesday *and* the $100 from Wednesday (thus a total of $250), as well as any future undermargined amounts *until* Customer A cures its entire undermargined amount. Again,

once a customer fails to meet a margin call within one business day, the FCM loses the one business day "grace period" for that customer meeting any of its future margin calls, until the point in time at which the customer is no longer undermargined.

The Commission proposes to amend regulation § 1.17(c)(5)(viii) to provide that an FCM that carries separate accounts for a separate account customer pursuant to proposed regulation § 1.44 must compute the amount of funds required to meet maintenance margin requirements for each separate account as if the account was owned by a distinct customer. However, if a margin call for any separate account of a separate account customer is outstanding for more than one business day, then (consistent with the treatment of multiple margin calls for a single customer described in the previous paragraph), no margin call for that separate account customer will benefit from the one business day grace period until the point in time at which all margin calls for the separate accounts of that separate account customer have been met in full.

As discussed further below in the context of proposed regulation § 1.44(f), the concepts of margin calls that are outstanding no more than one business day (for purposes of § 1.17(c)(5)(viii)), and meeting a one business day margin call (for purposes of § 1.44(f)) are separate and distinct – it is possible that a separate account customer may meet the test for the first, but not the second, or may meet the test for the second, but not the first.

The Commission notes that its proposed amendments to regulation § 1.17 also include a number of technical changes designed to improve clarity and promote consistency with other Commission regulations.[100]

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[100] *E.g.*, changes to punctuation and substitution of level of maintenance margin or performance bond required for the customer *and* noncustomer positions for level of maintenance margin or performance bond required for the customer *or* noncustomer positions with respect to the meaning of risk margin for an account. *See, e.g.*, proposed regulation § 1.17(b)(8). The Commission is further proposing to replace the term "FCM" in regulation § 1.17(b)(8) with "futures commission merchant." The Commission is also proposing to reorganize paragraph § 1.17(c)(5)(viii) into sub-paragraphs (A), (B), (C), and (D) to enhance clarity. The Commission is additionally proposing to reorganize the wording of the definition of the term

C. Proposed Amendments to Regulations §§ 1.20, 1.32, 22.2, and 30.7

As previously stated, a fundamental purpose of the CEA is to provide for the protection of market participants from misuses of customer assets.[101] Regulations §§ 1.32, 22.2(g), and 30.7(l) are designed in part to further this purpose by requiring each FCM carrying accounts for futures customers, Cleared Swaps Customers, or 30.7 customers, respectively, to perform a daily computation of, and to prepare a daily record demonstrating compliance with, the FCM's obligation to hold a sufficient amount of funds in designated customer segregated accounts to meet the aggregate credit balances of all of the FCM's futures customers, Cleared Swaps Customers, and 30.7 customers.[102] An FCM is required to prepare the daily segregation calculations reflecting customer account balances as of the close of business each day, and to submit the applicable segregation statements electronically to the Commission and to the FCM's DSRO by noon the next business day.

The Commission is proposing to amend regulations §§ 1.32, 22.2, and 30.7 to provide that an FCM that permits separate accounts pursuant to proposed regulation § 1.44 must perform its daily segregation calculations, and prepare its daily segregation statements, by treating the accounts of separate account customers as accounts of separate entities. The proposed amendments would add new paragraph (l) to regulation § 1.32, new paragraph (g)(11) to regulation § 22.2, and new paragraph (l)(11) to regulation §

"business day" in regulation § 1.17(b)(6) to read any day other than a Saturday, Sunday, or holiday rather than any day other than a Sunday, Saturday, or holiday. This change would align the wording with the wording of the term "business day" in proposed regulation § 1.3.

[101] Section 3(b) of the CEA, 7 U.S.C. 5(b).

[102] Each FCM that carries accounts for futures customers, Cleared Swaps Customers, and 30.7 customers is required to prepare daily statements demonstrating compliance with the applicable segregation requirements. For futures customers, the FCM must prepare a daily Statement of Segregation Requirements and Funds in Segregation for Customers Trading on U.S. Commodity Exchanges (17 CFR 1.32(a)) ("Futures Segregation Statement"); for Cleared Swaps Customers, the FCM must prepare a daily Statement of Cleared Swaps Customer Segregation Requirements and Funds in Cleared Swaps Customer Accounts under section 4d(f) of the CEA (17 CFR 22.2(g)(1) through (4)) ("Cleared Swaps Segregation Statement"); and for 30.7 customers, the FCM must prepare a daily Statement of Secured Amounts and Funds Held in Separate Accounts for 30.7 Customers pursuant to Commission Regulation 30.7 (17 CFR 30.7(l)(1)). The statements listed above are part of the Commission's Form 1-FR-FCM, which contains the financial reporting templates required to be filed by FCMs.

30.7. The purpose of the proposed amendments is to establish the manner in which these existing segregation and reporting obligations apply to FCMs that permit separate accounts pursuant to proposed regulation § 1.44. Regulations §§ 1.32, 22.2, and 30.7 require an FCM to prepare one daily segregation computation, and submit one segregation schedule, for each of its futures customer funds, Cleared Swaps Customer Collateral, and 30.7 customer funds, respectively. The proposed amendments to regulations §§ 1.32, 22.2(g), and 30.7(l) provide that an FCM that permits separate accounts, in preparing such computation and segregation schedule, would be required to record each separate account as if it was an account of a separate entity, and include all separate accounts with other futures accounts, Cleared Swaps Customer Accounts, and 30.7 accounts, as applicable, carried by the FCM that are not separate accounts.

In addition, the proposed amendments would provide that an FCM, in computing its segregation obligations, may offset a net deficit in a particular separate account customer's separate account against the current value of any readily marketable securities held by the FCM for the separate account customer, provided that the readily marketable securities are held as margin collateral for the specific separate account that is in deficit. Readily marketable securities held for other separate accounts of the separate account customer may not be used to offset the separate accounts that is in deficit.[103] The proposed amendments to regulations §§ 1.32, 22.2(g), and 30.7(l) with respect to the offsetting of a net deficit in a customer's account by the value of readily marketable securities held in the customer's account are consistent with how an FCM currently offsets a net deficit in a customer's account that is margined by securities. In addition,

[103] *I.e.*, if separate account customer *S* has separate accounts *A* and *B*, then readily marketable securities held for separate account *A* could not be used to offset a deficit in separate account *B*, and vice versa.

the proposed amendments are consistent with the separate account conditions to the no-action position in CFTC Letter No. 19-17.[104]

The Commission is also proposing to amend regulation § 22.2(f) to revise the regulatory description of the stated calculation of the total amount of funds that an FCM is required to hold in segregation for Cleared Swaps Customers. The proposed amendment would (i) correct an error included in the drafting of the description of the calculation when the regulation was originally adopted in 2012; and (ii) align the regulatory text describing the segregation calculation set forth in regulation § 22.2(f) with the calculation performed on the Cleared Swaps Segregation Statement that is submitted to the Commission each day by FCMs with Cleared Swaps Customers pursuant to regulation § 22.2(g). The proposed amendment would be applicable across FCMs with Cleared Swaps Customers, whether or not such FCMs maintain separate accounts.

The segregation calculation required by regulation § 22.2(f) is intended to ensure that an FCM holds, at all times, a sufficient amount of funds in segregation to cover its total financial obligation to all Cleared Swaps Customers. Compliance with the segregation requirements helps ensure that an FCM is not using the funds of one Cleared Swaps Customer to cover a deficit in the Cleared Swaps Customer Account of another Cleared Swaps Customer, and further helps ensure that an FCM holds sufficient funds in segregation to transfer the Cleared Swaps Customer Accounts, including the Cleared Swaps and the Cleared Swaps Customer Collateral, to a transferee FCM if the transferor FCM becomes insolvent.

To achieve the regulatory objective noted above, regulation § 22.2(f)(2) currently requires an FCM to calculate its minimum segregation requirement as the sum of the net

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[104] *See* CFTC Letter No. 19-17 (providing, among other conditions for separate account treatment, that "[e]ach receivable from a separate account shall be 'grossed up' on the applicable segregation, secured or cleared swaps customer statement; thus, an FCM shall use its own funds to cover the debit/deficit of each separate account.").

liquidating equities of each Cleared Swaps Customer Account with a positive account balance carried by the firm. The net liquidating equity of a Cleared Swaps Customer Account is explicitly calculated as the sum of the market value of any funds held in the Cleared Swaps Customer Account of a Cleared Swaps Customer (including readily marketable securities), as adjusted positively or negatively by, among other things, any unrealized gains or losses on open Cleared Swaps positions, the value of open long option positions and short option positions, fees charged to the account, and authorized withdrawals. To the extent that the calculation results in a net liquidating equity that is positive, the Cleared Swaps Customer Account has a credit balance.[105] To the extent that the calculation results in a net liquidating equity that is negative, the Cleared Swaps Customer Account has a debit balance.[106] Regulation § 22.2(f)(4) provides that an FCM must hold, at all times, a sufficient amount of funds in segregation to meet the total net liquidating equities of all Cleared Swaps Customer Accounts with credit balances, and further provides that the FCM may not offset this total by any Cleared Swaps Customer Accounts with debit balances.

With respect to Cleared Swaps Customer Accounts with debit balances, regulation § 22.2(f)(5) further requires the FCM to include in the total funds required to be held in segregation all debit balances to the extent secured by readily marketable securities held for the particular Cleared Swaps Customers that have debit balances. The required addition of debit balance accounts in regulation § 22.2(f)(5) was intended to be consistent with the long-standing Futures Segregation Statement contained in the Form 1-FR-FCM and the Form 1-FR-FCM Instructions Manual.[107] An error, however, was made

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[105] 17 CFR 22.2(f)(3).

[106] *Id*.

[107] In adopting the final regulation § 22.2(f), the Commission stated that proposed regulation § 22.2(f) set forth an explicit calculation for the amount of Cleared Swaps Customer Collateral that an FCM must maintain in segregation that did not materially differ from the calculation of the amount of funds an FCM is required to hold in segregation under the Form 1-FR-FCM for futures customers. The Commission adopted final regulation § 22.2(f) as proposed. *Protection of Cleared Swaps Customer Contracts and*

in drafting the description of the details of the segregation calculation in regulation § 22.2(f)(5). Specifically, as noted above, regulation § 22.2(f)(5) requires an FCM to include in the total segregation requirement any Cleared Swaps Customer Accounts with debit balances that are secured by readily marketable securities. However, the full value of the readily marketable collateral is part of the calculation of the net liquidating equity of the account. Therefore, a Cleared Swaps Customer Account with a debit balance would never have additional readily marketable securities available to offset a debit balance.[108]

The segregation calculation required under regulation § 1.32 for futures accounts, and the Commission's Form 1-FR-FCM and related Form 1-FR-FCM Instructions Manual, differs from the description as currently written in regulation § 22.2(f)(4) and (5) with respect to the offsetting of debit balances by readily marketable securities. Specifically, an FCM is required to calculate the net equity of each futures customer excluding the value of any noncash collateral held in the account.[109] If the calculation results in a debit balance, the FCM is permitted to offset the debit balance by the fair market value of any readily marketable securities (after application of applicable securities haircuts set forth in the regulation).[110]

Collateral; Conforming Amendments to the Commodity Broker Bankruptcy Provisions; Final Rule, 77 FR 6336, at 6352-6353 (Feb. 7, 2012).

[108] For example, if a Cleared Swaps Customer Account was comprised of cash of $300, securities of $200, and an unrealized loss on open Cleared Swaps of $600, the account would have a net equity debit balance of $100 under regulation § 22.2(f). There are no additional securities that the FCM may use to secure the $100 debit balance and, therefore, the FCM is required to increase its segregation requirement by $100 to ensure that there are sufficient funds in segregation to cover the FCM's obligation to all Cleared Swaps Customers with a credit balance.

[109] The Form 1-FR-FCM Instructions Manual provides that a customer account is in deficit when the combination of the account's cash ledger balance, unrealized gain or loss on open futures contracts, and the value of open option contracts liquidates to an amount less than zero. The manual explicitly provides that "[a]ny securities used to margin the account are not included in determining a customer's deficit." 1-FR-FCM Instructions Manual, p. 10-2. Accordingly, an FCM would exclude the value of any readily marketable securities from the calculation of the customer's account balance. The 1-FR-FCM Instructions Manual is available on the Commission's website at: *www.cftc.gov/sites/default/files/idc/groups/public/@iointermediaries/documents/file/1fr-fcminstructions.pdf*.

[110] 17 CFR 1.32(b). Applying the calculation in regulation § 1.32 to Cleared Swaps, if a Cleared Swaps Customer Account was comprised of cash of $300, securities of $200, and an unrealized loss on open

As noted above, the proposed amendments to regulation § 22.2(f)(4) and (5) are intended to correct the description of the segregation calculation and to make it consistent with how FCMs calculate their total Cleared Swaps segregation obligations under regulation § 22.2(g), with how FCMs report their total segregation requirements on the Cleared Swaps Segregation Statement, and with the segregation calculation requirements for futures accounts under regulation § 1.32. Thus, the proposed amendments are not expected to have any effect on FCMs.

In addition, the Commission is proposing to amend regulations §§ 1.20(i) and 30.7(f), which require an FCM carrying futures accounts and 30.7 accounts, respectively, to calculate its total segregation requirements in a manner that is consistent with current regulation § 22.2(f). As with the proposed amendment to regulation § 22.2(f), the proposed amendments to regulations §§ 1.20(i) and 30.7(f) apply across FCMs that maintain futures customer accounts or 30.7 customer accounts, respectively, whether or not such FCMs maintain separate accounts. The Commission adopted current regulations §§ 1.20(i) and 30.7(f) in 2013. The final regulations, however, did not include the provision set forth in regulation § 22.2(f)(5) requiring an FCM to include any secured debit balances in its segregation requirement. This omission was unintentional, as the Commission expressed its intent to "mirror" the requirements of regulation § 22.2(f) in regulation § 1.20(i) (and effectively regulation § 30.7(f)).[111]

Cleared Swaps of $600, the account would have a net equity debit balance of $300, as the value of the securities is not included in the calculation ($300 cash less $600 in unrealized losses, results in a $300 debit balance). The FCM may offset the $300 debit balance by $170, which represents the value of the readily marketable securities held in the account as collateral ($200 fair market value of the securities, less a $30 haircut). The FCM is then required to include $130 in its segregation requirement, which represents the amount of the unsecured debit balance remaining in the customer's account (*i.e.*, $300 debit balance, less $170 value of the securities after haircuts).

[111] *Enhancing Protections Afforded Customers and Customer Funds Held by Futures Commission Merchants and Derivatives Clearing Organizations,* 78 FR 68506, 68543 (Nov. 14, 2013) (discussing the Commission's intent to adopt regulation § 1.20(i) consistent with the corresponding requirements in regulation § 22.2(f)); *id.* at 68576 (discussing the Commission's intent for the daily segregation calculation for 30.7 accounts to be consistent with the requirements for the daily segregation calculations for futures customer funds in regulation § 1.32).

To address the omission, the Commission is proposing to amend regulations §§ 1.20(i) and 30.7(f) to reflect the requirement for an FCM to include in the calculation of its futures and foreign futures segregation requirement any unsecured customer debit balances, calculated consistent with the proposed amendments to regulation § 22.2(f)(4) and (5) that are discussed above. The proposed amendments to regulations §§1.20(i) and 30.7(f) would accurately describe and reflect the existing segregation calculations for futures, foreign futures, and Cleared Swaps as originally intended. The proposed amendments to regulations §§ 1.20(i) and 30.7(f) are not expected to have any impact on FCMs as the firms currently calculate their segregation requirements by including customer unsecured debit balances.

D. Proposed Regulation § 1.44(a)

Proposed regulation § 1.44 will represent a discrete set of regulations, first directly requiring FCMs to avoid returning margin to customers where doing so would create or exacerbate a margin deficiency in the customer's account, but then allowing FCMs to provide for separate account treatment within the Commission's broader regulatory framework for FCMs. As such, proposed regulation § 1.44 contains a number of terms that are specific to proposed regulation § 1.44, but are not applicable, or are not applicable in the same manner, with respect to other of the Commission's FCM regulations. The Commission therefore proposes to add new regulation § 1.44(a) to define certain terms "only for purposes of this section" (*i.e.*, proposed regulation § 1.44).

The Commission proposes to define "account" for purposes of proposed regulation § 1.44 as meaning a futures account, a Cleared Swaps Customer Account (both of which are defined in regulation § 1.3, which definitions apply broadly to all CFTC regulations) or a § 30.7 account (as defined in regulation § 30.1). This definition is intended to implement the proposed Margin Adequacy Requirement and requirements for

separate account treatment subject to such Margin Adequacy Requirement, with respect to accounts of all three types. This definition was not included in the First Proposal.

The Commission also proposes in proposed regulation § 1.44(a) to further define "business day," as having the same meaning as set forth in regulation § 1.3, but with the clarification that "holiday" refers to Federal holidays as established by 5 U.S.C. 6103. As noted above, this definition is similar to the definition of "United States business day" included in the First Proposal. In its comment responding to the First Proposal, FIA noted that the term "United States business day" accounts for days that banks are open, but may not encompass days when other markets, such as securities markets, are closed, which could make it difficult to meet margin calls by liquidating certain instruments.[112] The Commission requests further comment on this term, below.

Relatedly, the Commission proposes to define "one business day margin call" as a margin call that is issued and met in accordance with the requirements of proposed regulation § 1.44(f). The First Proposal did not include this definition, although it contained provisions that, similar to proposed regulation § 1.44(f), further explained when an FCM would be considered in compliance with a one business day margin call. As noted above, this definition (along with all of the definitions in proposed regulation § 1.44(a)) applies only for purposes of proposed regulation § 1.44, thus, this definition of "one business day margin call" is not intended to apply in any other context.

Under proposed regulation § 1.44, an FCM may engage in separate account treatment only when it, and its customer, are operating within the "ordinary course of business," as that term is defined in the proposed regulation. The Commission proposes to define "ordinary course of business" as meaning the standard day-to-day operation of the FCM's business relationship with its separate account customer, a condition where there are no unusual circumstances that might indicate a materially increased level of risk

[112] FIA Comment Letter.

that the separate account customer may fail promptly to perform its financial obligations to the FCM, or decreased financial resilience on the part of the FCM. As noted in the proposed definition, proposed regulation § 1.44(e) sets out circumstances that are inconsistent with the ordinary course of business, and the occurrence of which would require a cessation of separate account treatment. This definition of "ordinary course of business" is unchanged from the First Proposal, except that it replaces the term "customer" with the term "separate account customer." Comments received regarding the definition of "ordinary course of business" are addressed in connection with proposed regulation § 1.44(e) below, which enumerates events that are inconsistent with the ordinary course of business.

The Commission also proposes to define "separate account" as meaning any one of multiple accounts of the same separate account customer that are carried by the same FCM. The definition of this term is the same as in the First Proposal, except that it replaces "customer" with "separate account customer" and excludes the criteria that the FCM be a clearing member of a DCO. The Commission did not receive comments on the definition of this term in the First Proposal.

As noted above, the Commission proposes to define "separate account customer" as meaning a customer for which the FCM has elected to engage in separate account treatment. This definition was not included in the First Proposal.

Lastly, the Commission proposes to define "undermargined amount" for an account as meaning the amount, if any, by which the customer margin requirements with respect to all products held in that account, exceeds the net liquidating value plus the margin deposits currently remaining in that account.[113] The definition notes that for

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[113] The definition of "undermargined amount" in proposed regulation § 1.44(a) is different from, and simpler than, the definitions of "undermargined amount" for the purpose of residual interest calculations in regulations §§ 1.22(c)(1), 22.2(f)(6)(i), and 30.7(f)(1)(ii). The calculations in the latter cases are required to take into account information at the close of business on day *T-1* that will be used to calculate a residual interest requirement on day *T*, as well as payments that may be received on day *T*, and the elimination of double counting of debit balances.

purposes of this definition, "margin requirements" shall mean the level of maintenance margin or performance bond (including, as appropriate, the equity component or premium for long or short option positions) required for the positions in the account by the applicable exchanges or clearing organizations.[114] This clarification (which is drawn from the definition of risk margin in regulation § 1.17(b)(8)) is in recognition of the difference between exchange (or clearing organization) requirements for "initial margin" and "maintenance margin." However, here, in distinction to risk margin, the equity component or premium for long or short option positions is included, since those are part of the total required level of margin. "Initial margin" is the amount of margin (otherwise known as "performance bond"[115] in this context) required to establish a position. Some (though not all) contract markets and clearing houses establish "maintenance margin" requirements that are less than the corresponding initial margin requirement." Where, due to adverse market movements, the amount of margin on deposit is less than the initial margin requirement, but greater than or equal to maintenance margin, the FCM is not required to (though it may) call additional margin from the customer. Once the amount of margin on deposit is less than the maintenance margin required, the FCM must call the customer for enough margin to meet the *initial* margin level.

The Commission uses this term in connection with proposed regulation § 1.44(f) in defining the requirements for making and meeting a one business day margin call, as well as in regulation § 1.44(g) in setting LSOC compliance calculations for separate accounts. This definition was not included in the First Proposal.

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[114] The definition of "undermargined amount" in proposed regulation § 1.44(a) further provides that, with respect to positions for which maintenance margin is not specified, "margin requirements" shall refer to the initial margin required for such positions.

[115] "Performance bond" secures the performance by a customer to meet its variation margin payment obligations to its FCM (or the performance of variation margin payment obligations of an FCM to the clearinghouse, or to an intermediary upstream FCM).

Request for Comment

Question 4: How should the proposed definition of "business day" address days when securities and other markets are closed? For instance, should the Commission address in the definition days when such other markets are open, or create an exception for days when such markets are closed on a prescheduled basis? (*E.g.*, a requirement rolls over to the next day that the market is open.) What liquidity challenges or other risks would result from such an exception? How do FCMs and customers currently address these cases?

Question 5: In the proposed definition of "undermargined amount" in proposed regulation § 1.44(a), the term "margin deposits currently remaining" does not include a deduction for "haircuts" on non-cash collateral or collateral posted in alternate currencies. This is consistent with the approach taken with respect to calculating undermargined amounts for purposes of determining requirements for residual interest in regulations §§ 1.22(c)(1), 22.2(f)(6)(i), and 30.7(f)(1)(ii). By contrast, in a number of cases, Commission regulations require FCMs, in determining the amount of customer debit/deficit balances secured by readily marketable securities, to apply securities haircuts set forth in SEC Rule 15c3-1(c)(2).[116] Similarly, some exchanges require members, in determining the amount of margin they are required to collect from their customers, to apply haircuts to securities collateral in amounts consistent with SEC Rule 240.15c3-1, and to apply haircuts to commodities in amounts consistent with the inventory haircuts specified in Commission regulation § 1.17(c)(5)(ii).[117]

Should the definition of "undermargined amount" apply haircuts to the value of customer collateral held by the FCM? If so, should the amount of such haircuts be based on SEC rule 240.15c3-1 and Commission regulation § 1.17(c)(5)(ii), or some other basis?

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[116] *See, e.g.*, regulations §§ 1.32(b) and 22.2(f)(5)(iii).
[117] *See, e.g.*, CME Rule 930.C, ICE Futures U.S. Rule 5.03(j).

E. Proposed Regulation § 1.44(b)

As discussed above, the Commission proposes regulation § 1.44(b) to apply directly to FCMs, whether clearing or non-clearing, the same Margin Adequacy Requirement that DCOs are required to apply to their clearing FCMs pursuant to regulation § 39.13(g)(8)(iii). Proposed regulation § 1.44(b) provides that an FCM shall ensure that a customer does not withdraw funds from its accounts with such FCM unless the net liquidating value plus the margin deposits remaining in the customer's account after such withdrawal are sufficient to meet the customer initial margin requirements with respect to all products held in such customer's account, except as provided in proposed regulation § 1.44(c), which allows for separate account treatment under ordinary course of business conditions.[118]

The Commission acknowledges that real-time calculation of margin adequacy with respect to a potential withdrawal may prove impracticable. Instead, the Commission seeks to articulate a standard for the time as of which such calculation shall be made that is consistent with the Commission's requirements for calculation of undermargined amounts for purposes of an FCM's residual interest calculations. Regulations §§ 1.22(c)(2), 22.2(f)(6)(ii), and 30.7(f)(ii)(B) require each FCM to compute such undermargined amounts based on the information available to the FCM as of the close of each business day for futures customer accounts, Cleared Swaps Customer Accounts, and 30.7 accounts, respectively. To ensure such consistency, proposed regulation § 1.44(b)(1) provides that the sufficiency of the amount in a customer's account to meet customer initial margin requirements following a potential withdrawal shall be calculated as of close of business on the previous business day.

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[118] Consistent with the existing Margins Handbook, the Margin Adequacy Requirement is based on initial margin requirements rather than any lower maintenance margin requirement. *See* JAC Margins Handbook at p. 10-1 ("Margin Funds Available for Disbursement = Net Liquidating Value + Margin Deposits - Initial Margin Requirement ≥ 0"); *see also supra* n. 14 and accompanying text.

In order to address circumstances in which the previous day is a holiday on which markets, but not banks, may be open, proposed regulation § 1.44(b)(2) further provides that, for purposes of proposed regulation § 1.44(b)(1)'s margin adequacy calculation requirements, where the previous day (excluding Saturdays and Sundays) is a holiday, as defined in proposed regulation § 1.44(a), where any DCM on which the FCM trades is open for trading, and where an account of any of the FCM's customers includes positions traded on such a market, the margin adequacy calculation shall instead be made as of the close of business on such holiday. [119]

The Commission notes that proposed regulation § 1.44(b)'s requirements related to the timing of the margin adequacy calculation required by the same section are intended to represent a minimum standard, and are not intended to prevent an FCM from exercising its judgment in connection with good risk management practice to prevent the disbursement of customer funds based on intervening intraday market movements resulting in losses to a customer account between the calculation benchmark set forth in proposed regulation § 1.44(b) and the time at which a customer requests to withdraw funds. Ensuring that customers do not withdraw funds from their accounts at FCMs if such withdrawal would create or exacerbate an initial margin shortfall is reasonably necessary from a risk management perspective, in that it reduces the likelihood and extent of the risk that the FCM must cover losses due to a default by the customer on obligations that exceed the margin actually held by the FCM. Similarly, because customer funds are held by an FCM in omnibus accounts, this prohibition will reduce the likelihood and extent of the risk that the FCM will effectively use the margin of other customers to "margin or guarantee the trades or contracts, or to secure or extend the credit of" a

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[119] Proposed regulation § 1.44(b)(2), and proposed regulation § 1.44(f)(7), discussed below, are consistent with JAC Regulatory Alert 22-02, which provides that an FCM must issue margin calls to customers on holidays where futures markets are open and U.S. banks are closed. The margin calls are calculated based on information as of the close of the previous business day (*i.e.*, the business day prior to the holiday) and the FCM does not count the holiday for purposes of aging the margin call. JAC Regulatory Alert 22-01, Mar. 30, 2022, available at *www.jacfutures.com*.

customer that was permitted to withdraw margin in a manner that created or exacerbated an undermargined condition,[120] whether the duty to prevent such withdrawals falls on DCOs acting on their member FCMs, or directly on FCMs. Because regulation § 39.13(g)(8)(iii) applies only to DCOs (which in turn can only apply regulation § 39.13(g)(8)(iii)'s Margin Adequacy Requirement to their clearing member FCMs), and given the strong trend of the comments in favor of addressing these issues in a manner uniform among all types of FCMs directly in part 1 rather than indirectly through part 39, the Commission now views it as reasonably necessary to extend to all FCMs the requirement to prevent such under-margining scenarios.

Accordingly, the Commission preliminarily believes that proposed regulation § 1.44(b), which will apply a similar Margin Adequacy Requirement directly to FCMs, both clearing and non-clearing, would further serve to protect customer funds and mitigate systemic risk, thus effectuating CEA section 4d(a)(2), 4d(f)(2), and 4(b)(2)(A)[121] and accomplishing the purposes of "avoidance of systemic risk" and "protecting all market participants from … misuses of customer assets."[122]

F. Proposed Regulation § 1.44(c)

Proposed regulation § 1.44(c) sets forth the fundamental terms and conditions for separate account treatment. As a general matter, those terms and conditions are substantially the same as in CFTC Letter No. 19-17, and in the First Proposal, except that the FCM may choose to engage in separate account treatment without a DCO specifically authorizing such treatment. Proposed regulation § 1.44(c) provides that an FCM may, only during the ordinary course of business, as that term is defined in proposed regulation

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[120] *Cf.* CEA 4d(a)(2), 7 U.S.C. 6d(a)(2) (an FCM may not use the money or property of one customer "to margin or guarantee the trades or contracts, or to secure or extend the credit, of any customer or person other than the one for whom the same are held.")

[121] 7 U.S.C. 6d(a)(2), 6d(f)(2), and 6(b)(2)(A).

[122] CEA 3(b), 7 U.S.C. 5(b). *See*, as discussed above, section 8a(5) of the CEA, 7 U.S.C. 12a(5), authorizing the Commission to make and promulgate such rules and regulation as in the Commission's judgment are reasonably necessary to effectuate any of the provisions, or to accomplish any of the purposes, of the CEA.

§ 1.44, treat the separate accounts of a separate account customer as accounts of separate entities for purposes of proposed regulation § 1.44(b),[123] if such FCM elects to do so as specified in proposed regulation § 1.44(d). Proposed regulation § 1.44(c) further provides that an FCM that has made such an election shall comply with the risk-mitigating conditions set forth further in proposed regulation § 1.44 and maintain written internal controls and procedures designed to ensure such compliance.

The Commission preliminarily believes that permitting FCMs to treat the separate accounts of separate account customers as accounts of separate entities for purposes of proposed regulation § 1.44(b), subject to the risk-mitigating conditions set forth further in proposed regulation § 1.44, accomplishes the CEA's purpose of promoting responsible innovation, while also maintaining continuity of robust customer fund protection and risk mitigation.[124] Compliance with those conditions can best be achieved if the FCM maintains written internal controls and procedures designed to ensure such compliance.

G. Proposed Regulation § 1.44(d)

Proposed regulation § 1.44(d) provides that an FCM may elect to treat the separate accounts of a customer as accounts of separate entities for purposes of proposed regulation § 1.44(b). In order to do so, an FCM shall include the customer on a list of separate account customers maintained in its books and records. Such list shall include the identity of each separate account customer, as well as the identity of each separate account of such customer. The FCM is required to keep such list current. Furthermore, the first time that an FCM chooses to include a customer on a list of separate account customers, the FCM is required to provide notification of the election to allow separate account treatment for customers in accordance with the process specified in regulation §

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[123] As noted above, proposed regulation § 1.44(b) is intended to serve as an analog to regulation § 39.13(g)(8)(iii) for FCMs.
[124] *See* CEA 3(b), 8a(5).

1.12(n)(3).[125] For the avoidance of doubt, the notification of such election would remain a one-time notification made the first time the FCM begins providing separate account notification for a customer. Successive notifications would not be required for each additional customer for which the FCM provides separate account treatment. Furthermore, the FCM would need only provide notification of the election, and would not be required to include the identity of the separate account customer. Proposed regulation § 1.44(d) is intended to ensure that DSROs are able effectively to monitor and regulate FCMs that engage in separate account treatment, and that FCMs have the records necessary to understand which accounts receive separate account treatment for purposes of monitoring compliance with the proposed regulation.

