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Commodity Futures Trading Commission

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

COMMODITY FUTURES TRADING COMMISSION

17 CFR Parts 22 and 190

RIN Number 3038–AC99

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

AGENCY: Commodity Futures Trading Commission.

ACTION: Final rule.

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

DATES: The rules will become effective April 9, 2012. All parties must comply with the Part 22 rules by November 8, 2012. All parties must comply with the Part 190 rules by April 9, 2012. Prior to the compliance date for the Part 22 rules, the definition of 190.01(pp) (''Cleared Swap'') shall be limited to transactions where the rules or bylaws of a derivatives clearing organization require that such transactions, along with the money, securities, and other property margining, guaranteeing or securing such transactions, be held in a separate account for Cleared Swaps only.

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I. Background

A. Segregation Requirements

On July 21, 2010, President Obama signed the Dodd-Frank Act.[1] Title VII of the Dodd-Frank Act[2] amended the CEA[3] to establish a comprehensive new regulatory framework for swaps and certain security-based swaps. The legislation was enacted to reduce risk, increase transparency, and promote market integrity within the financial system by, among other things: (1) Providing for the registration and comprehensive regulation of swap dealers and major swap participants;[4] (2) imposing mandatory clearing and trade execution requirements on clearable swap contracts; (3) creating rigorous recordkeeping and real-time reporting regimes; and (4) enhancing the Commission's rulemaking and enforcement authorities with respect to, among others, all registered entities and intermediaries subject to the Commission's oversight.

Section 724 of the Dodd-Frank Act prescribes the manner in which Cleared

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

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

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

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

Swaps (and related collateral)[5] must be treated prior to and after bankruptcy. Section 724(a) of the Dodd-Frank Act amends section 4d of the CEA to add a new paragraph (f), which imposes the following requirements on an FCM, as well as any depository thereof (including, without limitation, a DCO):

1. The FCM must treat and deal with all collateral (including accruals thereon) deposited by a customer[6] to margin its Cleared Swaps as belonging to such customer;

2. The FCM must separately account for and may not commingle such collateral with its own property and may not, with certain exceptions, use such collateral to margin the Cleared Swaps of any person other than the customer depositing such collateral;

3. A DCO may not hold or dispose of the collateral that an FCM receives from a customer to margin Cleared Swaps in any manner that would indicate that such collateral belonged to the FCM or any person other than the customer; and

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

In other words, the FCM and the DCO (i) must hold such customer collateral in an account (or location) that is separate from the property belonging to the FCM or DCO, and (ii) must not use the collateral of one customer to (A) cover the obligations of another customer or (B) the obligations of the FCM or DCO. These basic requirements that Cleared Swaps Customer Collateral be treated as the property of customers and maintained in segregated accounts (or locations) are imposed by the statute and have the force of law regardless of the Commission's particular implementing regulations. Moreover, by the terms of the statute, these requirements would apply even if the Commission promulgated no implementing regulations.

Section 724(b) of the Dodd-Frank Act governs bankruptcy treatment of Cleared Swaps by clarifying that Cleared Swaps are ''commodity contracts'' within the meaning of section 761(4)(F) of the Bankruptcy Code.[7] Therefore, in the event of an FCM or DCO insolvency, Cleared Swaps Customers may invoke the protections of Subchapter IV of Chapter 7 of the Bankruptcy Code (''Subchapter IV''). Such protections include: (i) protected transfers of Cleared Swaps and related collateral;[8] and (ii) if Cleared Swaps are subject to liquidation, preferential distribution of remaining collateral.[9] However, section 766(h) of the Bankruptcy Code (''Section 766(h)'') subjects customers to mutualized risk by requiring that customer property be distributed ''ratably to customers on the basis and to the extent of such customers' allowed net equity claims.'' This requirement, in turn, limits the Commission's flexibility in designing a model for the protection of customer collateral.

B. Overview of the Clearing Process as It Relates to the Segregation Requirements

1. Central Counterparties/Derivatives Clearing Organizations

One of the primary objectives of the Dodd-Frank Act was to promote the central clearing of swaps and to establish the regulatory infrastructure for the clearing of swaps.[10] Clearing is the process by which transactions in derivatives are processed, guaranteed, and settled by a central counterparty, also known as a DCO. In accordance with this overall Congressional purpose, section 724 of the Dodd-Frank Act amends the CEA to provide the statutory foundation for the protection of Cleared Swaps Customer Collateral.

A DCO has members (''Clearing Members'') who clear derivatives transactions (*e.g.,* swaps) through the DCO and who are subject to the DCO's rules. Clearing Members may clear transactions on their own behalf (*i.e.,* ''proprietary transactions'') or on behalf of customers (*i.e.,* ''customer transactions''). Clearing members that clear swaps for customers must be registered as futures commission merchants (''FCMs'').[11]

The term ''central counterparty'' means, conceptually, that the DCO becomes the seller to every buyer, and the buyer to every seller. More specifically, the DCO novates swap transactions initially entered into between various market participants, such as swaps users, dealers, or end users, and cleared either directly (if the market participant is itself a Clearing Member) or indirectly (through an FCM that is a Clearing Member) . The contractual obligations between the original parties (''A'' and ''B'')[12] are replaced by sets of equivalent obligations: between the Clearing Member FCMs acting for the original parties and the DCO and between the Clearing Member FCMs and their individual customers. Thus, if the original swap agreement would require a certain payment from A to B, as a result of the clearing process this obligation becomes (1) a duty by A's clearing FCM to pay the DCO, (2) a corresponding claim by A's FCM to recompense from A, (3) a duty by the DCO to pay B's clearing FCM, and (4) a corresponding duty by B's FCM to pay B.

In economic effect, the DCO serves as a guarantor that every Clearing Member party to a cleared swap receives performance according to the terms of the swap, while the clearing FCM serves as a guarantor of its customers' swaps obligations to the DCO.

2. Variation

To avoid the accumulation of large obligations, the DCO conducts a variation payment and collection cycle at least once a day, and in the case of many DCOs, twice a day. The DCO will first calculate the gain (and corresponding loss) on each contract through a process known as ''marking to market,'' using reported market prices where available, or other means (such as surveys of Clearing Members). The DCO will then aggregate and net the gains and losses for each Clearing Member (separately for proprietary and customer accounts), collect from those Clearing Members with net losses, and pay those Clearing Members with net gains. This process is highly time sensitive: The Clearing Member typically has only one or a few hours between the demand for payment and the time payment is due. Similarly, the Clearing Member FCMs will debit the accounts of those customers who have losses on their transactions, and credit the accounts of those customers who have gained.

3. Margin (Collateral)

To secure the prompt payment of variation obligations, the DCO will require each Clearing Member to post collateral (often referred to as ''margin'') for the transactions it clears (separately for customer positions and proprietary positions). If the Clearing Member does not promptly make a variation payment to the DCO—referred to as a default—the collateral may immediately be liquidated and applied to the obligation. Margin may only be used to meet the

[5] Regulation 22.1 defines ''Cleared Swap'' and ''Cleared Swaps Customer Collateral.''

[6] Regulation 22.1 defines ''Cleared Swaps Customer.''

[7] 11 U.S.C. 761(4)(F).

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

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

[10] *See supra* n. 1; S. Rep. No. 111–176, at 33 (2010) (''[w]ith appropriate collateral and margin requirements, a central clearing organization can substantially reduce counterparty risk and provide an organized mechanism for clearing transactions''); Process for Review of Swaps for Mandatory Clearing, 76 FR 44464, July 26, 2011 (final rule); Derivatives Clearing Organizations General Provisions and Core Principles, 76 FR 69334, Nov. 8, 2011 (final rule).

[11] Section 4d(f)(1) of the CEA, 7 U.S.C. 6d(f)(1).

[12] For purposes of this example, neither A nor B is a Clearing Member.

default of the Clearing Member posting that margin. While proprietary margin may be used to meet obligations in either the Clearing Member's proprietary account or customer account, the reverse is not true: A Clearing Member's customer margin may *not* be used to meet a default in the Clearing Member's proprietary account.

Similarly, FCMs will—indeed, are required to—collect collateral from each of their customers, based on each customer's portfolio of positions, to secure the prompt payment of the customer's variation obligations.[13] If a customer fails to fulfill an obligation to the FCM arising out of a swap agreement the FCM clears for the customer, the FCM may use some or all of the value of the collateral that customer has posted to meet that obligation—that is the purpose of the collateral.

The DCO will generally set minimum collateral levels for each type of swap, and will prescribe a ''margin methodology'' to determine the minimum margin level for portfolios of swaps. The DCO's margin methodology will be designed to estimate the amount of loss a portfolio of swap positions may incur, calculated at a statistical confidence level no less than 99%, over a holding period generally between one and ten days, depending on the time it is estimated to take to liquidate the swaps in the portfolio.[14] The FCM will, in turn, use the same or similar methodology in determining the minimum level of collateral it must collect from each customer.[15]

4. Default Resources

As noted above, the margin collateral collected by a DCO is designed to cover most (*e.g.,* 99%), but not all, potential losses incurred by a Clearing Member. DCOs cover the ''tail risk'' (*i.e.,* the risk that a Clearing Member will incur, and default on, a loss in excess of the margin collected) by means of what is sometimes referred to as a default resources package, or ''waterfall.'' Elements of the waterfall may include a contribution of a specified amount of the DCO's own capital, pre-funded contributions from Clearing Members (a ''guaranty fund''),[16] or (to a limited extent), a power by the DCO to assess additional contributions from Clearing Members. Unlike margin, a Clearing Member's contribution to the guaranty fund will generally be usable to meet the default of another Clearing Member. In other words, the guaranty fund is ''mutualized.'' Elements of the waterfall are applied in an order pre-determined by the DCO's rules. Such rules will often apply the guaranty fund contribution of the defaulter before the DCO's own capital, and the remainder of the guaranty fund (*i.e.,* the guaranty fund contributions of the non-defaulting Clearing Members) thereafter.

Though seemingly complex, centralized clearing has important advantages in terms of transparency, risk management, netting out of countervailing obligations, and reduced exposure of market participants to each other's credit risk (by effectively substituting the DCO's credit risk).

5. Customer Accounts

Generally, a clearing FCM will have two different types of Cleared Swaps Customer Accounts in connection with collateral provided to it by Cleared Swaps Customers. One account is maintained (generally at a bank) by the FCM on behalf of its Cleared Swaps Customers (the ''FCM Customer Account''). The FCM Customer Account holds assets provided by customers, or other assets of equivalent value, that are not currently posted with the DCO to support swaps positions cleared by the FCM on behalf of its Cleared Swaps Customers. The other account is maintained by the DCO for the FCM on behalf of the FCM's Cleared Swaps Customers (the ''DCO Customer Account''). The DCO Customer Account holds customer assets, or assets of equivalent value, that the FCM has posted to the DCO as collateral for swaps positions that have been established and cleared by the FCM for its Cleared Swaps Customers.

The collateral posted by each Cleared Swaps Customer is, however, potentially exposed to risks that do not arise out of the obligations that a Cleared Swaps Customer has directly incurred by assuming his or her swaps position. [17] The most important impact of such risks would occur in the case of an insolvency on the part of the FCM through which the Cleared Swaps Customer clears. As discussed in more detail below, the new CEA section 4d(f), and the Commission's implementing regulations, are designed to provide protection for Cleared Swaps Customer Collateral against certain risks that may arise during an insolvency on the part of the FCM through which the Cleared Swaps Customer clears.

6. Fellow-Customer Risk

''Fellow-Customer Risk'' is the risk that a DCO would need to access the collateral of non-defaulting Cleared Swaps Customers to cure an FCM default. Fellow-Customer Risk arises in circumstances in which a Cleared Swaps Customer (the ''defaulting customer'') of a clearing FCM suffers a (significant) loss in connection with a cleared swap.[18] The loss will result in a call by the DCO for a variation payment from the clearing FCM that carries that Cleared Swaps Customer's Cleared Swaps.[19] The clearing FCM may demand expedited payment from the defaulting Cleared Swaps Customer, but is in any event directly obligated promptly to meet the payment obligation to the DCO.

If the loss is great enough, it may exceed the sum of the FCM's available liquid assets, the swaps collateral posted by the Cleared Swaps Customer, and any additional payments immediately available from the Cleared Swaps Customer. In this situation, sometimes called a ''double default,'' the defaulting Cleared Swaps Customer will have defaulted on its obligation to the clearing FCM which, in turn, will default on its obligation to the DCO. In such circumstances, the FCM will likely have to file for protection in bankruptcy. Meanwhile, the defaulting Cleared Swaps Customer's loss will translate to a gain by one or more other market participants. Notwithstanding the default by the clearing FCM, the DCO, in its capacity as central counterparty, is required to pay out these gains. The DCO will thus be faced with a potentially significant loss.

A potential resource for the DCO to apply to this loss in a double default

[13] See regulation 39.13(g)(8)(ii) (stating that ''[a] derivatives clearing organization shall require its clearing members to collect customer initial margin, as defined in § 1.3 of this chapter, from their customers, for nonhedge positions, at a level that is greater than 100 percent of the derivatives clearing organization's initial margin requirements with respect to each product and swap portfolio.''). 76 FR at 69439.

The purpose of this rulemaking is to protect Cleared Swaps Customer Collateral in the event that an FCM defaults to a DCO due to ''Fellow-Customer Risk'' (as such term is defined in section I(B)(6) herein). However, as section III(B) explores in greater detail, the segregation model selected in this rulemaking provides limited protection from operational and investment risks.

[14] *See generally,* 76 FR 69334. *See* specifically regulation 39.13(g)(2)(ii) (setting forth a one-day minimum liquidation time for agricultural, energy, and metals swaps, and a five-day minimum liquidation time for all other swaps). 76 FR 69438.

[15] The FCM is required to collect a higher level of collateral from its customers than that prescribed for Clearing Members (*see id.*) and may, in its discretion, collect a yet higher level. *See* regulation 22.13(a)(1).

[16] *See also infra* at n. 250.

[17] Examples of other risks include the possibility of misuse or misallocation of a Cleared Swaps Customer's assets by a dishonest or negligent FCM.

[18] *See also supra* n. 13.

[19] As noted above, the amount the DCO will call for or pay to the FCM in respect of its Cleared Swaps Customers is the net of the gains and losses computed on a customer-by-customer basis.

situation is the collateral held in the Cleared Swaps Customer Account maintained by the DCO for the defaulting FCM on behalf of the FCM's Cleared Swaps Customers. Under the current rules applicable to futures clearing, a DCO is permitted to use all of the collateral in the Clearing Member's customer account to meet a loss in that account, without regard to which customer(s) in fact supplied that collateral. Thus, in this case, the non-defaulting customers of the defaulting FCM clearing member would be exposed to loss due to ''Fellow-Customer Risk.''

C. Segregation Alternatives

In implementing new CEA section 4d(f), the Commission considered five alternative segregation models for Cleared Swaps Customer Collateral in the notice of proposed rulemaking issue by the Commission on June 9, 2011 (the ''NPRM'').[20]

1. Legal Segregation With Operational Commingling Model

The first alternative explored by the Commission was legal segregation with operational commingling (the ''LSOC Model'' or ''Complete Legal Segregation Model''). Under the LSOC Model, each FCM and DCO would enter (or ''segregate''), in its books and records, the Cleared Swaps of each individual customer and relevant collateral. Each FCM and DCO would ensure that such entries are separate from entries indicating (i) FCM or DCO obligations, or (ii) the obligations of non-cleared swaps customers. Operationally, however, each FCM and DCO would be permitted to hold (or ''commingle'') the relevant collateral in one account. Each FCM and DCO would ensure that such account is separate from any account holding FCM or DCO property or holding property belonging to non-cleared swaps customers.

Prior to the simultaneous default of an FCM and one of its Cleared Swaps Customers (as discussed above, a ''double default''), the FCM would ensure that the DCO does not use the collateral of one Cleared Swaps Customer to support the obligations of another customer by making certain that the value of the Cleared Swaps Customer Collateral that the DCO holds equals or exceeds the value of all Cleared Swaps Customer Collateral that it has received to secure the contracts of the FCM's customers. Following a double default, the DCO would be permitted to access the collateral of the defaulting Cleared Swaps Customers, but not the collateral of the non-defaulting Cleared Swaps Customers. Thus while, even under the LSOC Model, Section 766(h) requires the pro rata distribution of customer property, the collateral attributable to the non-defaulting Cleared Swaps Customers would be available to be distributed.