The First Proposal proposed to require a clearing FCM to (i) provide a one-time notification to its DSRO and any DCO of which it is a clearing member that it will apply such treatment; (ii) maintain and keep current a list of all separate accounts receiving such treatment; and (iii) conduct a review of such records of accounts receiving separate treatment no less than quarterly.

With respect to the proposed one-time notice requirement for separate account treatment, the JAC in its comment contended that such notice (and other notices required under the First Proposal) should be made to any DCO permitting separate account treatment of which a clearing FCM is a member, but should not be required to be provided to the clearing FCM's DSRO, as monitoring for compliance with separate account treatment requirements would not fall under the oversight of the DSRO.[126] Because the Commission is no longer proposing to codify the no-action position in CFTC Letter No. 19-17 in part 39, it is no longer proposing to require that notifications made to

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[125] *See* 17 CFR 1.12(n)(3). Once an FCM provides notice in the first instance that it will apply separate account treatment to one or more customers, it would not be required to provide the same notification each time it applies separate account treatment to a new or additional customer.

[126] JAC Comment Letter.

DSROs additionally be made to every DCO of which the notifying FCM is a member. Furthermore, the Commission believes notice to the Commission, and to DSROs (who review FCMs' compliance with the Commission's part 1 regulations) pursuant to proposed regulation § 1.44(d)(2) is proper.

With respect to the proposed recordkeeping requirement, CME opined in its comment that clearing FCMs should be required to be able to produce, upon request of the relevant DCO or the Commission, a current list of accounts receiving separate treatment.[127] The Commission believes such requirement is already provided for by the requirement in proposed regulation § 1.44(d) to maintain and keep current such a list, combined with Commission regulation § 1.31(d)'s requirement for records entities to produce regulatory records promptly upon request by Commission representatives.

The Commission notes that, in proposing the recordkeeping requirement in this Second Proposal, it has determined not to include the First Proposal's proposed requirement that an FCM review records of accounts receiving separate treatment no less than quarterly, as the Commission views the objective of such requirement – the keeping of accurate and current records – as being subsumed by this Second Proposal's proposed requirement to maintain and keep current a list of accounts receiving separate treatment.

H. Proposed Regulation § 1.44(e)

Proposed regulation § 1.44(e) enumerates events that would be inconsistent with the ordinary course of business, as that term is defined in proposed regulation § 1.44(a), and sets forth requirements related to the cessation and resumption of permitting disbursements on a separate account basis upon, respectively, the occurrence and cure of certain non-ordinary course of business events. Each of these events would raise

[127] CME Comment Letter.

important concerns about the financial resiliency of the FCM or one or more of its separate account customers.[128]

These events are divided into two categories: (i) those that concern the separate accounts of a particular separate account customer, and the occurrence of any one of which would require the FCM to cease permitting disbursements on a separate account basis with respect to all accounts of that customer; and (ii) those that concern the financial status of the FCM itself, and the occurrence of any one of which would require the FCM to cease permitting disbursements on a separate account basis with respect to all of its separate account customers.

It is important to note, however, that under this proposal, while a separate account customer is outside the ordinary course of business as defined in proposed regulation § 1.44(a), it is only the privilege of permitting disbursements on a separate account basis, pursuant to proposed regulation § 1.44(c), with respect to that customer and that customer's separate accounts, that is terminated (or suspended). So long as a customer remains a separate account customer, whether or not within the ordinary course of business, then the FCM is required to comply with the requirements in proposed regulation §§ 1.44(g) and (h), including with respect to the relevant provisions addressed in regulations §§ 1.17, 1.20, 1.22, 1.23, 1.32, 1.55, 1.58, 1.73, 22.2, 30.7, and 39.13(g)(8)(i) with respect to that customer and all of that customer's separate accounts. Similarly, if it is the FCM that is outside the ordinary course of business, it is only the privilege of permitting disbursements on a separate account basis with respect to any of the FCM's separate account customers and their separate accounts that is terminated (or suspended). The FCM continues to be required to comply with the requirements in

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[128] For example, while the bankruptcy of an FCM or a separate account customer would have direct effects, the bankruptcy of an FCM or separate account customer's parent company would also portend financial challenges for, respectively, the FCM or separate account customer (*e.g.*, if the parent company decided to liquidate its subsidiaries in bankruptcy). Experience in the bankruptcies of, *e.g.*, Refco and Lehman, demonstrates that when one member of an affiliate financial company structure files for bankruptcy, other affiliates soon follow.

regulation §§ 1.44(g) and (h), including with respect to the relevant provisions described above, with respect to all of its separate account customers and their separate accounts.

The first category of events is as follows:

- (1)(i) The separate account customer, including any separate account of such customer, fails to deposit initial margin or maintain maintenance margin or make payment of variation margin or option premium as specified in proposed regulation § 1.44(f).[129]
- (ii) The occurrence and declaration by the FCM of an event of default as defined in the account documentation executed between the FCM and the separate account customer.
- (iii) A good faith determination by the FCM's CCO, one of its senior risk managers, or other senior manager, following such FCM's own internal escalation procedures, that the separate account customer is in financial distress, or there is significant and bona fide risk that the separate account customer will be unable promptly to perform its financial obligations to the FCM, whether due to operational reasons or otherwise.
- (iv) The insolvency or bankruptcy of the separate account customer or a parent company of such customer.
- (v) The FCM receives notification that a board of trade, a DCO, a self-regulatory organization (SRO) as defined in regulation § 1.3 or section 3(a)(26) of the Securities Exchange Act of 1934, the Commission, or another regulator[130] with jurisdiction over the separate account customer, has initiated an action[131] with

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[129] *I.e.*, the one business day margin call requirement.
[130] *E.g.*, the SEC or a foreign regulator.
[131] In this context, the term "initiate an action" is intended to include the filing of a complaint or a petition to take action against an entity, or an analogous process. The initiation or conduct of an investigation would not be sufficient to constitute "initiating an action" in this context.

respect to such customer based on an allegation that the customer is in financial distress.

- (vi) The FCM is directed to cease permitting disbursements on a separate account basis, with respect to the separate account customer, by a board of trade, a DCO, an SRO, the Commission, or another regulator with jurisdiction over the FCM, pursuant to, as applicable, board of trade, DCO, or SRO rules, government regulations, or law.

The second set of events is as follows:

- (2)(i) The FCM is notified by a board of trade, a DCO, an SRO, the Commission, or another regulator with jurisdiction over the FCM, that the board of trade, the DCO, the SRO, the Commission, or other regulator, as applicable, believes the FCM is in financial or other distress.
- (ii) The FCM is under financial or other distress as determined in good faith by its CCO, senior risk managers, or other senior management.
- (iii) The insolvency or bankruptcy of the FCM or a parent company of the FCM.

Proposed regulation § 1.44(e)(3) provides that the FCM must provide notice to its DSRO and to the Commission of the occurrence of any of the events suspending or terminating separate account treatment for one or more separate account customers. The notice must be provided to the DSRO and the Commission in accordance with the process specified in regulation § 1.12(n)(3). The notice also must identify the event and, if applicable, the customer. The FCM would be required to provide such notice promptly in writing no later than the next business day following the date on which the FCM identifies or has been informed that the relevant event has occurred. The notification required upon exiting the ordinary course of business is intended to ensure that the Commission and DSROs will be apprised of the occurrence of non-ordinary course of business events, and will actively communicate with and monitor an FCM with respect to

the resolution of such events (*i.e.*, where an FCM attempts to reenter ordinary course of business conditions).

Proposed regulation § 1.44(e)(4) provides an avenue for an FCM that has experienced a non-ordinary course of business event with respect to itself or a customer to return to the ordinary course of business and resume separate account treatment for itself or its customers, as may be the case. Proposed regulation § 1.44(e)(4) provides that an FCM that has ceased permitting disbursements on a separate account basis to a separate account customer due to the occurrence of a non-ordinary course of business event, with respect to that specific separate account customer, or with respect to all such customers, may resume permitting disbursements to such customer(s) on a separate account basis if such FCM reasonably believes, based on new information, that those circumstances triggering the event have been cured, and such FCM documents in writing the factual basis and rationale for its conclusion. However, proposed regulation § 1.44(e)(4) also provides that, if the circumstances triggering cessation of separate account treatment were an action or direction by a board of trade, a DCO, an SRO, the Commission, or another regulator with jurisdiction over the separate account customer or the FCM, then cure of those circumstances would require the withdrawal or other appropriate termination of such action or direction by that entity.

That permitting disbursements on a separate account basis should be discontinued (or at least suspended) under certain circumstances is reflected in CME's recommendation, preceding issuance of CFTC Letter No. 19-17, that separate account treatment be permitted only during the ordinary course of business. As CME explained, FCMs should maintain the flexibility to determine that either the customer or the FCM itself is in distress and "pause" disbursements until the customer's other account can demonstrably meet the call to deposit funds.[132] Similarly, as CME noted, an FCM should

[132] CME Letter.

not be purposely releasing funds to a customer when the customer's overall account is in deficit, as doing so may create a shortfall in segregated, secured, or Cleared Swaps Accounts in the event the FCM becomes insolvent.[133] However, the Commission acknowledges that in some instances, an FCM or customer may exit a state of financial, operational, or other distress, such that resumption of separate account treatment would be appropriate. By explicitly providing FCMs with an avenue to resume separate account treatment consistent with the resumption of the ordinary course of business, the Commission seeks to incentivize transparency between FCMs and their DSROs and Commission staff with respect to conditions at the FCMs or customers that could indicate operational or financial distress and, more generally, the risk management program at the FCM.

Proposed regulation § 1.44(e) is designed to ensure that disbursements are permitted on a separate account basis only during the routine operation of the FCM's business relationship with its customer. Certain events signaling financial or operational distress of the FCM or customer are inconsistent with the normal operation of the business relationship between the FCM and its customer. The Commission believes that, when such events occur, and throughout the duration of their occurrence, suspending FCMs' ability to provide for separate account treatment with respect to the Margin Adequacy Requirement is reasonably necessary to accomplish the goals of protecting customer funds and mitigating systemic risk.

The list of non-ordinary course of business events proposed herein, as well as the criteria and process for an FCM to resume separate account treatment, remains the same as proposed in the First Proposal, except that the Commission has changed certain aspects of the proposed regulation to account for placement of the requirement in part 1 (and thus applicability to all FCMs, including non-clearing FCMs), and notification of non-

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[133] *Id.*

ordinary course of business events to the Commission and to the FCM's DSRO through the process specified by regulation § 1.12(n)(3) (*i.e.*, deleting the First Proposal's separate requirement for a clearing FCM to provide notice to any DCO of which it is a member that it has experienced a non-ordinary course of business event (in addition to its DSRO, as provided for in CFTC Letter No. 19-17), and deleting the requirement for a clearing FCM to provide separate notice to its DSRO and any DCO of which it is a member that it will resume separate account treatment).

In its comment responding to the First Proposal, CME recommended that the Commission add certain additional events to the list of non-ordinary course of business events: (1) when an FCM is under-capitalized; (2) when an FCM is not in compliance with segregated, secured, or Cleared Swaps requirements; (3) when an FCM has filed notice of non-current books and records; and (4) when an FCM has filed notice of a material inadequacy in internal controls that impact its ability to remain in compliance with Commission regulations.[134] The JAC similarly recommended adding as non-ordinary course of business event (1) when an FCM does not maintain required CFTC capital, futures customer funds, 30.7 customer funds, Cleared Swaps Customer Collateral, residual interest compliance or LSOC compliance, or does not comply with the First Proposal's financial computation requirements; and (2) when the FCM does not maintain current books and records or has a material inadequacy in internal controls.[135] The foregoing events are generally matters for which an FCM must already make a report to, *inter alia*, the Commission and the DSRO pursuant to regulation § 1.12.[136]

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[134] CME Comment Letter.

[135] JAC Comment Letter.

[136] *See*, *e.g.*, regulation § 1.12, which requires an FCM to provide written notice to the Commission and to the firm's DSRO if the FCM is undercapitalized (regulation § 1.12(a)); maintains a level of adjusted net capital that is below established "early warning levels" (regulation § 1.12(b)); fails to maintain current books and records (regulation § 1.12(c)); discovers or is notified by an independent public accountant of the existence of any material inadequacy in the firm's accounting system, the internal accounting controls, or the procedures for safeguarding customer and firm assets (regulation § 1.12(d)); is undersegregated with respect to futures customer funds, Cleared Swaps Customer Collateral, or 30.7 customer funds (regulation §

CME additionally opined that the Commission should make clear that any FCM undergoing an event that in the FCM's opinion is inconsistent with the ordinary course of business should be considered outside the ordinary course of business until such event is resolved, and clarify that the list of non-ordinary course of business events is not exhaustive and is subject to the discretion of the FCM in accordance with its risk management practices.[137]

In this Second Proposal, the Commission has determined not to adjust the list of non-ordinary course of business events, or add additional conditions to exiting or resuming separate account treatment, because the Commission believes the list of non-ordinary course of business events proposed herein is sufficiently flexible to capture CME and JAC's recommended additional non-ordinary course of business events, and is therefore not exhaustive.[138] In addition, the FCM's DSRO will generally have received notification of the occurrence of these events consistent with the requirements of regulation § 1.12, and could, if it deems necessary, take action that would result in the suspension of separate account treatment pursuant to proposed regulation § 1.44(e)(1)(vi) or (e)(2)(i).

FIA opposed the further definition of "ordinary course of business" through enumerated events, arguing that as long as a customer timely meets margin requirements and is not subject to bankruptcy, an FCM should be permitted to allow separate account treatment.[139] The Commission notes that, while there may be commercial and operational merits to FIA's more flexible proposed approach, a number of non-ordinary

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1.12(h)); or does not hold sufficient funds in segregated accounts to meet targeted residual interest amounts or maintains an amount of residual interest that is less than the sum of the undermargined amounts in customer accounts (regulation § 1.12(j)).

[137] CME Comment Letter.

[138] *E.g.*, proposed regulation § 1.44(e)(1)(iii) (A good faith determination by the FCM's CCO, one of its senior risk managers, or other senior manager, following such FCM's own internal escalation procedures, that the separate account customer is in financial distress, or there is significant and bona fide risk that the separate account customer will be unable promptly to perform its financial obligations to the FCM, whether due to operational reasons or otherwise.) could encompass a wide variety of conditions that could result in a cessation of separate account treatment.

[139] FIA Comment Letter.

course of business events are anticipatory – intended to result in cessation of separate account treatment when the customer is in distress, but before such customer reaches the point of bankruptcy or not being able to post margin. FIA's comment also does not consider non-ordinary course of business events occurring at the FCM, rather than just at the customer.

FIA additionally asserted that requirements in the First Proposal for DCOs permitting separate account treatment to require their clearing FCMs to communicate to their DSRO and any DCO of which they are a member (i) the occurrence of non-ordinary course of business events and (ii) the resumption of a state of ordinary course of business, would create a new filing requirement without any perceived benefit and incorrectly imply that separate accounts and their customers pose particular risk management challenges.[140] The Commission notes that, as a condition of the staff no-action position provided in CFTC Letter No. 19-17, a DCO permitting separate account treatment needed to require a clearing FCM to report to its DSRO the occurrence of a non-ordinary course of business event. The First Proposal's proposed requirement to include any DCO of which a clearing FCM is a member as an additional recipient for reports required of the FCM, would no longer apply under this proposal.

The JAC in its comment argued that an FCM exiting or reentering the ordinary course of business (as well as starting separate account treatment) should not be required to notify its DSRO of that fact on grounds that monitoring for compliance with the proposed separate account treatment does not fall under the oversight responsibilities of an SRO, DSRO, or the JAC, and that it would not make sense for a DCO to implement rules that would require a clearing FCM to notify its DSRO of activity specifically governed by the DCO's rules.[141] Under this Second Proposal, however, separate account

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[140] *Id.*
[141] JAC Comment Letter.

treatment will be governed by the Commission's part 1 regulations, and thus would fall within oversight responsibilities of an SRO or DSRO, or the oversight program maintained by the JAC.

The Commission further notes that, under this Second Proposal, the notice requirements for FCMs (to provide notice to the Commission and DSRO of the occurrence of a non-ordinary course of business event via the process set forth in regulation § 1.12(n)(3)) are substantially similar to their counterparts in CFTC Letter No. 19-17 (requiring notice of a non-ordinary course of business event to a DSRO, although not expressly to the Commission), and that the Commission is not now proposing a separate requirement for notice to DCOs of exit from and reentry into separate account treatment (or of initiation of separate account treatment).

In its comment, SIFMA-AMG asserted that the Commission's proposed definition of "ordinary course of business" did not provide clarity on the meaning of "standard day-to-day operation," noting that DCOs instead would be required to continuously monitor for a series of events.[142] SIFMA-AMG also asserted that some non-ordinary course of business events do not appear to rise to the level of significance to suggest they are not ordinary course of business, such as the failure of a customer to make a maintenance margin payment, and that other events require discretion and subjective analysis.[143] SIFMA-AMG recommended the Commission redefine the term "ordinary course of business" and clearly delineate events such as default or bankruptcy that are limited

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[142] SIFMA-AMG Comment Letter. With respect to continuous monitoring, there are six events (proposed regulation § 1.44(e)(1)(i) through (vi)) that are "inconsistent with the ordinary course of business with respect to the separate accounts of a particular separate account customer." The first three of these include a payment default and determinations by the FCM or its employees, all of which should otherwise be monitored by an FCM as part of its normal risk management. The last two involve cases where the FCM either "receives notification" or "is directed," neither of which requires monitoring by the FCM. By proposed regulation § 1.44(e)(1)(iv), the FCM *is* required to monitor whether a separate account customer has become "insolvent or bankrupt" – conditions that SIFMA-AMG agrees are outside the ordinary course of business. Monitoring for the insolvency or bankruptcy of a client would also appear to be a basic part of an FCM's credit risk management, regardless of separate account treatment.

[143] *Id.*

instances that would not be considered ordinary course of business. SIFMA-AMG did not propose an alternative definition of "ordinary course of business."

As discussed above, the Commission notes that a number of non-ordinary course of business events are anticipatory, and thus are intended to result in cessation of separate account treatment *before* a customer or FCM reaches the point of default or bankruptcy. Proposed regulation § 1.44(e) is intended to provide concrete criteria for when a customer or FCM is operating outside the Commission's definition of "ordinary course of business" in proposed regulation § 1.44(a) that are sufficiently flexible to account for the myriad ways in which a customer or FCM can enter a state of financial or operational distress, such that providing for separate account treatment would no longer be prudent from a risk management perspective.

I. Proposed Regulation § 1.44(f)

Proposed regulation § 1.44(f) requires that each separate account must be on a one business day margin call, subject to certain requirements designed to further define what constitutes a one business day margin call. Providing for a one business day margin call, as defined in this regulation § 1.44(f), ensures that margin shortfalls are timely corrected, and that a customer's inability to meet a margin call is timely identified. However, in certain circumstances, it may be impracticable for payments to be received on a same-day basis due to the mechanics of international payment systems (*e.g.*, time zones and schedules of correspondent banks). In proposing requirements to define timely payment of margin for purposes of the standard set forth in proposed regulation § 1.44(f), the Commission's goal is to establish requirements that reflect industry best practices among FCMs and customers.[144]

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[144] An analysis by FIA indicated that, for the FCMs studied, on average more than 90% of margin deficits were collected by the close of business on the day following the market movements creating such deficits. For a majority of the FCMs studied, 95% of margin deficits were collected by that time. *See* Letter from Barbara Wierzinski, General Counsel, FIA, to Melissa Jurgens, Secretary, CFTC, Costs of the Proposed

Specifically, the Commission understands that, while margin calls made in the morning in the U.S. Eastern Time Zone (ET) are typically capable of being met on a same-day basis when margin is paid in United States dollars (USD) and Canadian dollars (CAD), the operation of time zones and banking conventions in other jurisdictions may necessitate additional time when margin is paid in other currencies. For example, the Commission understands, based on discussions with market participants, that margin paid in Japanese yen (JPY) and certain other currencies is typically received two business days after a margin call is issued, and margin paid in British pounds (GBP), euros (EUR), and certain other non-USD/CAD/JPY currencies is typically received one business day after a margin call is issued.

Proposed regulation § 1.44(f)(1) provides that, except as explicitly provided in proposed regulation § 1.44(f), if, as a result of market movements or position changes on the previous business day, a separate account is undermargined (*i.e.*, the undermargined amount for the account is greater than zero), the FCM shall issue a margin call for that separate account for at least the amount necessary for the separate account to meet the initial margin required by the applicable exchanges or clearing organizations (including, as appropriate, the equity component or premium for long or short option positions) for the positions in the separate account.[145] Such call must be met by the applicable separate account customer no later than the close of the Fedwire Funds Service on the same business day, consistent with the industry standard for when 90-95% of margin deficits are cured.[146]

Residual Interest Requirement Compared to the FIA Alternative, at 3, available at *https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=59283&SearchText=FIA*.

[145] The undermargined amount is based on maintenance margin, which may be lower than initial margin. However, if an account falls below the maintenance margin level, the amount of the margin call is generally required to be the amount necessary to bring the account back to the (potentially higher) initial margin level.

[146] The Fedwire Funds Service is an electronic funds transfer service commonly used for settlement and clearing arrangements. The service currently closes at 7:00 p.m. ET. For purposes of the Fedwire Funds

In light of challenges to same-day settlement posed by margining in certain currencies, as described above, and in recognition of the particular banking conventions around payments in other currencies, proposed regulation § 1.44(f)(2) provides that payment of margin in certain currencies listed in proposed Appendix A to part 1 shall be considered in compliance with the requirements of proposed regulation § 1.44(f) provided they are received by the applicable FCM no later than the end of the second business day after the day on which the margin call is issued.

Furthermore, proposed regulation § 1.44(f)(3) provides that payment of margin in fiat currencies other than USD, CAD, or currencies listed in proposed Appendix A to part 1 shall be considered in compliance with the requirements of proposed regulation § 1.44(f) if received by the applicable FCM no later than the end of the business day after the business day on which the margin call was issued.

In the First Proposal, the Commission proposed that:

- Subject to certain exceptions, if the margin call is issued by 11:00 a.m. ET on a United States business day (as that term was proposed to be defined), it must be met by the applicable customer no later than the close of the Fedwire Funds Service on the same United States business day. In no case can a clearing member contractually agree to delay issuing such a margin call until after 11:00 a.m. ET on any given United States business day or to otherwise engage in practices that are intended to circumvent the one business day margin call standard by causing such delay.

Service, Federal Reserve Banks observe as holidays all Saturdays, all Sundays, and the holidays listed on the Federal Reserve Banks' Holiday Schedules. *See* The Federal Reserve, Fedwire® Funds Service and National Settlement Service Operating Hours and FedPayments® Manager Hours of Availability, available at *https://www.frbservices.org/resources/financial-services/wires/operating-hours.html*. Because the Fedwire Funds Service hours of operations may be subject to change, the Commission has determined to tie the timeframe to fulfill the one business day margin call requirements of proposed regulation § 1.44(f) to the Fedwire Funds Service's closing rather than an absolute time.

- Payment of margin in JPY shall be considered in compliance with the requirements of the one business day margin call standard if received by the applicable clearing member by 12:00 p.m., ET, on the second United States business day after the business day on which the margin call is issued.[147]
- Payment of margin in fiat currencies other than USD, CAD, or JPY shall be considered in compliance with the requirements of the one business day margin call standard if received by the applicable clearing member by 12:00 p.m., ET, on the United States business day after the business day on which the margin call is issued.

With respect to the timing of margin payments, CME, in its comment in response to the First Proposal, opined that the Commission should encourage FCMs to collect margin in all currencies as quickly as feasible.[148] While the Commission does encourage FCMs to collect margin in all currencies as quickly as feasible, the Commission understands that compliance challenges could arise with respect to FCMs attempting to determine whether they are meeting an "as quickly as feasible" standard, and chooses to maintain the more definite standard set forth in this proposed regulation, subject to certain revisions with respect to the specific margin payment timing requirements as discussed below.

CME also opined that the Commission should treat all currencies equally where relevant banking conventions render payment impracticable before the second U.S.

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[147] In the First Proposal, the Commission requested comment on whether there are other currencies besides JPY where the relevant banking conventions render payment before the second U.S. business day after a margin call is issued impracticable; to specifically identify any such currencies; and to provide specifics about the operational issues involved with respect to each such currency.

[148] CME Comment Letter. In addition, the Commission requested comment on whether, in anticipation of potential developments with respect to the use of central bank digital currencies or other digital assets, the proposed regulation should explicitly address the timing of payment of margin in digital assets. CME, the only commenter to respond to this question, opined that this question should be addressed in a separate request for comment. *Id.* The Commission is not proposing to address the timing of margin payments in digital assets in the present proposal, other than to note that, under regulation § 1.44(f) as currently proposed, payments of margin in digital assets that are not fiat currencies (*i.e.*, are not created by a government), and are not listed in proposed Appendix A to part 1, would be due on a same-day basis. To the extent that the future development and use of digital fiat currencies results in a situation where general practice is to settle payments in such currencies on a same-day basis, the Commission would address this in a subsequent rulemaking.

business day after a margin call is made (*i.e.*, such provision should not pertain solely to JPY).[149]

In this Second Proposal, the Commission again requests comment regarding the inclusion of currencies with respect to proposed Appendix A to part 1 (*i.e.*, currencies for which payment of margin may be impracticable before the second business day after a margin call is made) and proposes a process for the addition or removal of currencies with respect to proposed Appendix A to part 1 on a going-forward basis.

FIA commented that the one business day margin call requirements in the First Proposal were at once too broad with exceptions that were too narrow.[150] FIA asserted that while neither the CEA nor Commission regulations specify when an FCM must make a margin call, all customer accounts are subject to a one business day margin call under certain CME and ICE Futures U.S. rules as well as the JAC Margins Handbook.[151] FIA further noted that while neither the CEA nor Commission regulations specify when a margin call must be met, the JAC Margins Handbook provides that margin calls must be met within a "reasonable time," defined as "less than five business days for customers and less than four business days for noncustomers and omnibus accounts … counted from and includ[ing] the day the account became undermargined," and CME rules provide that a clearing member may deem a "reasonable time" to mean one hour.[152]

FIA also asserted that Commission regulations (*e.g.*, regulations §§ 1.22(c) and 1.17(c)(5)(viii)) already provide a strong incentive to ensure margin calls are met no later than the following (or, at the latest, second) business day after the event giving rise to the margin call, and that FCMs generally do make margin calls within one business day.[153]

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[149] *Id.*
[150] FIA Comment Letter. SIFMA-AMG voiced similar concerns, arguing that the Commission's proposal was overly prescriptive and did not consider legitimate reasons for why firms may have different margin call deadlines.
[151] *Id.*
[152] *Id.*
[153] *Id.*

Additionally, FIA argued that the proposed regulation would impose a new recordkeeping requirement because FCMs would have to record the precise time a margin call is issued and, likely, met.[154] FIA recommended that instead the Commission should instead provide that FCM policies and procedures assure all margin calls are met on no more than a one business day margin call basis except as a result of administrative error or operational constraint.[155]

With respect to the timing of margin payments in JPY, FIA argued that the Commission's proposal was too restrictive and that such requirement should focus on the date payment is irrevocably initiated rather than received.[156] With respect to the timing of margin payments in CAD, JPY, and other non-USD currencies, FIA opined that the Commission's proposal was arbitrary and unworkable.[157]

In the Commission's view, a "one business day margin call" should be defined beyond the term itself. FIA did not propose any such definition, and the Commission believes market participants should have clarity with respect to the criteria for a one business day margin call, with clear lines with respect to what conduct is and is not compliant. Additionally, while FCMs may ensure that margin calls are generally met within one business day, for purposes of separate account treatment, the Commission wishes to ensure that such margin calls are (subject to specified exceptions) always met on a one business day basis. With respect to FIA's comment that the definition of a one business day margin call should be based on when payment is irrevocably initiated, the Commission believes such suggestion may be impracticable, given the challenge to an FCM in having information that will reliably prove when a customer has initiated payment and information on whether and when such payments are "irrevocable."

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[154] *Id.*
[155] *Id.*
[156] *Id.*
[157] *Id.*

However, in the Second Proposal, the Commission has deleted its prior proposed specific timing requirements with respect to the making and meeting of margin calls on a one business day basis. Instead, if an account is undermargined as a result of the prior day's market moves, a margin call must be made and met on a same-day basis, with the allowance of either one or two additional business days for margin payments in certain non-USD/CAD currencies.[158] The Commission expects such alteration will also address FIA's concerns regarding the recording of precise timestamps with respect to when margin calls have been made or met.

In its comment, the JAC requested that the Commission clarify that its one business day margin call requirements do not impact existing regulations regarding the aging of margin calls or clearing FCMs' financial reporting, regardless of the time of day the FCM issues the margin call or if the customer is outside the U.S.[159] The Commission believes the proposed regulation accomplishes this by specifying that the definitions contained within proposed regulation § 1.44(a) apply only for purposes of proposed regulation § 1.44, and that the margin payment timing requirements of proposed regulation § 1.44(f) apply solely for purposes of proposed regulation § 1.44.

The JAC also requested that the Commission clarify that its proposed codification does not affect the balances recorded in customers' accounts, or the undermargined amount which the FCM must include in its residual interest and LSOC compliance calculations.[160] The Commission notes, with respect to the calculation of balances in customers' accounts and the undermargined amount which the FCM must include in its residual interest and LSOC compliance calculations, such figures would be calculated on a separate account basis, as discussed herein.[161]

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[158] Such requirement would not apply to margin calls made in light of intraday market movements.
[159] JAC Comment Letter.
[160] *Id.*
[161] *See, e.g.*, JAC, Regulatory Alert, #18-02, at 2, June 6, 2018 (discussing undermargined accounts), proposed regulation § 1.44(g)(5).

The JAC further requested that the Commission clarify that, notwithstanding its proposed one business day margin call requirements, a margin call must be issued to the customer within one business day after the event giving rise to the margin deficiency, even if the call cannot be made until after 11:00 a.m. ET, and even if the business day is not a business day in the customer's jurisdiction. The Commission believes proposed regulation § 1.44(f)(1) addresses this comment by removing the link to the specific time of 11:00 a.m. ET. Rather, if as a result of market moves or position changes on the prior business day, a separate account is undermargined, then the FCM is required to issue a margin call for the separate account for at least the amount necessary for the separate account to meet the initial margin required by the applicable exchanges or clearing organizations (including, as appropriate, the equity component or premium for long or short option positions), and that such call must be met by the applicable separate account customer no later than the close of the Fedwire Funds Service on the same business day regardless of what time the margin call was issued, subject to the proposed limited one or two business-day exception for margin payments posted by separate account customers in certain non-USD/CAD currencies, and other exceptions explicitly provided for in proposed regulation § 1.44(f).

The JAC additionally contended that receipts and disbursements from separate accounts should occur on the same day.[162] The Commission believes this standard will in the main be met where, under the proposed regulation, customers will be required to meet any margin call on the day it is issued, with the limited exceptions discussed in the previous paragraph of one or two business days for payments of margin in certain non-USD/CAD currencies.

With respect to the timing of margin payments in non-USD/CAD currencies, the JAC argued that the Commission should adopt a mechanism to provide timely and

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[162] *Id.*

efficient changes to payment timelines for meeting a one business day margin call, and that such authority should rest solely with the Commission, rather than with individual DCOs, in order to ensure consistency and avoid confusion where some separately margined accounts may contain positions with one or more DCO.[163]

The proposed procedure outlined herein to remove currencies from or add currencies to proposed Appendix A to part 1 as set forth in proposed regulation § 1.44 is intended to address this comment.[164]

While ICE did not object to the Commission's proposed margin payment timing framework in the First Proposal, ICE recommended that the Commission clarify that the proposed regulation would not affect stricter margin call timeframes established by DCOs for clearing members.

While such clarification may not be required in light of the applicability of proposed regulation § 1.44 to all FCMs regardless of clearing membership and removal of the proposed codification from part 39, for the avoidance of doubt, the Commission states explicitly that the proposed regulation is not intended to affect or prohibit more stringent risk management requirements, including margin call timeframes, that may be established by DCOs with respect to their members. The Commission confirms that an FCM that is a member of a DCO is obligated to comply with such DCO's margin call timeframes, applied in a manner consistent with DCO rules, including those that are more stringent than those addressed in proposed regulation § 1.44.[165] This is consistent with

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[163] *Id.*

[164] This procedure is intended to seek the aid of market participants in "evaluating when a particular foreign currency is eligible for one-day or two-day settlement," and thus, on an ongoing basis, matching proposed Appendix A to part 1 to current industry conventions. *Cf.* FIA Comment Letter.

[165] *Cf.* § 39.17(a)(1) (A DCO shall maintain adequate arrangements and resources for the effective monitoring and enforcement of compliance (by its clearing members) with the rules of the DCO.).

the approach taken with respect to other risk management measures, such as capital requirements.[166]

In its comment, MFA argued that the proposed regulation failed to consider that legitimate reasons exist for firms to impose different margin call deadlines for different clients, and asserted that CFTC Letter No. 19-17 instead recognized such operational complexities by affording firms greater operational flexibility in prescribing margin cutoff times.[167]

As discussed above, in this Second Proposal, the Commission has eliminated time-of-day-specific requirements for when margin calls must be made and met in favor of a general same-day requirement.

In its comment, SIFMA-AMG argued that the Commission should abandon its proposed currency-based three-tiered margin payment timing scheme, arguing that the allowance of grace periods permits for flexibility and serves to address issues posed by operational complexities.[168] For example, SIFMA-AMG further argued that the Commission's proposal did not consider what would happen if different managers for the same client chose different Eurozone countries to follow for purposes of banking holidays, and did not account for parties that may be located in different time zones. The Commission believes it is important from a risk mitigation perspective to preserve a one business day margin call standard, in accordance with industry best practice for prompt fulfillment of margining requirements, and further believes it important from a perspective of regulatory certainty that there be clear lines drawn around the meaning of a one business day margin call. In this Second Proposal, by eliminating prescriptive margin payment timing requirements in favor of a requirement that a margin call be made

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[166] *Compare, e.g.*, regulation § 1.17(a)(1) (setting adjusted net capital requirements with an absolute minimum of $1 million, *with* CME Rule 970.A.1 (setting minimum capital requirements with an absolute minimum of $5 million).
[167] MFA Comment Letter.
[168] SIFMA-AMG Comment Letter.

and met on a same-day basis, with limited extensions for payment of margin in certain currencies, the Commission seeks to implement a standard more flexible and capable of addressing operational complexities than the standard set forth in the First Proposal. With respect to the specific examples raised by SIFMA-AMG, different managers, of different separate accounts, for the same customer (client), would not be precluded from using different countries for purposes of banking holidays, as each such separate account would be separately margined. Nonetheless, if that were to create operational difficulties for the customer, then the customer could resolve those issues with the managers. Additionally, the Commission again invites comment on those currencies for which margin payments should be considered compliant if made by the second business day after a margin call is issued.

The occurrence of a foreign holiday during which banks are closed may also create difficulties in payment of margin in a fiat currency other than USD. Therefore, the Commission proposes regulation § 1.44(f)(4), which states that the relevant deadline for payment of margin in fiat currencies other than USD may be extended by up to one additional business day and still be considered in compliance with the requirements of proposed regulation § 1.44(f) if payment is delayed due to a banking holiday in the jurisdiction of issue of the currency. For payments in EUR, either the separate account customer or the investment manager managing the separate account may designate one country within the Eurozone with which they have the most significant contacts for purposes of meeting margin calls in that separate account, and whose banking holidays shall be referred to for purposes of compliance with the regulation.[169]

Proposed regulation § 1.44(f)(4) is designed to provide FCMs with a level of discretion in how they manage risk by allowing an FCM to *permit* limited delays in

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[169] With respect to margin payments in EUR, proposed regulation § 1.44(f)(4) is intended to prevent customers or investment managers from leveraging banking holidays in a multiplicity of jurisdictions, to circumvent requirements to pay margin timely.

margin payments due to non-U.S. banking conventions. Proposed regulation § 1.44(f)(4) would not, however, *require* an FCM to extend the deadline for payments of margin. Here, the Commission is seeking to allow FCMs to exercise risk management judgment in balancing, within limits, the risk management challenges caused by extending the time before a margin call is met with the burdens involved in requiring the client or investment manager to prefund potential margin calls in advance of the holiday or to arrange to pay margin more promptly in USD or another currency not affected by the holiday. The Commission expects that FCM risk management decisions, including the use of any extension permitted under proposed regulation § 1.44(f)(4), will be made in consideration of relevant risk management factors; *e.g.*, a client's risk profile and market conditions, evaluated at the time the risk management decisions are made.[170] The Commission included this proposed requirement in the First Proposal in substantively the same form.

In its comment in response to the First Proposal, the JAC argued that this proposed requirement would create a new recordkeeping requirement for clearing FCMs, and recommended that the Commission clarify that it does not impact the requirements of any other CFTC regulations or SRO rules related to margin calls.[171] As noted above, the Commission believes the proposed regulation addresses this comment in making clear that the requirements in proposed regulation § 1.44(f) for meeting a one business day margin call apply solely for purposes of proposed regulation § 1.44(f).

In CFTC Letter No. 19-17, staff stated that a failure to deposit, maintain, or pay margin or option premium due to administrative errors or operational constraints would

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[170] This expectation is consistent with the statement of the directors of DCR and DSIO in issuing CFTC Letter No. 19-17. CFTC, Statement by the Directors of the Division of Clearing and Risk and the Division of Swap Dealer and Intermediary Oversight Concerning the Treatment of Separate Accounts of the Same Beneficial Owner, Sept. 13, 2019, available at *https://www.cftc.gov/PressRoom/SpeechesTestimony/dcrdsiodirectorstatement091319* ("We fully expect that DCOs and FCMs and their customers will agree that FCMs must retain, at all times, the discretion to determine that the facts and circumstances of a particular shortfall are extraordinary and therefore necessitate accelerating the timeline and relying on the FCM's protocol for liquidation or for accessing funds in the other accounts of the beneficial owner held at the FCM."). *See also* CFTC Letter No. 20-28 (stating the same).

[171] JAC Comment Letter.

not constitute a failure to timely deposit or maintain initial or variation margin that would place a customer out of the ordinary course of business. This provision was intended to prevent a clearing FCM from being excluded from relying on the no-action position as a result of one-off exceptions, such as mis-entered data, a flawed software update, or an unusual and unexpected information technology outage (*e.g.*, an unanticipated outage of the Fedwire Funds Service).

Accordingly, the Commission proposes regulation § 1.44(f)(5), which provides that a failure with respect to a specific separate account to deposit, maintain, or pay margin or option premium that was called pursuant to proposed regulation § 1.44(f)(1), due to unusual administrative error or operational constraints that a separate account customer or investment manager acting diligently and in good faith could not have reasonably foreseen,[172] does not constitute a failure to comply with the requirements of proposed regulation § 1.44(f). For such purposes, an FCM's determination that the failure to deposit, maintain, or pay margin or option premium is due to such administrative error or operational constraints must be based on the FCM's reasonable belief in light of information known to the FCM at the time the FCM learns of the relevant administrative error or operational constraint.[173] The Commission included this

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[172] One would expect administrative errors at a well-run money manager to be unusual and unforeseen. For the avoidance of doubt, "unforeseen" refers to the particular occurrence of a constraint or error; for example, the fact that some small percentage of errors may be foreseen does not mean that any particular error is foreseen (and "unusual" means that such percentage should indeed be small). Moreover, an unusual and unforeseen administrative error or operational constraint that prevents payment might occur at one of a number of points in the payment chain beyond the money manager: Examples include an error or operational failure on the part of the bank that the money manager instructs to send a wire transfer to the FCM, an error or operational failure on the part of the bank (for cash) or custodian (for securities) designated to receive margin on behalf of the FCM, or an error or operational failure on the part of a bank in the middle of a chain between the sending bank and the FCM's bank (particularly in the context of transfers of foreign currency).

[173] The Commission is proposing to establish this reasonableness standard for an FCM's determination that a failure to timely deposit, maintain, or pay margin or option premium on the basis of administrative error or operational constraints. The Commission believes the proposed standard confers significant discretion upon FCMs to assess the disposition of their customers while requiring that FCMs act reasonably and on the basis of current and relevant information, diligently gathered.

proposed requirement in the First Proposal in substantially the same form, with one change.

The current proposal adds the term "with respect to a specific separate account" to make clear that "unusual" is based on a particular separate account, not the FCM's business with respect to separate accounts as a whole.[174]

In its comment in response to the First Proposal, FIA argued that the Commission's proposed standards for "unusual" and "unforeseen" are too subjective and would unnecessarily expose FCMs to enforcement actions, noting that unusual or unforeseen events are often outside an FCM's control.[175] FIA did not, however, propose alternative standards.

Similarly, MFA in its comment argued that FCMs, asset managers, and customers benefit from agreed-upon grace periods for shortfalls resulting from administrative or operational issues unrelated to ability to pay, and argued that use of terms such as "unusual," "diligently and in good faith" are subjective.[176] MFA argued that the Commission should remove the condition now encompassed by proposed regulation § 1.44(f)(5).

In its comment, SIFMA-AMG argued that the Commission should remove or re-propose the standard that failure to meet margin obligations "due to unusual

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[174] Consider an FCM with two dozen separate account customers, with an average of four separate accounts per customer, resulting in 96 separate accounts for that FCM. If each separate account has an exception only once per year, that would result in a total of 96 exceptions, or around two per week, for the FCM. While the Commission does not intend to set a prescriptive definition of "unusual" in this context, it may nonetheless be seen that once per year *is* unusual, while twice per week is not.

[175] FIA Comment Letter. FIA observes that "An FCM should not be subject to administrative sanctions for matters over which the FCM has no control." *Id.* The requirements of regulation § 1.44 are consistent with that principle.
The consequence of a separate account customer failing to meet a one-day margin call for reasons that fall outside the scope of an "unusual administrative error or operational constraints that a separate account customer or investment manager acting diligently and in good faith could not have reasonably foreseen" is that the customer is outside the "ordinary course of business," and that thus the FCM must cease treating the separate accounts of the separate account customer as accounts of separate entities for purposes of margin distribution under regulation § 1.44(b). That action – which would be required to be taken *by* the FCM – is not an administrative sanction *on* the FCM, which likely would not have direct control over financial and operational conditions at its customer, but rather a measure, designed to protect the FCM and the markets more broadly, that has a negative effect on the customer (rather than the FCM).

[176] MFA Comment Letter.

administrative error or operational constraints that a customer or investment manager acting diligently and in good faith could not have reasonably foreseen" does not constitute a failure to comply with the one business day margin call requirement, on the basis that this proposed provision is ambiguous.

The Commission believes the further criteria for determining the existence of an administrative error or operational constraint provide a clearer definition of the meaning of these terms. The Commission additionally believes that, while FCMs engaged in separate account treatment should not enter agreements that obviate the risk-mitigating purpose of requiring margin calls be met on a one business day basis, proposed regulation § 1.44(f)(5) strikes a reasonable balance in ensuring that FCMs and customers are not forced to cease separate account treatment as a result of unusual and unexpected, one-off errors.

It should also be noted that the provisions of paragraph (f) of proposed regulation § 1.44 are subject to the language that "the following provisions apply solely for the purposes of this paragraph (f)." This is separate from, *e.g.*, requirements for margin aging under regulation § 1.17(c)(5)(viii), which requires payment by the end of the business day after the business day on which the margin call is made.

For example, if a margin call for a separate account is made on Tuesday based on events on Monday, and the margin call is to be met in JPY, payment by close of business on Thursday would be timely for purposes of proposed regulation § 1.44(f), because JPY is a currency listed in proposed Appendix A to part 1, and that payment would be considered in compliance with the requirements of paragraph (f) of regulation § 1.44 "if received by the applicable futures commission merchant no later than the end of the second business day after the day on which the margin call is issued." However, payment for that margin call would not be timely for purposes of regulation § 1.17(c)(5)(viii) unless received by close of business on *Wednesday.*

On the other hand, if that margin call is to be made in USD or CAD, and it is not received until Wednesday, and there is no "unusual administrative error or operational constraints that a customer or investment manager acting diligently and in good faith could not have reasonably foreseen" (*i.e.*, proposed regulation § 1.44(f)(5) does not apply), then, while payment by Wednesday is timely for purposes of regulation § 1.17(c)(5)(viii), after the close of business on *Tuesday*, the separate account customer would be out of compliance with the one business day margin call called for by proposed regulation § 1.44(f).

Proposed regulation § 1.44(f)(6) states that an FCM would not be in compliance with the requirements of proposed regulation § 1.44(f) if it contractually agrees to provide separate account customers with periods of time to meet margin calls that extend beyond the time periods specified in proposed regulation §§ 1.44(f)(1) through (5),[177] or engages in practices that are designed to circumvent proposed regulation § 1.44(f). The Commission proposes this provision, which was included in the First Proposal in substantively the same form, in order to make clear that it is establishing a maximum period of time in which a margin call must be met for purposes of this regulation, rather than establishing a minimum time that an FCM must allow. Proposed regulation § 1.44(f) would not preclude an FCM from having customer agreements that provide for more stringent margining requirements, or applying more stringent margining requirements in appropriate circumstances. The statement that these "requirements apply solely for purposes of this paragraph (f)" means that such requirements are not intended to apply to any other provision; *e.g.*, they are not intended to define when an account is undermargined for purposes of regulation § 1.17. Conversely, the Commission does not

[177] For example, if an FCM and a customer contract for a grace or cure period that would operate to make margin due and payable later than the deadlines described herein, including a case where the FCM would not have the discretion to liquidate the customer's positions and/or collateral where margin is not paid by such time, such an agreement would be inconsistent with the conditions under which such FCM may engage in separate account treatment.

propose to prohibit contractual arrangements inconsistent with proposed regulation § 1.44(f). However, the FCM would not be permitted to engage in separate account treatment under such arrangements.

In its comment, CME argued that the proposed regulation could create confusion by incorrectly implying that customers not utilizing separate account treatment may be given contractual terms providing for a period of time longer than one business day to satisfy a margin call or may otherwise restrict the FCM's discretion as to liquidation in contravention of CME Group Exchange rules.[178]

In its comment, the JAC similarly contended that the Commission incorrectly implied that an FCM may contractually agree to a grace or cure period for any customers that are not treated as separate accounts, and recommended that the Commission make clear that if an FCM and customer contract for margin calls to be met on a longer than one business day basis, then the FCM is not making a bona fide attempt to collect margin within one business day after the event giving rise to the margin deficiency.[179]

The Commission notes that it is not proposing this regulation to conform to the rules of a particular DCO, to the extent the DCO may prohibit such grace or cure periods, and further notes that this proposed regulation does not prevent a DCO from maintaining and enforcing rules that apply more stringent risk management standards to their clearing members than are set forth therein.

Proposed regulation § 1.44(f)(7) is an exception to proposed regulation § 1.44(f)(1), dealing with the special case of certain holidays (*i.e.*, Columbus Day and Veterans day) on which some DCMs may be open for trading, but on which banks are closed (and, therefore, payment of margin may be difficult or impracticable). It only

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[178] CME Comment Letter.
[179] JAC Comment Letter.

applies to an FCM if that FCM trades on such a DCM, and to a separate account if that separate account includes positions traded on such a DCM.

Paragraph (i) deals with margin calls based on undermargined amounts in a separate account resulting from market movements on the business day before the holiday. Such calls may be made on the holiday, but would be due by the close of Fedwire on the next business day after the holiday.[180]

Paragraph (ii) deals with margin calls based on undermargined amounts resulting from market movements on the holiday. If, as a result of such market movements, a separate account is undermargined by an amount greater than the amount it was undermargined as a result of market movements or position changes on the business day before the holiday, the futures commission merchant shall issue a margin call for the separate account for at least the incremental undermargined amount.

The following uses Veterans Day (November 11) as an example, and assumes that no relevant day falls on a weekend. If, as a result of market movements on November 10, a separate account is undermargined by $100, the FCM would issue a margin call of at least $100 and, payment of that $100 would be due by the close of Fedwire on November 12.

If that separate account were to be undermargined by a total of $160 as a result of market movements on November 11, the FCM would issue a margin call for at least the incremental amount ($160 - $100 = $60) on November 12, and that incremental $60 would also be due by the close of Fedwire on November 12. If, instead, the separate account gained $60 on November 11, the original margin call for $100 (issued on November 11) would still need to be met by the close of Fedwire on November 12.

By contrast, if the separate account were not undermargined as a result of market movements on November 10, but then became undermargined by $60 as a result of

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[180] Additional days due to other provisions of proposed regulation § 1.44(f) would also be applicable.

market movements on November 11, the FCM would issue a margin call in the amount of at least $60 on November 12, and payment would be due by the close of Fedwire on November 12.

In its comment letter, the JAC also opined that if the Commission addresses unscheduled banking holidays or U.S. securities market closures, the Commission should make clear that any such provisions apply only to determining if a margin call is considered one-day and do not govern how such holidays or closures are considered for any other purpose.[181] The Commission believes the proposed regulation addresses this comment in making clear that the requirements in proposed regulation § 1.44(f) for meeting a one business day margin call apply solely for purposes of proposed regulation § 1.44(f).

CME asserted that unscheduled closings of banks or securities markets should be handled on an industry-wide basis, based on facts and circumstances specific to each such situation, and not prescriptively, noting that CME, FIA, SIFMA, and many other exchanges and clearing organizations have worked to establish protocols for these scenarios.[182] Such unscheduled closings (for, *e.g.*, a national day of mourning) would fall under the rubric of an "unusual … operational constraint[]."

In its comment letter, SIFMA-AMG recommended the Commission preserve the flexibility of a limited discretionary grace period, stating that the proposed regulation would mean that a "single 'foot fault'" with respect to a single manager could cause an FCM to revert to margining on a gross basis.

The Commission believes the requirement of a one business day margin call, as set forth in the no-action position and further expanded on in the Second Proposal, is a core component of mitigating the risk that separate account treatment will result in the

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[181] JAC Comment Letter.
[182] *Id*.

under-margining of one or more separate accounts. The effect of a one business day margin call is to limit the time during which a customer account (or, here, a customer's separate account) is undermargined, and thus to limit the risk to the FCM (and the FCM's omnibus customer account for futures, Cleared Swaps, or foreign futures or foreign options). One business day is industry best practice. The Commission notes that a "single," one-off error with respect to a single manager would also not under the proposed regulation result in a reversion to margining on a customer basis if such error meets the criteria for an unusual and unforeseen administrative error or operational constraint discussed above.

Lastly, the Commission proposes regulation § 1.44(f)(8) to set forth a procedure to adjust the scope of currencies in proposed Appendix A to part 1. In proposing regulation § 1.44(f)(8), the Commission seeks to ensure a more flexible process whereby members of the public, or the Commission itself, may initiate a process to expand or narrow proposed Appendix A to part 1 as may be required from time to time, subject to public notice and comment. Proposed regulation § 1.44(f)(8) provides that any person may submit to the Commission any currency that such person proposes to add to or remove from proposed Appendix A to part 1. The submission must include a statement that margin payments in the relevant currency cannot, in the case of a proposed addition, or can, in the case of a proposed removal, practicably be received by the futures commission merchant issuing a margin call no later than the end of the first business day after the day on which the margin call is issued. The submitter would need to support such assertion with documentation or other relevant supporting information, as well as any additional information that the Commission requests.[183] The Commission would be required to review the submission and determine whether to propose to add the relevant

[183] Submitters may request confidential treatment for parts of its submission in accordance with Commission regulation § 145.9(d).

currency to, or remove it from, proposed Appendix A to part 1. The Commission would also be required to issue such determination through notice-and-comment rulemaking, with a comment period of no less than thirty days. Proposed regulation § 1.44(f)(8) also provides that the Commission may propose to issue such a determination of its own accord, without prompting by a submission from a member of the public. As with a public submission, a Commission determination on its own accord would be subject to notice and comment rulemaking, with a public comment period of no less than thirty days.

Request for Comment

Question 6: The Commission requests comment regarding whether, in light of changes made in this Second Proposal relative to the First Proposal, the regulatory framework set forth in proposed regulation § 1.44(f) appropriately balances practicability and burden with risk management. If not, what alternative approach should be taken? How would such an alternative approach better balance those considerations? In particular, the Commission requests comment on whether the proposed standard of timeliness for a one business day margin call set forth in proposed regulation § 1.44(f) presents practicability challenges and, if so, what those challenges are, and how the proposed standard of timeliness could be improved.

Question 7: Proposed regulation § 1.44(f)(4) provides that the relevant deadline for payment of margin in fiat currencies other than USD may be extended by up to one additional business day and still be considered in compliance with the requirements of proposed regulation § 1.44(f) if payment is delayed due to a banking holiday in the jurisdiction of issue of the currency. Proposed regulation § 1.44(f)(4) further provides that, for payments in EUR, either the separate account customer or the investment manager managing the separate account may designate one country within the Eurozone that they have the most significant contacts with for purposes of meeting margin calls in

that separate account, whose banking holidays shall be referred to for such purpose. As noted above, this provision is intended to prevent customers or investment managers from leveraging banking holidays in a multiplicity of jurisdictions to circumvent requirements to pay margin promptly. Separately from Question 6 above, the Commission requests comment specifically in relation to proposed regulation § 1.44(f)(4), with respect to:

1) Whether commenters believe it will be impracticable to comply with proposed regulation § 1.44(f)(4), as that section pertains to payment of margin in EUR. For example, if a customer selects Eurozone Country A as the jurisdiction that is most significant to their operations for purposes of meeting margin calls in separate accounts, but also uses a bank in Eurozone Country B to meet margin payments in EUR, would a banking holiday in Country B (but not Country A) make it impracticable for the customer to pay margin in compliance with proposed regulation § 1.44(f)(3)? Commenters are requested to provide examples of operational or other challenges that would result in such impracticability.
2) To the extent commenters have such practicability concerns, how, in the alternative, should the Commission seek to achieve its goal, discussed above, of preventing evasion of the one business day margin call standard, in light of differing banking holidays within the national jurisdictions that comprise the Eurozone?

J. Proposed Regulation § 1.44(g)

Proposed regulation § 1.44(g) contains requirements related to calculations for capital, risk management, and segregation of customer funds. These provisions are substantially similar to the corresponding no-action conditions in CFTC Letter No. 19-17, and to corresponding conditions included in the First Proposal, except that they have been reorganized and subject to minor changes to account for their proposed inclusion in part 1

of the Commission's regulations as well as the proposed introduction of new defined terms. Many of these provisions are intended to ensure that an FCM treats each separate account as a distinct account from all other accounts of a separate account customer for purposes of the FCM computing its regulatory capital and segregation of customer funds. The proposed provisions are also intended to ensure that an FCM treats separate accounts in a consistent manner for purposes of risk management.

As FIA noted in its June 26, 2019 letter, customer agreements that provide for separate account treatment generally require that a separate account be margined separately from any other account maintained for the customer with the FCM, and assets held in one separate account should not ordinarily be used to offset, or (absent default) meet, any obligations of another separate account, including obligations that it or another investment manager may have incurred on behalf of a different account of the same customer.[184] In that letter, preceding issuance of CFTC Letter No. 19-17, FIA observed that these restrictions serve to assure the customer, or the asset manager responsible for a particular account, that the account will not be subject to unanticipated interference that may exacerbate stress on a customer's aggregate exposure to the FCM.[185] Additionally, FIA noted that where an FCM treats separate accounts as separate customers for risk management purposes, the FCM may manage risk more conservatively against the customer under the assumption that the customer has fewer assets than it may in fact have.[186]

Accordingly, proposed regulation § 1.44(g) would, if adopted, apply to all FCMs certain conditions in CFTC Letter No. 19-17. These conditions are designed to provide for consistent treatment of separate accounts. Proposed regulation § 1.44(g) requires a separate account of a customer to be treated separately from other separate accounts of

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[184] First FIA Letter.
[185] *Id.*
[186] *Id.*

the same customer for purposes of certain existing computational and recordkeeping requirements, which would otherwise be met by treating accounts of the same customer on a combined basis. Because accounts subject to proposed regulation § 1.44 would be risk-managed on a separate basis, the Commission believes it is appropriate for the proposed regulation to provide that FCMs apply these risk-mitigating computational and recordkeeping requirements on a separate account basis. The effect of the requirements in these paragraphs is to augment the FCM's existing obligations under various provisions of regulation § 1.17.

Proposed regulation § 1.44(g)(1) provides that an FCM's internal risk management policies and procedures shall provide for stress testing as set forth in regulation § 1.73, and credit limits for separate account customers. Proposed regulation § 1.44(g)(1) further provides that such stress testing must be performed, and the credit limits must be applied, both on an individual separate account and on a combined account basis. By conducting stress testing on both an individual separate account and on a combined account basis, an FCM can determine the potential for significant loss in the event of extreme market conditions, and the ability of traders and FCMs to absorb those losses, with respect to each individual account of a customer, as well as with respect to all of the customer's accounts. Additionally, by applying credit limits on both an individual separate account basis (to address issues that may be specific to the particular strategy governing the separate account) and on a combined account basis (to address issues that may be applicable to the customer's overall portfolio at the FCM), an FCM can be in a better position to manage the financial risks they incur as a result of carrying positions both for a customer's separate account and for all of the customer's accounts. By better managing the financial risks posed by customers and understanding the extent of customers' risk exposures, FCMs can better mitigate the risk that customers do not maintain sufficient funds to meet applicable initial and maintenance margin requirements,

and anticipate and mitigate the risk of the occurrence of certain of the events detailed in proposed regulation § 1.44(e).

Proposed regulation § 1.44(g)(2) provides that an FCM shall calculate the margin requirement for each separate account of a separate account customer independently from such margin requirement for all other separate accounts of the same customer with no offsets or spreads recognized across the separate accounts. An FCM would be required to treat each separate account of a customer independently from all other separate accounts of the same customer for purposes of computing capital charges for undermargined customer accounts in determining its adjusted net capital under regulation § 1.17.

Proposed regulation § 1.44(g)(3) provides that an FCM shall, in computing its adjusted net capital for purposes of regulation § 1.17, record each separate account of a separate account customer in the books and records of the FCM as a distinct account of a customer, including recording each separate account with a net debit balance or a deficit as a receivable from the separate account customer, with no offsets between the other separate accounts of the same separate account customer, with respect to separate account customers, comply with certain additional requirements in computing its adjusted net capital for purposes of regulation § 1.17.

Regulations §§ 1.20, 22.2, and 30.7 currently require an FCM to maintain a sufficient amount of customer funds in segregated accounts to meet its total obligations to all futures customers, Cleared Swaps Customers, and 30.7 customers, respectively.[187] In order to ensure that the FCM holds sufficient funds in segregation to satisfy the aggregate account balances of all customers with positive net liquidating balances, the FCM is prohibited from netting the account balances of customers with deficit or debit ledger

[187] 17 CFR 1.20(a), 22.2(f)(2), and 30.7(a).

balances against the account balances of customers with credit balances.[188] Each FCM is also required to prepare and submit to the Commission, and to FCM's DSRO, a daily statement demonstrating compliance with its segregation obligations.[189]

Proposed regulation § 1.44(g)(4) provides that an FCM shall, in calculating the amount of its own funds it is required to maintain in segregated accounts to cover deficits or debit ledger balances pursuant to regulations §§ 1.20(i), 22.2(f), or 30.7(f)(2) in any futures customer accounts, Cleared Swaps Customer Accounts, or 30.7 accounts, respectively, include any deficits or debit ledger balances of any separate account as if the accounts are accounts of separate entities. The purpose of proposed regulation § 1.44(g)(4) is to ensure that an FCM that elects to permit separate account customers treats separate accounts as if the accounts are accounts of separate entities for purposes of computing the amount of funds the FCM is required to hold in segregation for futures customers, Cleared Swaps Customers, and 30.7 customers. Specifically, proposed regulation § 1.44(g) would provide that an FCM may not offset a deficit or debit ledger balance in the separate account of a separate account customer by any credit balance in any other separate accounts of the separate account customer carried by the FCM. Proposed regulation § 1.44(g) would impose the same obligations on separate accounts that are currently imposed by regulations §§ 1.20, 22.2, and 30.7 on customer accounts that are not separate accounts. Proposed regulation § 1.44(g) is also consistent with CFTC Letter No. 19-17.[190]

Regulations §§ 1.22, 22.2, and 30.7 currently prohibit an FCM from using, or permitting the use of, the funds of one futures customer, Cleared Swaps Customer, or 30.7 customer, respectively, to purchase, margin or settle the positions of, or to secure or

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[188] 17 CFR 1.20(i)(4), 22.2(f)(4), and 30.7(f)(2)(iv) for futures customer accounts, Cleared Swaps Customer Accounts, and 30.7 accounts, respectively.
[189] *See* 17 CFR 1.32(d), 22.2(g)(3), and 30.7(l)(3).
[190] CFTC Letter No. 19-17 provides that an "FCM shall use its own funds to cover the debit/deficit of each separate account." CFTC Letter No. 19-17.

extend the credit of, any person other than such customer.[191] To ensure compliance with this prohibition, each FCM is required to compute, as of the close of the previous business day, the total undermargined amount of its customers' accounts and to maintain a sufficient amount of the FCMs' own funds (*i.e.,* residual interest) in the applicable customer segregated accounts to cover the undermargined amounts.[192]

The Commission is proposing regulation § 1.44(g)(5) to provide that, for purposes of its residual interest and LSOC compliance calculations, as applicable under regulations §§ 1.22(c), 22.2(f)(6), and 30.7(f)(1)(ii), the FCM shall treat the separate accounts of a separate account customer as if the accounts were accounts of separate entities and include the undermargined amount of each separate account, and cover such deficiency with its own funds. The proposed amendments would result in an FCM treating each separate account in a manner comparable with the treatment currently provided to customer accounts that are not separate accounts. The proposal is also consistent with CFTC Letter No. 19-17.[193]

Commission regulation § 1.11 requires an FCM that accepts customer funds to margin futures, Cleared Swaps, or foreign futures and foreign options to implement a risk management program designed to monitor and manage the risks associated with the activities of the FCM.[194] The risk management program is required to address, among other risks, segregation risk, and further requires an FCM to establish a targeted amount of its own funds, or residual interest, that the firm will hold in segregated accounts for futures customers, Cleared Swaps Customers, and 30.7 customers to reasonably ensure

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[191] 17 CFR 1.22(a), 22.2(d), and 30.7(f)(1)(i).

[192] An FCM is required to maintain a sufficient amount of its own funds in segregation to cover the FCM's customers' undermargined amounts by the residual interest deadline. The residual interest deadline for futures customers and 30.7 customers is 6:00 p.m. Eastern Time on the next business day. 17 CFR 1.22(c) & 30.7(f). The residual interest deadline for Cleared Swaps Customers is the time of settlement on the next business day of the applicable swaps clearing organization. 17 CFR 22.2(f)(6).