2. Legal Segregation With Recourse Model

Second, the Commission contemplated the Legal Segregation with Recourse Model (together with the LSOC Model, the ''Legal Segregation Models''). As with the LSOC Model, under the Legal Segregation with Recourse Model, each FCM and DCO would segregate the Cleared Swaps of each individual customer and relevant collateral in its books and records. However, each FCM and DCO would be permitted to commingle the relevant collateral in one account, provided that such account is separate from any proprietary accounts or accounts property belonging to non-cleared swaps customers.

Again, as with the LSOC Model, prior to a double default, the FCM would ensure that the DCO does not use the collateral of one Cleared Swaps Customer to support the obligations of another customer by making certain that the value of the Cleared Swaps Collateral that the DCO holds equals or exceeds the value of all Cleared Swaps Collateral that it has received to secure the contracts of the FCM's customers. However, unlike the LSOC Model, following a double default, the Legal Segregation with Recourse Model would not prohibit a DCO from accessing the collateral of the non-defaulting Cleared Swaps Customers, after the DCO applies its own capital to cure the default, as well as the guaranty fund contributions of its non-defaulting FCM members.

3. Physical Segregation Model

The Commission also explored the possibility of full physical segregation (the ''Physical Segregation Model'') for Cleared Swaps Customer Collateral. The Physical Segregation Model primarily differs from the Legal Segregation Models operationally. In the ordinary course of business (*i.e.,* prior to a double default), as with the Legal Segregation Models, each FCM and DCO would enter (or ''segregate''), in its books and records, the Cleared Swaps of each individual customer and relevant collateral. However, unlike the Legal Segregation Models, each FCM and DCO would maintain separate individual accounts for the relevant collateral. Hence, the FCM would ensure that the DCO does not use the collateral of one Cleared Swaps Customer to support the obligations of another customer by making certain that the DCO does not mistakenly transfer collateral in (i) the account belonging to the former to (ii) the account belonging to the latter.

Following a double default, the Physical Segregation Model would lead to the same result as the Complete Legal Segregation Model. Specifically, the DCO would be permitted to access the collateral of the defaulting Cleared Swaps Customers, but not the collateral of the non-defaulting customers.

As discussed above, one important limitation on the effectiveness of the Physical Segregation Model is section 766(h) of the Bankruptcy Code, which requires that customer property be distributed ratably. Thus, if because of Physical Segregation, certain Cleared Swaps Customer Collateral was better protected than the property of other Cleared Swaps Customers, it would not be permissible to pay Cleared Swaps Customers in the first group a higher proportion (*i.e.,* a higher cents-on-the-dollar distribution) of their net equity claims than Cleared Swaps Customers in the second group. Rather, Cleared Swaps Customers in both groups would receive the same proportion of their allowed net equity claims. In other words, in spite of incurring greater cost under the Physical Segregation Model, a Cleared Swaps Customer would essentially receive the same level of protection for its Cleared Swaps Customer Collateral under the Physical Segregation Model as it would under the LSOC Model.

4. Futures Model

The Commission also considered replicating the segregation requirement currently applicable to futures (the ''Futures Model''). Under this model, DCOs treat each FCM's customer account on an omnibus basis, that is, as belonging to an undifferentiated group of customers.

Prior to a double default, the Futures Model shares certain similarities with the Legal Segregation Models. Specifically, each FCM would enter (or ''segregate''), in its books and records, the Cleared Swaps of each individual customer and relevant collateral. Each DCO, however, would recognize, in its books and records, the Cleared Swaps that an FCM intermediates on a collective (or ''omnibus'') basis. Each FCM and DCO would be permitted to hold (or ''commingle'') all Cleared Swaps Customer Collateral in one account.

[20] *See* Notice of Proposed Rulemaking on the Protection of Cleared Swaps Customer Contracts and Collateral; Conforming Amendments to the Commodity Broker Bankruptcy Provisions, 76 FR 33818, 33822, June 9, 2011.

Following a double default, the Futures Model shares certain similarities with the Legal Segregation with Recourse Model. Specifically, the Futures Model would not prohibit a DCO from accessing the collateral of the non-defaulting Cleared Swaps Customers. However, unlike the Legal Segregation with Recourse Model, under the Futures Model the DCO would be permitted to access such collateral before applying its own capital or the guaranty fund contributions of non-defaulting FCM members.[21]

5. Optionality

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

D. Operation of the Segregation Models in an FCM Bankruptcy

When discussing the issues surrounding an FCM bankruptcy under the Bankruptcy Code, analytically there are several scenarios to consider: (1) The bankruptcy is unrelated to the loss of customer funds, and there is no such loss; (2) The bankruptcy involves shortfalls in customer funds due to operational risks; (3) The bankruptcy involves losses due to customer risk (*i.e.,* a customer incurs a loss in excess of the FCM's financial ability to cover); or (4) the bankruptcy involves shortfalls in customer funds due to operational risk and losses due to customer risk.

1. Bankruptcy Unrelated to Loss of Customer Funds

An FCM bankruptcy that is unrelated to the loss of customer funds may arise because of financial difficulties in the FCM, financial difficulties in the proprietary accounts, or because of the impact of difficulties at a corporate parent or affiliate. Under this scenario, all models share important characteristics: Customer positions and related collateral, whether at a DCO or at the FCM, can be transferred to one or more willing transferee FCMs, or may be liquidated and returned to the trustee. With respect to fostering transfer, however, the Legal Segregation Models (whether Complete or with Recourse) and the Physical Segregation Model do have a significant advantage compared to the Futures Model: In each of them, information about the customers as a whole, and about each individual customer's positions, are transmitted to the DCO every day, an information flow (and store) that is not present in the Futures Model. Thus, each DCO will have important customer information on a customer by customer basis that can be used to facilitate and implement transfers, and is thus less reliant upon the FCM for that information.

2. Bankruptcy With Shortfalls Due to Operational Risks or Investment Risks

An FCM bankruptcy with shortfalls due to operational risks would arise because of a shortfall in segregated funds due to, *e.g.,* negligence, theft or other mishap. An FCM may also have shortfalls due to investment risks resulting from extraordinary losses on the set of investments permitted under regulation 1.25 (as included in new regulation 22.2(e)(3)). Under this scenario, all models again share important characteristics: Customer positions and related collateral at a DCO may be delivered to the Trustee, or may transferred by the DCO, but only to the extent of each customer's pro rata share. Under all of the segregation models, to the extent there is a shortfall, each customer will ultimately receive the same cents-on-the-dollar proportion of the value of the customer's account.

However, with respect to fostering transfer, the other models again have a significant advantage compared to the Futures Model: In each of them, information about the customers as a whole, and about each individual customer's positions, are transmitted to the DCO every day, an information flow (and store) that is not present in the Futures Model. Thus, each DCO will have important customer information on a customer by customer basis that can be used to facilitate and implement transfers, and accordingly is less reliant upon the FCM for that information.

3. Bankruptcy With Shortfalls Due to Customer Risk

An FCM bankruptcy with shortfalls due to customer risk would arise because a customer incurs a loss that exceeds both the customer's collateral and the FCM's ability to pay.

Under the Futures Model, the DCO could use the entirety of the FCM's customer account (or as much of it as necessary) to meet the entire loss created by the default. Transfer of customer positions would be difficult, in that the DCO would lack information as to which customers were in default, and which positions belonged to defaulting customers (and, presumably, would not be transferred) and which did not.[22] The DCO would be permitted to liquidate customer positions, a process that might take between one and ten days.[23] Once the loss was crystalized, the DCO would be able to turn over the collateral (less that used to meet the default) to the Trustee for use in the pro rata distribution.

Under the LSOC Model, the DCO could only use the collateral attributable to defaulting customers (those whose positions suffered losses) to meet the loss. Thus, all collateral attributable to customers whose net positions gained or were ''flat'' (neither gained nor lost), and much of the collateral attributable to customers whose net positions lost, would be immediately available for transfer. Moreover, the DCO would have information that is no more than one business day old tying customers to portfolios of positions, and the DCO itself would maintain the margining methodology that would tie such portfolios of positions to the collateral requirement associated with such portfolios. Even if the DCO decided to liquidate all customer positions, the collateral of non-defaulting customers would be exposed to less loss than under the Futures Model because the DCO would not have the right to access it.

The Physical Segregation Model would work in a manner similar to the LSOC Model. Again, all collateral attributable to customers whose net positions gained or were ''flat'' (neither gained nor lost), and the remaining collateral attributable to customers whose net positions lost, would be immediately available for transfer. The DCO would have specific information on how much collateral was, in fact, attributable to each customer. However, because of the ratable distribution requirement, any losses that did exist would be shared ratably among all customers.

Under the Legal Segregation with Recourse, the DCO could only use the collateral attributable to defaulting customers (those whose positions suffered losses) to meet the loss—at first. It would also use the defaulting clearing member FCM's own contribution to the guaranty fund, its own contribution to the guaranty fund, as well as the contributions of non-defaulting clearing members. However, if those resources were insufficient to cover the default, the DCO would have ''recourse'' to the collateral of non-defaulting customers. While such

[21] For a more detailed discussion regarding the operation of the segregation models in an FCM bankruptcy, see section I.D.

[22] *See generally,* CME Group, Inc. (''CME'') at 14–15 (discussing information deficits at bankrupt FCM).

[23] *See* 76 FR at 69366–68.

recourse is much less likely under the Legal Segregation with Recourse Model than under the Futures Model—because the fellow-customer collateral would not be reached unless the loss was great enough to consume the entire guaranty fund—until the amount of loss from the default was crystalized (through liquidation or transfer), the DCO might be reluctant or unable to release the collateral of non-defaulting customers. Accordingly, while Legal Segregation with Recourse would (in most cases) provide customers superior recovery in a liquidation, it would be much less well-suited to a prompt transfer of positions.

E. Solicitation of Public Input

The Commission sought public comment on the segregation alternatives mentioned above, and on the advisability of permitting the DCO to choose between alternatives. First, the Commission, through its staff, held extensive external meetings with three segments of stakeholders (*i.e.,* DCOs, FCMs, and swaps customers).[24] Second, on October 22, 2010, the Commission, through its staff, held a roundtable (the ''First Roundtable'').[25] Third, on November 19, 2010, the Commission issued an Advance Notice of Proposed Rulemaking for Protection of Cleared Swaps Customers Before and After Commodity Broker Bankruptcies (the ''ANPR''). Fourth, on June 3, 2011, the Commission, through its staff, held a second roundtable (the ''Second Roundtable'').[26] Fifth, after careful consideration of the comments the Commission received on the ANPR, the Commission issued the NPRM.

1. First Roundtable

As the ANPR describes, the First Roundtable revealed that stakeholders had countervailing concerns regarding the alternative segregation models that the Commission set forth. On the one hand, a number of swaps customers argued that the Commission should focus on effectively eliminating Fellow-Customer Risk[27] and Investment Risk.[28] Such swaps customers emphasized that (i) They currently transact in uncleared swaps, (ii) they are able to negotiate for individual segregation at independent third parties for collateral supporting such uncleared swaps, and therefore (iii) they are currently subject to neither Fellow-Customer Risk nor Investment Risk. Such customers found it inappropriate that, under certain alternatives set forth by the Commission, they should be subject to Fellow-Customer Risk and Investment Risk when they transact in Cleared Swaps.

On the other hand, a number of FCMs and DCOs argued that the benefits of effectively eliminating Fellow-Customer Risk and Investment Risk are outweighed by the costs. With respect to benefits, these FCMs and DCOs noted that the Futures Model has served the futures industry well for many decades. With respect to costs, these FCMs and DCOs described two potential sources. First, FCMs and DCOs stated that, depending on the manner in which the Commission proposes to eliminate or mitigate Fellow-Customer Risk and Investment Risk, they may experience substantial increases to operational costs (*e.g.,* costs associated with transaction fees, reconciliations, recordkeeping, reporting). Second, and more significantly, FCMs and DCOs stated that they may incur additional risk costs due to proposed financial resources requirements.[29]

In addition, some DCOs may have anticipated including collateral from non-defaulting Cleared Swaps Customers as an element in their financial resources packages. If DCOs no longer have access to such collateral, then those DCOs would need to obtain additional financial resources to meet proposed Commission requirements. Both FCMs and DCOs averred that the costs associated with obtaining such additional financial resources may be substantial, and would ultimately be borne by Cleared Swaps Customers.[30]

2. ANPR

Given the concerns that stakeholders expressed at the First Roundtable, the Commission decided to seek further comment through the ANPR on the potential benefits and costs of (i) The Legal Segregation Models (whether Complete or with Recourse), (ii) the Physical Segregation Model, and (iii) the Futures Model. As the ANPR explicitly stated, ''[t]he Commission [was] seeking to achieve two basic goals: Protection of customers and their collateral, and minimization of costs imposed on customers and on the industry as a whole.'' [31] In addition, the Commission requested comment on the impact of each model on behavior, as well as whether Congress evinced intent for the Commission to adopt any one or more of these models.

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

[25] The transcript from the First Roundtable (the ''First Roundtable Tr.'') is available at: *http://www.cftc.gov/ucm/groups/public/@swaps/documents/dfsubmission/dfsubmission6_102210-transcrip.pdf.*

[26] The transcript from the Second Roundtable (the ''Second Roundtable Tr.'') is available at: *http://www.cftc.gov/ucm/groups/public/@swaps/documents/dfsubmission/dfsubmission6_060311-transcri.pdf.*

[27] As noted in section I.B.1, an FCM functions as a guarantor of customer transactions with a DCO. Section 4d(f) of the CEA prohibits an FCM from using the collateral deposited by one Cleared Swaps Customer to support the swap transactions of another Cleared Swaps Customer. Therefore, if one Cleared Swaps Customer owes money to the FCM (*i.e.,* the Cleared Swaps Customer has a debit balance), the FCM, acting as guarantor, must deposit its own capital with the DCO to settle obligations attributable to such customer. If the Cleared Swaps Customer defaults to the FCM, and the Cleared Swaps Customer's obligations are so significant that the FCM does not have sufficient capital to meet them, then the FCM would default to the DCO.

As discussed in Section I.B.4, the financial resources DCOs maintain to cover Clearing Member defaults with respect to customer positions in excess of collateral provided by the Clearing Member include property of the defaulting Clearing Member (*i.e.,* collateral deposited to support FCM proprietary transactions and contributions to the DCO guaranty fund). Other elements of such packages may include: (i) The collateral that the FCM deposited to support the transactions of non-defaulting customers; (ii) a portion of the capital of the DCO; and (iii) contributions to the guaranty fund from other DCO Clearing Members. Typically, a DCO would exhaust one element before moving onto the next element. Therefore, the risk that the DCO would use any one element depends on the position of that element in the package.

[28] ''Investment Risk'' is the risk that each Cleared Swaps Customer would share *pro rata* in any decline in the value of FCM or DCO investments of Cleared Swaps Customer Collateral. Section 4d(f) of the CEA permits an FCM to invest Cleared Swaps Customer Collateral in certain enumerated instruments. The Commission is proposing to expand such instruments to include those referenced in regulation 1.25 (as it may be amended from time to time). Even though (i) such investments are ''consistent with the objectives of preserving principal and maintaining liquidity,'' and (ii) both the FCM, as well as the DCO, value such investments conservatively (by, *e.g.,* applying haircuts), the value of such investments may decline to less than the value of the collateral originally deposited. *See* regulation 1.25(b) (as amended in *Investment of Customer Funds and Funds Held in an Account for Foreign Futures and Foreign Options Transactions,* 76 FR 78776, December 19, 2011). In such a situation, all customers would share in the decline *pro rata,* even if the invested collateral belonged to certain customers and not others.

[29] As described below, the term ''Risks Costs'' refers to the costs associated with the allocation of loss in the event of a default under the Complete Legal Segregation Model relative to the Futures Model. For a more detailed explanation of these costs, *see* the discussion in section VII.B.2.b., under the heading titled '''Risk Costs' and potential effects on margin levels and DCO guaranty fund levels in response to complete legal segregation.''

[30] 75 FR at 75163. For example, one DCO estimated that it would have to increase the amount of collateral that each Cleared Swaps Customer must provide by 60 percent, if it could no longer access the collateral of non-defaulting Cleared Swaps Customers to cure certain defaults. *See infra* n. 258.

[31] *Id.*

As described in the NPRM, the Commission received thirty-one comments from twenty-nine commenters.[32] The comments were generally divided by the nature of the commenter: Most (though not all) of the comments from current or potential Cleared Swaps Customers favored either the Legal Segregation Models (whether Complete or with Recourse) or the Physical Segregation Model, manifesting a willingness to bear the added costs.[33] Most of the FCMs and DCOs favored the Futures Model, though one commenter favored the Complete Legal Segregation Model.[34] Finally, another commenter, in its supplemental comment, opined that the most important factor that the Commission should consider is the extent to which a model fostered the portability [35] of Cleared Swaps belonging to non-defaulting customers.[36] This commenter noted that the Physical Segregation Model and what is now referred to as the Complete Legal Segregation Model were most conducive to that goal.[37]

After careful consideration of the First Roundtable discussion and the comments received in response to the ANPR, the Commission issued the NPRM on June 9, 2011.

3. Second Roundtable

Discussions during the Second Roundtable generally reflected the conflicting concerns expressed by market participants regarding the alternative segregation models set forth by the Commission. Swaps customers continued to state that the Commission should focus on mitigating Fellow-Customer Risk, with some also advocating for the elimination of Investment Risk, while FCMs and DCOs reiterated that the Commission should select the Futures Model as the segregation model for Cleared Swaps Customer Collateral because the Futures Model has served the futures industry well for many decades. Pension funds, and a few investment managers, remained concerned about their potential exposure to Fellow-Customer Risk and Investment Risk and continued to press the Commission to adopt the Physical Segregation Model either outright or on an optional basis.

In addition, participants discussed various cost and benefits issues arising in relation to the Futures and the Legal Segregation Models. Specifically, several participants believed that the operational costs would not be significantly different between the Futures Model and the Complete Legal Segregation Model.[38] Moreover, although some participants projected that risk costs would significantly increase if the Commission were to select the Complete Legal Segregation Model,[39] one participant argued that these risk costs would not be incremental risk costs; rather they are risk costs that exist in the Futures Model that would most likely ultimately be borne by customers.[40] Finally, one participant argued that any model that facilitates the ability to port ''is superior to one that doesn't'' because ''the closeout cost in the future's model was the most expensive,'' meaning that ''closing out a client account and rates could be extremely devastating to the market, and * * * be really significant losses * * * [and] any way [the losses] can be avoided would be beneficial to every participant in the market.'' [41]

4. NPRM

After carefully considering all comments to the ANPR and statements made during the First Roundtable discussion, the Commission proposed in the NPRM the Complete Legal Segregation Model as the segregation model for Cleared Swaps Collateral because the Complete Legal Segregation Model provided the best balance between benefits and costs in order to protect market participants and the public. Nonetheless, due in part to the strong opposing views expressed by market participants, the NPRM made clear that the Commission was still considering whether to adopt, in the alternative, the Legal Segregation with Recourse Model, and was continuing to assess the feasibility of an optional approach and the Futures Model.

Commenters to the ANPR generally observed that customers ultimately would bear the costs of implementing whatever segregation model was selected by the Commission. Nonetheless, most (though not all) of the buy-side commenters favored individual protection for Cleared Swaps Customer Collateral. These commenters generally viewed the Complete Legal Segregation Model as the minimum level of protection necessary for Cleared Swaps Customer Collateral. Because it was largely recognized that customers would ultimately bear the costs of implementing the selected segregation model, the Commission believed it appropriate to give weight to the views of market participants who would bear those costs, and found it compelling that most buy-side commenters favored adoption of either the LSOC Model or the Physical Segregation Model. The Commission noted that the Legal Segregation Models and the Physical Segregation Model would provide greater individualized protection to Cleared Swaps Customer Collateral than the Futures Model, and was in accordance with section 4d(f) of the CEA. In addition, the Commission noted that the LSOC Model and the Physical Segregation Model may provide substantial benefits in the form of (i)

[32] All comment letters are available through the Commission's Web site at: *http://www.cftc.gov/LawRegulation/FederalRegister/ProposedRules/2010-29836.*

[33] *See id.*

[34] *See id.*

[35] The terms ''portability,'' ''port,'' and ''porting'' refer to the ability to reliably transfer the swaps (and related collateral) of a non-defaulting customer from an insolvent FCM to a solvent FCM, without the necessity of liquidating and re-establishing the swaps.

[36] *See* ISDA comment letters on ANPR.

[37] *See id.*

[38] *See* Second Roundtable Tr. at 250, l.2 (In response to whether the Complete Legal Segregation Model would impose operational costs over the Futures Model, Ms. Bregasi stated that ''[t]here is no additional cost between LSOC and the futures model;'' Mr. Prager stated that ''[w]e don't see them incurring other than the start-up costs, the one time that everyone will have to incur to set up, the running cost. We don't see any incremental cost;'' and Mr. MacFarlane stated that ''I would agree there are no additional operational costs.''). *See also,* Second Roundtable Tr. at 239, l.8 (Mr. Frankel explaining that operational costs resulting from passing ''the client identity and * * * some other multiplier that explains how much excess there is in the seg account for the client * * * [is] a small build.''); Second Roundtable Tr. at 243, l.22 (Mr. Kahn stating that ''in terms of the cost, the fact is OTC is a little different than futures because there is a tremendous build that everyone is doing in the case of OTC so if we need to build LSOC which in essence we've done in the LCH European model, there is a cost of that but I can't really define what it is. It's relatively small and not material.'').

[39] *See* Second Roundtable Tr. at 255, l.12 (Mr. Frankel arguing that ''Moving to a 99.9 percent confidence of coverage we think will increase margins by about 60 percent [for rates] * * * I think for CDS it could be more than double.''). *See also* Second Roundtable Tr. at 262, l.2 (Mr. Diplas arguing that ''not having the additional pool of funds that are associated with the fellow customers means that we definitely need to actually margin from a CCP perspective, the higher confidence interval. That will differ depending on the asset class we're looking at. Some of them, at least based on the existing pool of trades, it could be manageable like at 60, 70 percent in rates. We'll talk about three to four times the amount that—in credit—and the more we get to instruments with fatter tails the higher the number is going to be. I think that is something that clients need to be cognizant of.'').

[40] *See, e.g.,* Second Roundtable Tr. at 257, l.6 (Mr. MacFarlane stating that ''what's being said, if our transactions had to be margined on an individual basis it would require that we put up 60 to 70 percent more, which says that then the real risk of that transaction is 75 percent more than what we're collateralizing. So in the event of a default, not by us but by another counterparty potentially, they will be under-collateralized relative to what their individual transaction would require, and then that potentially could work its way back to us.'').

[41] *See, e.g.,* Second Roundtable Tr. at 259, l.6 (quoting Mr. Frankel). For a more detailed discussion of cost and benefit considerations, please *see* discussion below in section VII.

Decreased Fellow-Customer Risk, (ii) increased likelihood of portability, (iii) decreased systemic risk, and (iv) positive impact on portfolio margining, and asked for comment as to whether and why commenters favor or oppose adoption of the Futures Model.

In choosing between the Legal Segregation Models and the Physical Segregation Model, the Commission noted that the operational costs for the Physical Segregation Model would be substantially higher than the operational costs for the Legal Segregation Models (whether Complete or with Recourse). With respect to benefits, the Commission believed that the Physical Segregation Model would provide only incremental advantages over the Complete Legal Segregation Model with respect to the mitigation of Fellow-Customer Risk. In addition, the Commission noted that while the Physical Segregation Model does eliminate Investment Risk, (i) the Commission was in the process of further addressing Investment Risk by proposing amendments to regulation 1.25, and (ii) each FCM and DCO already values investments conservatively. Finally, the Commission observed that the Physical Segregation Model would generally enhance portability to the same extent as the Complete Legal Segregation Model, and therefore would have similar effects on systemic risk. In addition, the Commission stated that the Physical Segregation Model and the Complete Legal Segregation Model would likely enhance portfolio margining to the same extent. Therefore, the Commission chose not to propose the Physical Segregation Model in the NPRM.

In choosing between the Complete Legal Segregation Model and the Legal Segregation with Recourse Model, the Commission noted that commenters argued that implementing the former would result in significant Risk Costs,[42] whereas implementing the latter would result in no Risk Costs. In addition, the Commission believes that comments to the ANPR that question the assumptions underlying the upper estimates of Risk Costs for the Complete Legal Segregation Model have raised credible issues regarding the accuracy of those estimates. Nevertheless, the Commission recognized that such assumptions formed an area of divergence between commenters, and therefore asked for additional comment on the Risk Costs for the Complete Legal Segregation Model. The Commission also observed that operational costs for the Complete Legal Segregation Model and the Legal Segregation with Recourse Model were approximately the same. With respect to benefits, the Commission noted that the Complete Legal Segregation Model would (i) Mitigate Fellow-Customer Risk even in extreme FCM defaults, unlike the Legal Segregation with Recourse Model, (ii) enhance portability (and therefore mitigate systemic risk) to a significantly greater extent than the Legal Segregation with Recourse Model, and (iii) have an incremental advantage over the Legal Segregation with Recourse Model with respect to impact on portfolio margining.[43] Consequently, the Commission chose not to propose the Legal Segregation with Recourse Model in the NPRM, but stated that it was still considering this model as an alternative.

F. Clarification of the Application of Financial and Segregation Interpretation No. 10 to Cleared Swaps

In response to the Commission's NPRM, clarification was requested[44] regarding the applicability to the cleared swaps market of the Commission's 2005 Amendment to Financial and Segregation Interpretation No. 10 on the Treatment of Funds Deposited in Safekeeping Accounts (''Segregation Interpretation 10–1'').[45] The commenter noted that ''[u]ntil 2005, the CFTC permitted the use of third-party custodial accounts for futures margin by pension plans and investment companies registered under the 1940 Act * * *. In 1984, the CFTC issued Financial and Segregation Interpretation No. 10 * * *, permitting the use of third party custodial accounts for the holding of customer property subject to certain conditions ensuring that an FCM would have immediate and unfettered access to customer funds.''[46] However, Segregation Interpretation 10–1 made it clear that, with limited exceptions, FCMs would not be in compliance with the requirements of section 4d(a)(2) of the CEA if they hold customer funds in a third-party custodial account.

The Commission agrees that Segregation Interpretation 10–1 does not apply to Cleared Swaps. Accordingly, and subject to the conditions described below, Cleared Swaps Customer Collateral may be deposited at a bank in a third-party safekeeping account, in lieu of posting such collateral directly to the FCM, without the FCM being deemed in violation of section 4d(f) of the CEA, and FCMs are permitted to allowed Cleared Swaps Customers to elect to have their Cleared Swaps Customer Collateral held in such accounts.

However, if an FCM uses, or allows the use of, a third-party safekeeping account, that FCM must comply with all of the conditions for such accounts set forth in Segregation Interpretation 10 as originally issued in 1984.[47] In addition, as noted in Segregation Interpretation 10, though the use of third-party safekeeping accounts is not prohibited, such collateral constitutes customer property within the meaning of the Bankruptcy Code. As such, positions and collateral held in third-party custodial accounts are subject to the U.S. Bankruptcy Code and applicable provisions in the CEA, which provide for the pro rata share of available customer property.

The commenter also requested that the Commission revise or repeal Segregation Interpretation 10–1 to allow futures and options customers to have their collateral held in third-party safekeeping accounts.[48] However, while the Commission does not believe it would be appropriate to address this request at this time, as it is beyond the scope of this rulemaking, the Commission may address this concern in the future.

The Commission also notes that a number of commenters[49] have proposed alternative arrangements that would provide individual protection for collateral belonging to cleared swaps market participants (and, in some cases, futures customers) that are willing and able to bear the associated costs. However, these proposals raise important risk management and cost externality issues, particularly with respect to ensuring that collateral is promptly available to DCOs in the event of a default, ensuring proper capital treatment for the relevant market participants, and protecting all customers.

The Commission has directed staff to carefully analyze these proposals with the goal of developing proposed rules that provide additional protection for

[42] For a more detailed discussion regarding risk costs, *see* section VII.B.2.b., *infra.*

[43] *See* 33818 FR at 33828.

[44] *See* Committee on Investment of Employee Benefit Assets (''CIEBA'') December 22, 2011 letter (''CIEBA Supplemental'') at 2.

[45] Amendment of Interpretation, 70 FR 24768, May 11, 2005 (Notice) The underlying Financial and Segregation Interpretation No. 10 (''Segregation Interpretation 10'') was issued on May 23, 1984, and can be found at Comm. Fut. L. Rep. (CCH) ¶7120.

[46] CIEBA Supplemental at 4.

[47] These conditions include limitations regarding the titling and location of the third-party safekeeping account, and requirements concerning the FCM's rights to promptly liquidate positions and access collateral.

[48] *See* CIEBA Supplemental at 12

[49] *See generally* CIEBA August 8, 2011 letter (''CIEBA Original'') at 1–5; Salzman at 1–9; CME at 18; State Street at 2–4.

collateral belonging to market participants.[50]

The Commission agrees with the comment that ''swap margin is not meant to enhance the swap dealers' bottom line, but to protect the system against counterparty failure,'' [51] and remains committed to protecting the market and market participants.

II. The Final Rules

In determining the scope and content of the final rules, the Commission has taken into account issues raised by commenters, including those issues with respect to the costs and benefits associated with the proposed segregation model for Cleared Swaps Customer Collateral. The Commission received twenty-eight (28) comment letters on the proposed rules,[52] twenty-five (25) of which addressed the issue of which segregation model the Commission should adopt for Cleared Swaps Customer Collateral. Of these twenty-five (25), the strong weight of the commenters rested in favor of individual protection for Cleared Swaps Customer Collateral, with twenty (20) comment letters supporting implementation of the Complete Legal Segregation Model, the Physical Segregation Model or some combination thereof.[53] Four (4) comment letters supported adoption of the current Futures Model,[54] with one (1) comment letter, from the FIA, showing support for both the Complete Legal Segregation Model and the Futures Model.

After carefully considering all comments, the Commission has selected the Complete Legal Segregation Model as the most appropriate segregation model for Cleared Swaps Customer Collateral under section 4d(f) of the CEA. The Commission believes this model provides the best balance between benefits and costs in order to protect market participants and the public. The Commission has adopted a number of clarifications and corrections suggested in the comment letters. In other cases the final rules are adopted as proposed. The discussion below provides a more detailed analysis of the issues raised by the comment letters.

III. Segregation Model for Cleared Swaps Customer Collateral

In the NPRM, the Commission proposed the Complete Legal Segregation Model but made clear that, because the costs and benefits associated with the Complete Legal Segregation Model were still being evaluated, the Commission was considering whether to adopt the Legal Segregation with Recourse Model as an alternative, and was continuing to assess the feasibility of the Futures Model and a clearinghouse-by-clearinghouse Optional Approach. Below is a summary of the comments the Commission received regarding the alternative segregation models for Cleared Swaps Customer Collateral.