[193] CFTC Letter No. 19-17 provides that an "FCM shall include the margin deficiency of each separate account, and cover with its own funds as applicable, for purposes of its [r]esidual [i]nterest and LSOC compliance calculations. CFTC Letter No. 19-17 (Condition 10).

[194] 17 CFR 1.11.

that the FCM remains in compliance with its obligation to hold, at all times, a sufficient level of funds in segregation to cover its full obligation to its customers.[195] Regulation 1.23(c) further requires an FCM to establish a targeted residual interest amount that is held in segregation to reasonably ensure that the FCM remains in compliance, at all times, with its customer funds segregation requirements.[196]

The Commission is proposing to adopt regulation § 1.44(g)(6) to provide that, in determining its residual interest target for purposes of regulations §§ 1.11(e)(3)(i)(D) and 1.23(c), the FCM must treat separate accounts of separate account customers as accounts of separate entities. In this regard, an FCM is required to consider the potential impact to segregated funds and to the FCM's targeted residual interest resulting from one or more separate accounts of a separate account customer that are undermargined, or that contain deficits or debit ledger balances, without taking into consideration the funds in excess of the margin requirements maintained in other separate accounts of the separate account customer.

Currently, Commission regulations require an FCM to maintain its own capital, or residual interest, in customer segregated accounts in an amount equal to or greater than its customers' aggregate undermargined accounts.[197] Additionally, each day, an FCM is required to perform a segregated calculation to verify its compliance with segregation requirements. The FCM must file a daily electronic report showing its segregation calculation with its DSRO, and the DSRO must be provided with electronic access to the FCM's bank accounts to verify that the funds are maintained. The FCM must also assure its DSRO that when it meets a margin call for customer positions, it never uses value provided by one customer to meet another customer's obligation.[198] These requirements

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[195] 17 CFR 1.11(e)(3)(i)(D).
[196] 17 CFR 1.23(c).
[197] *See, e.g.*, 17 CFR 1.22(c)(3); 17 CFR 22.2(f)(6)(iii)(A).
[198] *See, e.g.*, 17 CFR 22.2(g).

are intended to prevent FCMs from being induced to cover one customer's margin shortfall with another customer's excess margin, and allow DSROs to verify that FCMs are not in fact doing so. Proposed regulation § 1.44(g)(6) is designed to ensure that margin deficiencies are calculated accurately for accounts receiving separate treatment, and that such deficiencies are covered consistent with existing Commission regulations. Proposed regulation § 1.44(g)(6) is also consistent with the conditions to the no-action position in CFTC Letter No. 19-17.[199]

With respect to the provisions in the First Proposal corresponding to the provisions in proposed regulation § 1.44(g), the Commission received a comment from FIA. With respect to proposed regulation § 1.44(g)(1), FIA noted that FCMs are already required under regulation § 1.73 to provide for stress testing and credit limits for all customers, including separate account customers.[200] FIA asserted that stress testing for separate accounts would provide no additional risk management benefits when they do not account for all of a customer's underlying assets.[201]

Regulation § 1.73 does not presently provide for stress testing on a separate account basis, and does not apply to non-clearing FCMs. As discussed further below, the Commission believes that it is appropriate to apply these risk management requirements, including requirements for stress testing, to non-clearing FCMs with respect to the separate accounts of their separate account customers, and that doing so on such basis could allow FCMs to detect potential deficiencies, the correction of which would prevent the occurrence of conditions that would necessitate a cessation of separate account treatment. The separate requirement to additionally conduct stress testing on a combined account basis is intended to serve as a backstop so that an FCM can have a view of all of

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[199] CFTC Letter No. 19-17 provides that the "FCM shall factor into its residual interest target customer receivables as computed on a separate account basis." CFTC Letter No. 19-17 (Condition 9).
[200] FIA Comment Letter.
[201] *Id.*

a customer's actual holdings. If the customer does default, the FCM will have to liquidate all of the customer's holdings. Understanding the extent to which the positions within separate accounts may be additive (and perhaps create more concentrated positions when considered together) is also important to an FCM's ability to manage risk.

K. Proposed Regulation § 1.44(h)

Proposed regulation § 1.44(h) contains requirements related to information and disclosures. As with the provisions in proposed regulation § 1.44(g), these provisions are substantially similar to their corresponding no-action conditions in CFTC Letter No. 19-17, and to corresponding conditions included in the First Proposal, except that they have been reorganized and subject to minor changes to account for their proposed inclusion in part 1 as well as the proposed introduction of new defined terms.

Proposed regulation § 1.44(h)(1) provides that an FCM shall obtain from each separate account customer or, as applicable, the manager of a separate account, information sufficient for the FCM to (i) assess the value of the assets dedicated to such separate account; and (ii) identify the direct or indirect parent company of the separate account customer, as applicable, if such customer has a direct or indirect parent company.[202] Proposed regulation § 1.44(h)(1) is intended to ensure that FCMs have visibility with respect to customers' financial resources appropriate to ensure that a customer's separate account is adequately margined, and to identify when a customer's financial circumstances would necessitate the cessation of separate account treatment. Proposed regulation § 1.44(h)(1)(i) contemplates that, in certain instances, an investment manager may manage one or more accounts under power of attorney on a customer's behalf; in such cases, an FCM may obtain the requisite financial information from the investment manager. Proposed regulation § 1.44(h)(1)(ii) is intended to ensure that

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[202] The Commission understands that, in certain cases, such as when a customer is a fund, the customer may not have a parent company. In such cases, the requirement to obtain information sufficient to identify the direct or indirect parent company would not apply.

FCMs have sufficient information to identify the direct or indirect parent company of a customer so that they may identify when a parent company of a customer has become insolvent, for purposes of proposed regulation § 1.44(e)(1)(iv).

In its comment in response to the First Proposal, CME asserted that if the parent of an FCM has multiple relationships with a customer (*e.g.*, prime brokerage or lending), it should be sufficient that the FCM's parent has this information and can provide it to the Commission upon request. The Commission believes that if an asset manager is managing a specified set of assets, then it is relevant for the FCM to know the size of that set of assets. Additionally, the requirement to gather information sufficient to identify the direct or indirect parent of the customer is intended to ensure that the FCM understands who the parent is so that it can be aware if the parent becomes insolvent or otherwise experiences a non-ordinary course of business event. That an FCM's parent may hold such information does not necessarily mean that the FCM has such information readily available – a goal this proposed provision is designed to accomplish.

In its comment, FIA argued that this provision was unnecessary as the proposed requirement is already consistent with proper risk management or otherwise required by applicable law.[203] FIA further argued that this provision may imply that an FCM has obligations with regard to separate account customers that do not exist for other customers. The Commission notes that to the extent 31 CFR 1010.230, which pertains to the identification of beneficial owners, does not contain specific requirements related to the identification of direct or indirect parent companies, or the value of assets dedicated to separate accounts, proposed regulation § 1.44(h)(1) is designed to capture such information; additionally, while proposed regulation § 1.44 makes clear that its requirements are applicable to FCMs that provide separate account treatment for customers, it does not state that it is intended to supersede any other requirements related

[203] FIA Comment Letter (citing 31 CFR 1010.230).

to ascertaining the identity of beneficial owners (*i.e.*, customers). FIA additionally opposed any further amendment to this provision that would require an FCM to obtain any specific information or documentation, or prescribe the schedule by which an FCM must update such information; the Commission in this Second Proposal has determined not to propose such further requirements and expects that FCMs will obtain the requisite information in a time and manner consistent with the FCM's existing risk management policies.

In its comment, the JAC asserted that further clarity is needed on how clearing FCMs should determine the value of assets dedicated to separate accounts, and that such information should be updated at least annually and more often as facts and circumstances warrant. The Commission recognizes that there may exist significant diversity among separate account customers in the nature of customer positions, underlying assets, and frequency with which such assets change in terms of size and composition. The Commission does not wish to set a prescriptive, one-size-fits-all standard in the method and frequency of the valuation contemplated by proposed regulation § 1.44(h)(1), and believes an FCM should be able to value assets in a manner consistent with its otherwise appropriate risk management policies.

Proposed regulation § 1.44(h)(2) provides that, where a separate account customer has appointed a third-party as the primary contact to the FCM, the FCM must obtain and maintain current contact information of an authorized representative at the customer, and take reasonable steps to verify that such contact information is and remains accurate, and that the person is in fact an authorized representative of the customer. In many cases, an investment manager acts under a power of attorney on behalf of a customer, and the FCM has little direct contact with the customer. Proposed regulation § 1.44(h)(2) is designed to ensure that FCMs have a reliable means of contacting separate account customers directly if the investment manager fails to ensure prompt payment on behalf of the

customer. Under the First Proposal, a DCO would have needed to require that a clearing FCM engaged in separate account treatment review and, if necessary, update the relevant contact information no less than annually. The Commission has determined to omit the requirement of an annual review from this Second Proposal for the avoidance of confusion with respect to the requirement to maintain current contact information for authorized representatives as, in the Commission's view, reasonable steps to verify that contact information remains accurate may, depending on the circumstances, necessitate review and update of such information on a basis more or less frequent than annually.

In its comment in response to the First Proposal, FIA opposed required annual updates of contact information for customer representatives, asserting that FCMs are in regular contact with investment managers and will have current contact information for them. While FCMs may communicate regularly with investment managers, and generally have current contact information for them, the Commission notes that its intent is to enable the FCM to have contact information for the customer, in addition to having contact information for the investment manager, in order to enable the FCM to contact the customer directly if the FCM has problems with the account manager. As noted above, in this Second Proposal, the Commission has omitted the annual update requirement, but will require that customer representative contact information be kept current. The Commission considers it prudent risk management practice that the FCM maintain a line of contact to the customer of a separate account, and this is consistent with a condition of the no-action position.

In its comment, the JAC argued that the Commission should require a corporate resolution or similar document authorizing a representative at a customer to represent the customer if the customer is not an individual. The JAC opined that maintaining current contact information for authorized representatives of customers with associated corporate resolutions or similar documentation should already be part of a clearing FCM's policies

and procedures (noting that most such FCMs likely already review such information on at least an annual basis), and noted that the additional cost of adding such a requirement would likely be *de minimis*. The Commission notes that the proposed regulation already would require FCMs to take reasonable steps to verify that the authorized representative of a customer is in fact an authorized representative of the customer. While the proposed regulation would not preclude an FCM from requiring from a customer a corporate resolution authorizing a representative to represent a customer in order for the FCM to comply with this requirement, the Commission wishes to preserve a degree of flexibility in how FCMs may choose to verify the identity and authorization of customer representatives, and is not at this time prescribing specific means of verifying such information.

Proposed regulation § 1.44 will not affect the Commission's bankruptcy rules under part 190 of its regulations or any rights of a customer or FCM in bankruptcy thereunder. In the event that an FCM electing separate account treatment experiences a bankruptcy, the accounts of a customer in each account class will be consolidated, and accounts of the same customer treated separately for purposes of proposed regulation § 1.44 will not be treated separately in bankruptcy. To make this limitation clear to customers and FCMs, the Commission proposes regulation § 1.44(h)(3), which provides that an FCM must provide each separate account customer with a disclosure that, pursuant to part 190 of the Commission's regulations, all separate accounts of the customer in each account class will be combined in the event of the FCM's bankruptcy. The disclosure statement required by proposed regulation § 1.44(h)(3) must be delivered directly to the customer via electronic means, in writing or in such other manner as the FCM customarily delivers disclosures pursuant to applicable Commission regulations, and as permissible under the FCM's customer documentation. Furthermore, the FCM must maintain documentation demonstrating that the disclosure statement required by

proposed regulation § 1.44(h)(3) was delivered directly to the customer. Additionally, the FCM must include the disclosure statement required by proposed regulation § 1.44(h)(3) on its website or within its Disclosure Document required by Commission regulation § 1.55(i).

The Bankruptcy Reform Act of 1978[204] enacted subchapter IV of chapter 7 of the Bankruptcy Code, title 11 of the U.S. Code, to add certain provisions designed to afford enhanced protections to commodity customer property and protect markets from the reversal of certain transfers of money or other property, in recognition of the complexity of the commodity business.[205] The Commission enacted part 190 of its regulations, 17 CFR part 190, to implement subchapter IV. Under part 190, all separate accounts of a customer in an account class will be combined in the event of an FCM's bankruptcy.[206] The Commission proposes to adopt proposed regulation § 1.44(h)(3) so that customers receive full and fair disclosure as to the treatment of their accounts in an FCM bankruptcy.

Proposed regulation § 1.44(h)(4) provides that an FCM that has made an election pursuant to proposed regulation § 1.44(d) shall disclose in the Disclosure Document required by regulation § 1.55(i) that it permits the separate treatment of accounts for the same customer under the terms and conditions of proposed regulation § 1.44. A similar provision was included in the First Proposal as proposed regulation § 39.13(j)(13). Regulation § 1.55 was adopted to advise new customers of the substantial risk of loss inherent in trading commodity futures.[207] The Commission amended regulation § 1.55 in

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[204] Public Law 95-598, 92 Stat. 2549.
[205] Bankruptcy, 46 FR 57535, 57535-36 (Nov. 24, 1981).
[206] 17 CFR 190.08(b)(2)(i) and (xii) (Aggregate the credit and debit equity balances of all accounts of the same class held by a customer in the same capacity. Except as otherwise provided in this paragraph (b)(2), all accounts that are deemed to be held by a person in its individual capacity shall be deemed to be held in the same capacity. Except as otherwise provided in this section, an account maintained with a debtor by an agent or nominee for a principal or a beneficial owner shall be deemed to be an account held in the individual capacity of such principal or beneficial owner.).
[207] Adoption of Customer Protection Rules, 43 FR 31886, 31888 (July 24, 1978).

2013 to, among other things, add new paragraph (i) requiring FCMs to disclose to customers all information about the FCM, including its business, operations, risk profile, and affiliates, that would be material to the customer's decision to entrust funds to and otherwise do business with the FCM and that is otherwise necessary for full and fair disclosure.[208] Such disclosures include material information regarding specific topics identified in regulation § 1.55(k), which include a basic overview of customer funds segregation, as well as current risk practices, controls, and procedures.[209] These disclosures are designed to "enable customers to make informed judgments regarding the appropriateness of selecting an FCM" and enhance the diligence that a customer can conduct prior to opening an account and on an ongoing basis.[210] The Commission believes that the application of separate account treatment for some customers of an FCM, is "material to the … decision to entrust … funds to and otherwise do business with the [FCM]" with respect to the customers of such FCM generally because, in the event that separate account treatment for some customers were to contribute to a loss that exceeds the FCM's ability to cover, that loss might affect the segregated funds of all of the FCM's customers in one or more account classes.[211] Accordingly, the Commission proposes regulation § 1.44(h)(4) to ensure that customers are apprised of a matter that is relevant to the FCM's risk management policies.

In its comment in response to the First Proposal, the JAC contended that the Disclosure Document should be provided directly to the authorized representative of a customer to ensure the customer has a complete understanding of how its accounts will be combined in FCM bankruptcy. The JAC also requested that the Commission clarify what is meant by "delivered separately" to the underlying customer. The Commission

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[208] 17 CFR 1.55(i).
[209] 17 CFR 1.55(k)(8), (11).
[210] Enhancing Protections Afforded Customers and Customer Funds Held by Futures Commission Merchants and Derivatives Clearing Organizations, 78 FR 68506, 68564 (Nov. 14, 2013).
[211] *See* 17 CFR 1.55(i).

notes that in this Second Proposal, "delivered separately" has been changed to "delivered directly," to clarify that the Disclosure Document must be provided specifically to the customer.

The JAC also contended that the regulation § 1.55(i) disclosure should be expanded "not only to indicate that the FCM permits separate account treatment, but also to include a thorough discussion of additional risks to other customers as highlighted by the Commission in the Preamble discussion."[212] In the Commission's view, the proposed conditions for separate account treatment are intended to achieve the same risk management objectives that would otherwise be achieved through application of the Margin Adequacy Requirement, and an FCM that complies with those conditions would not subject customers other than separate account customers to substantial additional or different risks. Nonetheless, while such risks may not be substantial, they cannot be said to be nonexistent, and so the Commission is adding in proposed regulation § 1.44(h)(4) to the disclosure proposed in the First Proposal the language that "in the event that separate account treatment for some customers were to contribute to a loss that exceeds the FCM's ability to cover, that loss may affect the segregated funds of all of the FCM's customers in one or more account classes."

Additionally, the JAC recommended that the Commission address how separate account treatment may impact a pro rata distribution in the event of a clearing FCM bankruptcy. For the avoidance of doubt, the Commission confirms that, if an FCM disburses funds to a customer receiving separate treatment which would not otherwise have been available if the accounts were treated on a gross basis, the FCM subsequently declares bankruptcy and, as a result of the separate account disbursement, the customer has a smaller amount of funds on deposit when its separate accounts are combined in bankruptcy, then the customer may share in any shortfall in customer funds at the FCM to

[212] JAC Comment Letter.

a lesser extent than would a customer not subject to separate account treatment. This result is an inherent risk of separate account treatment, but is not unique; any customer that reduces their amount of margin on deposit at an FCM shortly before the FCM goes into bankruptcy (either by reducing excess margin, or reducing the risk of their positions and withdrawing the resulting margin excess) would similarly benefit.

Additionally, proposed regulation § 1.44(h)(4)(i) provides that an FCM that applies separate account treatment pursuant to proposed regulation § 1.44 must apply such treatment in a consistent manner over time, and that if the election pursuant to proposed regulation § 1.44(d) for a separate account customer is revoked, such election may not be reinstated during the 30 days following such revocation. The Commission proposes this 30-day period to further ensure that FCMs will conduct a diligent and thorough review to confirm that the circumstances leading to cessation of separate account treatment have been cured, and to prevent the possibility that, as discussed below, an FCM could toggle its separate account treatment election for purposes other than serving customers' bona fide commercial purposes. Proposed regulation § 1.44(h)(i) is intended to ensure that FCMs employ separate account treatment in a way that is consistent with the customer protection and FCM risk management provisions of the CEA and Commission regulations. The Commission recognizes that, while bona fide business or risk management purposes may at times warrant application or cessation of separate account treatment, FCMs should not apply or cease separate account treatment for reasons, or in a manner, that would contravene the customer protection and risk mitigation purposes of the CEA and Commission regulations. For instance, an FCM should not switch back and forth between separate and combined treatment for customer accounts in order to achieve more preferable margining outcomes or offset margin shortfalls in particular accounts. The period of 30 days was chosen to balance this goal with a recognition that, after a sufficient period of time, the relevant circumstances for a

particular customer may change for reasons other than strategic switching. The Commission recognizes that there are a wide variety of circumstances that may indicate inconsistent application of separate account treatment.

L. Proposed Appendix A to Part 1

As discussed above, the Commission proposes Appendix A to part 1 to set forth those currencies for which payment of margin shall be considered in compliance with the one business day margin call requirements of proposed regulation § 1.44(f) if received no later than the end of the second business day after the day on which the margin call is issued. As discussed above, the procedures for adding currencies to or removing currencies from proposed Appendix A to part 1 would be set forth in proposed regulation § 1.44(f)(8).

In the First Proposal, the Commission proposed that margin paid in JPY would receive two-business day treatment and requested that commenters indicate which, if any, additional currencies would require similar treatment. In its comment, FIA stated, based on its members' knowledge and experience, considering time zone limitations and industry settlement conventions, that the following currencies may also require such treatment: Australian dollar (AUD), Chinese renminbi (CNY), Hong Kong dollar (HKD), Hungarian forint (HUF), Israeli new shekel (ILS), New Zealand dollar (NZD), Singapore dollar (SGD), South African rand (ZAR), and Turkish lira (TRY).[213] The Commission is persuaded by this analysis, and understands that the list of currencies in proposed Appendix A to part 1 is consistent with current industry settlement conventions, based on the Commission staff's informational discussions with industry professionals knowledgeable regarding such conventions. The Commission proposes that the initial currencies under proposed Appendix A to part 1 should be AUD, HKD, HUF, ILS, NZD,

[213] FIA Comment Letter.

SGD, ZAR, TRY, and CNY. The Commission would welcome further comment indicating industry settlement conventions for other currencies.

M. Proposed Amendments to Regulation § 1.58

Regulation § 1.58(a) currently provides that each FCM that carries a commodity futures or commodity option position for another FCM or a foreign broker on an omnibus basis must collect, and each FCM and foreign broker whose account is so carried, must deposit initial and maintenance margin on positions reportable under Commission regulation § 17.04 at a level of at least that established for customer accounts by the rules of the relevant contract market. Regulation § 1.58(a) is designed to ensure that where a clearing FCM (*i.e.*, a carrying FCM) carries a customer omnibus account for a non-clearing FCM (*i.e.*, a depositing FCM), the risk posed by the customers of the depositing FCM continues to be appropriately mitigated through margining of those positions (*i.e.*, calculation of initial and maintenance margins) on a gross basis at the depositing FCM. This is analogous to the margining of positions of a clearing FCM on a gross basis at the DCO.[214]

In proposing regulation § 1.58(a), the "Commission view[ed] with great concern the fact that [a significant] amount of customer funds [was] being held by firms [*i.e.*, non-clearing FCMs] that, in comparison to clearing FCMs, generally have less capital and are less equipped to handle the volatility of the commodity markets, a concern which was highlighted by the . . . bankruptcies [of three FCMs] which occurred during the last half of 1980."[215] In light of the segregation requirements at the time – which did not yet apply to foreign futures and foreign options, and also did not apply to cleared swaps (a category that did not then exist), these requirements were designed only to apply to futures and

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[214] *See* § 39.13(g)(8)(i).
[215] *See* Gross Margining of Omnibus Accounts, 46 FR 62864 (Dec. 29, 1981).

options. The requirement was therefore tied to position reporting under regulation § 17.04, a reporting requirement that is limited to futures and options.

By 2011, industry practice had developed such that "[u]nder current industry practice, omnibus accounts report gross positions to their clearing members and clearing members collect margins on a gross basis for positions held in omnibus accounts."[216] The Commission thus required DCOs to require that clearing members post margin to DCOs on a gross basis for both domestic futures and cleared swaps.[217] The Commission stated, as its rationale, that it

> continues to believe, as stated in the notice of proposed rulemaking, that gross margining of customer accounts will: (a) More appropriately address the risks posed to a DCO by its clearing members' customers than net margining; (b) will increase the financial resources available to a DCO in the event of a customer default; and (c) with respect to cleared swaps, will support the requirement in § 39.13(g)(2)(iii) that a DCO must margin each swap portfolio at a minimum 99 percent confidence level.[218]

The Commission also noted that, "under certain circumstances gross margining may also increase the portability of customer positions in an FCM insolvency. That is, a gross margining requirement would increase the likelihood that there will be sufficient collateral on deposit in support of a customer position to enable the DCO to transfer it to a solvent FCM."[219]

At the time, with its focus on implementing rules for DCOs, the Commission did not amend regulation § 1.58 explicitly to require gross margining for omnibus accounts cleared by a non-clearing FCM through a clearing FCM. However, reviewing the matter presently, the Commission is of the view that the reasons for requiring clearing FCMs to post margin at a DCO on a gross basis apply, *mutatis mutandis*, to support requiring gross

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[216] *See* Derivatives Clearing Organization General Provisions and Core Principles, 76 FR 69334, 69375 (Nov. 8, 2011).
[217] *See id.*, regulation § 39.13(g)(8)(i).
[218] Derivatives Clearing Organization General Provisions and Core Principles, 76 FR 69375-69376.
[219] *Id.* at 69376 n. 133 (citing CPSS–IOSCO Consultative Report [on PFMI], Principle 14: Segregation and Portability, Explanatory Notes 3.14.6 and 3.14.8, at 67–68).

margining for omnibus customer accounts of non-clearing FCMs for Cleared Swaps in addition to domestic futures.[220]

Accordingly, the Commission is proposing to amend regulations § 1.58(a) and (b) to require, in the case of (a), addressing gross collection of margin generally, that each futures commission merchant which carries a futures, options, or Cleared Swaps position for another futures commission merchant or for a foreign broker on an omnibus basis must collect, and each futures commission merchant and foreign broker for which an omnibus account is being carried must deposit, initial and maintenance margin on each position so carried at a level no less than that established for customer accounts by the rules of the applicable contract market or other board of trade (or, if the board of trade does not specify any such margin level, the level specified by the relevant clearing organization), *i.e.*, on a gross margin basis, and, in the case of (b), addressing entitlement to spread or hedge margin treatment, that where an FCM carries a futures, options, or Cleared Swaps position for another futures commission merchant or for a foreign broker on an omnibus basis allows a position to be margined as a spread position or as a hedged position in accordance with the rules of the applicable contract market, the carrying futures commission merchant must obtain and retain a written representation from the futures commission merchant or from the foreign broker for which the omnibus account is being carried that each such position is entitled to be so margined.

Under this proposal, clearing FCM initial and maintenance margin requirements for separate accounts of the same customer are proposed to be calculated on a gross basis

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[220] By contrast, the Commission has imposed limits on holding the foreign futures or foreign options secured amount outside the United States. *See* regulation § 30.7(c) (limiting such amounts to 120% of the total amount of funds necessary to meet margin and prefunding margin requirements established by rule, regulation or order of foreign boards of trade or foreign clearing organizations, or to meet margin calls issued by foreign brokers carrying the 30.7 customers' foreign futures and foreign options positions.) Requiring an FCM to send a larger amount of 30.7 funds upstream to a foreign broker or foreign clearing organization would run counter to the regulation's goal of limiting such amounts. Accordingly, the Commission is not proposing to require gross margining with respect to 30.7 accounts.

as the margin for accounts of distinct customers.[221] The Commission preliminarily believes it is important to continuity of risk management that the same approach also be applied in the case of a non-clearing (depositing) FCM whose accounts are carried by a clearing (carrying) FCM, with respect to the amount that depositing FCM is required to deposit, and that the carrying FCM is required to collect.[222] The Commission is therefore proposing to amend regulation § 1.58 to add new paragraph (c) providing that, where an FCM has established an omnibus account that is carried by another FCM, and the depositing FCM has elected to treat the separate accounts of a customer as accounts of separate entities for purposes of proposed regulation § 1.44, then the depositing FCM must calculate initial and maintenance margin for purposes of regulation § 1.58(a) separately for each separate account. [223]

N. Proposed Amendments to Regulation § 1.73

The Commission proposes to amend regulation § 1.73 to add new paragraph (c) providing that an FCM that is not a clearing member of a DCO but that treats the separate accounts of a customer as accounts of separate entities for purposes of proposed regulation § 1.44 shall comply with regulation § 1.73(a) and (b) with respect to accounts and separate accounts of separate account customers receiving separate treatment, as if the FCM were a clearing member of a DCO. Regulation § 1.73 currently sets forth risk management requirements only for FCMs that are clearing members of DCOs. The Commission proposes this amendment to ensure that, where non-clearing FCMs are engaging in separate account treatment, they are required to comply with the same

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[221] *See* proposed regulation § 1.44(g)(2).

[222] As a result, each customer with accounts subject to separate account treatment should be subject to the same or greater margin requirements as such customer would be subject to if its separate accounts were margined on a combined account basis.

[223] If non-clearing FCM *N* has customers *P* and *Q*, and *Q* is a separate account customer with separate accounts *R*, *S*, and *T*, then *N* would calculate, on a gross basis, the margin requirements for accounts *P*, *R*, *S*, and *T*, consistent with proposed regulation § 1.58(c). That gross margin requirement, across those four accounts, will be the amount that, consistent with regulation § 1.58(a), *N* must deposit and *N*'s clearing FCM, *C*, must collect.

baseline risk management requirements with respect to those separate accounts as their clearing counterparts do with respect to all accounts. In particular, this amendment will link with a non-clearing FCM's compliance with proposed regulation § 1.44(g)(1)'s stress testing and credit limit requirements. Since 2019, clearing FCMs have successfully applied regulation § 1.73(a), in conjunction with the no-action position's stress testing and credit limit conditions,[224] to manage the risk of accounts subject to separate treatment. In proposing to codify the no-action position in part 1 of the Commission's regulations, the Commission believes it would be prudent from a customer funds protection perspective, and a systemic risk mitigation perspective, to ensure that any FCMs that provide for separate account treatment, whether clearing or non-clearing, do so subject to similarly heightened risk management requirements. The Commission expects that, by applying the heightened risk management requirements applicable to clearing FCMs to all of a non-clearing FCM's accounts for a customer receiving separate treatment, a non-clearing FCM would be better able to detect and prevent the emergence of risks that could lead to operational or financial distress at such customer, reducing the potential risk of a default (or a failure to maintain adequate customer funds) by the non-clearing FCM.

O. Proposed Amendments to Regulation § 30.2

Commission regulation § 30.2(b) currently excludes an FCM engaging in foreign futures and foreign option transactions for 30.7 customers from certain provision of the Commission's regulations, including regulation § 1.44, in recognition that such transactions are entered into on contract markets that are subject to regulation by non-U.S. authorities.[225] Regulation § 1.44 is currently reserved, and the Commission is

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[224] CFTC Letter No. 19-17 (Condition 3).

[225] For example, regulation § 30.2 excludes persons and foreign futures and foreign options transactions from the segregation requirements of § 1.20, which applies only to futures customer funds and transactions. Commission regulation § 30.7 addresses the segregation requirements of 30.7 customer funds.

proposing to amend regulation § 30.2(b) to remove regulation § 1.44 from the list of excluded regulations.[226]

The proposed amendment to regulation § 30.2(b) is consistent with the proposed imposition of the Margin Adequacy Requirement on 30.7 accounts and the proposed definition of the term "account" in regulation § 1.44(a), which would include 30.7 accounts in addition to futures accounts and Cleared Swaps Customer Accounts.

The Commission is also proposing to remove the exclusion of regulations §§ 1.41-1.43 from applicability to part 30. When regulation § 30.2 was promulgated in 1987 as part of the establishment of part 30,[227] it explicitly provided that certain of its existing regulations would not be applicable "to the persons and transactions that are subject to the requirements of" part 30. At that time, regulations §§ 1.41-1.43 addressed, respectively, crop or market information letters, filing of contract market rules with the Commission, and warehouses, depositories, and other similar entities. Those regulations were subsequently deleted, and those sections were reserved.

When the Commission revised its part 190 bankruptcy rules in 2021, the Commission added, as regulations §§ 1.41-1.43, designation of hedging accounts, delivery accounts, and conditions on accepting letters of credit as collateral. Each of these regulations was intended to apply to foreign futures accounts. However, regulation § 30.2 was not amended to conform with that intention. The Commission proposes to address that now.

P. Proposed Amendments to Regulation § 39.13(g)(8)

Regulation § 39.13(g)(8)(i) requires DCOs to collect customer margin from their clearing members on a gross basis, that is, collect margin equal to the sum of initial

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[226] Regulation § 1.44 is currently reserved and, accordingly, does not impose any regulatory obligation on an FCM. When regulation § 30.2 was promulgated, regulation § 1.44 addressed records and reports of warehouses, depositories, and other similar entities; this regulation was subsequently deleted.

[227] Foreign Futures and Foreign Options Transactions, 52 FR 28980 (Aug. 5, 1987).

margin amounts that would be required by the DCO for each individual customer within that account if each individual customer were a clearing member.[228] The Commission proposes to add new regulation § 39.13(g)(8)(i)(E) to clarify that, for purposes of this regulation on gross margining, each separate account of a separate account customer shall be treated as an account of a separate individual customer.