A. Summary of the Comments

1. Complete Legal Segregation Model

As mentioned above, the majority of the comment letters supported adoption of the Complete Legal Segregation Model either outright or as a viable alternative to the Physical Segregation Model, with most arguing that the Complete Legal Segregation Model presents the best balance between costs and adequacy of collateral protections,[55] and several calling it a ''significant improvement over the'' Futures Model.[56] Several commenters also opined that the Complete Legal Segregation Model is supported by the statutory language and purposes of the Dodd-Frank Act.[57]

In addition, many of the comment letters asserted that the Complete Legal Segregation Model largely mitigates Fellow-Customer Risk and enhances the portability of cleared swap positions and associated collateral.[58] One commenter stated that the Complete Legal Segregation Model is ''the most cost effective framework to adequately protect the margin customers post to cleared swap transactions'' because it effectively mitigates Fellow-Customer Risk, avoids the costs associated with establishing the Physical Segregation Model by allowing margin to be held in an omnibus account, and enhances the portability of cleared swap positions and related margin.[59] Another commenter stated that the Complete Legal Segregation Model ''provides the most operationally efficient framework to manage risk on a daily basis or port portfolios especially in periods of stress.'' [60] And yet other commenters argued that there has been little substantiation of the ''increased costs'' that would arise from implementation of the Complete Legal Segregation Model, especially with respect to costs surrounding the reporting requirements associated with maintaining separate legal accounts given that ''other regulatory rulemakings that require similar reporting will likely result in many of these incremental operational costs being incurred regardless of which model is chosen.'' [61]

[50] The Commission also notes that any market participant may become a clearing member of a DCO, consistent with the DCO's membership eligibility requirements and the CEA and Commission regulations, with all the rights and responsibilities associated therewith.

[51] *See* CIEBA Supplemental at 14.

[52] All comment letters are available through the Commission's Web site at: *http://comments.cftc.gov/PublicComments/CommentList.aspx?id=1038*. Comments addressing the proposed rules were received from: APG Algemene Pensioen Groep N.V. and the European Federation Retirement Provision (''APG/EFRP''), American Council of Life Insurers (''ACLI''), Association of Institutional Investors (''AII''), Bank of America, N.A., BlackRock, Inc. (''BlackRock''), Chris Barnard, CME, CIEBA, Federal Home Loan Banks (''FHLB''), Fidelity Management & Research Co. (''Fidelity''), Freddie Mac, Futures Industry Association (''FIA''), IntercontinentalExchange, Inc. (''ICE''), Investment Company Institute (''ICI''), International Swaps and Derivatives Association, Inc. (''ISDA''), LCH.Clearnet Group Limited (''LCH''), Managed Funds Association (''MFA''), Natural Gas Exchange, Inc. (''NGX''), Newedge USA, LLC (''Newedge''), Och-Ziff Capital Management Group (''Och-Ziff''), Jerrold E. Salzman, Securities Industry and Financial Markets Association (''SIFMA''), Tudor Investment Corporation (''Tudor''), and Vanguard. Note, CIEBA, Fidelity and the MFA each submitted two comment letters.

[53] The following commenters support the Complete Legal Segregation Model outright: ACLI, AII, BlackRock, Mr. Barnard, Freddie Mac, ICI, ISDA, LCH, SIFMA, and Vanguard. APG/EFRP, CIEBA, Fidelity, MFA, Tudor and FHLB support implementation of the Physical Segregation Model.

[54] The commenters in favor of adoption of the Futures Model were CME, ICE, Newedge, and Mr. Salzman.

[55] *See* ACLI at 2; AII at 1; BlackRock at 1; Barnard at 2; Fidelity at 2; Freddie Mac at 2; LCH at 1–2; SIFMA at 3; Vanguard at 8.

[56] CIEBA at 1; and FHLB at 1.

[57] *See* BlackRock at 3; Fidelity at 5–6; FIA at 3, n. 10; ICI at 2; Mr. Barnard at 1; and SIFMA at 3, n. 7.

[58] *See, e.g.,* AII at 3 (stating that the Complete Legal Segregation Model effectively eliminates Fellow-Customer Risk, enhances portability of positions and related margin, and largely avoids the costs associated with establishing individually segregated accounts); BlackRock at 2 (arguing that the Complete Legal Segregation Model ''eliminates Fellow-Customer Risk and facilitates 'immediate' portability of customer positions if required''); CIEBA Original at 5 (acknowledging that the Complete Legal Segregation Model could eliminate Fellow-Customer Risk); FHLB at 3 (agreeing that the Complete Legal Segregation Model greatly reduces Fellow-Customer Risk); ICI at 3 (stating that the Complete Legal Segregation Model mitigates Fellow-Customer Risk); ISDA at 1–2 (agreeing that Complete Legal Segregation Model facilitates post-default portability); MFA at 3–4 (stating that the Complete Legal Segregation Model eliminates Fellow-Customer Risk and enhances the portability of customer positions); Vanguard at 4–6 (arguing that the Complete Legal Segregation Model addresses counterparty risk and Fellow-Customer Risk); and SIFMA at 5 (stating that Complete Legal Segregation Model minimizes Fellow-Customer Risk and facilitates the ability of Cleared Swaps Customers to port their positions to a non-defaulting FCM).

[59] AII at 1.

[60] BlackRock at 6.

[61] Fidelity at 6. *See also* LCH at 2–3. The Commission has adopted a gross margining requirement. *See* 76 FR at 69374–76.

Several commenters also argued that, in selecting a segregation model for Cleared Swaps Customer Collateral, the Commission should take into account the differences between the risk profiles of futures and over the counter (''OTC'') swaps.[62]

Furthermore, commenters argued that, unlike the Futures Model, the Complete Legal Segregation Model would not degrade the collateral protections that currently exist in the OTC swaps market.[63] In addition, one commenter indicated that the Complete Legal Segregation Model is ''the model that most closely parallels the protections that [LCH] understand[s] will be required in Europe under the European Commission's proposal for a European Market Infrastructure Regulation (''EMIR'').'' [64]

Commenters who did not support adoption of the Complete Legal Segregation Model largely argued that (1) The costs of implementing the Complete Legal Segregation Model outweigh any of the purported benefits of such model; [65] (2) the Complete Legal Segregation Model would, in the view of the commenter, fail to work operationally or legally,[66] and does not take into account the operational complexities of multi-tiered and multi-DCO clearing; [67] (3) individualized segregation potentially introduces systemic costs because it impedes timely market settlements during periods of market stress; [68] (4) since the Futures Model has served the industry well during times of stress in the futures market, it should be the segregation model for Cleared Swaps Customer Collateral; [69] (5) the Complete Legal Segregation Model introduces moral hazard; [70] or (6) the Complete Legal Segregation Model does not provide enough protection of Cleared Swaps Customer Collateral because there is some residual Fellow-Customer Risk,[71] and it does not protect against fraud-related risks,[72] record-keeping/operational risk, and Investment Risks.[73] Moreover, several commenters disagreed with the Commission's interpretation of the statutory language in the Dodd-Frank Act, and argued that the statutory language cited by the Commission does not indicate Congressional intent for individual protection for Cleared Swaps Customer Collateral.[74]

2. Physical Segregation Model

Comments with respect to the Physical Segregation Model were mixed, with some commenters advocating the adoption of the Physical Segregation Model outright,[75] others advocating for its adoption on an optional basis,[76] and others arguing that the Physical Segregation Model should not be adopted because the increased costs and operational burdens associated with adoption of the Physical Segregation Model outweigh the benefits.[77]

Two commenters requested that the Commission reconsider adoption of the Physical Segregation Model on the basis that (i) Customer collateral should be individually segregated at both the FCM and the DCO to provide the same level of customer collateral protection that currently exists in the OTC swaps market, (ii) none of the other models are sufficient to fully protect customer collateral from recordkeeping/operational, investment and fraud-related risks, (iii) the Physical Segregation Model facilitates porting more than the other models, and (iv) the commenters would be willing to bear any increased costs associated with the adoption of the Physical Segregation Model.[78]

In addition, though several commenters supported the Complete Legal Segregation Model as the best alternative under consideration, these commenters urged the Commission to develop a framework for the adoption of the Physical Segregation Model because (i) The protections offered by the Physical Segregation Model are greater than those offered by the Complete Legal Segregation Model, (ii) the Physical Segregation Model facilitates porting more than the other models, and (iii) the costs assertions resulting from implementing the Physical Segregation Model have either not been substantiated or are costs that the commenters are willing to bear.[79]

Commenters that opposed adoption of the Physical Segregation Model generally did so on the basis that implementation of the model would give rise to substantial increased costs with little increased benefit, as compared with the Complete Legal Segregation Model.[80]

3. Futures Model

As mentioned above, four comment letters supported adoption of the Futures Model, with one commenter supporting adoption of both the Complete Legal Segregation Model and the Futures Model.

CME argued that the Futures Model provides the best balance of costs versus industry risk as a whole and is ''the *only* approach that provides both legal and operational certainty to all parties in the event of an FCM default.'' [81] According to CME, the Complete Legal Segregation Model imperfectly protects customer collateral and thus, ''the Commission [should] not rush [sic] to implement a 'solution' that gives superficial comfort, but may not work either operationally or legally in the event of an actual default.'' [82] CME encouraged the Commission to ''engage in further study, and establish a review process that includes a representative group of interested parties with expertise in the area, in order to evaluate alternative approaches.'' [83] Because the Futures Model has effectively protected customer interests in the futures market, CME recommended that, in the interim, the Commission implement swaps clearing employing the Futures

[62] BlackRock at 2–4; Fidelity at 4; SIFMA at 2; Vanguard at 3–4.

[63] *See* Fidelity at 2–4; Freddie Mac at 1; and LCH at 1. *See also* Tudor at 2 (arguing that the segregation model selected by the Commission should not provide a lesser degree of protection for Cleared Swaps Customer Collateral).

[64] LCH at 1.

[65] *See, e.g.,* ICE at 11.

[66] *See* CME at 5 (stating that ''the framework established by the [Complete Legal Segregation Model] concept and the proposed regulations will be wholly inadequate to achieve the Commission's desired objectives: Namely, in an FCM default, the preservation of non-defaulting cleared swaps customers' collateral and the ability to port their positions and collateral to another FCM.'').

[67] *See, e.g.,* CME at 6–8. *See also* Mr. Salzman at 7 (stating that ''the benefits promised by the proponents of the [Complete Legal Segregation Model] are illusory,'' and arguing that the Commission's authority to adopt, and a bankruptcy court's willingness to respect, such model are questionable).

[68] *See* ICE at 3.

[69] *See, e.g.,* Newedge at 8; and CME at 23.

[70] *See, e.g.,* Newedge at 4–5.

[71] *See, e.g.,* CME at 7.

[72] Fraud-related risks are risks associated to an FCM's fraudulent activity with respect to the cleared swap margin account.

[73] *See, e.g.,* Tudor at 4; CIEBA Original at 1; and FHLB at 3–6 (each advocating for the adoption and implementation, either outright or on an optional basis, of the Physical Segregation Model, though acknowledging that the Complete Legal Segregation Model is preferable to the Futures Model).

[74] *See* CME at 21–22 (arguing that if Congress intended to change the framework for the protection of customer collateral it would have explicitly done so); FIA at 3, n. 10 (agreeing that the complete legal segregation model is permitted by the language of section 4d(f), but arguing that Commission reliance on the differences between sections 4d(a) and 4d(b) are misplaced); and ICE at 5 (arguing that the Commission should not rely on the language in section 4d(f) because there is no legislative history interpreting the statutory language).

[75] FHLB at 1; Tudor at 1–2.

[76] ACLI at 2; CIEBA at 2; MFA at 2; Mr. Salzman at 8.

[77] BlackRock at 6; Vanguard at 6.

[78] *See, e.g.,* ICI at 2 and 9.

[79] *See, e.g.,* ACLI at 2; BlackRock at 5.

[80] *See, e.g.,* AII at 2; ICE at 9; FIA at 6; SIFMA at 4 n. 9; and Vanguard at 6.

[81] CME at 23.

[82] *Id.* at 2.

[83] *Id.*

Model.[84] Moreover, CME suggests that the Commission support a new industry effort to, at some point in the future, develop and implement a guaranteed clearing participant relationship that would allow a client, on an optional basis, to have a direct relationship with a DCO, with the client's positions guaranteed by a guaranteeing clearing member of the DCO and the client's Cleared Swaps Customer Collateral held in an outside account by a third party custodian.

Mr. Salzman supported adoption of the Futures Model with optional full physical segregation of Cleared Swaps Customer Collateral.

ICE advocated adoption of the Futures Model, arguing against fundamentally changing a clearinghouse's existing operations, and positing that customers that wish to avoid Fellow-Customer Risk might explore becoming direct clearing participants once they ''fully appreciate[e] the substantial costs * * * associated with implementing and maintaining [the Complete Legal Segregation Model].'' [85] However, ICE also proposed, as a middle ground, a model that appears to be based on the Futures Model but that provides some protection against Fellow-Customer Risk. ICE explained that its ICE Clear Credit affiliate had adopted a model under which, ''customers are exposed to 'fellow-customer risk' only with respect to the customer's pro-rata share of the net customer-related margin requirement of its clearing member.'' [86] ICE Clear Credit considers ''the difference between a customer's gross margin requirement and the customer's net margin requirement'' to be ''Excess Margin.'' [87] ICE stated that a customer's Excess Margin is segregated and held by ICE Clear Credit on a custodial basis and is therefore not exposed to Fellow-Customer Risk. ICE argued that this model would provide some protection against Fellow-Customer Risk but would be more cost-effective than the proposed Complete Legal Segregation Model. In addition, ICE stated that individual segregation should be offered to customers at the option of a DCO, and also advanced the notion that the Commission should ''carefully consider and weigh the costs and benefits of potential customer-related OTC clearing models by asset class * * *.'' [88]

Newedge, which submitted a comment on behalf of itself, DRW Trading Group and nine ''Customers,'' supported adoption of the Futures Model on the basis that the Futures Model ''is the model most consistent with the general purposes of Title VII of Dodd-Frank as well as least likely to add moral hazard to the industry.'' [89] Newedge argued that Title VII is about the reduction of systemic risk through the mutualization of risk, and that by mutualizing credit risk the Futures Model promotes the purpose of the Dodd-Frank Act because such mutualization encourages the creation and maintenance of well-capitalized FCMs. In addition, Newedge argued that the loss of customer off-sets would increase moral hazard because it would encourage FCMs to maintain less excess capital. Furthermore, Newedge suggested that, as an alternative to the adoption of the Complete Legal Segregation Model, the Commission should require greater FCM disclosure to allow customers to better assess Fellow-Customer Risk.[90]

Comment letters supporting individual protection for customer collateral over the Futures Model generally did so on the basis that the Futures Model (i) does not protect Cleared Swaps Customer Collateral from Fellow-Customer Risk, Investment Risk, operational risk or fraud-related risk, and (ii) does not facilitate the portability of customer positions and associated collateral in the event of an FCM's default.[91]

BlackRock argued that not only does the Futures Model fail to address the core risk differences between futures and OTC swaps, but because of the buffer created by the mutualized risk provided by the customer collateral, the Futures Model may result in less stringent selection and oversight of customers by FCMs.[92] In addition, BlackRock argued that the moral hazard argument advocated by proponents of the Futures Model presumes that futures customers have access to information that allows them to make informed decisions regarding their fellow customers. However, BlackRock stated that access to such information is currently lacking, there are no requirements or incentives for a DCO or FCM to inform a customer when a fellow customer is in a stress or potential default situation and, as a result, customers are forced to rely on DCOs and regulators for protection.[93]

Freddie Mac argued that by allowing DCOs to access the collateral of non-defaulting customers to cover the losses of defaulting customers, the Futures Model provides a ''subsidy to DCOs, FCMs and their riskiest customers at the expense of customers that present less risk[, and] this non-transparent shifting of risk would create moral hazard and inefficient credit decisions.'' [94]

Similarly, FHLB argued that DCOs and FCMs should bear all Fellow-Customer Risk as they are in a superior position to conduct analyses of other cleared swap customers.[95] In addition, FHLB indicated that if the Commission adopts the Futures Model as the segregation model for Cleared Swaps Customer Collateral, it would be anomalous for market participants to have the initial margin they post for Cleared Swaps face greater risk than the initial margin they post for uncleared swaps.[96] Moreover, the Futures Model would impede portability because the collateral posted for Cleared Swaps ''could be tied up in the omnibus account indefinitely.'' [97]

SIFMA stated that avoiding Fellow-Customer Risk presented by the Futures Model should be the most important

[84] *See id.* at 23.

[85] ICE at 3.

[86] *Id.*

[87] *Id.* at 3, n. 3.

[88] ICE at 1–2.

[89] Newedge at 2.

[90] Newedge argues that such disclosure be provided in ''plain English'' on an annual basis, and include the following data:

The FCM's total equity, regulatory capital and net worth;

The dollar value of the FCM's proprietary margin requirements as a percentage of its segregated and secured customer margin requirements;

What number of the FCM's customers comprise an agreed significant percentage of its customer segregated funds;

The aggregate notional value of non-hedged, principal OTC transactions into which the FCM has entered;

The amount, generic source and purpose of any unsecured and uncommitted short-term funding the FCM is using;

The aggregate amount of financing the FCM provides for customer transactions involving illiquid financial products for which it is difficult to obtain timely and accurate prices;

The percentage of customer ''bad debts'' the FCM had during the prior year compared to its year-end segregated and secured customer funds; and

A summary of the FCM's current risk practices, controls and procedures.

Newedge at 7. *See also* FHLB at 7, n. 14 (encouraging the Commission, in response to a question in the NPRM regarding additional disclosure of FCM financial information, to make such information publicly available on a real time basis); and MFA at 5 (arguing that ''if the Commission mandates the disclosure by FCMs of certain financial information, customers will be in a better position than they are today to evaluate the financial strength of their FCM.'').

[91] *See, e.g.,* AII at 1–2; BlackRock at 2, 7–8; CIEBA Original at 5; FHLB at 6–7; Fidelity at 3; Freddie Mac at 1–2; SIFMA at 5; and Vanguard at 4–5.

[92] Blackrock at 8.

[93] *Id.*

[94] Freddie Mac at 2.

[95] FHLB at 6–7.

[96] FHLB at 7. FHLB also states that market participants have a statutory right to segregate initial margin they post for uncleared swaps with an independent custodian. *Id.* at 6.

[97] FHLB at 7.

objective in selecting a segregation model for Cleared Swaps Customer Collateral and, as such, none of the members of the Asset Management Group supports the Futures Model.[98] In addition, SIFMA argued that the Futures Model does not facilitate portability to the same extent as the Complete Legal Segregation Model and, therefore, is not as effective at reducing systemic risk.[99]

Vanguard asserted that the Futures Model exposes market participants to Fellow-Customer Risk and because this risk is not a factor in the OTC swaps markets, the magnitude of such risk is not something that a customer could ever assess, especially given the ''complete lack of transparency with respect to [an] FCM's other customers and their trading positions.'' [100] Furthermore, Vanguard stated that mutualization of customer losses effectively allows ''less sophisticated analysis of the risk presented by individual customers and their trading portfolios as such individual risk can ultimately be covered by the overall pool of margin posted by all of the FCM's customers,'' with the result that ''riskier customers (and trading portfolios) [are] likely to be under margined and safer clients (and trading portfolios) [are] likely to be over margined relative to their actual level of risk presented to the system.'' [101] In sum, Vanguard stated that, given the differences between the swaps and futures markets, the Futures Model could expose a Cleared Swaps Customer to significantly greater and potentially unlimited risk.[102]

4. Legal Segregation With Recourse Model

None of the comment letters received by the Commission appeared to support the Legal Segregation with Recourse Model. Commenters that discussed this model generally stated that the Commission should not adopt the Legal Segregation with Recourse Model because either (1) by failing to mitigate Fellow-Customer Risk, it is substantially inferior to the Complete Legal Segregation Model [103] or (2) it suffers from the same shortcomings as the Complete Legal Segregation Model since it is costly to implement and fails to mitigate investment and operational risks.[104]

5. Optional Approach

Though some commenters expressed a desire to have optional full physical segregation of Cleared Swaps Customer Collateral, none of the commenters supported the Optional Approach outlined by the Commission.[105] Under this approach, each DCO would choose the level of customer collateral protection it chooses to offer.[106] The Commission noted that this approach might be reconciled with section 766(h) of the Bankruptcy Code by permitting DCOs to require that FCMs establish separate legal entities, each of which is limited to clearing at DCOs that use only the same customer collateral protection model.[107]

One commenter stated that it is ''likely that the benefits of creating such a regulatory structure would be illusory,'' [108] while another argued that ''[o]ptionality will produce complexity and expense that might be tolerable when the cleared swaps market is well established, but that will be burdensome to a developing market.'' [109] In addition, one commenter expressed concern regarding the appropriateness of the Commission adopting a segregation regime ''that provides protection to customers based on their ability and willingness to pay.'' [110]

B. Discussion of the Comments

After careful analysis of the issues raised by the comment letters with respect to the selection of a segregation model for Cleared Swaps Customer Collateral, the Commission is adopting the Complete Legal Segregation Model. As described above, the majority of market participants supported adoption of either the Complete Legal Segregation Model or the Physical Segregation Model. In addition, while certain technical corrections/clarifications were requested, none of the commenters identified material new information with respect to costs or benefits associated with the adoption of the Complete Legal Segregation Model or any other model under consideration. Some commenters did, however, reiterate their view that their business model depended upon receiving stronger protection for their Cleared Swaps Customer Collateral than what exists under the Futures Model. These commenters are accustomed to paying for the higher costs implicit in separate accounting in the current bilateral market.

On the other hand, CME, ICE, and Mr. Salzman identified a number of issues with the Complete Legal Segregation Model, including a number of limitations on the protection it provides to customers. They did not, however, provide reason to reject the conclusion that the Complete Legal Segregation Model provides substantially greater protection against Fellow-Customer Risk than the Futures Model.

CME notes [111] that a portion of the Cleared Swaps Customer Collateral will be held at the FCM, not the DCO, and that this collateral will not be protected by Complete Legal Segregation in the event that an FCM becomes insolvent. This proposition is true [112] but is of little or no relevance to the comparison of Complete Legal Segregation with the Futures Model favored by these commenters. Complete Legal Segregation is intended to protect against Fellow-Customer Risk. As discussed in the NPRM and above,[113] Fellow-Customer Risk is the risk that the collateral of one customer will be used to compensate a DCO for market losses resulting from the swaps of another customer.[114] In other words, Fellow-Customer Risk arises in connection with collateral maintained in an FCM's customer account posted with a DCO because, under the Futures Model, the DCO is potentially entitled to take all of the collateral in this account to cover losses created by the swaps of any customer. However, Cleared Swaps Customer Collateral held at the FCM (or at a location other than at the DCO, such as a bank) is not accessible to the DCO. Thus, such

[98] SIFMA at 3.

[99] *See* SIFMA at 4–6.

[100] Vanguard at 5.

[101] *Id.*

[102] *Id.*

[103] *See* BlackRock at 7; FHLB at 7; Freddie Mac at 2; FIA at 6–7; MFA at 2; and Vanguard at 4.

[104] *See, e.g.,* CME at 16.

[105] *See, e.g.,* MFA at 3 n. 11 (stating ''[t]he Commission should allow market participants to elect the Physical Segregation Model but only to the extent that it is compatible with the Complete Legal Segregation Model. We are not advocating that the Commission adopt the ''Optional Approach'' set forth in the Proposing Release, because we believe that approach would be very difficult to implement.''); ACLI at 2 (supporting the option to negotiate and select the Physical Segregation Model); BlackRock at 5 (stating that BlackRock would support an optional approach if the Commission believes such an approach would be prudent, but cautions that optionality may present implementation challenges and result in portability delays); CIEBA Original at 1 (promoting optional individual segregation of Cleared Swaps Customer Collateral); CME at 17–20 (arguing that the Commission should support efforts to establish programs that would permit individuals to physically segregate the collateral associated with their Cleared Swaps positions on an optional basis); and Tudor at 6 (arguing that if the Commission does not adopt the Physical Segregation Model, the Commission should ''require DCOs to offer various segregation models to their cleared swaps customers, including full physical segregation.'').

[106] *See* 76 FR at 33825.

[107] *See* 76 FR at 33829.

[108] CME at 20.

[109] ISDA at 2.

[110] FIA at 6.

[111] CME at 6.

[112] *See supra* note 13.

[113] *See supra* at Section 1.B.6.

[114] 76 FR at 33821 n. 21.

collateral is not subject to Fellow-Customer Risk.[115] While Cleared Swaps Customer Collateral in the customer account at the FCM is available to meet customers' swaps-related obligations to the FCM, the FCM is prohibited by statute from using one customer's Cleared Swaps Customer Collateral as margin or security for another customer's swaps.[116]

To be sure, Cleared Swaps Customer Collateral is subject to operational risk—the risk that, due to fraud, incompetence, or other mishap, customer funds that are required to be segregated are lost. Operational risk, however, is common to all of the segregation models for Cleared Swaps Customer Collateral, including the Physical Segregation Model.[117] Collateral at the FCM is also subject to a modicum of Investment Risk. But Commission regulation 1.25, upon which regulation 22.2(e)(1) is based, is designed to ensure that customer segregated funds are invested in a manner that minimizes their exposure to credit, liquidity, and market risks both to preserve their availability to customers and DCOs and to enable investments to be quickly converted to cash at a predictable value in order to avoid systemic risk. Towards these ends, regulation 1.25 establishes a general prudential standard by requiring that all permitted investments be ''consistent with the objectives of preserving principal and maintaining liquidity.'' [118]

CME also provides a detailed description of how, due to the ''the extended operational timeline for derivatives clearing and the netting of payments,'' a customer could default on a payment on Tuesday, but the DCO would, due to a countervailing gain by a different customer or customers of the same clearing member, not see such a default until after Wednesday's clearing cycle (payments for which may not be due until Thursday morning).[119] This analysis elides the fact that, pursuant to the calculations required under regulation 22.2(f), an FCM with a customer who incurred a loss in excess of that customer's Cleared Swaps Customer Collateral would, unless and until that customer posted additional collateral, be required to have covered such loss with the FCM's own capital deposited into the Cleared Swaps Customer Account. If, at any moment, such customer loss was not covered by the FCM's own capital, then the FCM would be in violation of its segregation requirements. Pursuant to Commission regulation 1.12(h),

> [w]henever a person registered as a futures commission merchant knows or should know that the total amount of its funds on deposit in segregated accounts on behalf of customers * * * is less than the total amount of such funds required by the Act and the Commission's rules to be on deposit in segregated * * * accounts on behalf of such customers, the registrant must report such deficiency immediately by telephonic notice * * * to the registrant's designated self-regulatory organization and the principal office of the Commission in Washington, DC * * *.[120]

Thus, an FCM whose customer suffers such a loss which is not covered by the FCM's own capital on deposit in the Cleared Swaps Customer Account will certainly know of such deficiency no later than noon the next day (Wednesday in CME's example), when it will be required, pursuant to regulation 22.2(g), to compute its segregated funds requirements and the amount of segregated funds it has on deposit to meet such requirements. Moreover, the Commission believes that an FCM carrying a customer account that suffers losses in excess of that firm's ability to cover ''should know'' of such losses by the end of that trading day (Tuesday in CME's example).

Such notice will permit the Commission to act to notify the relevant clearing organizations and to ensure that prompt action is taken to either bring capital in to enable the FCM to meet its segregated funds requirements or to otherwise act to minimize customer losses.

CME implies that a successful porting of customer accounts requires information that is ''100% accurate,'' [121] and that an FCM is unlikely to meet that standard each day. CME also notes that there may be portfolio changes in customer accounts on the day of default.[122] Moreover, CME notes that a defaulting FCM may have systems that fail.[123] CME notes that in the case of Lehman Brothers,[124] there was a ''rushed, confused, uncertain and near-panic atmosphere,'' as described in the report of the SIPA Trustee.[125]

Recent experience demonstrates, however, that transfers can occur despite less than perfect information. For example, in the case of the bankruptcy of Lehman Brothers the commodity customer accounts were effectively transferred to Barclays over the weekend of September 20–21, 2008, immediately following the commencement of the liquidation of the firm,[126] and any discrepancies were resolved, despite the difficulties described. Indeed, the key issue will be to identify the collateral attributable to the defaulting customer, as distinguished from the collateral attributable to all other customers, as discrepancies between non-defaulting customers can be resolved either as transferred accounts are reconciled, or through the claims process.

Thus, while CME is correct in stating that ''the risk of ultimate financial loss to customers due to a fellow-customer default is reduced but certainly not eliminated under CLSM,'' [127] the Commission concludes, based on its experience with its rules in general and with FCM bankruptcies in particular, that the probability and probable amount of such loss is far less than CME implies.

Moreover, the swift portability of collateral associated with customer positions in the event of an FCM's default remains problematic under the Futures Model where there is a customer default. Furthermore, many of the imperfections of the Complete Legal Segregation Model and the residual Fellow-Customer Risk associated therewith that were highlighted by CME arise from the ''last-day risk'' that results from the fact that information about each customer's positions is only provided once each day. However, the NPRM made clear in relevant portions of sections 22.11 and 22.12, and the Commission reiterates herein, that information must be provided and calculations must be made *at least* once a business day. In other words, many of the imperfections discussed by CME are not inherent to the Complete Legal Segregation Model. Rather, each DCO is free to make improvements to that

[115] As explained above, FCMs typically maintain two separate Cleared Swaps Customer Accounts. One is maintained at the DCO and contains collateral required by the DCO to secure current swaps positions. The second is maintained by the FCM itself, typically at a bank, and contains collateral provided to the FCM by customers but not currently posted to the account at the DCO.

[116] Section 4d(f)(2)(B) of the CEA, 7 U.S.C. 6d(f)(2)(B).

[117] Moreover, as noted above (*see supra* section I.D.2), while the LSOC Model does not protect against operational risk any more than the Futures Model, it is superior in that it enhances the ability to transfer collateral after an insolvency caused by operational risk.

[118] *See* regulation 1.25(b).

[119] CME at 9.

[120] Commission regulation 1.12(h) emphasis added.

[121] CME at 13.

[122] *Id.* at 12.

[123] *Id.* at 14.

[124] The Lehman Brothers FCM was placed into a Securities Investor Protection Corporation liquidation on Friday, September 19, 2008.

[125] CME at 14 (citation omitted).

[126] This transfer was authorized in the hours immediately following the commencement of Lehman's liquidation, and was implemented in the hours immediately thereafter.

[127] CME at 15.

minimum regulatory standard if the DCO finds such improvements to be technologically feasible and economically justifiable. For example, a DCO could require its clearing members to identify the customer associated with each swap as it is cleared, and the DCO could use this information to associate gains and losses more tightly with each customer, thereby minimizing ''last-day risk.'' The NPRM and this final rule simply set a minimum threshold for daily tracking.

With respect to costs associated with evaluating the credit risks of individual customers, CME noted that it calculates, ''at the end of each trading day * * * for each FCM's cleared swaps customer account * * * the net position of *each* customer in the account [and] the net margin requirement for *each* customer in the account.'' [128] Thus, based on CME's description of its current clearing practices, it would appear that CME already undertakes an individualized evaluation of the sufficiency of the collateral posted by each customer of an FCM.[129] In addition, as CME notes, ''FCMs are subject to compliance audits that are conducted for each FCM by the DCO serving as its ''designated self-regulatory organization.'' [130] It would therefore seem that at least some of the costs associated with evaluating the credit risk of individual customers are already being incurred by DCOs.

With respect to ICE's proposal, the Commission notes that it would provide less Fellow-Customer Risk protection than the Complete Legal Segregation Model. The fact that swap customers seem to overwhelmingly favor at least as much Fellow-Customer Risk protection as afforded to them under the Complete Legal Segregation Model, notwithstanding the potential costs, weighs in favor of the Complete Legal Segregation Model rather than ICE's proposal.

With respect to Newedge's suggestion for increased disclosure of FCM information, additional disclosure is often beneficial, and the Commission will consider additional disclosure requirements as a means of enhancing protection for collateral belonging to market participants. However, because of confidentiality concerns, any feasible enhanced disclosure is insufficient for quantifying risk exposure to Fellow-Customer Risk and, thus, insufficient for providing Cleared Swaps Customers with the ability to effectively manage such exposure.[131] Moreover, even if it were practical to provide Cleared Swaps Customers with information sufficient to assess Fellow-Customer Risk, that task is better left to the DCO since (1) DCOs have a concentrated ability to ensure adequate risk mitigation, and (2) having each Cleared Swaps Customer effectively risk-manage each FCM would likely entail duplication with resulting cost.