The Commission also proposes to amend regulation § 39.13(g)(8)(iii), to provide that such paragraph shall apply except as provided for in regulation § 1.44. The Commission proposes this amendment to ensure that the carve-out (represented by proposed regulation § 1.44(c) through (h)) to the Margin Adequacy Requirement (represented by proposed regulation § 1.44(b)) that would apply to all FCMs is also effectuated with respect to the Margin Adequacy Requirement applicable to clearing members through DCOs pursuant to regulation § 39.13(g)(8)(iii).

Question 8: If the Commission includes the Margin Adequacy Requirement and requirements regarding separate account treatment in Part 1 of its regulations as proposed, should the Commission remove regulation 39.13(g)(8)(iii)?

III. Cost Benefit Considerations

A. Introduction

Section 15(a) of the CEA requires the Commission to "consider the costs and benefits" of its actions before promulgating a regulation under the CEA or issuing certain orders.[229] Section 15(a) further specifies that the costs and benefits shall be evaluated in light of five broad areas of market and public concern: (1) protection of market participants and the public; (2) efficiency; competitiveness, and financial integrity of markets; (3) price discovery; (4) sound risk management practices; and (5) other public

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[228] 17 CFR 39.13(g)(3)(i)(A).
[229] 7 U.S.C. 19(a).

interest considerations (collectively referred to herein as the Section 15(a) Factors). Accordingly, the Commission considers the costs and benefits associated with the proposed regulation in light of the Section 15(a) Factors. In conducting its analysis, the Commission may, in its discretion, give greater weight to any one of the five enumerated areas of concern. In the sections that follow, the Commission considers: (1) the costs and benefits of the proposed regulation; (2) the alternatives contemplated by the Commission and their costs and benefits; and (3) the impact of the proposed regulation on the Section 15(a) Factors.

By its terms, section 15(a) does not require the Commission to quantify the costs and benefits of a new rule or to determine whether the benefits of the adopted rule outweigh its costs. Nonetheless, the Commission has endeavored to assess the expected costs and benefits of the proposed amendments in quantitative terms, including Paperwork Reduction Act (PRA)-related costs, where practicable. In situations where the Commission is unable to quantify the costs and benefits, the Commission identifies and considers the costs and benefits of the applicable proposed amendments in qualitative terms. However, the Commission lacks the data necessary to reasonably quantify all of the costs and benefits considered below. In some instances, it is not reasonably feasible to quantify the costs and benefits to FCMs with respect to certain factors, such as market integrity. Additionally, any initial and recurring compliance costs for any particular FCM will depend on its size, existing infrastructure, practices, and cost structures. The Commission welcomes comments on any such costs, especially by clearing FCMs, who may be better able to provide quantitative costs data or estimates, based on their respective experiences relating to the application of CFTC Letter No. 19-17. Notwithstanding these types of limitations, the Commission otherwise identifies and considers the costs and benefits of these proposed rule amendments in qualitative terms.

In the following consideration of costs and benefits, the Commission first identifies and discusses the benefits and costs attributable to the proposed rule amendments. Next, the Commission identifies and discusses the benefits and costs attributable to the proposed rule amendments as compared to alternatives to the proposed rule amendments. The Commission, where applicable, then considers the costs and benefits of the proposed rule amendments in light of the Section 15(a) Factors.

The Commission notes that this consideration of costs and benefits is based on, *inter alia*, its understanding that the derivatives markets regulated by the Commission function internationally, with (1) transactions that involve entities organized in the United States occurring across different international jurisdictions, (2) some entities organized outside of the United States that are prospective Commission registrants, and (3) some entities that typically operate both within and outside the United States, and that follow substantially similar business practices wherever located. Where the Commission does not specifically refer to matters of location, the discussion of costs and benefits below refers to the effects of the proposed regulations on all relevant derivatives activity, whether based on their actual occurrence in the United States or on their connection with, or effect on, U.S. commerce.[230]

The Commission generally requests comment on all aspects of its cost-benefit considerations, including the identification and assessment of any costs or benefits not discussed herein; the potential costs and benefits of the alternatives that the Commission discussed in this release; data and any other information to assist or otherwise inform the Commission's ability to quantify or qualitatively describe the costs and benefits of the proposed rule amendments; and substantiating data, statistics, and any other information to support positions posited by commenters with respect to the Commission's discussion. Commenters may also suggest other alternatives to the proposed approach where the

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[230] *See, e.g.,* 7 U.S.C. 2(i).

commenters believe that the alternatives would be appropriate under the CEA and would provide a more appropriate cost-benefit profile.

The Commission is also including a number of questions for the purpose of eliciting cost and benefit estimates from public commenters wherever possible. Quantifying other costs and benefits, such as the effects of potential changes in the behavior of FCMs resulting from the proposal are inherently harder to measure. Thus, the Commission is similarly requesting comment through questions to help it better quantify these impacts. Due to these quantification difficulties, for this NPRM (Second Proposal), the Commission offers the following qualitative discussion of its costs and benefits.

1. Proposed Regulation

The Commission is proposing to promulgate new regulations in part 1 of its regulations designed to (1) further ensure that FCMs hold customer funds sufficient to cover the required initial margin for the customer's positions, by prohibiting an FCM from permitting customers to withdraw funds from their accounts with such FCM unless the net liquidating value plus the margin deposits remaining in the customer's account after the withdrawal would be sufficient to meet the customer initial margin requirements with respect to the products or portfolios in the customer's account (*i.e.*, the Margin Adequacy Requirement) (proposed regulation § 1.44(b)) and (2) permit FCMs to treat the separate accounts of a single customer as accounts of separate entities for purposes of the Margin Adequacy Requirement, subject to conditions designed to ensure that such separate account treatment is carried out in a documented and consistent manner, and that FCMs, their DSROs, and the Commission are apprised of, and able to respond to, conditions that, for risk mitigation reasons, would necessitate the cessation of such separate account treatment (proposed regulation § 1.44(c) through (h)).[231] The

[231] Proposed regulation § 1.44(a) provides definitions supporting the other paragraph of the regulation.

Commission is also proposing to revise regulations in parts 1, 22, and 30 of its regulations related to definitions, FCM minimum financial requirements, reporting, collection of margin, and clearing FCM risk management (proposed amendments to regulations §§ 1.3, 1.17, 1.20, 1.58, and 1.73, as well as §§ 22.2 and 30.7), and part 39 of its regulations related to DCO risk management (proposed amendments to regulation § 39.13), to facilitate full implementation of the Margin Adequacy Requirement and conditions for separate account treatment.

2. Baseline: Current Part 1 and Regulation 39.13(g)(8)(iii)

The Commission identifies the costs and benefits of the proposed amendments relative to the baseline of the regulatory status quo. In particular, the baseline that the Commission considers for the costs and benefits of these proposed rule amendments is the Commission regulations now in effect; specifically, part 1 of the Commission's regulations (where the operative part of the proposed regulation would be codified) and regulation § 39.13(g)(8)(iii) (which contains the Commission's current Margin Adequacy Requirement). In considering the costs and benefits of the proposed regulation against this baseline, the Commission considers the costs and benefits for both clearing FCMs and non-clearing FCMs – the two categories of market participants that would be directly affected by the proposed regulation. To the extent that certain FCMs that are clearing members of DCOs have taken actions in reliance on CFTC Letter No. 19-17, the Commission recognizes the practical implications of those actions on the costs and benefits of the proposed regulation.

a. Baseline with Respect to Clearing FCMs

Regulation § 39.13(g)(8)(iii) currently provides that DCOs shall establish a Margin Adequacy Requirement for their clearing FCMs with respect to the products that the DCOs clear. Thus, under the status quo baseline, clearing FCMs are, albeit indirectly (through the operation of DCO rules designed to implement regulation § 39.13(g)(8)(iii)),

subject to the Margin Adequacy Requirement for futures and Cleared Swaps. They are not, however, subject to the Margin Adequacy Requirement for foreign futures that are not cleared by a DCO.[232] Under the baseline – which does not include the effect of CFTC Letter No. 19-17 and its superseding letters – clearing FCMs are not permitted to engage in separate account treatment with respect to the Margin Adequacy Requirement.

b. Baseline with Respect to Non-Clearing FCMs

Commission regulations do not, either directly or indirectly, impose a Margin Adequacy Requirement on non-clearing FCMs. Accordingly, they currently have no need to engage in separate account treatment with respect to such a requirement.

The Commission's current part 1 regulations do not contain any requirements specifically related to the separate treatment of accounts. As noted above, under the baseline, clearing FCMs are not permitted to engage in separate account treatment with respect to regulation § 39.13(g)(8)(iii)'s Margin Adequacy Requirement, and non-clearing FCMs have no need to engage in separate account treatment with respect to the Margin Adequacy Requirement of regulation § 39.13(g)(8)(iii) (because DCO rules addressing that regulation do not apply to non-clearing FCMs). Additionally, a non-clearing FCM would not be permitted to treat the accounts of a single customer as accounts of separate entities for purposes of regulatory requirements imposed by the Commission (*e.g.*, capital requirements under regulation § 1.17).

B. Consideration of the Costs and Benefits of the Commission's Action

1. Benefits

a. Margin Adequacy Requirement (Proposed Regulation § 1.44(b))

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[232] While existing regulation § 39.13(g)(8)(iii) does not require DCOs to impose a Margin Adequacy Requirement on their clearing FCMs with respect to such FCMs' foreign futures (part 30) accounts, it may well be the case that such FCMs' existing systems and procedures already apply that requirement to those accounts, because it may be impracticable operationally to treat those accounts differently from futures and Cleared Swaps Accounts. If that assumption is correct, the proposed part 1 Margin Adequacy Requirement is unlikely to impose significant costs on, or cause significant benefits with respect to, clearing FCMs. The Commission seeks comment on the validity of that assumption.

As discussed above, the Commission is proposing to (a) promulgate new regulations in part 1 of its regulations designed to (1) further ensure that FCMs hold customer funds sufficient to cover the required initial margin for the customer's positions, and (2) permit FCMs to treat the separate accounts of a single customer as accounts of separate entities for purposes of such Margin Adequacy Requirement, subject to requirements designed to mitigate the risk that such separate account treatment could result in or worsen an under-margining scenario; and (b) make supporting amendments in parts 1, 22, 30, and 39 to facilitate the Margin Adequacy Requirement and requirements for separate account treatment, namely through changes to definitions, amendment of certain margin calculation requirements, application of certain risk management requirements to non-clearing FCMs engaged in separate account treatment, and amendment of regulation § 39.13(g)(8)(iii)'s Margin Adequacy Requirement to accommodate separate account treatment under the proposed regulation.

Existing regulation § 39.13(g)(8)(iii) establishes a Margin Adequacy Requirement, designed to mitigate the risk that a clearing member fails to hold, from a customer, funds sufficient to cover the required initial margin for the customer's cleared positions, and thereby designed to avoid the risk that a clearing FCM will, whether deliberately or inadvertently, misuse customer funds by using one customer's funds to cover another customer's margin shortfall. DCO Core Principle D, which concerns DCO risk management, imposes a number of duties upon DCOs related to their ability to manage the risks associated with discharging their responsibilities as DCOs, such as measuring credit exposures, limiting exposures to potential default-related losses, setting margin requirements, and establishing risk management models and parameters.[233] Among other requirements, Core Principle D requires that the margin required from each member and participant of a DCO be sufficient to cover potential exposures in normal

[233] Section 5b(c)(2)(D) of the CEA, 7 U.S.C. 7a-1(c)(2)(D).

market conditions.[234] Regulation § 39.13 implements Core Principle D, including through regulation § 39.13(g)(8)(iii)'s restrictions on withdrawal of customer initial margin.

With respect to clearing FCMs, because regulation § 39.13(g)(8)(iii) already results in the application of a Margin Adequacy Requirement to clearing FCMs through DCO rules in the context of futures and Cleared Swaps, the benefits of a Margin Adequacy Requirement in part 1 that applies directly to FCMs will be more limited than the benefits with respect to non-clearing FCMs. However, the Commission preliminarily believes that, to the extent there are failures in compliance with respect to margin adequacy, proposed regulation § 1.44(b) will provide an additional avenue (*i.e.*, through the Commission) for monitoring and enforcement of margin adequacy for clearing FCMs. Moreover, proposed regulation § 1.44(b) will expand the Margin Adequacy Requirement to apply to foreign futures transactions cleared through both clearing and non-clearing FCMs.[235]

With respect to non-clearing FCMs, the Margin Adequacy Requirement of proposed regulation § 1.44(b) will result in similar benefits to those currently experienced with respect to clearing FCMs under regulation § 39.13(g)(8)(iii). Regulation § 39.13(g)(8)(iii) provides that DCOs shall require clearing FCMs to ensure that their customers do not withdraw funds from their accounts unless sufficient funds remain to meet customer initial margin requirements with respect to all products and swap portfolios held in the customers' accounts and cleared by the DCO. This requirement is designed to prevent the under-margining of customer accounts, and thus mitigate the risk

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[234] Section 5b(c)(2)(D)(iv) of the CEA, 7 U.S.C. 7a-1(c)(2)(D)(iv).

[235] To the extent that FCMs already follow the Margin Adequacy Requirement for foreign futures, *e.g.*, for reasons of operational convenience (for example, if a clearing FCM applies the Margin Adequacy Requirement to its customer risk management for futures and Cleared Swaps, it may be easier to also apply it in the context of customer risk management for foreign futures than to have two different approaches) or as a matter of prudent risk management, the related costs and benefits would be reduced.

of a clearing member default and the consequences that could accrue to the broader financial system.

Section 4d(a)(2) of the CEA and regulation § 1.20(a) require an FCM to separately account for and segregate all money, securities, and property which it has received to margin, guarantee, or secure the trades or contracts of its commodity customers, and section 4d(a)(2) of the CEA and regulation § 1.22(a) prohibit an FCM from using the money, securities, or property of one customer to margin or settle the trades or contracts of another customer.[236]

The Commission preliminarily believes that proposed regulation § 1.44(b), which will apply a Margin Adequacy Requirement directly to FCMs, both clearing and non-clearing, would further achieve the benefits of serving to protect customer funds, and mitigating systemic risk that could arise from misuse of customer funds, by applying the under-margining avoidance requirements of regulation § 39.13(g)(8)(iii) directly to all FCMs. As noted above, this Margin Adequacy Requirement does not currently apply to non-clearing FCMs. The Commission further preliminarily believes that the application of such a Margin Adequacy Requirement to all FCMs (and to all three types of customer transactions, including (additionally) foreign futures transactions), through more broadly preventing under-margining situations, is reasonably necessary to better effectuate CEA section 4d(a)(2) and to better accomplish the purposes of the CEA (from section 3(b)) of "avoidance of systemic risk" and "protecting all market participants from … misuses of customer assets."

b. Requirements for Separate Account Treatment (Proposed Regulation § 1.44(c) through (h) and Supporting Amendments to Regulations §§ 1.3, 1.17, 1.20, 1.32, 1.58, 1.73, 22.2, 30.2, 30.7, and 39.13(g)(8))

As discussed in section I.B above, there are a number of commercial reasons why an FCM or customer may wish to treat the separate accounts of a single customer as

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[236] 7 U.S.C. 6d(a)(2); 17 CFR 1.20(a); 17 CFR 1.22(a).

accounts of separate entities. Combination of all accounts of the same customer within the same regulatory account classification for purposes of margining and determining funds available for disbursement may make it challenging for certain customers and their investment managers to achieve certain commercial purposes.[237] For example, where a customer has apportioned assets among multiple investment managers, neither the customer nor their investment managers may be able to obtain certainty that the individual portion of funds allocated to one investment manager will not be affected by the activities of other investment managers.

Where FCMs are able to treat the separate accounts of a single customer as accounts of separate entities for purposes of the proposed Margin Adequacy Requirement, customers benefit from being better able to leverage the skills and expertise of investment managers, and realize the benefits of a balance of investment strategies in order to meet specific commercial goals. Moreover, as discussed further below, clearing FCMs and customers of clearing FCMs already relying on the no-action position would also obtain the benefit of continuing to leverage existing systems and procedures to provide for separate account treatment.

The Commission believes that, where such separate account treatment is offered, it should be subject to safeguards that mitigate the risk that it will result in the under-margining of customer accounts. By applying regulatory safeguards designed to preserve the goals of the Margin Adequacy Requirement during such treatment, the proposal would achieve the benefit of permitting separate account treatment in a manner that would not contravene the customer funds protection and risk mitigation purposes of the CEA and Commission regulations.

The Commission also believes that several years of successful separate account activity based on the no-action conditions of CFTC Letter No. 19-17 and its superseding

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[237] *See* First FIA Letter.

letters by DCOs, clearing FCMs, and customers demonstrate that separate account treatment can be successfully applied, subject to certain safeguards.

As discussed above, section 4d(a)(2) of the CEA and Commission regulations §§ 1.20(a) and 1.22(a) require an FCM to account separately for and segregate futures customer funds and prohibit FCMs from using one customer's funds to cover another customer's margin shortfall[238] – requirements which serve to further the CEA's purposes (as set forth in section 3(b)) of protecting customer funds and avoiding systemic risk.

Part 1 of the Commission's regulations contain the principle regulations applicable to the operation of FCMs that support the above-described statutory purposes and requirements. Such regulations include requirements related to financial and other reporting, risk management, treatment of customer funds, and recordkeeping, among others. As noted above, the Commission believes that a Margin Adequacy Requirement, directly applied to all FCMs and combined with separate account treatment, can further CEA section 4d(a)(2)'s customer fund protection and risk avoidance requirements[239] while offering commercial utility for a variety of market participants. However, part 1 does not currently contain any regulations imposing such a Margin Adequacy Requirement, or governing the manner in which separate account treatment may be conducted.

The proposed regulation is designed to achieve the benefit of bridging this gap by

(i) inserting a Margin Adequacy Requirement (proposed regulation § 1.44(b)) into part 1 to ensure further that an FCM (whether a clearing or non-clearing FCM) does not

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[238] *See also* the analogous requirements in CEA §§ 4d(f)(2) and 4(b), and regulations §§ 22.2 and 30.7 (for, respectively, Cleared Swaps and foreign futures).

[239] And, similarly, those of CEA section 4d(f)(2) and 4(b).

permit margin withdrawals that would create or exacerbate an under-margining situation,

(ii) allowing FCMs to treat the separate accounts of a single customer as accounts of separate entities for purposes of the Margin Adequacy Requirement, with the benefits discussed above (proposed regulation § 1.44(c)),

(iii) establishing the manner in which FCMs may elect to engage in separate account treatment for a particular customer, with the benefit of identifying both for the FCM and its supervisory authorities (the Commission and SROs) whether it is engaging in separate account treatment, and, if so, for which customers, with the benefit of facilitating effective regulatory/self-regulatory supervision (proposed regulation § 1.44(d)),

(iv) setting forth financial and operational conditions for customers and FCMs that would identify risk management issues that are sufficiently significant to disqualify a particular separate account customer (or an FCM with respect to all of its separate account customers) from separate account treatment, with the benefit of mitigating risk by suspending separate account treatment under such circumstances (proposed regulation § 1.44(e)),

(v) requiring that separate accounts be on a one business day margin call, while setting forth limited circumstances where failure to actually receive margin on a same-day basis may be

excused, with the benefit of limiting the extent of potential under-margining, (proposed regulation § 1.44(f)), and

(vi) establishing requirements designed to ensure that separate account treatment is carried out in a consistent and documented manner, and carrying that treatment through to related FCM capital, customer funds protection, and risk management requirements in part 1 (proposed regulation § 1.44(g) through (h)), with the benefit of further ensuring that the risk management objectives of the Margin Adequacy Requirement continue to be met during separate account treatment.

Proposed revisions to regulations §§ 1.3, 1.17, 1.20, 1.32, 1.58, 1.73, 22.2, 30.2, 30.7, and 39.13(g)(8)(i) are designed to define terms used in proposed regulation § 1.44 and facilitate implementation of provisions in proposed regulation § 1.44 that would affect compliance with financial requirements for FCMs, collection of margin, and FCM risk management. Additionally, a proposed revision to regulation § 39.13(g)(8)(iii) is intended to make clear that regulation § 39.13(g)(8)(iii)'s Margin Adequacy Requirement, applicable directly to DCOs and indirectly to clearing FCMs, and similar in substance to the Margin Adequacy Requirement of proposed regulation § 1.44(b), does not require DCOs to preclude separate account treatment carried out subject to proposed regulation § 1.44.

The Commission preliminarily believes that proposed regulation § 1.44(c) through (h), and proposed supporting amendments to regulations §§ 1.3, 1.17, 1.20, 1.32, 1.58, 1.73, 22.2, 30.2, 30.7, and 39.13 would benefit both clearing FCMs and non-clearing FCMs, in addition to customers and other market participants, by providing a comprehensive framework that affirms the availability of separate account treatment, and

sets forth the manner in which such treatment can be carried out consistent with the customer fund protection and risk avoidance objectives of regulation § 39.13(g)(8)(iii) (as applied via DCO rules, with respect to clearing FCMs) and proposed regulation § 1.44(b)'s Margin Adequacy Requirement (with respect to both clearing FCMs and non-clearing FCMs).

The Commission additionally notes that the allowance of, and requirements for separate account treatment in proposed regulation § 1.44(c) through (h) are substantially similar to the conditions to the staff no-action position in CFTC Letter No. 19-17. A number of clearing FCMs have adopted some practices based on this no-action position provided by Commission staff. As such, to the extent that some clearing FCMs have relied on the no-action position, the actual costs and benefits of the proposed rule amendments as realized in the market may not be as significant as a comparison of the rule to the regulatory baseline would suggest.[240]

Moreover, if the Commission were to allow the no-action position in CFTC Letter No. 19-17 to expire, and did not adopt the proposed regulation, then clearing FCMs that already engage in separate account treatment consistent with the terms of CFTC Letter No. 19-17 would be required to reverse those changes. This could entail significant expenditures of funds and resources in order to rework systems, procedures, and customer documentation for such FCMs.[241] Hence, actual benefits to the regulation may accrue from the ability of many FCMs to avoid these costs.

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[240] For those clearing FCMs that currently choose not to engage in separate account treatment, and therefore, do not adhere to CFTC Letter No. 19-17, but choose to do so after this proposed regulation were to be adopted, the Commission submits that there will be significant costs; similar to those faced by non-clearing FCMs. This is discussed further below in the costs section.

[241] *See* Second FIA Letter. For instance, FIA noted that clearing FCMs would again be required to review and amend customer agreements, noting that negotiations to amend such agreements would likely prove "extremely difficult" as "advisers would seek to assure that their ability to manage their clients' assets entrusted to them would not be adversely affected by the actions (or inactions) of another adviser." FIA letter dated May 11, 2022 to Robert Wasserman (Third FIA Letter). FIA further noted that "an adviser may be less likely to use exchange-traded derivatives to hedge its customers' cash market positions if the adviser could not have confidence that it would be able to withdraw its customers' excess margin as necessary to meet its obligations in other markets." *Id.*

Request for Comment

Question 9: What evidence can be provided that customers have been able to achieve better performance by virtue of allowing separate account treatment? Is there evidence of under margining due to separate account treatment since CFTC Letter No. 19-17 was issued?

Question 10: Is there evidence of regulatory arbitrage between clearing FCMs and non-clearing FCMs on the grounds that the latter are not currently subject to the Margin Adequacy Requirement?

2. Costs

The proposed regulation would (i) amend part 1 of the Commission regulations to add a new requirement (proposed regulation § 1.44(b)) for FCMs to hold customer funds sufficient to cover the required initial margin for the customer's positions (the Margin Adequacy Requirement); (ii) amend part 1 to, in the same new section, (proposed regulation § 1.44(c-h)) permit FCMs, subject to certain conditions and for purposes of the Margin Adequacy Requirement, treat the accounts of a single customer as accounts of separate entities; and (iii) amend existing regulations in parts 1 and 39 to facilitate implementation of the proposed new regulation. The Commission herein discusses the costs related to each such set of amendments with respect to clearing and non-clearing FCMs. There are currently 60 registered FCMs, and of these, the Commission estimates that approximately 40 are clearing FCMs and approximately 20 are non-clearing FCMs.[242] While the proposed regulation would require all FCMs to comply with the Margin Adequacy Requirement, it would not require FCMs to engage in separate account treatment, and the Commission does not expect that all FCMs will engage in separate

[242] CFTC, Financial Data for FCMs, Sept. 20, 2023, available at *https://www.cftc.gov/MarketReports/financialfcmdata/index.htm*.

account treatment.[243] Accordingly, as noted in connection with the Commission's discussion below related to the PRA, the Commission estimates that 30 FCMs will choose to apply separate account treatment.

a. Margin Adequacy Requirement (Proposed Regulation § 1.44(b))

The Margin Adequacy Requirement of proposed regulation § 1.44(b) would require FCMs to hold customer funds sufficient to cover the required initial margin for customer positions. With respect to clearing FCMs, the Commission estimates that the cost of compliance would be *de minimis*. As discussed above, existing regulation § 39.13(g)(8)(iii) provides that a DCO shall require its clearing members to ensure that their customers do not withdraw funds from their accounts with such clearing members unless the net liquidating value plus the margin deposits remaining in a customer's account after such withdrawal are sufficient to meet the customer initial margin requirements with respect to all products and swap portfolios held in such customer's account which are cleared by the DCO. Thus, regulation § 39.13(g)(8)(iii) applies a requirement that is substantively identical to the proposed requirement indirectly to clearing FCMs, through the rules of their DCOs. Because clearing FCMs are already functionally subject to the Margin Adequacy Requirements of proposed regulation § 1.44(b) as a result of regulation § 39.13(g)(8)(iii), the Commission does not expect any significant additional cost of compliance for clearing FCMs.

Non-clearing FCMs are not currently subject to a Margin Adequacy Requirement promulgated by the Commission, and the Commission expects that the costs for a non-clearing FCM to comply could be significant. The Commission expects that compliance with the Margin Adequacy Requirement for a non-clearing FCM may entail many of the same types of costs noted below in connection with compliance with separate account

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[243] *See* CME Comment Letter (noting that 14 of 42 clearing FCMs at CME had notified CME that they intended to avail themselves of the no-action position in CFTC Letter No. 19-17, but that a number of these firms did not ultimately implement separate account treatment).

treatment requirements. Such costs could include personnel, operational, and other costs related to updating internal policies and procedures, updating or renegotiating customer documentation, and implementing or configuring internal systems to identify and prevent margin withdrawals that would be inconsistent with the proposed Margin Adequacy Requirement. The Commission expects that the compliance costs for non-clearing FCMs could vary significantly depending on factors such as the FCM's size, customer base, and existing compliance infrastructure and resources. The extent to which non-clearing FCMs need to develop new tools, policies, and procedures may however be reduced, to the extent that such FCMs already voluntarily take steps to avoid distributing funds back to their customers in a manner that would create or exacerbate an undermargined condition for a customer, as a means of managing risks to the FCM.

Moreover, while promoting margin adequacy is a policy goal of many of the regulations in CEA, there are potential costs to individual investors of the Margin Adequacy Requirement. In general, tightening the rules concerning margins can reduce the return to investors, and some effects of this type could result from requiring margin adequacy at non-clearing FCMs.

b. Requirements for Separate Account Treatment (Proposed Regulation § 1.44(c) through (h) and Supporting Amendments to Regulations §§ 1.3, 1.17, 1.20, 1.32, 1.58, 1.73, 22.2, 30.2, 30.7, and 39.13(g)(8))

In addition to the Margin Adequacy Requirement of proposed regulation § 1.44(b), the Commission is also proposing in proposed regulation § 1.44(c) through (h) rules to allow FCMs to apply separate account treatment for purposes of the Margin Adequacy Requirement, and requirements for the application of such treatment. The proposed regulation would not require FCMs to apply separate account treatment, and FCMs that do not presently apply separate account treatment, and do not desire to do so in the future, would generally not incur any costs related to the application of such treatment. Furthermore, the Commission believes that an FCM electing to allow for

separate account treatment will do so because such FCM believes the benefits of doing so will exceed the costs of doing so.

With respect to FCMs that choose to engage in separate account treatment under the proposed regulation, the Commission expects that clearing FCMs and non-clearing FCMs will generally incur the same types of compliance costs, as there are no applicable requirements for separate account treatment under the baseline with respect to either clearing FCMs or non-clearing FCMs, and the requirements of the proposed regulation generally do not distinguish between clearing FCMs and non-clearing FCMs.[244]

The costs of the proposed regulation related to application of separate account treatment will likely vary across FCMs depending on the nature of their existing rule and compliance infrastructures, and as such would be difficult to quantify with precision. However, for those FCMs that choose to engage in separate account treatment in a manner consistent with the proposed regulation, the costs of compliance could be significant, and may vary based on factors such as the size and existing compliance resources of a particular FCM, as well as the extent to which the FCM's existing risk management policies and procedures already incorporate risk management measures that overlap with those required under the proposed rule. FCMs that wish to allow for separate account treatment would likely incur costs in connection with updating their policies and procedures, internal systems, customer documentation and (re-)negotiation

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[244] There are two distinctions between clearing and non-clearing FCMs relevant to separate account compliance costs.
The first would not create a difference in costs: Gross collection of margin without netting between separate accounts is required by proposed regulation § 1.44(g)(2) and existing regulation § 39.13(g)(8)(i), as clarified by proposed regulation § 39.13(g)(8)(i)(E) for clearing FCMs, and proposed regulation § 1.58(c) creates this requirement for non-clearing FCMs.
The second would create some difference in additional costs: Under current regulation § 1.73, clearing FCMs are required to establish risk-based credit limits, screen orders for compliance with those limits, and monitor adherence to those limits, as well as conduct stress testing of positions that could pose material risk. Non-clearing FCMs are not currently required to do these things. Under proposed regulations §§ 1.44(g)(1) and 1.73(c), they would be required to do so for separate account customers and separate accounts, both on an individual separate account and aggregate basis. As such, there are additional incremental costs faced by non-clearing FCMs that choose separate account treatment.

of customer agreements to allow for separate account treatment under the conditions codified in the proposed regulation.

In a letter to the Commission staff dated April 1, 2022, FIA noted that, "For many [clearing] FCMs and their customers, the terms and conditions of the no-action position . . . presented significant operational and systems challenges," as clearing FCMs were required to "(i) adopt new practices for stress testing accounts; (ii) review and possibly change margin-timing expectations for non-US accounts; (iii) undertake legal analysis to clarify interpretive questions; and (iv) revise their segregation calculation and recordkeeping practices," as well as engage in "time-consuming documentation changes and customer outreach." [245]

FIA further described these challenges in a letter to the Commission staff dated May 11, 2022, noting that in order to meet the conditions of the no-action position, clearing FCMs were required to review and in some cases amend customer agreements, and identify and implement information technology systems changes.[246] FIA also asserted that clearing FCMs were likely required to revise internal controls and procedures.[247] FIA stated that while the costs incurred by each clearing FCM varied depending on its customer base, among larger clearing FCMs with a significant institutional customer base, personnel costs would have included identifying and reviewing up to 3,000 customer agreements to determine which agreements required modification, and then negotiating amendments with customers or their advisers.[248] FIA further stated that because the relevant provisions of these agreements were not uniform, they generally required individual attention.[249]

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[245] FIA letter dated Apr. 1, 2022 to Clark Hutchison and Amanda Olear (Second FIA Letter).
[246] Third FIA Letter. FIA noted that these changes were particularly challenging for FCMs that are part of a bank holding company structure, as "[m]odifying integrated technology information systems across a bank holding company structure is complicated, expensive and time-consuming." *Id.*
[247] *Id.*
[248] *Id.*
[249] *Id.*

The Commission anticipates that similar costs would arise for FCMs attempting to meet the requirements of the proposed separate accounts rule.

Of the costs that FCMs would likely incur related to application of separate account treatment, some costs would be incurred on a one-time basis (*e.g.*, updates to systems, procedures, disclosure documents, and recordkeeping practices, and renegotiation of customer agreements with separate account customers), and some would be recurring (*e.g.*, monitoring compliance with the one-day margin call requirement and the other conditions for ordinary course of business). However, those costs could vary widely on an FCM-by-FCM basis, depending on factors such as the number of customers at a particular FCM who wish to have separate treatment applied to their accounts; thus, for some FCMs, ongoing costs of maintaining compliance may be less significant.

While the Commission, in connection with its Paperwork Reduction Act assessment below,[250] estimates that certain reporting, disclosure, and recordkeeping costs would not be significant on an entity level, as FIA noted, taken as a whole, compliance with the conditions that the proposed regulation would codify could result in significant operational and systems costs. In other words, the Commission anticipates that FCMs may incur significant costs related to designing and implementing new systems, or enhancing existing systems, to comply with the proposed regulation, as well as negotiation costs, even where direct recordkeeping costs may not be significant on an entity-by-entity basis.[251]

In terms of implementation costs relative to the baseline (that does not consider the effects of NAL 19-17), the Commission believes clearing FCMs and non-clearing

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[250] As discussed below, the Commission staff estimates total annual costs of $1,700,010 across 30 respondents with respect to reporting, disclosure, and recordkeeping requirements; however, as certain such costs are one-time costs, the Commission staff expects such figure would be reduced after the first year of application of separate account treatment.

[251] This may be true to a somewhat lesser extent with respect to new entrants to the FCM business, in that those FCMs would incur the cost of implementing policies, procedures, and systems that comply with the conditions of the proposed regulation, but would not need to retrofit existing policies, procedures, and systems.

FCMs will be subject to the same types of costs related to application of separate account treatment.

As discussed above, a number of clearing FCMs have adopted some current practices based not only upon regulation § 39.13(g)(8)(iii)'s existing Margin Adequacy Requirement applicable to clearing FCMs through the rules of such clearing FCMs' DCOs, but also on the no-action position provided by Commission staff in CFTC Letter No. 19-17, and decisions by DCOs to provide relief from their rules adopting a Margin Adequacy Requirement in line with (and subject to the conditions specified in) that staff no-action position. As such, to the extent that clearing FCMs have relied on the no-action position, the actual costs and benefits of the proposed rule amendments as realized in the market may not be as significant as a comparison of the rule to the regulatory baseline would suggest.[252] Specifically, to the extent clearing FCMs already rely on the effects of the no-action position, the tools (*e.g.*, software) and policies and procedures necessary to comply with the proposed regulation on an ongoing basis will largely have already been built, and the costs associated with compliance will largely have already been incurred.[253] (This would not apply to non-clearing FCMs, who have no current need to rely on the effects of the no-action position.) However, the Commission notes that because the provisions of the proposed regulation vary in some respects from the terms of the no-action position, at least some additional costs are likely to be incurred by clearing FCMs that already rely on the no-action position.

In addition to compliance costs, one other type of costs should be noted: The Commission is of the view that the risk mitigants in proposed regulation § 1.44(c) through (h) would achieve the benefits of the Margin Adequacy Requirement while

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[252] For those clearing FCMs that currently choose not to engage in separate account treatment, and therefore, do not adhere to CFTC Letter No. 19-17, but choose to do so after this proposed regulation were to be adopted, the Commission submits that there will be significant costs similar to non-clearing FCMs.

[253] Communications from FIA indicate that significant resources have, in fact, been expended to meet the conditions of the NAL. *See* Second FIA Letter.

permitting separate account treatment. However, there does exist a possibility that, despite these risk mitigants, an under-margin condition could exist, followed by a default by the customer to the FCM, and a consequent default by the FCM upstream (either to a DCO or to a clearing FCM), where the losses due to that default would be greater than they would have been absent separate account treatment.

Question 11: Are the descriptions of the types of costs that would be incurred by FCMs to implement each of the Margin Adequacy Requirement and Separate Account Treatment under the proposed rules appropriately comprehensive? What data can be provided about the magnitude of these costs, either by type or in the aggregate?

Question 12: The Commission requests comment on the extent to which FCMs that are not presently clearing members that rely on the no-action position in CFTC Letter No. 19-17 would, following implementation of the proposed regulation, seek to engage in separate account treatment. Commenters are requested to provide data where available.

Question 13: The Commission requests comment regarding whether there are FCMs that chose not to rely on the no-action position provided by CFTC Letter No. 19-17 due to the conditions required to rely on that position. The Commission further requests comment on how the implementation of those conditions in the current rulemaking proposal could be modified to mitigate the burden of compliance while achieving the goals of mitigating systemic risk and protecting customer funds.

C. Costs and Benefits of the Commission's Action as Compared to Alternatives

The Commission considered as an alternative to the proposed regulation codifying the no-action position absent the conditions. This alternative would preserve the benefits of separate account treatment for FCMs and customers. However, as discussed further below, the conditions of the no-action position – proposed to be codified herein on an FCM-wide basis – are designed to permit separate account treatment only to the extent

that such treatment would not contravene the risk mitigation goals of regulation § 39.13 (and the Margin Adequacy Requirement of proposed regulation § 1.44(b)). The Commission preliminarily believes that codifying the staff no-action position without the conditions would intensify risks for DCOs, FCMs, and customers. For instance, without a requirement to cease separate account treatment in cases in which a customer is in financial distress, it is more likely that an under-margining scenario would be exacerbated, and a customer default to the clearing FCM – and potentially a default of the clearing FCM to the DCO – would be more likely. It would also forego applying the benefits of the Margin Adequacy Requirement and specific risk-mitigating requirements for separate account treatment to all FCMs.

D. Section 15(a) Factors

Section 15(a) of the CEA requires the Commission to consider the effects of its actions in light of the following five factors:

1. Protection of Market Participants and the Public

Section 15(a)(2)(A) of the CEA requires the Commission to evaluate the costs and benefits of a proposed regulation in light of considerations of protection of market participants and the public. The Commission preliminarily believes that the amendments proposed herein would strengthen the customer protection and risk mitigation provisions of part 1 applicable to FCMs generally, and, with respect to clearing FCMs, maintain the efficacy of protections for customers and the broader financial system contained in Core Principle D and regulation § 39.13.

The Commission believes that the proposed regulation's Margin Adequacy Requirement will have a salutary effect on the protection of market participants and the public. Section 4d(a)(2) of the CEA and the Commission's implementing regulations under part 1 require FCMs to segregate customer funds to margin trades and prohibit FCMs from using one customer's funds to margin another customer's trades. The

proposed regulation is designed to effectuate and support these requirements by implementing requirements for FCMs to limit the potential for losses from defaults and maintain margin sufficient to cover potential exposures in normal market conditions[254] by requiring FCMs to ensure that their customers do not withdraw funds from their accounts if such withdrawal would create or exacerbate an initial margin shortfall, and to do so in a manner consistent with the Margin Adequacy Requirement in regulation § 39.13(g)(8)(iii) already applicable through DCO rules to clearing FCMs. This requirement protects not only market participants by requiring FCMs to ensure that adequate margin exists to cover customer positions; it also protects the public from disruption to the wider financial system by mitigating the risk that an FCM will default due to customer nonpayment of variation margin obligations combined with insufficient initial margin.

The Commission also believes the requirements in the proposed regulation for carrying out separate account treatment will provide for separate account treatment in a manner that protects market participants and the public. While, with respect to clearing FCMs subject to the indirect effects of current § 39.13(g)(8)(iii), permitting separate account treatment unavoidably creates some additional risk of a margin deficiency, the conditions of the no-action position outlined in CFTC Letter No. 19-17, and proposed to be codified herein, as modified and applicable on an FCM-wide basis, are designed to effectuate these customer protection and risk mitigation goals notwithstanding an FCM's application of separate account treatment (and the consequent additional risk). For example, separate account treatment is not permitted in certain circumstances outside the ordinary course of business (*e.g.*, where an FCM learns a customer is in financial distress, and thus may be unable promptly to meet initial margin requirements, whether in one or more separate accounts or on a combined account basis). The proposed regulation would

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[254] 7 U.S.C. 7a-1(c)(2)(D)(iii) through (iv).

also put in place requirements for FCMs designed to ensure that they collect information sufficient to understand the value of assets dedicated to a separate account, apply separate account treatment consistently, and maintain reliable lines of contact for the ultimate customer of the account. Clearing FCMs have, for over four years, successfully relied on a no-action letter, as applied through their DCOs, establishing conditions substantially similar to the conditions in the proposed rule, and the Commission believes codification of these conditions, as proposed herein, supports protection of market participants and the public.

2. Efficiency, Competitiveness, and Financial Integrity of Futures Markets

Section 15(a)(2)(B) of the CEA requires the Commission to evaluate the costs and benefits of a proposed regulation in light of efficiency, competitiveness, and financial integrity of futures markets. The Commission preliminarily believes that the proposed regulation may carry potential implications for the financial integrity of markets, but not for the efficiency or competitiveness of markets, which the Commission preliminarily believes remain unchanged.

As stated above, the purposes of the Commission's customer funds protection and risk management regulations include not just protection of customer assets, but also mitigation of systemic risk: a customer in default to an FCM may in turn trigger the FCM to default, either to the DCO (if it is a clearing member) or to another FCM that is itself a clearing member, with cascading consequences for the clearing FCM (if applicable) or the DCO and the wider financial system. The proposed Margin Adequacy Requirement advances those purposes directly. The proposed amendments permitting separate account treatment reflect the Commission's preliminary conclusion that the conditions of CFTC Letter No. 19-17, as proposed to be codified herein, are sufficient and appropriate to guard against such risks for purposes of the proposed Margin Adequacy Requirement.

In CFTC Letter No. 19-17, the Commission staff highlighted market participants' concerns that the Commission should recognize "diverse practices among FCMs and their customers with respect to the handling of separate accounts of the same beneficial owner" as consistent with regulation § 39.13(g)(8)(iii). FIA, in particular, outlined several business cases in which a customer may want to apply separate account treatment, and each of SIFMA-AMG, FIA, and CME outlined controls that clearing FCMs could apply to ensure that, in instances in which separate account treatment is desired, such treatment can be applied in a manner that effectively prevents systemic risk.[255] By proposing to codify in part 1 a Margin Adequacy Requirement directly applicable to FCMs similar to the Margin Adequacy Requirement of regulation § 39.13(g)(8)(iii), and a modified version of the no-action position provided for by CFTC Letter No. 19-17 and its superseding letters, applicable to all FCMs, the Commission is proposing a framework for FCMs, whether clearing or non-clearing, to provide separate account treatment for customers subject to enhanced customer fund and risk mitigation protections, thereby ensuring FCMs can compete on services offered to customers to address their financial needs, in a manner consistent with the customer protection and risk mitigation goals of the CEA.

3. Price Discovery

Section 15(a)(2)(C) of the CEA requires the Commission to evaluate the costs and benefits of a proposed regulation in light of price discovery considerations. The Commission preliminarily believes that the proposed amendments will not have a significant impact on price discovery.

4. Sound Risk Management Practices

Section 15(a)(2)(D) of the CEA requires the Commission to evaluate the costs and benefits of a proposed regulation in light of sound risk management practices. As

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[255] *See* First FIA Letter; SIFMA-AMG Letter; CME Letter.

discussed above, the CEA sets forth requirements providing that an FCM may not use one customer's funds to cover another customer's margin shortfall. The proposed Margin Adequacy Requirement serves these purposes by further ensuring that FCMs do not allow customers to create or increase under-margining in their accounts through withdrawals of funds. While, as discussed above, clearing FCMs are already subject to this requirement as a result of DCO rules adopted under regulation § 39.13(g)(8)(iii), the proposed regulation will also apply this requirement to non-clearing FCMs, and will create another avenue to monitoring and enforcement of this requirement for clearing FCMs.

Additionally, the Commission believes that the proposed regulation will ensure that application of the proposed regime for separate account treatment occurs in a manner that continues to be consistent with the CEA's customer fund protection and risk mitigation objectives. As discussed above, the no-action position has been successfully used to allow clearing FCMs to engage in separate account treatment in a manner that is consistent with the protection of customer funds and the mitigation of systemic risk, including by requiring the application of separate account treatment in a consistent manner, and requiring regulatory notifications and the cessation of separate account treatment in certain instances of operational or financial distress. The Commission preliminarily believes codification of the no-action conditions, and the Margin Adequacy Requirement they address, applied directly to all FCMs, promotes sound FCM risk management practices.[256]

5. Other Public Interest Considerations

Section 15(a)(2)(e) of the CEA requires the Commission to evaluate the costs and benefits of a proposed regulation in light of other public interest considerations. The Commission is identifying a public interest benefit in codifying the Divisions' no-action

[256] *See, e.g.*, First FIA Letter (describing use of separate account treatment for hedging purposes).

position, where the efficacy of that position has been demonstrated. In such a situation, the Commission believes it serves the public interest and, in particular, the interests of market participants, to engage in notice-and-comment rulemaking, where it seeks and considers the views of the public in amending its regulations, rather than for market participants to continue to rely on a time-limited no-action position that can be easily withdrawn, provides less long-term certainty for market participants, and offers a more limited opportunity for public input.

Request for Comment

Question 14: The Commission requests comment, including any available quantifiable data and analysis, concerning its analysis of the Section 15(a) factors.

IV. Related Matters

A. Antitrust Considerations

Section 15(b) of the CEA requires the Commission to take into consideration the public interest to be protected by the antitrust laws and endeavor to take the least anticompetitive means of achieving the purposes of the CEA in issuing any order or adopting any Commission rule or regulation.[257]

The Commission believes that the public interest to be protected by the antitrust laws is generally to protect competition. The Commission requests comment on whether the proposed regulation implicates any other specific public interest to be protected by the antitrust laws.

The Commission has considered the proposed regulation to determine whether it is anticompetitive and has preliminarily identified no anticompetitive effects. The Commission requests comment on whether the proposed regulation is anticompetitive and, if it is, what the anticompetitive effects are.

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[257] 7 U.S.C. 19(b).

Because the Commission has preliminarily determined that the proposed regulation is not anticompetitive and has no anticompetitive effects, the Commission has not identified any less anticompetitive means of achieving the purposes of the CEA. The Commission requests comment on whether there are less anticompetitive means of achieving the relevant purposes of the CEA that would otherwise be served by adopting the proposed regulation.

B. Regulatory Flexibility Act

The Regulatory Flexibility Act (RFA) requires agencies to 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 with respect to such impact.[258] The rules proposed herein would require all FCMs to ensure that they do not permit their customers to withdraw funds from their accounts unless the net liquidating value plus the margin deposits remaining in the account are sufficient to meet the customer initial margin requirements for such accounts, but would also establish conditions under which FCMs could engage in separate account treatment. The Commission has previously established certain definitions of "small entities" to be used by the Commission in evaluating the impact of its regulations on small entities in accordance with the RFA.[259] The Commission has previously determined that FCMs are not small entities for the purpose of the RFA.[260] Accordingly, the Chairman, on behalf of the Commission, hereby certifies pursuant to 5 U.S.C. 605(b) that these proposed rules will not have a significant economic impact on a substantial number of small entities.

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[258] 5 U.S.C. 601 *et seq*.

[259] Bankruptcy Regulations, 86 FR 19324, 19416 (Apr. 13, 2021) (citing Policy Statement and Establishment of Definitions of "Small Entities" for Purposes of the Regulatory Flexibility Act, 47 FR 18618 (Apr. 30, 1982)).

[260] *See id.* (citing New Regulatory Framework for Clearing Organizations, 66 FR 45604, 45609 (Aug. 29, 2001); Customer Margin Rules Relating to Security Futures, 67 FR 53146, 53171 (Aug. 14, 2002)).

C. Paperwork Reduction Act

The PRA[261] imposes certain requirements on Federal agencies in connection with their conducting or sponsoring any collection of information as defined by the PRA. Any 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. The Office of Management and Budget (OMB) has not yet assigned a control number to the new collection.

This proposed rulemaking would result in a new collection of information within the meaning of the PRA, as discussed below. The Commission therefore is submitting this proposal to OMB for review, in accordance with 44 U.S.C. 3507(d) and 5 CFR 1320.11. If adopted, responses to this collection of information would be required to obtain a benefit. Specifically, FCMs would be required to respond to the collection in order to obtain the benefit of engaging in separate account treatment for purposes of regulation § 1.44.

The Commission will protect proprietary information it may receive according to the Freedom of Information Act and 17 CFR part 145, "Commission Records and Information." In addition, section 8(a)(1) of the CEA strictly prohibits the Commission, unless specifically authorized by the CEA, from making public data and information that would separately disclose the business transactions or market positions of any person and trade secrets or names of customers.[262] The Commission also is required to protect certain information contained in a government system of records according to the Privacy Act of 1974, 5 U.S.C. 552a.

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[261] 44 U.S.C. 3501 *et seq*.
[262] 7 U.S.C. 12(a)(1).

1. Information Provided by Reporting Entities/Persons

The proposed regulation applies directly to FCMs. All FCMs that engage in separate account treatment, both those that are clearing members of DCOs and those that are not, would be subject to certain reporting, disclosure, and recordkeeping requirements to comply with the conditions specified in proposed regulation § 1.44.

While the Commission staff estimates burden hours and costs using current part 1 and regulation § 39.13(g)(8)(iii) as a baseline, the Commission notes that FCMs that are clearing members of DCOs are already effectively subject to the Margin Adequacy Requirement, in order to comply with rules that their DCOs have established in order to in turn comply with the DCO's obligations under regulation § 39.13(g)(8)(iii). Thus, the Commission notes that many clearing FCMs already are subject to the conditions of the no-action position, which are substantially similar to the proposed regulation. For these clearing FCMs, the Commission expects that any additional cost or administrative burden associated with complying with the proposed regulation would be reduced.[263]

a. Reporting Requirements

The proposed regulation contains two reporting requirements that could result in a collection of information from ten or more persons over a 12-month period.

There are currently approximately 61 registered FCMs.[264] The Commission staff estimates that slightly less than half of all FCMs would engage in separate account treatment under the proposed regulation, resulting in approximately 30 respondents.

First, proposed regulation § 1.44(d)(2) provides that, to the extent an FCM elects to treat the separate accounts of a customer as accounts of separate entities pursuant to

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[263] However, the Commission expects that FCMs that do not currently rely on the no-action position, but choose to apply separate account treatment after (and if) the proposed regulation is finalized, would incur new costs. This would include all non-clearing FCMs that choose to apply separate account treatment after (and if) the proposed regulation is finalized.

[264] *See* CFTC, Selected FCM Financial Data as of August 31, 2023, available at *https://www.cftc.gov/sites/default/files/2023-10/01%20-%20FCM%20Webpage%20Update%20-%20August%202023.xlsx*.

the terms of proposed regulation § 1.44, the FCM must provide a one-time notification to its DSRO and to the Commission that it will apply such treatment. The Commission staff estimates this would result in a total of one response per respondent on a one-time basis, and that respondents could expend up to $273, based on an hourly rate of $273,[265] to comply with the proposed regulation. This would result in an annual burden of 30 hours and an aggregated cost of $8,190 (30 respondents × $273).

Second, proposed regulation § 1.44(e)(3) requires an FCM engaging in separate account treatment to communicate promptly in writing to its DSRO and to the Commission the occurrence of certain enumerated "non-ordinary course of business" events. The Commission staff estimates that each such FCM may experience two non-ordinary course of business events per year, either with respect to themselves, or a customer. For purposes of determining the number of responses, the Commission staff anticipates that additional notifications of substantially the same information, and at substantially the same time, by means of electronic communication to both the DSRO and the Commission would not materially increase the time and cost burden for such FCM. Therefore, for purposes of these estimates, the Commission staff treats a set of notifications sent to the DSRO and to the Commission as a single response.[266]

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[265] This figure is rounded to the nearest dollar and based on the annual mean wage for U.S. Bureau of Labor Statistics (BLS) category 13-2061, "Financial Examiners." BLS, Occupational Employment and Wages, May 2022 [hereinafter "BLS Data"], available at *https://www.bls.gov/oes/current/oes_nat.htm*. This category consists of professionals who "[e]nforce or ensure compliance with laws and regulations governing financial and securities institutions and financial and real estate transactions." BLS, Occupational Employment and Wages, May 2022: 13-2061 Financial Examiners, available at *https://www.bls.gov/oes/current/oes132061.htm*. According to BLS, the mean salary for this category in the context of Securities, Commodity Contracts, and Other Financial Investments and Related Activities is $117,270. This number is divided by 1,800 work hours in a year to account for sick leave and vacations and multiplied by 4 to account for retirement, health, and other benefits or compensation, as well as for office space, computer equipment support, and human resources support. This number is further multiplied by 1.0494 to account for the 4.94% change in the Consumer Price Index for Urban Wage-Earners and Clerical Workers between May 2022 and September 2023 (288.022 to 302.257). BLS, CPI for Urban Wage Earners and Clerical Workers (CPI-W), U.S. City Average, All Items – CWUR0000SA0, available at *https://www.bls.gov/data/#prices*. Together, these modifications yield an hourly rate of $273. The rounding and modifications applied with respect to the estimated average burden hour cost for this occupational category have been applied with respect to each occupational category discussed as part of this analysis.

[266] The Commission staff applies the same assumption to notifications to DSROs and the Commission with respect to proposed regulation § 1.44(d)(2) and proposed regulation § 1.44(e)(3).

Accordingly, the Commission staff estimates a total of two responses per respondent on an annual basis. In addition, the Commission staff estimates that each response would take eight hours. This yields a total annual burden of 480 hours (2 responses * 8 hours/response * 30 respondents). In addition, the Commission staff estimates that each respondent could expend up to $4,368 annually, based on an hourly rate of $273, to comply with this requirement.[267] This would result in an aggregated cost of $131,040 per annum (30 respondents ×$4,368).

The aggregate information collection burden estimate associated with the proposed reporting requirements is as follows:[268]

Estimated number of respondents: 30.

Estimated number of reports: 90.

Estimated annual hours burden: 510.

Estimated annual cost: $139,230.

b. Disclosure Requirements

The proposed regulation contains three disclosure requirements that could affect ten or more persons in a 12-month period.

First, proposed regulation § 1.44(h)(3)(i) requires an FCM to provide each customer using separate accounts with a disclosure that, pursuant to part 190 of the Commission's regulations, all separate accounts of the customer will be combined in the event of the FCM's bankruptcy. The Commission staff estimates that this would result in a total of 125 responses per respondent on a one-time basis, and that respondents are likely to spend one hour to comply with this requirement for a total of 125 annual burden

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[267] Financial Examiners.

[268] This estimate reflects the aggregate information collection burden estimate associated with the proposed reporting requirements for the first annual period following implementation of the proposed regulation. Because proposed regulation § 1.44(d)(2) would result in a one-time reporting requirement, the Commission staff estimates that for each subsequent annual period, the number of reports, burden hours, and burden cost would be reduced accordingly.

hours and up to $19,500 annually, based on an hourly rate of $156.[269] This would result in an annual burden of 3,750 hours and an aggregated cost of $585,000 (30 respondents × $19,500). This estimate reflects an initial disclosure distributed to existing customers subject to separate account treatment. The Commission staff expects that, on a going forward basis, this disclosure would be included in standard disclosures for new customers, and would therefore not result in any additional costs.

Second, proposed regulation § 1.44(h)(3)(iii) requires that an FCM engaging in separate account treatment include the disclosure statement required by proposed regulation § 1.44(h)(3) on its website or within its Disclosure Document required by regulation § 1.55(i). If the FCM opts to update its Disclosure Document, the Commission staff estimates that this proposed requirement would result in a total of one response on a one-time basis, and that each respondent could expend up to $580 annually, based on an hourly rate of $580,[270] to comply with the proposed regulation. This would result in an estimated 30 burden hours annually and an aggregated cost of $17,400 (30 respondents × $580). This estimate reflects one updated disclosure distributed to existing customers. If the FCM opts to include the disclosure on its website, the Commission staff estimates that this proposed requirement would result in a total of one response on a one-time basis, and that each respondent could expend up to $293 annually, based on an hourly rate of $293, to comply with the proposed regulation.[271] This would result in an estimated 30 burden hours annually and an aggregated cost of $8,790 (30 respondents × $293). The Commission staff expects that once the disclosure is included in the

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[269] This figure is based on the annual mean wage of $67,070 for BLS category 43-6012, "Legal Secretaries & Administrative Assistants" in the New York City Metropolitan Area, one of the top paying metropolitan areas for this category. BLS Data. https://www.bls.gov/oes/current/oes436012.htm

[270] BLS 2022 Data for BLS Category 23-1011, "Lawyers," in Securities, Commodity Contracts, and Other Financial Investments and Related Activities, https://data.bls.gov/oes/#/indOcc/Multiple%20occupations%20for%20one%20industry (mean annual salary of $248,830).

[271] This figure is based on the annual mean wage for BLS category 15-1254, "Web Developers." According to BLS, the mean salary for this category in the context of Securities, Commodity Contracts, and Other Financial Investments and Related Activities is $125,760.

Disclosure Document required by regulation § 1.55(i) or posted on the FCM's website, the FCM would not incur any additional costs.

Third, proposed regulation § 1.44(h)(4) requires an FCM that has made an election pursuant to regulation § 1.44(d) to disclose in the Disclosure Document required under regulation § 1.55(i) that it permits the separate treatment of accounts for the same customer under the terms and conditions of regulation § 1.44. The Commission staff estimates that this would result in a total of one response per respondent on a one-time basis, and that respondents could expend up to $580 annually, based on an hourly rate of $580,[272] to comply with the proposed regulation. This would result in an estimated 30 burden hours annually and an aggregated cost of $17,400 (30 respondents × $580). This estimate reflects an initial updated disclosure distributed to existing customers. The Commission staff expects that once this disclosure is made, the disclosure would be included in the Disclosure Document required by regulation § 1.55(i) going forward, and would not result in any additional costs.

The aggregate information collection burden estimate associated with the proposed disclosure requirements is as follows:[273]

Estimated number of respondents: 30.

Estimated number of reports: 3,840.

Estimated annual hours burden: 3,840.

Estimated annual cost: $628,590.

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[272] Lawyers.

[273] For purposes of this analysis, the Commission staff calculates the aggregate information collection burden assuming that respondents choose to include the disclosure statement required by proposed regulation § 1.44(h)(3) on their websites *and* within their Disclosure Document required by proposed regulation § 1.55(i), in order to comply with proposed regulation § 1.44(h)(3)(iii). Additionally, this estimate reflects the aggregate information collection burden estimate associated with the proposed disclosure requirements for the first annual period following implementation of the proposed regulation. Because each of proposed regulation § 1.44(h)(3)(i), § 1.44(h)(3)(iii), and § 1.44(h)(4) would result in a one-time disclosure requirement for PRA purposes, the Commission staff estimates that for each subsequent annual period the number of respondents, reports, burden hours, and burden cost would be reduced accordingly.

c. Recordkeeping Requirements

The proposed regulation contains four recordkeeping requirements that could affect ten or more persons in a 12-month period.

First, proposed regulation § 1.44(d)(1) provides that, to elect to treat the separate accounts of a customer as accounts of separate entities, for purposes of the Margin Adequacy Requirement, the FCM shall include the customer on a list of separate account customers maintained in its books and records receiving such treatment. The Commission staff estimates that this would result in a total of 125 responses per respondent on a one-time basis, and that respondents could expend up to $8,531 annually, based on an hourly rate of $273,[274] to comply with the proposed regulation. This would result in an estimated 938 burden hours annually and an aggregated cost of $255,930 per annum (30 respondents × $8,531).

Second, proposed regulation § 1.44(e)(4) provides that an FCM that has ceased permitting disbursements on a separate account basis to a separate account customer due to the occurrence of a non-ordinary course of business event may resume permitting disbursements on a separate account basis if the FCM reasonably believes, based on new information, that the circumstances leading to cessation of separate account treatment have been cured, and the FCM documents in writing the factual basis and rationale for its conclusion that such circumstances have been cured. Where the Commission staff have estimated above that an FCM may experience two non-ordinary course of business events per year, the Commission staff conservatively estimate that in each case the conditions leading to cessation of separate account treatment would be cured. Accordingly, the Commission staff estimates that documenting the cure of each non-ordinary course of business event would require two recordkeeping responses per respondent on an annual basis, and that respondents could expend up to $1,092 annually, based on an hourly rate

[274] Financial Examiners.

of $273,[275] to comply with this requirement. This would result in an aggregated cost of $32,760 per annum (30 respondents x $1,092).

Third, proposed regulation § 1.44(h)(2) provides that where a separate accounts customer has appointed a third-party as the primary contact to the FCM, the FCM must obtain and maintain current contact information of an authorized representative(s) at the customer and take reasonable steps to verify that such contact information is and remains accurate and that such person is in fact an authorized representative of the customer. The Commission staff estimates this would result in a total of 125 responses per respondent on an annual basis,[276] and that respondents could expend up to $19,500 annually, based on an hourly rate of $156.[277] This would result in an estimated 3,750 burden hours annually and an aggregated cost of $585,000 per annum (30 respondents × $19,500).

Fourth, proposed regulation § 1.44(h)(3)(ii) requires that an FCM maintain documentation demonstrating that the part 190 disclosure statement required by proposed regulation § 1.44(h)(3)(i) was delivered directly to the customer. The Commission staff estimates that this would result in a total of 125 responses per respondent on a one-time basis, and that respondents could expend up to $1,950 annually, based on an hourly rate of $156, to comply with the proposed regulation. This would result in an estimated 375 burden hours annually and an aggregated cost of $58,500 (30 respondents × $1,950). This estimate reflects initial recordkeeping of documentation that the disclosure was delivered to existing customers subject to separate account treatment. The Commission

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[275] Financial Examiners.

[276] FIA stated that while the costs incurred by each FCM to comply with the conditions of CFTC Letter No. 19-17 varies depending on customer base, among larger FCMs with a significant institutional customer base, personnel costs would have included identifying and reviewing up to 3,000 customer agreements to determine which agreements required modification, and then negotiating amendments with customers or their advisors. The Commission staff estimates, based on the 30 largest FCMs by customer assets in segregation as of the Commission's FCM financial data report for May 31, 2022, that there are 3,750 customers of FCMs whose accounts could be in scope for the proposed regulation, with an average of 125 customers per FCM.

[277] This figure is based on the annual mean wage of $67,070 for BLS category 43-6012, "Legal Secretaries & Administrative Assistants" in the New York City Metropolitan Area, one of the top paying metropolitan areas for this category. BLS Data, available at *https://www.bls.gov/oes/current/oes436012.htm*.

staff estimates that, once such recordkeeping is complete, the recordkeeping required by proposed regulation § 1.44(h)(3)(ii) would be required only with respect to new customers who receive disclosures pursuant to proposed regulation § 1.44(h)(3)(ii), and the costs and burden hours associated with proposed regulation § 1.44(h)(3)(ii) would be reduced accordingly. [278]

The Commission notes that while certain other provisions of the proposed regulation may result in recordkeeping requirements, the Commission anticipates that any burden associated with these requirements is likely to be *de minimis* and therefore does not expect these provisions to increase the recordkeeping burden for FCMs.