Thus, after careful analysis of the comments, the Commission believes that the Complete Legal Segregation Model provides the most appropriate framework for the protection of Cleared Swaps Customer Collateral at this time. None of the segregation models the Commission considered provides perfect protection for Cleared Swaps Customer Collateral, and the degree of imperfection of any of the models is influenced by ''the facts and circumstances'' of an FCM default. However, as CME notes, the Complete Legal Segregation Model ''would, on its face, lead to greater protection of cleared swaps customer collateral against Fellow-Customer Risk than the Futures Model'' [132] and is ''more likely to facilitate portability of cleared swaps customer positions than the Futures Model, in the event of an FCM default in its cleared swaps customer account * * *.'' [133] Furthermore, the Complete Legal Segregation Model provides the best balance between benefits and costs in order to protect market participants and the public.

Finally, while the Complete Legal Segregation Model is a critical step in the efforts to protect customers and their collateral, as noted above, the Commission is actively considering seeking notice and comment on a proposal to allow individual protection of client assets. In addition, the Commission is directing staff to look into the possibility of adopting the Complete Legal Segregation Model for the futures market. The Commission remains committed to protecting market participants.

IV. Section by Section Analysis: Regulation Part 22

A. Regulation 22.1: Definitions

Proposed regulation 22.1 established definitions for, *inter alia,* the following terms: ''cleared swap,'' ''cleared swaps customer,'' ''cleared swaps customer account,'' ''cleared swaps customer collateral,'' ''cleared swaps proprietary account,'' ''clearing member,'' [134] ''collecting futures commission merchant,'' ''commingle,'' ''customer,'' ''depositing futures commission merchant,'' ''permitted depository,'' [135] and ''segregate.''

1. ''Segregate'' and ''Commingle''

Regulation 22.1 proposed definitions for the terms ''segregate'' and ''commingle'' that are intended to codify the common meaning of such terms under the part 1 of the Commission's regulations (the ''Part 1 Provisions''). Pursuant to the proposal, to ''segregate'' two or more items means to keep them in separate accounts and to avoid combining them in the same transfer between accounts. In contrast, ''commingle'' means to hold two or more items in the same account, or to combine such items in a transfer between accounts. The Commission did not receive comments on these

[128] *Id.* at 9 (emphasis supplied).

[129] In addition, during the Second Roundtable, Ms. Taylor of CME stated that with respect to risk management, CME is ''set up to do it in the over-the-counter business at the individual customer level.'' *See* Second Roundtable Tr. at168, l. 10.

[130] *See also* Second Roundtable Tr. at 171, l. 18 (Ms. Taylor stating that ''on a day-to-day basis we don't see the collateral that's in the account of a customer at an FCM, but we do have transparency into the efficacy of the practices of holding margin and holding it in segregated accounts through the financial supervision and audit functions so that there is ongoing monitoring of that * * *'').

[131] *See* Second Roundtable at p. 183, 1.12–p. 184, 1.10 (In reference to the disclosure of additional FCM information, Mr. Kahn stating ''Barclays does agree and would be willing to show our risk-management procedures and policies, and we do talk to our buy side clients about that * * * [but] if Barclays is providing clearing services for any of the individual firms on the other side of the table, we do not say that, nor would we ever give out any position level information. It is very important to us that in whatever paradigm it's set up and how you evaluate from a risk-management standpoint that the buy side and their trades that they've put on that we are serving remains confidential and does not leak to the market in any side.''); and Second Roundtable at p. 185, 1.6 (Ms. Taylor stating that ''when we know when people clear, that's very confidential information and I'm very sympathetic to the fear about fellow customer risk, but I'm also very sympathetic to the fact that none of you would want your information disclosed so that there is a balance on the other side * * *''). *See also* In re Stotler and Co., 144 B.R. 385, 393 (Bankr.N.D.Ill. 1992) (''[T]he legislative history of *11 U.S.C. 766* emphasizes that the risk of a broker's bankruptcy is not to be borne by the customer * * *.'' Individual customers ''face a formidable task in researching the relative solvency, reputation, and success of competing FCMs.'').

[132] CME at 16.

[133] *Id.*

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

[135] The Commission proposed to define ''permitted depository'' as a depository that is a bank located in the United States, a trust company located in the United States, a Collecting Futures Commission Merchant registered with the Commission (but only with respect to a Depositing Futures Commission Merchant providing Cleared Swaps Customer Collateral), or a derivatives clearing organization registered with the Commission. In addition, the FCM or the DCO must hold a written acknowledgment letter from the depository as required by proposed regulation 22.5.

proposed definitions and is, therefore, adopting them as proposed.

2. ''Cleared Swap''

Regulation 22.1 proposed a definition of the term ''Cleared Swap'' that (i) excludes, for purposes of Part 22 only, cleared swaps (and related collateral) that, pursuant either to a Commission rule, regulation, or order (including an order under section 4d(a) of the CEA) or to a DCO rule approved in accordance with regulation 39.15(b)(2),[136] are commingled with futures contracts (and related collateral) in a customer account established for the futures contracts, but (ii) includes, for purposes of Part 22 only, futures contracts or foreign futures contracts (and, in each case, related collateral) that, pursuant to either a Commission rule, regulation, or order (including an order under section 4d(f) of the CEA) or to a DCO rule approved in accordance with regulation 39.15(b)(2),[137] are commingled with cleared swaps (and related collateral) in a customer account established for the cleared swaps. The Commission did not receive comments on the proposed definition of ''Cleared Swap'' and is adopting it as proposed with one change. The Commission finalized regulation 39.15 on October 18, 2011.[138] That final regulation requires a DCO seeking to commingle Cleared Swaps (and related collateral) with futures contracts (and related collateral) in a futures account to petition for a Commission order under section 4d(a) of the CEA. Thus, the final definition of ''Cleared Swap'' in this rulemaking removes the reference to DCO rule approval procedures relevant to such commingling.

3. ''Cleared Swaps Customer'' and ''Customer''

Regulation 22.1 proposed definitions of ''Cleared Swaps Customer'' and ''Customer.'' The Commission is adopting the definitions of ''Cleared Swaps Customer'' and ''Customer'' essentially as proposed, except that a technical amendment is made to the definition of Cleared Swaps Customer to clarify that a clearing member of a DCO is not a Cleared Swaps Customer with respect to Cleared Swaps cleared on that DCO.

4. ''Cleared Swaps Customer Collateral''

Proposed regulation 22.1 defined Cleared Swaps Customer Collateral to include (i) money, securities, or other property that an FCM or a DCO receives, from, for, or on behalf of a Cleared Swaps Customer that is intended to or does margin, guarantee, or secure a Cleared Swap[139] or, if the Cleared Swap is in the form or nature of an option, constitutes the settlement value of such option and (ii) ''accruals,'' which are the money, securities, or other property that an FCM or DCO receives, either directly or indirectly, as incident to or resulting from a Cleared Swap that the FCM intermediates for a Cleared Swaps Customer. The proposed definition explicitly included a Cleared Swap in the form or nature of an option as Cleared Swaps Customer Collateral, but did not explicitly include option premiums as Cleared Swaps Customer Collateral. The proposed definition also explicitly included in ''accruals'' the money, securities, or other property that a DCO may receive relating to the Cleared Swap that an FCM intermediates for a Cleared Swap Customer.

FIA suggested that the Commission confirm that the term Cleared Swaps Customer Collateral includes all assets provided by a Cleared Swaps Customer, including any sums required by an FCM to margin a Cleared Swap, even if that sum is in excess of the amount required by the relevant DCO, as well as collateral ''voluntarily'' deposited by a Cleared Swaps Customer in a Cleared Swaps Customer Account.[140] In response, the Commission is clarifying that the definition of Cleared Swaps Customer Collateral includes any sums required by an FCM that is intended to, or does, margin a Cleared Swap as well as collateral ''voluntarily'' deposited by, or on behalf of, a Cleared Swaps Customer in a Cleared Swaps Customer Account. Moreover, in response to this comment, the Commission is adding a new section 22.13(c), which states that collateral posted by a Cleared Swaps Customer in excess of the amount required by a DCO (the ''excess collateral'') may be transmitted by the Cleared Swaps Customer's FCM to the DCO if, but only if, (i) the FCM is permitted to do so by DCO rule and (ii) the DCO provides a mechanism by which the FCM can identify the amount of such excess collateral attributable to each Cleared Swaps Customer, and such mechanism is employed effectively to accomplish that goal.

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

As proposed, regulation 22.1 defined a ''Cleared Swaps Customer Account'' as (i) an account that an FCM maintains at a Permitted Depository for the Cleared Swaps (and related collateral) of its Cleared Swaps Customers, or (ii) an account that a DCO maintains at a Permitted Depository for collateral related to Cleared Swaps that the FCM members intermediate for their Cleared Swaps Customers. Regulation 22.1 also proposed a definition for ''Cleared Swaps Proprietary Account'' that is substantially similar to regulation 1.3, which defines ''Proprietary Account'' for futures contracts. The Commission requested comment on whether the proviso in paragraph (b)(8), which states that ''an account owned by any shareholder or member of a cooperative association of producers, within the meaning of section 6a of the Act, which association is registered as an FCM and carries such account on its records, shall be deemed to be a Cleared Swaps Customer Account and not a Cleared Swaps Proprietary Account of such association, unless the shareholder or member is an officer, director, or manager of the association,'' remains relevant, particularly with respect to Cleared Swaps. The Commission did not receive comments on these proposed definitions and is, therefore, adopting the definitions of ''Cleared Swaps Customer Account'' and ''Cleared Swaps Proprietary Account'' as proposed.

6. ''Clearing Member''

Regulation 22.1 proposed a definition of ''Clearing Member.'' The Commission did not receive comments on this proposed definition. Therefore, the Commission is adopting the definition of ''Clearing Member'' as proposed.

7. ''Collecting Futures Commission Merchant'' and ''Depositing Futures Commission Merchant''

Proposed regulation 22.1 defined a ''Collecting Futures Commission Merchant'' or ''Collecting FCM'' as one that carries Cleared Swaps on behalf of another FCM and the Cleared Swaps Customers of that other FCM and, as part of doing so, collects Cleared Swaps

[136] Section 4d(a) of the CEA, 7 U.S.C. 6d(a).

[137] Section 4d(f) of the CEA, 7 U.S.C. 6d(f).

[138] 76 FR 69441.

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

[140] *See* FIA at 7–8.

Customer Collateral.[141] In contrast, a ''Depositing Futures Commission Merchant'' or ''Depositing FCM'' was defined as one that carries Cleared Swaps on behalf of its Cleared Swaps Customers through a Collecting FCM, and, as part of doing so, deposits Cleared Swaps Customer Collateral with such Collecting FCM. The Commission did not receive comments on these proposed definitions and is adopting the definitions of ''Collecting Futures Commission Merchant'' and ''Depositing Futures Commission Merchant'' as proposed.

8. ''Permitted Depository''

Regulation 22.1 proposed a definition of ''Permitted Depository.'' The Commission did not receive comments on this proposed definition and is, therefore, adopting the definition of ''Permitted Depository'' as proposed.

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

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

1. In General

Proposed regulation 22.2(a) required an FCM to treat and deal with the Cleared Swaps of Cleared Swaps Customers, as well as associated Cleared Swaps Customer Collateral, as belonging to the Cleared Swaps Customers. The Commission did not receive any comments on regulation 22.2(a) and is therefore adopting regulation 22.2(a) as proposed.

2. Location of Collateral

Proposed regulation 22.2(b) required that an FCM segregate all Cleared Swaps Customer Collateral that it receives. Additionally, proposed regulation 22.2(b) required that an FCM adopt one of two methods to hold segregated Cleared Swaps Customer Collateral, which parallel either implicit assumptions or explicit provisions of regulation 1.20(a).

The Commission did not receive any comments on regulation 22.2(b) and is therefore adopting regulation 22.2(b) as proposed.

3. Commingling

Proposed regulation 22.2(c) permitted an FCM to commingle the Cleared Swaps Customer Collateral of multiple Cleared Swaps Customers, while prohibiting the FCM from commingling Cleared Swaps Customer Collateral with:

- FCM property, except as permitted under proposed regulation 22.2(e) (as discussed below); or
- ''customer funds'' (as regulation 1.3 defines such term) for futures contracts or the ''foreign futures or foreign options secured amount'' (as regulation 1.3 defines such term), except as permitted by a Commission rule, regulation or order (or a derivatives clearing organization rule approved pursuant to regulation 39.15(b)(2)).[142]

The Commission did not receive any comments on regulation 22.2(c) and is therefore adopting regulation 22.2(c) as proposed.

4. Limitations on Use

Proposed regulation 22.2(d) prohibited an FCM from (i) using, or permitting the use of, the Cleared Swaps Customer Collateral of one Cleared Swaps Customer to purchase, margin, or settle the Cleared Swaps, or any other transaction, of a person other than the Cleared Swaps Customer; (ii) using Cleared Swaps Customer Collateral to margin, guarantee, or secure the non-Cleared Swap contracts (*e.g.,* futures or foreign futures contracts) of the entity constituting the Cleared Swaps Customer; [143] (iii) imposing, or permitting the imposition of, a lien on Cleared Swaps Customer Collateral, including on any FCM residual financial interest therein; and (iv) claiming that any of the following constitutes Cleared Swaps Customer Collateral:

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

ISDA argued that these proposed rules could prevent or inhibit portfolio margining, even where netting itself is legally enforceable, and stated that the Commission should ''acknowledge in rule that *excess* collateral may be managed and applied so as to facilitate portfolio based-margining (including to the benefit of uncleared swaps).'' [144] FIA requested that the Commission confirm that regulation 22.2(d) will permit FCMs to take security interests in their Cleared Swaps Customers' Cleared Swaps Customer Accounts in support of other positions held by such customers at the FCM, or for other entities (including affiliates of FCMs) to take such security interests in support of financing the Cleared Swaps Customer's margin obligations. MFA asked the Commission to ensure that Cleared Swaps Customers are able to grant liens on Cleared Swaps Customer Collateral (subordinate to a DCO's rights) to be able to continue entering into cross-product, and other multilateral, netting agreements. MFA also argued that the Commission should either (i) modify proposed regulation 22.2(d)(2) to limit application of the rule to ''prohibiting an FCM's creditors from obtaining a lien on [Cleared Swaps Customer Collateral]'' or (ii) clarify in the final rule release or in interpretive guidance that the language of proposed regulation 22.2(d) is not intended to limit a Cleared Swaps Customer's ability ''to grant liens on entitlements to cleared swap positions and related collateral as contemplated by UCC 9–102(14), 102(15), 9–102(16), 9–102(17), 9–102(49);'' provided such lien does not impair a DCO's first priority interests to such collateral.[145]

As explained above, ''excess'' collateral refers to the collateral that a Cleared Swaps Customer deposits with an FCM or DCO that is more than the amount required by the FCM or DCO to margin such customer's Cleared Swaps portfolio. Since the ''excess'' collateral belongs to the Cleared Swaps Customer, and is not required by the FCM or DCO, it is entirely proper for the Cleared Swaps Customer to manage the collateral. The Cleared Swaps Customer may manage ''excess'' collateral by giving instructions to the FCM to,

[141] For the avoidance of doubt, an FCM does not become a Collecting FCM simply by intermediating the proprietary transactions of another FCM. An FCM only becomes a Collecting FCM by intermediating, on behalf of another FCM, Cleared Swaps belonging to Cleared Swaps Customers (and the relevant collateral).

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

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

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

[144] ISDA at 4–5.

[145] *See* MFA at 5–6.

among other things, transfer such collateral from one account (*e.g.,* a Cleared Swaps Customer Account) to another account (*e.g.,* a futures account).[146] However, it is less clear how collateral that is not ''excess''—namely, collateral margining cleared positions (for which the counterparty is the DCO, through the FCM)—can also be used to margin uncleared positions (for which the counterparty is, by definition, other than a DCO). Accordingly, while the Commission supports the benefits of portfolio margining, the Commission does not believe it would be prudent to permit collateral margining cleared positions to simultaneously be used to margin uncleared positions.