The aggregate information collection burden estimate associated with the proposed reporting requirements is as follows:

Estimated number of respondents: 30.

Estimated number of reports: 11,310.

Estimated annual hours burden: 5,183.

Estimated annual cost: $932,190.

2. Information Collection Comments

The Commission invites the public and other Federal agencies to comment on any aspect of the proposed information collection requirements discussed above. Pursuant to 44 U.S.C. 3506(c)(2)(B), the Commission will consider public comments on this proposed collection of information regarding:

[278] This estimate reflects the aggregate information collection burden estimates associated with the proposed disclosure requirements for the first annual period following implementation of the proposed regulation. Because, as noted above, proposed regulation § 1.44(h)(3)(i) would result in a one-time recordkeeping requirement as to each customer (*i.e.*, once the disclosure is provided to existing customers, it would need to be provided only to new customers on a going forward basis), the Commission staff estimates that for each subsequent annual period the number of reports, burden hours, and burden cost would be reduced accordingly.

- Evaluating whether the proposed collection of information is necessary for the proper performance of the functions of the Commission, including whether the information will have a practical use;
- Evaluating the accuracy of the estimated burden of the proposed collection of information, including the degree to which the methodology and the assumptions that the Commission employed were valid;
- Enhancing the quality, utility, and clarity of the information proposed to be collected; and
- Reducing the burden of the proposed information collection requirements on registered entities, including through the use of appropriate automated, electronic, mechanical, or other technological information collection techniques; *e.g.*, permitting electronic submission of responses.

Organizations and individuals desiring to submit comments on the proposed information collection requirements should send those comments to:

- The Office of Information and Regulatory Affairs, Office of Management and Budget, Room 10235, New Executive Office Building, Washington, DC 20503, Attn: Desk Officer of the Commodity Futures Trading Commission;
- (202) 395-6566 (fax); or
- *OIRAsubmissions@omb.eop.gov* (email).

Please provide the Commission with a copy of submitted comments so that, if the Commission determines to promulgate a final rule, all such comments can be summarized and addressed in the final rule preamble. Refer to the **ADDRESSES** section of this notice of proposed rulemaking for comment submission instructions to the Commission. A copy of the supporting statements for the collections of information discussed above may be obtained by visiting RegInfo.gov. OMB is required to make a decision concerning the collection of information between 30 and 60 days after

publication of this document in the *Federal Register*. Therefore, a comment is best assured of receiving full consideration if OMB receives it within 30 days of publication of this notice of proposed rulemaking. Nothing in the foregoing affects the deadline enumerated above for public comment to the Commission on the proposed rules.

List of Subjects

17 CFR Part 1

Brokers, Commodity futures, Consumer protection, Reporting and recordkeeping requirements.

17 CFR Part 22

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

17 CFR Part 30

Consumer protection.

17 CFR Part 39

Clearing, Clearing organizations, Commodity futures, Consumer protection.

For the reasons set forth in the preamble, the Commodity Futures Trading Commission proposes to amend 17 CFR chapter I as follows:

PART 1—GENERAL REGULATIONS UNDER THE COMMODITY EXCHANGE ACT

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

Authority: 7 U.S.C. 1a, 2, 5, 6, 6a, 6b, 6c, 6d, 6e, 6f, 6g, 6h, 6i, 6k, 6l, 6m, 6n, 6o, 6p, 6r, 6s, 7, 7a–1, 7a–2, 7b, 7b–3, 8, 9, 10a, 12, 12a, 12c, 13a, 13a–1, 16, 16a, 19, 21, 23, and 24 (2012).

2. Amend § 1.3 by revising the definition of "business day" to read as follows:

§ 1.3 Definitions.

* * * * *

Business day. This term means any day other than a Saturday, Sunday, or holiday. In all notices required by the Act or by the rules and regulations in this chapter to be given in terms of business days the rule for computing time shall be to exclude the day on

which notice is given and include the day on which shall take place the act of which notice is given.

* * * * *

3. Amend § 1.17 by:

a. Republishing the paragraph heading of paragraph (b);

b. Revising paragraph (b)(6);

c. Revising introductory text of paragraph (b)(8);

d. Adding new paragraph (b)(8)(v);

e. Republishing the paragraph heading of paragraph (c);

f. Republishing the paragraph heading of paragraph (c)(2);

g. Revising paragraph (c)(2)(i);

h. Republishing the paragraph heading of paragraph (c)(4);

i. Revising paragraph (c)(4)(ii);

j. Republishing the paragraph heading of (c)(5); and

k. Revising paragraph (c)(5)(viii).

The republications, revisions, and additions read as follows:

§ 1.17 Minimum financial requirements for futures commission merchants and introducing brokers.

* * * * *

(b) For the purposes of this section:

* * * * *

(6) ***Business day*** means any day other than a Saturday, Sunday, or holiday.

* * * * *

(8) ***Risk margin*** for an account means the level of maintenance margin or performance bond required for the customer -and noncustomer positions by the applicable exchanges or clearing organizations, and, where margin or performance bond

is required only for accounts at the clearing organization, for purposes of the futures commission merchant's risk-based capital calculations applying the same margin or performance bond requirements to customer and noncustomer positions in accounts carried by the futures commission merchant, subject to the following.

* * * * *

(v) If a futures commission merchant carries separate accounts for separate account customers pursuant to § 1.44 of this part, the futures commission merchant shall calculate the risk margin pursuant to this section as if the separate accounts are owned by separate entities.

* * * * *

(c) Definitions: For the purposes of this section:

* * * * *

(2) The term *current assets* means cash and other assets or resources commonly identified as those which are reasonably expected to be realized in cash or sold during the next 12 months. "Current assets" shall:

(i) Exclude any unsecured commodity futures, options, cleared swaps, or other Commission regulated account containing a ledger balance and open trades, the combination of which liquidates to a deficit or containing a debit ledger balance only. For purposes of this paragraph (c)(2)(i), a futures commission merchant that carries separate accounts for separate account customers pursuant to § 1.44 of this part shall treat each separate account as if it is the account of a separate entity, apply only margin collateral held for the particular separate account in determining if the deficit or debit ledger balance is secured, and exclude from current assets a separate account that liquidates to a deficit or contains a debit ledger balance only. Provided, however, that any deficit or debit ledger balance in an account listed above, including a separate account, which is the subject of a call for margin or other required deposits may be included in current assets

until the close of business on the business day following the date on which such deficit or debit ledger balance originated provided that the account had timely satisfied, through the deposit of new funds, the previous day's deficit or debit ledger balance, if any, in its entirety. If a separate account does not meet a previous day's margin call for a deficit or debit balance, the futures commission merchant shall exclude all separate accounts of that separate account customer carried by the futures commission merchant that have a deficit or debit ledger balance from current assets under this paragraph.

* * * * *

(4) The term *liabilities* means the total money liabilities of an applicant or registrant arising in connection with any transaction whatsoever, including economic obligations of an applicant or registrant that are recognized and measured in conformity with generally accepted accounting principles. "Liabilities" also include certain deferred credits that are not obligations but that are recognized and measured in conformity with generally accepted accounting principles. For the purposes of computing "net capital," the term "liabilities":

* * * * *

(ii) Excludes, in the case of a futures commission merchant, the amount of money, securities and property due to customers which is held in segregated accounts in compliance with the requirements of the Act and these regulations. For purposes of this paragraph (c)(4)(ii), a futures commission merchant that carries separate accounts of a separate account customer pursuant to § 1.44 of this part shall compute the amount of money, securities and property due to the separate account customer as if the separate accounts were accounts of separate entities. A futures commission merchant may exclude money, securities and property due to customers, including separate account customers, only if such money, securities and property held in segregated accounts have been excluded from current assets in computing net capital;

* * * * *

(5) The term *adjusted net capital* means net capital less:

* * * * *

(viii) (A) In the case of a futures commission merchant, for undermargined customer accounts, the amount of funds required in each such account to meet maintenance margin requirements of the applicable board of trade, or if there are no such maintenance margin requirements, clearing organization margin requirements applicable to such positions, after application of calls for margin or other required deposits which are outstanding no more than one business day. If there are no such maintenance margin requirements or clearing organization margin requirements, then the amount of funds required to provide margin equal to the amount necessary, after application of calls for margin or other required deposits outstanding no more than one business day, to restore original margin when the original margin has been depleted by 50 percent or more. If, however, a call for margin or other required deposits for an undermargined customer account is outstanding for more than one business day, then no such call for that undermargined customer account shall be applied until all such calls for margin have been met in full.

(B) If a futures commission merchant carries separate accounts for one or more separate account customers pursuant to § 1.44 of this part, the futures commission merchant shall compute the amount of funds required under paragraph (c)(5)(viii)(A) of this section to meet maintenance margin requirements for each separate account as if the account is owned by a separate entity, after application of calls for margin or other required deposits which are outstanding no more than one business day. If, however, a call for margin or other required deposits for any separate account of a particular separate account customer is outstanding for more than one business day, then all outstanding margin calls for all separate accounts of that separate account customer shall be treated as

if the margin calls are outstanding for more than one business day, and shall be deducted from net capital until all such calls have been met in full.

(C) If a customer account or a customer separate account deficit or debit ledger balance is excluded from current assets in accordance with paragraph (c)(2)(i) of this section, such deficit or debit ledger balance amount shall not also be deducted from current assets under this paragraph (c)(5)(viii) of this section.

(D) In the event that an owner of a customer account, or a customer separate account pursuant to § 1.44 of this part, has deposited an asset other than cash to margin, guarantee or secure the account, the value attributable to such asset for purposes of this paragraph (c)(5)(viii) of this section shall be the lesser of:

(*1*) The value attributable to the asset pursuant to the margin rules of the applicable board of trade, or

(*2*) The market value of the asset after application of the percentage deductions specified in paragraph (c)(5) of this section;

* * * * *

4. Amend § 1.20 by revising paragraph (i)(4) and adding new paragraph (i)(5) to read as follows:

§ 1.20 Futures customer funds to be segregated and separately accounted for.

* * * * *

(i) * * *

(4) The futures commission merchant must, at all times, maintain in segregation an amount equal to the sum of any credit and debit balances that the futures customers of the futures commission merchant have in their accounts. Notwithstanding the above, a futures commission merchant must add back to the total amount of funds required to be maintained in segregation any futures customer accounts with debit balances in the amounts calculated in accordance with paragraph (5) of this section.

(5) The futures commission merchant, in calculating the total amount of funds required to be maintained in segregation pursuant to paragraph (i)(4) of this section, must include any debit balance, as calculated pursuant to this paragraph (i)(5), that a futures customer has in its account, to the extent that such debit balance is not secured by "readily marketable securities" that the particular futures customer deposited with the futures commission merchant.

(i) For purposes of calculating the amount of a futures account's debit balance that the futures commission merchant is required to include in its calculation of its total segregation requirement pursuant to this paragraph (i)(5), the futures commission merchant shall calculate the net liquidating equity of each futures account in accordance with paragraph (i)(2) of this section, except that the futures commission merchant shall exclude from the calculation any noncash collateral held in the futures customer account as margin collateral. The futures commission merchant may offset the debit balance computed under this paragraph (i)(5) to the extent of any "readily marketable securities," subject to percentage deductions (*i.e.*, "securities haircuts") as specified in paragraph (f)(5)(iv) of this section, held for the particular futures customer to secure its debit balance.

(ii) 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).

(iii) 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.

(iv) To determine the amount of such debit balance 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). Futures commission merchants that establish and enforce written policies and procedures to assess the credit risk of commercial paper, convertible debt instruments, or nonconvertible debt instruments in accordance with Rule 240.15c3–1(c)(2)(vi) of the Securities and Exchange Commission (§ 240.15c3–1(c)(2)(vi) of this title) may apply the lower haircut percentages specified in Rule 240.15c3–1(c)(2)(vi) for such commercial paper, convertible debt instruments and nonconvertible debt instruments.

* * * * *

5. Amend § 1.32 by adding new paragraph (l) to read as follows:

§ 1.32 Reporting of segregated account computation and details regarding the holding of futures customer funds.

* * * * *

(l) A futures commission merchant that carries futures accounts for futures customers as separate accounts for separate account customers pursuant to § 1.44 of this part shall:

(i) Calculate the total amount of futures customer funds on deposit in segregated accounts carried as separate accounts of separate account customers on behalf of such futures customers pursuant to paragraph (a)(1) of this section and the total amount of futures customer funds required to be on deposit in segregated accounts carried as separate accounts of separate account customers on behalf of such futures customers pursuant to paragraph (a)(2) of this section by including the separate accounts of the separate account customers as if the separate accounts were accounts of separate entities;

(ii) Offset a net deficit in a particular futures account carried as a separate account of a separate account customer in accordance with paragraph (b) of this section against the current market value of readily marketable securities held only for the particular separate account of such separate account customer; and

(iii) Document its segregation computation in the Statement of Segregation Requirements and Funds in Segregation of Customers Trading on U.S. Commodity Exchanges required by paragraph (c) of this section by incorporating and reflecting the futures accounts carried as separate accounts of separate account customers as accounts of separate entities.

6. Add § 1.44 to read as follows:

§ 1.44 Margin Adequacy and Treatment of Separate Accounts

(a) ***Definitions.*** These following definitions apply only for purposes of this section, except to the extent explicitly noted:

Account means a futures account as defined in § 1.3 of this part, a Cleared Swaps Customer Account as defined in § 1.3 of this part, or, a 30.7 account as defined in § 30.1 of this chapter.

Business day has the meaning set forth in § 1.3 of this part, with the clarification that "holiday" has the meaning defined in paragraph (a) of this section.

Holiday means Federal holidays as established by 5 U.S.C. 6103.

One business day margin call means a margin call that is issued and met in accordance with the requirements of paragraph (f) of this section.

Ordinary course of business means the standard day-to-day operation of the futures commission merchant's business relationship with its separate account customer. Events specified in paragraph (e) of this section are inconsistent with the ordinary course of business.

Separate account means any one of multiple accounts of the same separate account customer that are carried by the same futures commission merchant.

Separate account customer means a customer for which the futures commission merchant has made the election set forth in paragraph (d) of this section.

Undermargined amount for an account means the amount, if any, by which the customer margin requirements with respect to all products held in that account exceeds the net liquidating value plus the margin deposits currently remaining in that account. For purposes of this definition, "margin requirements" shall mean the level of maintenance margin or performance bond (including, as appropriate, the equity component or premium for long or short option positions) required for the positions in the account by the applicable exchanges or clearing organizations. With respect to positions for which maintenance margin is not specified, "margin requirements" shall refer to the clearing organization margin requirements applicable to such positions.

(b) ***Ensuring adequacy of customer initial margin.***

(1) A futures commission merchant shall ensure that a customer does not withdraw funds from its accounts with such futures commission merchant unless the net liquidating value (calculated as of the close of business on the previous business day) plus the margin deposits remaining in the customer's account after such withdrawal are sufficient to meet the customer initial margin requirements with respect to all products held in such customer's account, except as provided in paragraph (c) of this section.

(2) For the purposes of paragraph (1) above, where the previous day (excluding Saturdays and Sundays) is a holiday, as defined in § 1.44(a) of this chapter, where any designated contract market on which the futures commission merchant trades is open for trading, and where an account of any of the futures commission merchant's customers includes positions traded on such a market, the net liquidating value for such an account should instead be calculated as of the close of business on such holiday.

(c) ***Separate account treatment with respect to withdrawal of customer initial margin.*** A futures commission merchant may, only during the "ordinary course of business" as that term is defined in this section, treat the separate accounts of a separate account customer as accounts of separate entities for purposes of paragraph (b) of this section if such futures commission merchant elects to do so as specified in paragraph (d) of this section. A futures commission merchant that has made such an election shall comply with the requirements set forth in this section, and maintain written internal controls and procedures designed to ensure such compliance.

(d) ***Election to treat a customer's accounts as separate accounts.***

(1) To elect to treat the separate accounts of a customer as accounts of separate entities for purposes of paragraph (b) of this section, the futures commission merchant shall include the customer on a list of separate account customers maintained in its books and records. This list shall include the identity of each separate account customer, identify each separate account of such customer, and be kept current.

(2) The first time that the futures commission merchant includes a customer on the list of separate account customers, it shall, within one business day, provide notification of the election to allow separate account treatment for customers to its designated self-regulatory organization and to the Commission. The notice shall be provided in accordance with the process specified in paragraph 1.12(n)(3) of this part.

(e) ***Events inconsistent with the ordinary course of business.***

(1) The following events are inconsistent with the ordinary course of business with respect to the separate accounts of a particular separate account customer, and the occurrence of any such event would require the futures commission merchant to cease permitting disbursements on a separate account basis with respect to all accounts of the relevant separate account customer:

(i) The separate account customer, including any separate account of such customer, fails to deposit initial margin or maintain maintenance margin or make payment of variation margin or option premium as specified in paragraph (f) of this section.

(ii) The occurrence and declaration by the futures commission merchant of an event of default as defined in the account documentation executed between the futures commission merchant and the separate account customer.

(iii) A good faith determination by the futures commission merchant's chief compliance officer, one of its senior risk managers, or other senior manager, following such futures commission merchant's own internal escalation procedures, that the separate account customer is in financial distress, or there is significant and bona fide risk that the separate account customer will be unable promptly to perform its financial obligations to the futures commission merchant, whether due to operational reasons or otherwise.

(iv) The insolvency or bankruptcy of the separate account customer or a parent company of such customer.

(v) The futures commission merchant receives notification that a board of trade, a derivatives clearing organization, a self-regulatory organization as defined in § 1.3 of this part or § 3(a)(26) of the Securities Exchange Act of 1934, the Commission, or another regulator with jurisdiction over the separate account customer, has initiated an action with respect to such customer based on an allegation that the customer is in financial distress.

(vi) The futures commission merchant is directed to cease permitting disbursements on a separate account basis, with respect to the separate account customer, by a board of trade, a derivatives clearing organization, a self-regulatory organization, the Commission, or another regulator with jurisdiction over the futures commission

merchant, pursuant to, as applicable, board of trade, derivatives clearing organization or self-regulatory organization rules, government regulations, or law.

(2) The following events are inconsistent with the ordinary course of business with respect to the separate accounts of all separate account customers of the futures commission merchant, and the occurrence of any such event would require the futures commission merchant to cease permitting disbursements on a separate account basis with respect to any of its customers:

(i) The futures commission merchant is notified by a board of trade, a derivatives clearing organization, a self-regulatory organization, the Commission, or another regulator with jurisdiction over the futures commission merchant, that the board of trade, the derivatives clearing organization, the self-regulatory organization, the Commission, or other regulator, as applicable, believes the futures commission merchant is in financial or other distress.

(ii) The futures commission merchant is under financial or other distress as determined in good faith by its chief compliance officer, senior risk managers, or other senior management.

(iii) The insolvency or bankruptcy of the futures commission merchant or a parent company of the futures commission merchant.

(3) The futures commission merchant must provide notice to its designated self-regulatory organization and to the Commission of the occurrence of any of the events enumerated in paragraphs (e)(1) or (e)(2) of this section. The notice must identify the event and (if applicable) the customer, and be provided promptly in writing, and in any case no later than the next business day following the date on which the futures commission merchant identifies or has been informed that such event has occurred. Such notice must be provided in accordance with the process specified in paragraph 1.12(n)(3) of this part.

(4) A futures commission merchant that has ceased permitting disbursements on a separate account basis to a separate account customer due to the occurrence of any of the events enumerated in paragraph (e)(1) of this section with respect to a specific separate account customer (or in paragraph (e)(2) with respect to all of its separate account customers) may resume permitting disbursements on a separate account basis to that customer (or, respectively, all customers) if such futures commission merchant reasonably believes, based on new information, that those circumstances have been cured, and such futures commission merchant documents in writing the factual basis and rationale for that conclusion. If the circumstances triggering cessation of separate account treatment were an action or direction by one of the entities described in paragraphs (e)(1)(v) or (vi), or paragraph (e)(2)(i), of this section, then the cure of those circumstances would require the withdrawal or other appropriate termination of such action or direction by that entity.

(f) ***Requirements: One business day margin call.*** Each separate account must be on a one business day margin call. The following provisions apply solely for purposes of this paragraph (f):

(1) Except as explicitly provided in this paragraph (f), if, as a result of market movements or changes in positions on the previous business day, a separate account is undermargined (*i.e.*, the undermargined amount for that account is greater than zero), the futures commission merchant shall issue a margin call for the separate account for at least the amount necessary for the separate account to meet the initial margin required by the applicable exchanges or clearing organizations (including, as appropriate, the equity component or premium for long or short option positions) for the positions in the separate account, and that call must be met by the applicable separate account customer no later than the close of the Fedwire Funds Service on the same business day.

(2) Payment of margin in currencies listed in Appendix A to this part shall be considered in compliance with the requirements of this paragraph (f) if received by the applicable futures commission merchant no later than the end of the second business day after the day on which the margin call is issued.

(3) Payment of margin in fiat currencies other than U.S. Dollars, Canadian Dollars, or currencies listed in Appendix A to this part shall be considered in compliance with the requirements of this paragraph (f) if received by the applicable futures commission merchant no later than the end of the business day after the day on which the margin call is issued.

(4) The relevant deadline for payment of margin in fiat currencies other than U.S. Dollars may be extended by up to one additional business day and still be considered in compliance with the requirements of this paragraph (f) if payment is delayed due to a banking holiday in the jurisdiction of issue of the currency. For payments in Euro, either the separate account customer or the investment manager managing the separate account may designate one country within the Eurozone that they have the most significant contacts with for purposes of meeting margin calls in that separate account, whose banking holidays shall be referred to for this purpose.

(5) A failure with respect to a specific separate account to deposit, maintain, or pay margin or option premium that was called pursuant to paragraph (f)(1) of this section, due to unusual administrative error or operational constraints that a separate account customer or investment manager acting diligently and in good faith could not have reasonably foreseen, does not constitute a failure to comply with the requirements of this paragraph (f). For these purposes, a futures commission merchant's determination that the failure to deposit, maintain, or pay margin or option premium is due to such administrative error or operational constraints must be based on the futures commission merchant's reasonable belief in light of information known to the futures commission

merchant at the time the futures commission merchant learns of the relevant administrative error or operational constraint.

(6) A futures commission merchant would not be in compliance with the requirements of this paragraph (f) if it contractually agrees to provide separate account customers with periods of time to meet margin calls that extend beyond the time periods specified in paragraph (f)(1) through (5) of this section, or engages in practices that are designed to circumvent this paragraph (f).

(7) In the case of a holiday where any designated contract market on which the futures commission merchant trades is open for trading, and where a separate account of any of the futures commission merchant's separate account customers includes positions traded on such a market, then for any such separate account:

(i) If, as a result of market movements or changes in positions on the business day before the holiday, a separate account is undermargined, the futures commission merchant shall issue a margin call for the separate account for at least the undermargined amount, and that call must be met by the applicable separate account customer no later than the close of the Fedwire Funds Service on the next business day after the holiday, and,

(ii) If, as a result of market movements or changes in positions on the holiday, a separate account is undermargined by an amount greater than the amount it was undermargined as a result of market movements or changes in positions on the business day before the holiday, the futures commission merchant shall issue a margin call for the separate account for at least the incremental undermargined amount, and that call must be met by the applicable separate account customer no later than the close of the Fedwire Funds Service on the next business day after the holiday.

(8) Any person may submit to the Commission any currency that such person proposes should be added to or removed from Appendix A to this part.

(i) A submission pursuant to this paragraph (f)(8) shall include:

(A) A statement that margin payments in the relevant currency cannot, in the case of a proposed addition, or can, in the case of a proposed removal, practicably be received by the futures commission merchant issuing a margin call no later than the end of the first business day after the day on which the margin call is issued;

(B) Documentation or other information sufficient to support the statement contemplated by paragraph (f)(8)(i)(A) of this section; and

(C) Any additional information specifically requested by the Commission.

(ii) A submitter pursuant to paragraph (f)(8)(i) of this section that wishes to request confidential treatment for portions of its submission may do so in accordance with the procedures set out in § 145.9(d) of this chapter.

(iii) The Commission shall review a submission made pursuant to paragraph (f)(8) of this section and determine whether to propose to add the relevant currency to, or remove the relevant currency from, Appendix A to this part.

(iv) If the Commission proposes to add a currency to or remove a currency from Appendix A to this part, the Commission shall issue such determination through notice and comment rulemaking, and shall provide a public comment period of no less than thirty days.

(v) The Commission may, of its own accord and absent a submission pursuant to paragraph (f)(8) of this section, propose to issue a determination to add a currency to or remove a currency from Appendix A to this part pursuant to the procedure set forth in paragraph (f)(8)(iv) of this section.

(g) ***Requirements: Calculations for capital, risk management, and segregation.***

(1) The futures commission merchant's internal risk management policies and procedures shall provide for stress testing and credit limits as set forth in § 1.73 of this part for separate account customers. Such stress testing must be performed, and the credit

limits must be applied, both on an individual separate account and on a combined account basis.

(2) A futures commission merchant shall calculate the margin requirement for each separate account of a separate account customer independently from such margin requirement for all other separate accounts of the same customer with no offsets or spreads recognized across the separate accounts.

(3) A futures commission merchant shall, in computing its adjusted net capital for purposes of § 1.17 of this part, record each separate account of a separate account customer in the books and records of the futures commission merchant as a distinct account of a customer. This includes recording each separate account with a net debit balance or a deficit as a receivable from the separate account customer, with no offsets between the other separate accounts of the same separate account customer.

(4) A futures commission merchant shall, in calculating the amount of its own funds it is required to maintain in segregated accounts to cover deficits or debit ledger balances pursuant to §§ 1.20(i), 22.2(f), or 30.7(f)(2) of this chapter in any futures customer accounts, Cleared Swaps Customer Accounts, or 30.7 accounts, respectively, include any deficits or debit ledger balances of any separate accounts as if the accounts are accounts of separate entities.

(5) For purposes of its residual interest and legally segregated operationally commingled compliance calculations, as applicable under §§ 1.22(c), 22.2(f)(6), and 30.7(f)(1)(ii) of this chapter, a futures commission merchant shall treat the separate accounts of a separate account customer as if the accounts were accounts of separate entities and include the undermargined amount of each separate account, and cover such undermargined amount with its own funds.

(6) In determining its residual interest target for purposes of §§ 1.11(e)(3)(i)(D) and 1.23(c) of this part, the futures commission merchant must consider the impact of

calculating customer receivables for separate account customers on a separate account basis.

(h) ***Requirements: information and disclosures.***

(1) A futures commission merchant shall obtain from each separate account customer or, as applicable, the manager of a separate account, information sufficient for the futures commission merchant to:

(i) Assess the value of the assets dedicated to such separate account; and

(ii) Identify the direct or indirect parent company of the separate account customer, as applicable, if such customer has a direct or indirect parent company.

(2) Where a separate account customer has appointed a third-party as the primary contact to the futures commission merchant, the futures commission merchant must obtain and maintain current contact information of an authorized representative at the customer, and take reasonable steps to verify that such contact information is and remains accurate, and that the person is in fact an authorized representative of the customer.

(3) A futures commission merchant must provide each separate account customer a disclosure that, pursuant to part 190 of the Commission's regulations, all separate accounts of the customer in each account class will be combined in the event of the futures commission merchant's bankruptcy.

(i) The disclosure statement required by this paragraph (h)(3) must be delivered directly to the customer via electronic means, in writing or in such other manner as the futures commission merchant customarily delivers disclosures pursuant to applicable Commission regulations, and as permissible under the futures commission merchant's customer documentation.

(ii) The futures commission merchant must maintain documentation demonstrating that the disclosure statement required by this paragraph (h)(3) was delivered directly to the customer.

(iii) The futures commission merchant must include the disclosure statement required by this paragraph (h)(3) on its website or within its Disclosure Document required by paragraph 1.55(i) of this chapter.

(4) A futures commission merchant that has made an election pursuant to paragraph (d) of this section shall disclose in the Disclosure Document required under paragraph 1.55(i) of this part that it permits the separate treatment of accounts for the same customer under the terms and conditions of this § 1.44 and that, in the event that separate account treatment for some customers were to contribute to a loss that exceeds the futures commission merchant's ability to cover, that loss may affect the segregated funds of all of the futures commission merchant's customers in one or more account classes.

(i) A futures commission merchant that applies separate account treatment pursuant to this section shall apply such treatment in a consistent manner over time. If the election pursuant to paragraph (d) of this section for a separate account customer is revoked, it may not be reinstated during the 30 days following such revocation.

7. Amend § 1.58 by revising paragraphs (a) and (b) and adding new paragraph (c) as follows:

§ 1.58 Gross collection of exchange-set margins.

(a) Each futures commission merchant which carries a futures, options on futures, or Cleared Swaps position for another futures commission merchant or for a foreign broker on an omnibus basis must collect, and each futures commission merchant and foreign broker for which an omnibus account is being carried must deposit, initial and maintenance margin on each position so carried at a level no less than that established for customer accounts by the rules of the applicable contract market or other board of trade. If the contract market or other board of trade does not specify any such margin level, the level required will be that specified by the relevant clearing organization.

(b) If the futures commission merchant which carries a futures, options on futures, or Cleared Swaps position for another futures commission merchant or for a foreign broker on an omnibus basis allows a position to be margined as a spread position or as a hedged position in accordance with the rules of the applicable contract market, the carrying futures commission merchant must obtain and retain a written representation from the futures commission merchant or from the foreign broker for which the omnibus account is being carried that each such position is entitled to be so margined.

(c) Where a futures commission merchant has established an omnibus account that is carried by another futures commission merchant, and the depositing futures commission merchant has elected to treat the separate accounts of a futures customer or a Cleared Swaps Customer as accounts of separate entities for purposes of § 1.44 of this part, the depositing futures commission merchant shall calculate the required initial and maintenance margin for purposes of paragraph (a) of this section separately for each such separate account.

8. Amend § 1.73 by adding new paragraph (c) as follows:

§ 1.73 Clearing futures commission merchant risk management.

* * * * *

(c) A futures commission merchant that is not a clearing member of a derivatives clearing organization, but that treats the separate accounts of a customer as accounts of separate entities for purposes of § 1.44 of this part, shall comply with paragraphs (a) and (b) of this section with respect to the accounts and separate accounts of separate account customers as if it was a clearing member of a derivatives clearing organization.

9. Add new Appendix A to Part 1 to read as follows:

Appendix A to Part 1 – Treatment of Certain Foreign Currencies for Margin Adequacy Requirements under Regulation 1.44

Payment of margin in currencies listed in Table 1 of this Appendix A shall be considered in compliance with the requirements of Regulation 1.44(f) of Part 1 of the Commission's regulations if received by the applicable futures commission merchant no later than the end of the second business day after the day on which the margin call is issued.

Table 1 to Appendix A
Currency
Australian dollar (AUD)
Chinese renminbi (CNY)
Hong Kong dollar (HKD)
Hungarian forint (HUF)
Israeli new shekel (ILS)
Japanese yen (JPY)
New Zealand dollar (NZD)
Singapore dollar (SGD)
South African rand (ZAR)
Turkish lira (TRY)

PART 22—CLEARED SWAPS

10. The authority citation for part 22 continues to read as follows:

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

11. Amend § 22.2 by

a. Republishing the paragraph heading of paragraph (f);

b. Revising paragraphs (f)(4) and (5);

c. Republishing the paragraph heading of paragraph (g); and

d. Adding new paragraph (g)(11).

The republications, revisions, and additions read as follows:

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

* * * * *

(f) **Requirement as to amount**.

* * * * *

(4) The futures commission merchant must, at all times, maintain in segregation, in its FCM Physical Locations and/or its Cleared Swaps Customer Accounts at Permitted Depositories, an amount equal to the sum of any credit and debit balances that the Cleared Swaps Customers of the futures commission merchant have in their accounts. Notwithstanding the above, a futures commission merchant must add back to the total amount of funds required to be maintained in segregation any Cleared Swaps Customer Accounts with debit balances in the amounts calculated in accordance with paragraph (5) of this section.

(5) The futures commission merchant, in calculating the total amount of funds required to be maintained in segregation pursuant to paragraph (f)(4) of this section, must include any debit balance, as calculated pursuant to this paragraph (f)(5), that a Cleared Swaps Customer has in its account, to the extent that such debit balance is not secured by "readily marketable securities" that the particular Cleared Swaps Customer deposited with the futures commission merchant.

(i) For purposes of calculating the amount of a Cleared Swaps Customer Account's debit balance that the futures commission merchant is required to include in its calculation of its total segregation requirement pursuant to this paragraph (f)(5), the futures commission merchant shall calculate the net liquidating equity of each Cleared Swaps Customer Account in accordance with paragraph (f)(2) of this section, except that the futures commission merchant shall exclude from the calculation any noncash collateral held in the Cleared Swaps Customer Account as margin collateral. The futures commission merchant may offset the debit balance computed under this paragraph (f)(5) to the extent of any "readily marketable securities," subject to percentage deductions (*i.e.*, "securities haircuts") as specified in paragraph (f)(5)(iv) of this section, held for the particular Cleared Swaps Customer to secure its debit balance.

(ii) 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).

(iii) 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.

(iv) To determine the amount of such debit balance 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). Futures commission merchants that establish and enforce written policies and procedures to assess the credit risk of commercial paper, convertible debt instruments, or nonconvertible debt instruments in

accordance with Rule 240.15c3–1(c)(2)(vi) of the Securities and Exchange Commission (§ 240.15c3–1(c)(2)(vi) of this title) may apply the lower haircut percentages specified in Rule 240.15c3–1(c)(2)(vi) for such commercial paper, convertible debt instruments and nonconvertible debt instruments.

* * * * *

(g) ***Segregated account; Daily computation and record.***

* * * * *

(11) A futures commission merchant that carries Cleared Swaps Accounts for Cleared Swaps Customers as separate accounts for separate account customers pursuant to § 1.44 of this chapter shall:

(i) Calculate the total amount of Cleared Swaps Customer Collateral on deposit in segregated accounts on behalf of Cleared Swaps Customers pursuant to paragraph (g)(1)(i) of this section and the total amount of Cleared Swaps Customer Collateral required to be on deposit in segregated accounts on behalf of Cleared Swaps Customers pursuant to paragraph (g)(1)(ii) of this section by including the separate accounts of the separate account customers as if the separate accounts were accounts of separate entities;

(ii) Offset a net deficit in a particular Cleared Swaps Customer Account carried as a separate account of a separate account customer in accordance with paragraphs (f)(4) and (5) and (g)(1)(ii) of this section against the current market value of readily marketable securities held only for the particular separate account of such separate account customer; and

(iii) Document its segregation computation in the Statement of Cleared Swaps Customer Segregation Requirements and Funds in Cleared Swaps Customer Accounts under 4d(f) of the CEA required by paragraph (g)(2) of this section by incorporating and reflecting the Cleared Swaps Customer Accounts carried as separate accounts of separate account customers as accounts of separate entities.

PART 30—FOREIGN FUTURES AND FOREIGN OPTIONS TRANSACTIONS

12. The authority citation for part 30 continues to read as follows:

Authority: 7 U.S.C. 1a, 2, 6, 6c, and 12a, unless otherwise noted.

13. Amend § 30.2 by revising paragraph (b) to read as follows:

§ 30.2 Applicability of the Act and rules.

* * * * *

(b) The provisions of §§ 1.20 through 1.30, 1.32, 1.35(a)(2) through (4) and (c) through (i), 1.36(b), 1.38, 1.39, 1.40, 1.45 through 1.51, 1.53, 1.54, 1.55, 1.58, 1.59, 33.2 through 33.6 and parts 15 through 20 of this chapter shall not be applicable to the persons and transactions that are subject to the requirements of this part.

14. Amend § 30.7 by:

a. Republishing the paragraph heading of paragraph (f);

b. Republishing the paragraph heading of paragraph (f)(2);

c. Revising paragraph (f)(2)(iv);

d. Adding paragraph (f)(2)(v);

e. Republishing the paragraph heading of paragraph (l); and

f. Adding paragraph (l)(11).

The republications, revisions, and additions read as follows:

§ 30.7 Treatment of foreign futures or foreign options secured amount.

* * * * *

(f) ***Limitations on use of 30.7 customer funds.***

* * * * *

(2) **Requirements as to amount.**

* * * * *

(iv) The futures commission merchant must, at all times, maintain in segregation an amount equal to the sum of any credit and debit balances that 30.7 customers of the futures commission merchant have in their accounts. Notwithstanding the above, a futures commission merchant must add back to the total amount of funds required to be maintained in segregation any 30.7 accounts with debit balances in the amounts calculated in accordance with paragraph (f)(2)(v) of this section.

(v) The futures commission merchant, in calculating the total amount of funds required to be maintained in segregation pursuant to paragraph (f)(2)(iv) of this section, must include any debit balance, as calculated pursuant to this paragraph (f)(2)(v), that a 30.7 customer has in its account, to the extent that such debit balance is not secured by "readily marketable securities" that the particular 30.7 customer deposited with the futures commission merchant..

(A) For purposes of calculating the amount of a 30.7 account's debit balance that the futures commission merchant is required to include in its calculation of its total segregation requirement pursuant to this paragraph (f)(2)(v), the futures commission merchant shall calculate the net liquidating equity of each 30.7 account in accordance with paragraph (f)(2)(ii) of this section, except that the futures commission merchant shall exclude from the calculation any noncash collateral held in the 30.7 account as margin collateral. The futures commission merchant may offset the debit balance computed under this paragraph (f)(2)(v) to the extent of any "readily marketable securities," subject to percentage deductions (*i.e.*, "securities haircuts") as specified in paragraph (f)(2)(v)(D) of this section, held for the particular 30.7 customer to secure its debit balance.

(B) 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).

(C) 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.

(D) To determine the amount of such debit balance secured by "readily marketable securities." To do so, the futures commission merchant shall:

(1) Determine the market value of such securities; and

(2) Reduce such market value by applicable percentage deductions (*i.e.*, "securities haircuts") as set forth in Rule 15c3–1(c)(2)(vi) of the Securities and Exchange Commission (§ 240.15c3–1(c)(2)(vi) of this title). Futures commission merchants that establish and enforce written policies and procedures to assess the credit risk of commercial paper, convertible debt instruments, or nonconvertible debt instruments in accordance with Rule 240.15c3–1(c)(2)(vi) of the Securities and Exchange Commission (§ 240.15c3–1(c)(2)(vi) of this title) may apply the lower haircut percentages specified in Rule 240.15c3–1(c)(2)(vi) for such commercial paper, convertible debt instruments and nonconvertible debt instruments.

* * * * *

(l) ***Daily computation of 30.7 customer secured amount requirement and details regarding the holding and investing of 30.7 customer funds.***

* * * * *

(11) A futures commission merchant that carries 30.7 accounts for 30.7 customers as separate accounts for separate account customers pursuant to § 1.44 of this chapter shall:

(i) Calculate the total amount of 30.7 customer funds on deposit in 30.7 accounts on behalf of 30.7 customers pursuant to paragraph (l)(1) of this section and the total amount of 30.7 customer funds required to be on deposit in segregated accounts on behalf

of 30.7 customers pursuant to paragraph (l)(1) of this section by including the separate accounts of the separate account customers as if the separate accounts were accounts of separate entities;

(ii) Offset a net deficit in a particular 30.7 account carried as a separate account of a separate account customer in accordance with this paragraph (l) against the current market value of readily marketable securities held only for the particular separate account of such separate account customer; and

(iii) Document its segregation computation in the Statement of Secured Amounts and Funds Held in Separate Accounts for 30.7 Customers pursuant to Commission Regulation 30.7 required by paragraph (l)(3) of this section by incorporating and reflecting the 30.7 accounts carried as separate accounts of separate account customers as accounts of separate entities.

PART 39—DERIVATIVES CLEARING ORGANIZATIONS

15. The authority citation for part 39 continues to read as follows:

Authority: 7 U.S.C. 2, 6(c), 7a–1, and 12a(5); 12 U.S.C. 5464; 15 U.S.C. 8325; Section 752 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. 111–203, title VII, sec. 752, July 21, 2010, 124 Stat. 1749.

16. Amend § 39.13 by:

a. Republishing the paragraph heading of paragraph (g);

b. Republishing the paragraph heading of paragraph (g)(8);

c. Adding paragraph (g)(8)(i)(E); and

d. Revising paragraph (g)(8)(iii).

The republications, addition and revision to read as follows:

§ 39.13 Risk management.

* * * * *

(g) **Margin requirements –**

* * * * *

(8) Customer margin –

(i) * * *

(E) For purposes of this paragraph (g)(8)(i), each separate account of a separate account customer (as such terms are defined in § 1.44 of this chapter) shall be treated as an account of a separate individual customer.

* * * * *

(iii) ***Withdrawal of customer initial margin.*** A derivatives clearing organization shall require its clearing members to ensure that their customers do not withdraw funds from their accounts with such clearing members unless the net liquidating value plus the margin deposits remaining in a customer's account after such withdrawal are sufficient to meet the customer initial margin requirements with respect to all products and swap portfolios held in such customer's account which are cleared by the derivatives clearing organization, except as provided for in § 1.44 of this chapter.

* * * * *

Issued in Washington, DC on February 23, 2024, by the Commission.

Robert Sidman,

Deputy Secretary of the Commission.

NOTE: The following appendices will not appear in the Code of Federal Regulations.

Appendices to Regulations to Address Margin Adequacy and to Account for the Treatment of Separate Accounts by Futures Commission Merchants—Commission Voting Summary and Chairman's and Commissioners' Statements

Appendix 1—Commission Voting Summary

On this matter, Chairman Behnam and Commissioners Goldsmith Romero, Mersinger, and Pham voted in the affirmative. Commissioner Johnson voted to concur. No Commissioner voted in the negative.

Appendix 2—Statement of Commissioner Kristin N. Johnson

Introduction

The Commodity Futures Trading Commission (Commission or CFTC) has adopted several key regulations that establish guardrails to protect against the misuse or misapplication of customer funds. The Commodity Exchange Act (CEA) and Commission regulations establish critical protections for customers to help prevent them from losing money as a result of losses caused by their futures commission merchant (FCM) or their fellow customers at the FCM. These include Sections 4 and 4d of the CEA and Parts 1, 22, and 30 of the Commission regulations, which require an FCM to segregate its own funds from those of its customers and prohibit an FCM from using one customer's funds to cover the losses of another.

A foundational principle of the Commission's customer protection regime is a prohibition against the use of one customer's funds to cover the liabilities of another customer. It is difficult to overstate the importance of regulations that prevent this kind of misuse, particularly when customer funds are commingled in a single omnibus account. The Commission must not weaken regulations intended to reinforce these protections. Determining whether a regulation might result in weakening these protections requires careful qualitative and quantitative assessment and evaluation of (un)anticipated risks and thoughtful reinforcement of robust risk management requirements.

The Commission is amending an existing customer protection provision under CFTC Regulation 39.13(g)(8)(iii). This regulation establishes a margin adequacy requirement by prohibiting the withdrawal of funds by a customer of a clearing FCM if such withdrawal would result in the account being undermargined. The purpose of

Commission Regulation 39.13(g)(8)(iii) is to mitigate the risk that a clearing member, using an omnibus margin account, fails to hold sufficient funds from one customer to cover that customer's initial margin requirements and effectively covers the customer's margin shortfall using another customer's funds.

The proposed amendment would codify the requirements of CFTC Regulation 39.13(g)(8)(iii) in Part 1 of the Commission's regulations governing FCMs, thus extending the requirements to non-clearing FCMs as well, but would permit an FCM to treat the separate accounts of a single customer, or beneficial owner, as accounts of separate entities, subject to certain risk-mitigation conditions (Proposed Rule).[1] This amendment thus allows disbursements on a separate account basis such that a customer may withdraw funds from one account even if its other account is undermargined, so long as the customer is in compliance with the relevant risk-management conditions.

It is indisputable that the Proposed Rule introduces risks that do not exist under CFTC Regulation 39.13(g)(8)(iii). Permitting a customer to withdraw "excess" margin from one account when it has insufficient margin in another account could exacerbate the customer's overall margin deficiency and any shortfall in the FCM's customer account, amplify default risk, and increase fellow-customer risk. Prior to finalizing this rule, it is imperative that the Commission understand the potential risks that may arise by permitting disbursements on a separate account basis.

Customer asset protections are essential to the individuals and institutional businesses whose assets are held by an intermediary and therefore may be at risk. As I have stated previously,

> creating and enforcing effective, well-tailored rules governing the custody, investment, and preservation of customer funds must be among the

[1] This would permit non-clearing FCMs to engage in separate account treatment and would allow FCMs, rather than DCOs, to determine whether or not to permit their customers to elect such treatment.

> Commission's highest priorities. Without these rules and rigorous enforcement, our markets would lack the foundation of trust upon which every transaction is built.[2]

I am supportive of careful, well-tailored, workable, and practical regulations that do not undermine or weaken customer protection. I strongly believe that the Commission would have benefited from a formal report detailing relevant risk management concerns that may arise as a result of introducing the Proposed Rule. Among other issues outlined below, the Commission would benefit from receiving data and analysis that details the potential risk management consequences attendant to adopting the Proposed Rule as well as any related measures that may mitigate risk management concerns.

Before adopting a final rule, the Commission, through supporting data and analyses, must assure itself that the Proposed Rule accomplishes the customer protection and risk management goals of regulation 39.13(g)(8)(iii).

Call for Supporting Risk Management Data and Analyses

The Commission is amending CFTC Regulation 39.13(g)(8)(iii) to permit disbursements on a separate accounts basis, subject to certain risk-mitigating conditions.

As I have said before, permitting disbursements on a separate accounts basis is inconsistent with the plain language of CFTC Regulation 39.13(g)(8)(iii), which was adopted by the Commission following the 2008-2009 financial crisis pursuant to the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act), and introduces new or additional risks. I am, however, supportive of solutions that are grounded in data and analyses demonstrating that an amendment to CFTC Regulation 39.13(g)(8)(iii) achieves the same goals and objectives underpinning this regulation.

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[2] Kristin N. Johnson, Commissioner, CFTC, Statement on Preserving Trust and Preventing the Erosion of Customer Protection Regulation (Nov. 3, 2023), *https://www.cftc.gov/PressRoom/SpeechesTestimony/johnstatement110323*.

It would be helpful, in the context of evaluating the Proposed Rule, to have a sufficiently robust analysis of the sufficiency and adequacy of the risk-mitigating measures that have been in place since 2019.

The Commission should conduct a study to assess any additional risks and the scope and magnitude of such risks. Alongside a formal report offering a data-driven analysis, commentators should include comprehensive analyses and evidence indicating that the adoption of the Proposed Rule does not increase risks to our markets, or, if there are increased risks, that the risk-mitigation measures adopted by the Commission are effective. We also welcome feedback on other measures to ensure that FCMs maintain robust risk-management practices.

Margin Adequacy Requirement

In order to register, and maintain registration, as a derivatives clearing organization (DCO), a clearinghouse must demonstrate the ability, and continue, to comply with the core principles for DCOs set forth in Section 5b of the CEA. The core principles were added to the CEA by the Commodity Futures Modernization Act of 2000 (CFMA). In implementing the CFMA, the Commission did not adopt implementing rules and regulations, but instead promulgated guidance for DCOs on compliance with the core principles.

Section 725(c) of the Dodd-Frank Act amended Section 5b(c)(2) of the CEA to expressly confirm that the Commission may adopt implementing rules and regulations pursuant to its rulemaking authority under Section 8a(5) of the CEA.

The Commission adopted CFTC Regulation 39.13(g)(8)(iii) in 2011. The adoption was part of a broader rulemaking to implement certain provisions of the Dodd-Frank Act governing the activities of DCOs, including Core Principle D—risk management—requiring each DCO to ensure that its risk management framework is sufficient to manage the risks associated with discharging the responsibilities of a DCO

through the use of appropriate tools and procedures. CFTC regulations require DCOs to collect initial margin from their customers on a gross basis, even if customer collateral is held in an omnibus account.

Under CFTC Regulation 39.13(g)(8)(iii), a DCO must require "its clearing members to ensure that their customers do not withdraw funds from their accounts with such clearing members unless the net liquidating value plus the margin deposits remaining in a customer's account after such withdrawal are sufficient to meet the customer initial margin requirements with respect to all products and swap portfolios held in such customer's account which are cleared by the derivatives clearing organization."[3]

The purpose of this regulation is to mitigate the risk that a clearing member, using an omnibus margin account, fails to hold sufficient funds from one customer to cover such customer's initial margin requirements and effectively covers such customer's margin shortfall using another customer's funds.

In the Preamble to the Proposed Rule, the Commission recognizes,

> [i]n light of the use of omnibus margin accounts, where the funds of multiple customers are held together, this safeguard is necessary to "avoid the misuse of customer funds" by mitigating the likelihood that the clearing member will effectively cover one customer's margin shortfall using another customer's funds.[4]

An omnibus account structure creates a potential dilution of the pool of funds available to U.S. customers in the event of a bankruptcy of the FCM to the extent the FCM's customer account is undermargined. In a bankruptcy proceeding, customer property is distributed *pro rata* and so all customers share in any shortfall in the customer account of a particular class.

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[3] 17 CFR 39.13 (g)(8)(iii).

[4] Regulations to Address Margin Adequacy and to Account for the Treatment of Separate Accounts by Futures Commission Merchants (Voting Draft) at 7.

Concerns with Separate Accounts

In 2019, the Joint Audit Committee (JAC) issued a regulatory alert providing an interpretation of the requirements of CFTC Regulation 39.13(g)(8)(iii).[5] Under the JAC's interpretation, separate accounts of the same customer were to be combined for the purpose of determining the amount of margin funds available for disbursement from any of the accounts.

This interpretation was inconsistent with the prevailing practices, including as documented under customer agreements, among FCMs, and FCM customers with respect to the treatment of separate accounts.

FCMs would establish separate accounts for customers for commercial purposes. For example, "such accounts are: (i) separately contracted for with different asset management firms; (ii) established as a separate investment portfolio within the same asset management firm; (iii) established by a commercial entity for the purpose of a commodity or margin financing arrangement and secured by the lender as a secondary security interest; or (iv) necessary to separately account for or settle obligations of separate branches established pursuant to separate legal/country jurisdictions."[6] Although separate accounts may be owned by the same customer or beneficial owner, FCMs did not combine those accounts for margin purposes.

In response to the JAC's interpretation, several industry trade associations requested that the Commission provide time limited no-action relief with respect to the treatment of separate accounts by FCMs.[7] Specifically, they requested that the Commission interpret Commission Regulation 39.13(g)(8)(iii) to permit separate

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[5] *See* JAC, Regulatory Alert #19-02 (May 14, 2019), *http://www.jacfutures.com/jac/jacupdates/2019/jac1902.pdf*.

[6] *See*, *e.g.*, Letter from SIFMA AMG to Brain A. Bussey, Dir. at Div. of Clearing and Risk, CFTC, & Matthew B. Kulkin, Dir. at Div. of Swap Dealer and Intermediary Oversight, CFTC (June 7, 2019), *https://www.sifma.org/wp-content/uploads/2021/01/Request-for-Interpretation-Rule-1.56b-and-Rule-39.131.pdf*.

[7] *Id.*

accounts of the same customer to "be treated as separate legal entities" therefore not combined when determining an account's margin funds available for disbursement."[8]

The separate account treatment permits margin to be withdrawn from one account of a customer while another account of that same customer faces a margin call, it creates the risk that a customer will withdraw funds from the account in surplus and then later default on the margin call, leaving the FCM with fewer resources to cover the resulting losses.

Separate Account Treatment

In 2019, the Commission issued a time-limited, temporary no-action letter that permitted disbursements on a separate account basis, subject to certain conditions that mitigate the risk of default and strengthen an FCM's risk-management of customers granted separate account treatment. The Commission aimed to achieve the customer protection and risk management goals of CFTC Regulation 39.13(g)(8)(iii).

In 2023, the Commission approved a proposed rule to codify, in Part 39 governing DCOs, the staff no-action position regarding the treatment of separate accounts of a single customer by an FCM that is a clearing member of a DCO. In April 2023, the Commission published in the Federal Register a notice of proposed rulemaking that would codify the no-action letter.

Following comments to the proposed rule supporting direct application of separate account treatment to FCMs (both clearing and non-clearing), the Commission proposes to withdraw the original proposal in favor of the Proposed Rule.[9]

The Proposed Rule codifies (with important changes, including the establishment of a margin adequacy requirement applicable to clearing and non-clearing FCMs and increased specificity in the one-day margin requirement) the existing no-action position

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[8] *Id.*

[9] This would permit non-clearing FCMs to engage in separate account treatment and would allow FCMs, rather than DCOs, to determine whether or not to permit their customers to elect such treatment.

under which FCMs are permitted to treat different accounts of the same beneficial owner as separate accounts for purposes of permitting margin withdrawals.

Sufficiency of Risk-Mitigation Conditions

The Proposed Rule permits separate account treatment subject to risk-management standards. The customer protections built into this Proposed Rule help to mitigate the risk that it creates, particularly by requiring customers receiving separate account treatment to meet margin calls the same day they are made (referred to as the one-day margin requirement), and requiring separate account treatment to cease when the customer or the FCM is no longer operating in the ordinary course of business. In many ways, the enhanced requirements for FCMs to maintain internal controls and policies and procedures designed to ensure compliance with the Proposed Rule strengthen the risk-management compliance practices of FCMs.

One-day margin requirement. Under the one-day margin requirement, a separate account customer must meet any margin call by the close of the Fedwire Funds Service on the same day.[10] This requirement is subject to enumerated exemptions, including for payments in certain foreign currencies where the mechanics of international payment systems would make compliance with the one-day margin requirement impractical.[11]

Ordinary course of business. Under the Proposed Rule, separate account treatment for a customer would cease if the customer or its FCM ceased operating in the ordinary course of business—the day-to-day operation of the FCM's relationship with its customer.[12] These events include a failure to meet the one-day margin call as well as an event of default, financial distress, other distress, insolvency, bankruptcy, or an inability

[10] *See e.g.*, Proposed 17 CFR 1.44(f).
[11] *Id.*
[12] *See e.g.*, Proposed 17 CFR 1.44(c).

to perform financial obligations. These events are standard across all FCMs that elect separate account treatment.[13]

These two requirements work together to mitigate the risk of default by a customer that benefits from separate account treatment. The ordinary course of business standard works to prevent an insolvent or soon-to-be insolvent beneficial owner from continuing to receive separate account treatment. And the one-day margin requirement creates a cap on the amount of time during which an insolvent or soon-to-be insolvent beneficial owner could take funds out of one account while failing to meet a margin call for another account.

Conclusion

As I have previously noted,

> [s]ince the earliest days of federal prudential and market regulation in our nation, thought leaders have advocated for regulation that preserves customer assets held by others. In his book published in 1914—*Other People's Money*—former Supreme Court Justice Louis Brandeis advocated for similar reforms that safeguard the assets of financial markets customers.[14]

Under the CEA, the Commission is directed to "protect all market participants from … misuses of customer assets."[15] For these reasons articulated above, I concur with the Proposed Rule.

The final rule addressing these issues, however, must be supported by data and analyses indicating the potential risks arising from the Proposed Rule and how such risks will be managed. I look forward to comments on this Proposed Rule, particularly

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[13] *See e.g.*, Proposed 17 CFR 1.44(e).
[14] Kristin N. Johnson, Commissioner, CFTC, Statement on Closing a Gap, Preserving Market Integrity and Protecting Clearing Member Funds Held by Derivatives Clearing Organizations (Dec. 18, 2023), *https://www.cftc.gov/PressRoom/SpeechesTestimony/johnsonstatement121823b*.
[15] 7 U.S.C. 5(b).

comments that demonstrate the sufficiency or adequacy of the risk-mitigation conditions in the Proposed Rule.

I would like to thank the staff of the Division of Clearing and Risk for their thoughtful work on this rule and for their willingness to incorporate feedback from my office into the proposed amendments published today.

Appendix 3—Statement of Support of Commissioner Caroline D. Pham

I support the Notice of Proposed Rulemaking on the Regulations to Address Margin Adequacy and to Account for the Treatment of Separate Accounts by Futures Commission Merchants (FCMs) (Treatment of Separate Accounts Proposal or NPRM), as well as the Commission's withdrawal of the first proposal on this issue (2023 Proposal).[1] Today's Treatment of Separate Accounts Proposal gets the Commission closer to the pragmatic approach it was striving for in the 2023 Proposal. To help ensure the Commission truly gets there in the final rule, I highlight specific areas for public comment below.

I would like to thank Daniel O'Connell and Bob Wasserman in the Division of Clearing and Risk, and Jennifer Bauer and Joshua Beale in the Market Participants Division, for their work on the NPRM. I appreciate the staff's generosity with their time for briefings and answering questions, as well as working with me to make revisions to address my concerns.

As the Treatment of Separate Accounts Proposal explains, two of the fundamental purposes of the Commodity Exchange Act (CEA) are the avoidance of systemic risk and the protection of market participants from misuses of customer assets.[2] Regulation

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[1] The Commission's first proposal on the matter was in April 2023. *See* Derivatives Clearing Organization Risk Management Regulations to Account for the Treatment of Separate Accounts by Futures Commission Merchants, 88 FR 22934 (Apr. 14, 2023) (2023 Proposal), *https://www.federalregister.gov/documents/2023/04/14/2023-06248/derivatives-clearing-organization-risk-management-regulations-to-account-for-the-treatment-of*.

[2] CEA section 4d(a)(2) Regulation 1.20(a) require an FCM to separately account for and segregate from its own funds all money, securities, and property which it has received to margin, guarantee, or secure the

39.13(g)(8)(iii) requires that a CFTC-registered derivatives clearing organization (DCO) requires its clearing members to ensure that their customers do not withdraw funds from clearing member accounts, with one exception.

Clearing member customers can withdraw funds if the net liquidating value plus the margin deposits remaining in the account meet the customer's initial margin requirements with respect to all products and swap portfolios cleared by the DCO that are held in the customer's account. This is known as the "Margin Adequacy Requirement" because it helps ensure a clearing member has, from a customer, funds sufficient to cover the customer's cleared initial margin requirements. And, in light of the use of omnibus margin accounts, the Margin Adequacy Requirement avoids the clearing member covering one customer's margin shortfall with another customer's funds. Overall, this is one of the many CFTC rules that protects customer funds.

The 2023 Proposal, among other things, proposed allowing DCOs to permit clearing FCMs to treat the separate accounts of a single beneficial owner, or customer, as accounts of separate legal entities to satisfy the requirements of Regulation 39.13(g)(8)(iii),[3] subject to multiple conditions. The 2023 Proposal was intended to accommodate certain FCM customer agreements that provide that certain accounts carried by the FCM that have the same beneficial owner are treated as accounts for different legal entities for commercial purposes.

However, in response to comments, the Commission is now withdrawing the 2023 Proposal and issuing the Treatment of Separate Accounts Proposal. I commend this

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trades or contracts of its commodity customers. 7 U.S.C. 6d(a)(2); 17 CFR 1.20(a). CEA section 4d(a)(2) and Regulation 1.22(a) prohibit an FCM from using the money, securities, or property of one customer to margin or settle the trades or contracts of another customer. 7 U.S.C. 6d(a)(2); 17 CFR 1.22(a).

[3] As explained in the NPRM and the 2023 Proposal, the Commission is proposing to codify the relief in CFTC Letter No. 19-17, July 10, 2019, *https://www.cftc.gov/csl/19-17/download* as extended by CFTC Letter No. 20-28, Sept. 15, 2020, *https://www.cftc.gov/csl/20-28/download*; CFTC Letter No. 21-29, Dec. 21, 2021, *https://www.cftc.gov/csl/21-29/download*; and CFTC Letter No. 22-11, Sept. 15, 2022, *https://www.cftc.gov/csl/22-11/download*; CFTC Letter No. 23-13, Sept. 11, 2023, *https://www.cftc.gov/csl/23-13/download*.

decision because I believe this NPRM gets the Commission closer to what it set out to do in the 2023 Proposal: accommodate certain FCM customer agreements that provide that certain accounts carried by the FCM that have the same beneficial owner are treated as accounts for different legal entities for commercial purposes.

To aid in this effort, I have highlighted specific areas for public comment below.

Specific Areas for Public Comment

Ordinary course of business

I encourage commenters to review all of the definitions, in particular those in proposed new Regulation 1.44. For instance, I am particularly interested in whether the Commission has improved the accuracy of the definition of "ordinary course of business," along with what constitutes events inconsistent with the "ordinary course of business" in Regulation 1.44(e). As we learned with the 2023 Proposal, getting this right is pivotal to having the proposed framework function as intended.

One business day margin call

As a second definitions example, I am interested in whether the Commission has improved the definition of "one business day margin call" along with its requirements in Regulation 1.44(f). Commenters provided extensive comments on this provision, and while the NPRM has improved on it, we need to be sure the proposed definition does not impede FCM risk management practices and is consistent with the law or standard practices in other jurisdictions and operationally feasible.

The Treatment of Separate Accounts Proposal provides that the relevant deadline for payment of margin in fiat currencies other than USD may be extended by up to one additional business day and still be considered in compliance with the requirements of Regulation 1.44(f) if payment is delayed due to a banking holiday in the jurisdiction of issue of the currency.

Regulation 1.44(f)(4) further provides that, for payments in EUR, either the separate account customer or the investment manager managing the separate account may designate only **one** country within the eurozone that they have the most significant contacts with for purposes of meeting margin calls in that separate account, whose banking holidays shall be referred to for such purpose.

Since the eurozone is comprised of 20 countries, each with their own national laws and banking holidays, I am concerned that the CFTC is imposing an overly prescriptive and unworkable requirement with little practical benefit. I am interested in whether commenters believe it will be impracticable to comply with Regulation 1.44(f)(4). I encourage commenters to look at Question 7 in the NPRM – which staff added at my request – for specific examples and additional prompts.

Other circumstances involving banking holidays

Similarly, the Treatment of Separate Accounts Proposal also provides an exception from Regulation 1.44(f)(1), set forth in Regulation 1.44(f)(7), for the special case of certain holidays when some DCMs may be open for trading, but banks are closed. I am interested in whether the Commission's expansion of the exception from the 2023 Proposal fully resolves the issues raised by commenters, or still poses operational or compliance issues for FCMs.

Conclusion

Overall, I am pleased to support the Treatment of Separate Accounts Proposal and hope we can get it right in the final rule. I look forward to the comments on the NPRM.

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