In addition, the Commission clarifies that an FCM may not, under any circumstances, grant a lien to any person (other than to a DCO) on its Cleared Swaps Customer Account, or on the FCM's residual interest in its Cleared Swaps Customer Account. On the other hand, a Cleared Swaps Customer may grant a lien on the Cleared Swaps Customer's individual cleared swaps account (an ''FCM customer account'') that is held and maintained at the Cleared Swaps Customer's FCM.[147] The Commission notes that by permitting a Cleared Swaps Customer to grant a lien on that Cleared Swaps Customer's FCM customer account, an FCM is *not* permitting the grant of a lien on Cleared Swaps Customer Collateral. Furthermore, the Commission confirms that regulation 22.2(d) permits (i) FCMs to take a security interest in a Cleared Swaps Customer's FCM customer account in support of other positions held by such customer at the FCM, and (ii) other entities (including affiliates of FCMs) to take a security interest in a Cleared Swaps Customer's FCM customer account in support of financing the Cleared Swaps Customer's margin obligations.

5. Exceptions

Regulation 22.2(e) proposed certain exceptions to the abovementioned requirements and limitations. Specifically, proposed regulation 22.2(e)(1) allowed an FCM to invest Cleared Swaps Customer Collateral in accordance with regulation 1.25, as such regulation may be amended from time to time. Proposed regulation 22.2(e)(2) permitted an FCM to withdraw Cleared Swaps Customer Collateral for such purposes as meeting margin calls at a DCO or a Collecting FCM, or to meet charges lawfully accruing in connection with a cleared swap, such as brokerage or storage charges. Proposed regulation 22.2(e)(3) permitted an FCM (i) to place its own property in an FCM Physical Location or (ii) to deposit its own property in a Cleared Swaps Customer Account.[148] Finally, as proposed, regulation 22.2(e)(4) clarified that, if an FCM places or deposits its own property in an FCM Physical Location or a Cleared Swaps Customer Account, as applicable, then that property becomes Cleared Swaps Customer Collateral. However, an FCM would be permitted to retain a residual financial interest in property in excess of that necessary.

SIFMA and Vanguard argued that the Commission should require an FCM to identify when it has used its own capital to meet a Cleared Swap Customer's margin obligation and whether such capital can be used by a DCO to cure a defaulting Cleared Swap Customer's margin obligations.[149] To address this comment, the Commission is amending regulation 22.2(e)(3) to distinguish between (a) cases where an FCM uses its own capital to cure a Cleared Swaps Customer's undermargined or deficit account and (b) cases where an FCM uses its own capital to create a ''buffer'' in the Cleared Swaps Customer Account. The Commission notes that in case (a), the FCM has, in essence, provided an advance to the Cleared Swaps Customer, and the DCO should be able to use such collateral to meet a default by that Cleared Swaps Customer to the same extent as if that Cleared Swaps Customer provided the collateral. However, in case (b) the FCM has provided collateral that does not belong to any specific Cleared Swaps Customer, and thus there is no reason to restrict the use of that collateral to any specific Cleared Swaps Customer. The Commission also notes that, to the extent the DCO permits the FCM to post ''excess'' collateral, the DCO must, through its own rules, require that the FCM separately account for the separately identified ''buffer collateral'' (which originated from the FCM's own capital) and the collateral attributed (at the DCO) to the FCM's Cleared Swaps Customers (which belongs to those customers).

ISDA noted that the use of ''such'' in regulation 22.2(e)(4)(ii) is ambiguous and could imply that an FCM has a residual interest only in the particular account (*i.e.,* cash versus securities) into which it has deposited property. ISDA argued that this might cause unintended consequences if the customer deposits a security and the FCM, faced with a need to advance variation margin on behalf such customer in cash, does not liquidate the security but rather deposits cash secured by that security. ISDA suggested that the Commission clarify the language by making clear that the FCM has a residual interest in all property in Cleared Swaps Customer Accounts in excess of that required by the regulation 22.2(f)(4) segregation requirement.[150] In response, the Commission clarifies that an FCM has a residual interest in all property in Cleared Swaps Customer Accounts in excess of that required by the regulation 22.2(f)(4) segregation requirements.

e. Requirements As to Amount

As 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, which did not materially differ in the Form 1–FR–FCM from the calculation for ''customer funds'' of futures customers. First, proposed regulation 22.2(f) defined ''account'' to reference an FCM's books and records pertaining to the Cleared Swaps Customer Collateral of a particular Cleared Swaps Customer. Second, proposed regulation 22.2(f) required an FCM to reflect in its account for each Cleared Swaps Customer the market value of any Cleared Swaps Collateral that it receives from such customer, as adjusted for:

- Any uses that proposed regulation 22.2(d) permits;
- Any accruals or losses on investments permitted by proposed regulation 22.2(e) that, pursuant to the applicable FCM customer agreement,

[146] Regulation Part 22 creates the presumption that all money, securities, and other property deposited in a Cleared Swaps Customer Account constitutes Cleared Swaps Customer Collateral. Therefore, in order for a Cleared Swaps Customer to use ''excess'' collateral to margin, *e.g.,* uncleared swaps, such customer must direct the transfer of such collateral from the Cleared Swaps Customer Account.

[147] An FCM customer account is an account maintained by the FCM on behalf of a specific Cleared Swaps Customer that holds assets provided by that Cleared Swaps Customer, or other assets of equivalent value, that are not currently posted with the DCO to support swaps positions cleared by the FCM on behalf of such Cleared Swaps Customer. Typically, an FCM customer account constitutes a notation in the books and records of the FCM, and not a separate account at a depository. For a more detailed discussion of FCM customer accounts, *see* the discussion in section I.B.5.

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

[149] *See* SIFMA at 10; and Vanguard at 7.

[150] *See* ISDA at 8–9.

are creditable or chargeable to such Cleared Swaps Customer;

- Any charges lawfully accruing to the Cleared Swaps Customer, including any commission, brokerage fee, interest, tax, or storage fee; and
- Any appropriately authorized distribution or transfer of the Cleared Swaps Collateral.

Third, proposed regulation 22.2(f) categorized accounts of Cleared Swaps Customers as having credit or debit balances. Accounts where the market value of Cleared Swaps Customer Collateral is positive after adjustments have credit balances. Conversely, accounts where the market value of Cleared Swaps Customer Collateral is negative after adjustments have debit balances. Fourth, proposed regulation 22.2(f) required an FCM to maintain in segregation, in its FCM Physical Location and/or its Cleared Swaps Customer Accounts at Permitted Depositories, an amount equal to the sum of any credit balances that Cleared Swaps Customers have in their accounts, excluding from such sum any debit balances that Cleared Swaps Customers have in their accounts (the ''Collateral Requirement''). Finally, regulation 22.2(f) proposed an exception to the exclusion of debit balances. Specifically, to the extent that a Cleared Swaps Customer deposited ''readily marketable securities'' with the FCM to secure a debit balance in its account, then the FCM must include such balance in the Collateral Requirement. ''Readily marketable'' was 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). Proposed regulation 22.2(f) deemed a debit balance ''secured'' only if the FCM maintains a security interest in the ''readily marketable securities,'' and holds a written authorization to liquidate such securities in its discretion. To determine the amount of the debit balance that the FCM must include in the Collateral Requirement, proposed regulation 22.2(f) required the FCM (i) to determine the market value of such securities, and (ii) to reduce such market value by applicable percentage deductions (*i.e.,* ''securities haircuts'') as set forth in rule 15c3–1(c)(2)(vi) of the Securities and Exchange Commission. The FCM would include in the Collateral Requirement that portion of the debit balance, not exceeding 100 percent, which is secured by such reduced market value. The Commission requested comment on the Collateral Requirement proposed in regulation 22.2(f). Specifically, the Commission requested comment on whether the explicit calculation of such Collateral Requirement materially differs from the implicit calculation in the Part 1 Provisions for segregated ''customer funds'' of futures customers.

ISDA expressed concern that the definition of Cleared Swaps Customer Collateral may sweep in investment returns, which may be inconsistent with regulation 22.10 that allows DCOs and FCMs to keep investment returns unless otherwise agreed and regulation 22.2(f)(2)(ii) that refers to investment returns creditable to a customer by agreement.[151] FIA asked the Commission to clarify whether the definition of Cleared Swaps Customer Collateral included the interest earned on investments of customer funds, which FCMs have traditionally been permitted to retain.[152] In addition, FIA stated that because an FCM is required to include accruals or losses on investments of customer collateral under proposed regulation 22.3, the provision appears to state that customers can agree to assume all or a portion of the losses incurred in connection with the investment of customer collateral. FIA ''does not believe that a customer may agree to share in losses incurred in connection with investments under Rule 1.25.'' [153] The Commission confirms that investment returns are includable in Cleared Swaps Customer Collateral only to the extent creditable pursuant to the customer agreement. As such, the Commission is deleting the words ''or losses'' and ''or chargeable,'' from regulation § 22.2(f)(2)(ii). To be clear, Cleared Swaps Customers are not responsible for losses on investments made pursuant to, and in accordance with, regulation 1.25.

AII requested that the Commission ''ensure that swaps customers may direct the investments in which initial margin is invested, as is done today through bilateral agreements with dealer counterparties.'' [154] While Cleared Swaps Customers in the Cleared Swaps Customer Account Class would share in Investment Risk, the Commission notes that these comments are beyond the limited scope of these regulations, and it will consider how to address them outside of this rulemaking. However, nothing contained herein would limit an FCM from adopting as a policy—and commit itself by contract with its customers—to further limit its investments of customer funds for all customers of one or more account classes (*i.e.,* futures, foreign futures, Cleared Swaps).[155]

FIA argued that the calculation requirements set forth in regulation 22.2 pose an excessive burden because an FCM cannot offset negative and positive balances in different currencies. Thus, if a Cleared Swaps Customer has a positive balance in USD but a negative balance in Euro, the FCM would need to deposit its own capital to cover the negative balance in Euro without respect to the Cleared Swaps Customer's positive balance in USD. FIA noted that though proposed regulation 22.2(g) mirrors existing regulation 1.32(a), there is an important difference in circumstances that warrants different treatment of the two cases: while relatively few futures contracts traded on U.S. DCMs are denominated in a foreign currency, a significant number of Cleared Swaps are expected to be denominated in foreign currencies.[156] In response, the Commission recognizes the concerns expressed by the FIA. However, efforts to provide that an FCM may, in making its segregation calculations, include a debit balance to the extent such balance is secured by funds in other currencies, subject to appropriate haircuts, are beyond the limited scope of this rulemaking. The Commission will, therefore, consider how to address these issues outside of this rulemaking.

f. Segregated Account; Daily Computation and Record

Proposed regulation 22.2(g) required an FCM to compute, as of the close of

[151] ISDA at 6–7.

[152] *See* FIA at 7–8 & nn. 25–30.

[153] The FIA cited to a number of cases where courts have stated that ''Congress intended that futures commission merchants be entitled to any and all interest on their investment of customer margin funds.'' *See id.* at n. 29 (citing *Marchese* v. *Shearson Hayden Stone, Inc.* 644 F.Supp. 1381 (C.D. Cal. 1986), aff'd, 822 F.2d 876 (9th Cir. 1987); *Craig* v. *Refco,* 624 F.Supp 944 (N.D. Ill. 1983), aff'd. 816 F.2d 347 (7th Cir. 1987) (confirming that ''the FCM, not the customer, bears the risk of any decline in the value of investments purchased with customer funds''); and *Bibbo* v. *Dean Witter Reynolds, Inc.,* 151 F.3d 559 (6th Cir. 1998). *See also id.* at 8–9 & n. 31.

[154] AII at 4. The term ''initial margin'' is defined in regulation 1.3(ccc) and means ''money, securities, or property posted by a party to a futures, option, or swap as performance bond to cover potential future exposures arising from changes in the market value of the position.'' The term ''variation margin'' is defined in regulation 1.3(fff) and means ''a payment made by a party to a futures, option, or swap to cover the current exposure arising from changes in the market value of the position since the trade was executed or the previous time the position was marked to market.''

[155] Because of pro rata distribution, limiting the investments of customer funds attributable to individual customers would be insufficient to protect such customers from Investment Risk attributable to the investment of customer funds attributable to other customers within the same account class.

[156] *See* FIA at 10–11.

each business day, on a currency-by-currency basis:

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

Proposed regulation 22.2(g) also required the FCM to complete the abovementioned computation prior to noon[157] on the next business day, and to keep all computations, together with supporting data, in accordance with regulation 1.31.

The Commission did not receive any comments on regulation 22.2(g) and is therefore adopting regulation 22.2(g) as proposed.

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

Regulation 22.3 proposed requirements for DCO treatment of Cleared Swaps Customer Collateral from FCMs, as well as the associated Cleared Swaps. Specifically, regulation 22.3(a) required a DCO to treat Cleared Swaps Customer Collateral deposited by an FCM as belonging to the Cleared Swaps Customers of that FCM and not other persons. Moreover, regulation 22.3(b) required DCOs to segregate all Cleared Swaps Customer Collateral either with itself or a Permitted Depository. Proposed regulation 22.3(c) allowed a DCO to commingle the Cleared Swaps Customer Collateral that it receives from multiple FCMs on behalf of their Cleared Swaps Customers, while prohibiting the DCO from commingling Cleared Swaps Customer Collateral with (i) The money, securities, or other property belonging to the DCO, (ii) the money, securities, or other property belonging to any FCM, or (iii) other categories of funds that it receives from an FCM on behalf of Customers, including ''customer funds'' (as regulation 1.3 defines such term) for futures contracts or the ''foreign futures or foreign options secured amount'' (as regulation 1.3 defines such term), except as permitted by a Commission rule, regulation or order (or by a derivatives clearing organization rule approved pursuant to regulation 39.15(b)(2)).[158] Regulations 22.3(d) and (e), on the other hand, proposed certain exceptions to the abovementioned requirements and limitations. Regulation 22.3(d) as proposed (i) allowed a DCO to place money, securities, or other property belonging to an FCM in a DCO Physical Location, or deposit such money, securities, or other property in the relevant Cleared Swaps Customer Account, pursuant to an instruction from the FCM, and (ii) to permit FCM withdrawals of money, securities, or other property from a DCO Physical Location or Cleared Swaps Customer Account. Proposed regulation 22.3(d) is being deleted consistent with the changes to regulation 22.2(e)(3), which require delineation between cases where an FCM posts collateral on behalf of a particular customer and cases where an FCM posts collateral on behalf of its customer account in general. Proposed regulation 22.3(e) (now, regulation 22.3(d)) allowed a DCO to invest Cleared Swaps Customer Collateral in accordance with regulation 1.25, as such regulation may be amended from time to time.

The Commission requested comment on what, if any, changes to proposed regulation 22.3 may be appropriate to accommodate the possibility that a depository registered with either domestic or foreign banking regulators may seek to become a DCO, and that such depository may seek to hold Cleared Swaps Customer Collateral, as well as other forms of customer property. Specifically, the Commission requested comment on (i) whether a DCO that is also a registered depository should be permitted to hold both tangible and intangible forms of Cleared Swaps Customer Collateral from FCMs itself, (ii) the challenges that a DCO holding tangible and intangible forms of Cleared Swaps Customer Collateral pose to the protection (including effective segregation) of Cleared Swaps Customer Collateral (as well as other forms of customer property), and (iii) how any challenges identified in (ii) might be addressed.

ISDA stated that the definition of Cleared Swaps Customer Collateral does not distinguish between initial and variation margin. Both FIA and ISDA expressed concerns that, if variation margin is considered as collateral, regulations 22.3(a) and 22.3(b) would prevent a DCO from taking Cleared Swaps Customer Collateral received from one FCM as variation margin ''and transferring it to an FCM whose customers are on the opposite side of the relevant trades.''[159] FIA asked the Commission to confirm that a DCO may pass variation margin to the receiving party ''if such variation is characterized as collateral and not as a settlement payment *by the parties to the swap.''*[160] Similarly, ICE requested clarification that a DCO that has received ''variation or mark-to-market margin (as opposed to initial margin)'' may be used to settle variation for offsetting swaps. ICE argues that without an amendment permitting DCOs to treat ''variation or mark-to-market'' margin as a pass-through, ''clearinghouses could effectively be prohibited from clearing much of the OTC swaps market as it transacts today.''[161] The Commission is adopting regulation 22.3 as proposed. The Commission recognizes the concerns expressed by commenters and confirms that regulation 22.3 is intended to permit DCOs to use variation margin collected from Cleared Swaps Customers to pay variation margin to, among others, Cleared Swaps Customers.

ISDA also observed that a variation margin payment ''may be considered as a settlement payment—a realized profit/loss—as in the case of listed futures; or as collateralizing current exposure, a payment representing unrealized profit/loss, as in the case of bilateral (uncleared) swap contracts.''[162] ISDA argued that Cleared Swaps Customers would be subject to a ''mark-to-market'' tax regime, paying ordinary income on swap returns, if a DCO were to treat as a contract settlement, a variation margin payment made with respect to a Cleared Swap.[163] Accordingly, ISDA noted that recording daily mark-to-market income on swaps would poorly match the periodic realized coupon income on the bonds hedged by such swaps.[164] Similarly, FIA noted that it has ''been advised that, because cleared swaps are not subject to section 1256 of the Internal Revenue Code, the characterization of such payments as settlement payments may have tax consequences that may impair the ability of certain financial end-users * * * to enter into cleared swaps transactions.''[165] ISDA suggested that Congress did not intend to change the tax treatment of swaps, because section 1601 of the Dodd-Frank Act explicitly exempts Cleared Swaps from being treated as ''section 1256 contracts.''[166] As such, ISDA requested that the

[157] ''Noon'' refers to noon in the time zone where the FCM's principal office is located.

[158] *See* 76 FR at 69390–92.

[159] ISDA at 5. *See* FIA at 9.

[160] FIA at 9 (emphasis supplied).

[161] ICE at 10.

[162] ISDA at 5.

[163] *Id.*

[164] *Id.* at 6.

[165] FIA at 9, n. 33.

[166] ISDA at 6.

Commission clarify that DCOs can treat variation margin as collateral rather than settlement payments.[167] These comments are beyond the limited scope of these regulations and outside the scope of the Commission's authority. The Commission does not take any view on the proper treatment of variation margin associated with swaps for tax purposes. Rather, the Commission believes that the Internal Revenue Service is the regulatory body best equipped to address the identified taxation issue.

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

Proposed regulation 22.4 listed depositories permitted to hold Cleared Swaps Customer Collateral (the ''Permitted Depositories''),[168] and noted that an FCM could serve as a Permitted Depository, but only if it is a Collecting FCM carrying the Cleared Swaps (and related Cleared Swaps Customer Collateral) of a Depositing FCM. The Commission sought public comment regarding the appropriateness of allowing an FCM to serve as a Permitted Depository only if the FCM is a ''Collecting FCM.'' The Commission did not receive any comments in response thereto or on regulation 22.4 generally. The Commission is, therefore, adopting regulation 22.4 as proposed.

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

As proposed, regulation 22.5 required a DCO or FCM to obtain written acknowledgement letters from depositories (including, by implication, depositories located outside the United States) before opening a Cleared Swaps Customer Account.[169] Proposed regulation 22.5 also set forth substantive requirements for such acknowledgement letter. The Commission requested comment on the appropriateness of the following: (i) the addition of regulation 1.20 (as the Commission may choose to amend such regulation) in proposed regulation 22.5, and (ii) the adaptation of any form letter that the Commission may choose to promulgate under regulation 1.20 to accommodate Cleared Swaps Customer Collateral under regulation 22.5.

ISDA stated that an acknowledgement letter from a foreign depository ''may be difficult to get and of little purpose, if obtained'' because the letter would not alter the fact that the foreign depository would be subject to local bankruptcy jurisdiction.[170] The Commission is adopting regulation 22.5 as proposed. The Commission notes that under regulation 1.49(d)(1) depositories in the futures market must provide the depositing FCM or DCO with the appropriate written acknowledgements required under regulations 1.20 and 1.26. The requirements set forth in regulation 22.5 parallel the requirements set forth under regulations 1.20 and 1.26. The Commission has no reason to believe that written acknowledgements from foreign depositories would be any more difficult to obtain in the swaps market than they would be in the futures market. Moreover, the written acknowledgment is intended to clearly establish the commercial expectations of the parties before a bankruptcy or insolvency event. In addition, the written acknowledgements could aid a bankruptcy judge's or trustee's allocation of assets to the extent a bankruptcy court or other insolvency regime finds the commercial expectations of the parties to be helpful information.

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

Proposed regulation 22.6 required an FCM or DCO to ensure that the name of each Cleared Swaps Customer Account that it maintains with a Permitted Depository (i) clearly identifies the account as a ''Cleared Swaps Customer Account,'' and (ii) clearly indicates that the collateral therein is ''Cleared Swaps Customer Collateral'' subject to segregation in accordance with section 4d(f) of the CEA and Part 22. The Commission did not receive any comments on this regulation and is, therefore, adopting regulation 22.6 as proposed.

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

As proposed, under regulation 22.7 a Permitted Depository is (i) required to treat all funds in a Cleared Swaps Customer Account as Cleared Swaps Customer Collateral and (ii) prohibited from holding, disposing of, or using any Cleared Swaps Customer Collateral as belonging to any person other than the Cleared Swaps Customers of the FCM maintaining such Cleared Swaps Customer Account or the Cleared Swaps Customers of the FCMs for which the DCO maintains such Cleared Swaps Customer Account. The Commission did not receive any comments on this proposed rule and is adopting regulation 22.7 as proposed.

H. Regulation 22.8—Situs of Cleared Swaps Customer Accounts

1. Proposed Requirements

Proposed regulation 22.8 required (i) each FCM to designate the United States as the site (*i.e.,* the legal situs) of the FCM Physical Location and the ''account'' (as regulation 22.2(f)(1) defines such term) that the FCM maintains for each Cleared Swaps Customer, and (ii) each DCO to designate the United States as the site (*i.e.,* the legal situs) of the DCO Physical Location and the Cleared Swaps Customer Account that the DCO maintains on its books and records for the Cleared Swaps Customers of each FCM. The Commission sought comment on whether, as proposed, regulation 22.8 ensured that Cleared Swaps Customer Collateral be treated in accordance with the U.S. Bankruptcy Code, to the extent possible, and if it did not achieve this purpose, what alternatives the Commission should consider to achieve such purpose. Additionally, the Commission requested comment on the benefits and costs of proposed regulation 22.8, as well as any alternatives.

NGX states that the requirement of U.S. situs for a customer account may increase legal uncertainty with respect to the insolvency regime that would apply to a bankruptcy, and such uncertainty may slow down resolution of a clearing participant's default and bankruptcy. Moreover, NGX argues that ''it is unclear how the U.S. account situs requirement will interact with the choice of law provision'' [171] of a non-U.S. DCO that chooses to apply its home country insolvency regime. In light of this uncertainty, NGX recommends that the Commission adopt the approach it proposed for foreign non-U.S. clearinghouses seeking DCO registration; namely, that the DCO registration application include a ''memorandum of local law analyzing

[167] *Id.*

[168] As proposed, for a DCO or an FCM, a Permitted Depository must (subject to regulation 22.9) be: (i) A bank located in the United States; (ii) a trust company located in the United States; or (iii) a DCO.

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

[170] ISDA at 8.

[171] NGX at 4.

insolvency issues in the [relevant] foreign jurisdiction * * * and describing how the applicant has addressed any conflict of law issues, which jurisdiction's law is intended to apply to each aspect of the applicant's clearing house's operations, and the enforceability of the choice of law in the relevant jurisdictions.'' [172] However, NGX requested that the Commission provide greater guidance regarding the operation of the proposed rule if it opts to retain the account situs requirements, specifically making clear that ''a DCO choice of law rule should be able to include both choice of forum as well as the substantive law to be applied'' with respect to a clearinghouse's insolvency and the remedies available to a clearinghouse in the event of a clearing member's default or insolvency.[173]

The Commission notes that, in the event of an FCM's bankruptcy, the legal situs provision is intended to make clear that the insolvency regime that will apply to the customers of the FCM is the U.S. insolvency regime embodied in Subchapter IV of Chapter 7 of the U.S. Bankruptcy Code and Part 190 of the Commission's regulations.[174] While a DCO is free to make the choice that local law applies to all other aspects of a DCO's relationships with its members, the Commission has historically required, and intends to continue requiring, that customers of FCMs in bankruptcy be treated in accordance with U.S. bankruptcy law.

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

Proposed regulation 22.9 applies regulation 1.49 to Cleared Swaps Customer Collateral. Regulation 1.49 sets forth rules determining the permitted denominations of customer funds (*i.e.,* permitted currencies and amounts in each currency), permitted locations of customer funds (*i.e.,* permitted countries and amounts in each country), and qualifications that entities outside of the United States must meet to become Permitted Depositories (*e.g.,* minimum regulatory capital). Specifically, regulation 1.49(b)(1)(iii) permits an FCM's obligations to a customer to be denominated in ''a currency in which funds have accrued to the customer as a result of trading conducted on a designated contract market or registered derivatives transaction execution facility,'' while regulation 1.49(d)(3) requires depositories that are located outside the United States to be (i) A bank or trust company that meets certain financial requirements, (ii) an FCM, or (iii) a DCO. In addition, regulation 22.9 proposed to allow an FCM to serve as a Permitted Depository only if the FCM was a Collecting FCM carrying the Cleared Swaps, and associated Cleared Swaps Customer Collateral, for the Cleared Swaps Customers of a Depositing FCM.

ISDA stated that regulation 1.49(b)(1)(iii) should be amended to reflect the wider scope of execution methods available for Cleared Swaps.[175] In response, the Commission is amending regulation 22.9 to allow the FCM's obligations to a Cleared Swaps Customer to be denominated in the currency in which funds have accrued to the Cleared Swaps Customer as a result of a Cleared Swap carried through such FCM, to the extent of such accruals. However, the Commission notes that it cannot amend regulation 1.49(b)(1)(iii) at this time because such an amendment was not part of the NPRM.

ISDA also requested that the Commission make plain that central securities depositories are acceptable depositories.[176] Similarly, FIA argued that Euroclear, a central securities depository for Euro-denominated securities, should be permitted to act as a depository under Commission regulations.[177] The Commission notes that although the notion of a central securities depository as an acceptable depository for securities has considerable intuitive appeal, CEA § 4d(f)(3)(A)(i) limits acceptable depositories for commingled funds to ''any bank or trust company or * * * a derivatives clearing organization.'' [178] Because these comments are beyond the limited scope of these regulations, the Commission will consider how to address them outside of this rulemaking.

Finally, FHLB argued that ''customer collateral should only be held in banks or trust companies located in the United States.'' [179] The Commission does not believe it would be appropriate to address this comment at this time, as it is beyond the scope of this rulemaking.

J. Regulation 22.10—Application of Other Regulatory Provisions

Proposed regulation 22.10 applies 1.27 (Record of investments),[180] 1.28 (Appraisal of obligations purchased with customer funds),[181] 1.29 (Increment or interest resulting from investment of customer funds),[182] and 1.30 (Loans by futures commission merchants; treatment of proceeds) [183] to Cleared Swaps Customers and Cleared Swaps Customer Collateral.

While several commenters cited regulation 22.10, they did so in the context of discussion of other regulations. Because the Commission did not receive any comments regarding the substance of regulation 22.10, it is adopting regulation 22.10 as proposed.

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

Proposed regulation 22.11 required that (i) each Depositing FCM provide to its Collecting FCM and (ii) each FCM member provide to its DCO, in each case, information sufficient to identify Cleared Swaps Customers on a one-time basis, and information sufficient to identify the portfolio of rights and obligations belonging to such customers with respect to their Cleared Swaps ''at least once each business day.'' If a Depositing FCM or FCM member also serves as a Collecting FCM, then it must

[172] *Id.* at 5 (citing to the ''Risk Management Requirements for Derivative Clearing Organizations,'' 76 FR. 3698, 3742, Jan. 20, 2011).

[173] *Id.* at 4–5.

[174] As discussed in the NPRM, the Commission does not intend for regulation 22.8 to affect the actual location in which an FCM or DCO may keep Cleared Swaps Customer Collateral. Though the legal situs of an ''account'' (as regulation 22.2(f)(1) defines the term) and a Cleared Swaps Customer Account must be in the United States, the Commission recognizes that Cleared Swaps Customer Collateral may, in actuality, be kept outside the United States in certain circumstances. However, the Commission notes that regulation 22.8 does not override other Commission regulations regarding the location of customer funds. Specifically, regulation 22.9, which applies regulation 1.49 to Cleared Swaps, requires, among other things, FCMs and DCOs to hold, in a segregated account on behalf of Cleared Swaps Customers, sufficient United States dollars *in the United States* to meet all United States dollar obligations.

[175] ISDA at 8.

[176] *Id.*

[177] *See* FIA at 11.

[178] Section 4d(f)(3)(A)(ii) of the CEA permits customer property to be used to margin a cleared swap with a member of a DCO, *i.e.*, a collecting FCM. However, the Commission notes that a foreign bank that meets the requirements of regulation 1.49(d)(3)(i) is a good depository, and such a foreign bank may itself hold foreign securities in an account at a foreign central securities depository.

[179] FHLB at 9.

[180] Regulation 1.27 requires FCMs and DCOs investing customer funds to maintain specified records concerning such investments.

[181] Regulation 1.28 requires FCMs investing customer funds to record and report such investment at no greater than market value.

[182] Regulation 1.29 permits FCMs and DCOs investing customer funds to receive and retain any increment or interest thereon.

[183] Regulation 1.30 permits FCMs to loan their own funds to customers on a secured basis, and to repledge or sell such security pursuant to agreement with such customers. However, regulation 1.30 does make clear that the proceeds of such loans, when used to purchase, margin, guarantee, or secure futures contracts, shall be treated as customer funds.

provide the specified information with respect to each individual Cleared Swaps Customer for which it acts (on behalf of a Depositing FCM) as a Collecting FCM. As proposed, regulation 22.11 also held the DCO responsible for taking appropriate steps to confirm that the information that it receives is accurate and complete, and ensure that the information is being produced on a timely basis. However, because the DCO may not have a direct relationship with, *e.g.,* a Depositing FCM, the regulation required the DCO to take ''appropriate steps'' to ensure that its FCM members enter into suitable arrangements with, *e.g.,* a Depositing FCM to verify the accuracy and timeliness of information. The Commission requested comment on whether (i) The proposed requirement in regulation 22.11 for a Depositing FCM to provide a Collecting FCM with information sufficient to identify its Cleared Swaps Customers raises any competitive concerns, (ii) such concerns, if any, could be resolved if the identities of the Cleared Swaps Customers are coded, with the DCO, but not the Collecting FCM, receiving a copy of such code, and (iii) other methods were available to resolve any such concerns.

ISDA requested that the Commission further clarify the language of regulation 22.11 to make explicit that an FCM must provide identifying information to the DCO or to the Collecting FCM the first time the FCM intermediates a swap for a Cleared Swaps Customer with the particular relevant DCO or collecting FCM.[184] In response, the Commission is amending the language of regulation 22.11 to make clear that an FCM must provide identifying information to a DCO or Collecting FCM the first time it intermediates a Cleared Swap with that DCO or Collecting FCM.

In addition, a number of commenters raised concerns regarding the need for specific recordkeeping and reporting requirements.[185] These commenters requested that the Commission mandate reporting and recordkeeping requirements for DCOs and require DCOs to implement rules requiring their clearing members to comply with such reporting and recordkeeping requirements. FHLB argued that, at a minimum, an FCM should have to identify (i) collateral posted by an individual customer as cash or securities and (ii) with respect to identifiable securities, which customer posted such securities.[186] CME, by contrast, stated that auditing for accuracy of ''a full breakdown of all forms of collateral at all levels of clearing for each end customer, allocated specifically to each DCO * * * will increase costs exponentially.'' [187] CIEBA, CME, ICE, FHLB, SIFMA, BlackRock, and Vanguard stated that it is important to be able to ensure that an FCM's books and records are accurate in order to support implementation of Cleared Swaps Customer Collateral in bankruptcy. The preferred means of addressing this problem ranged from increasing recordkeeping and monitoring burdens on FCMs and DCOs to abandoning the Complete Legal Segregation Model. On the other hand, CME complained that the phrase ''portfolio of rights and obligations arising from the Cleared Swaps that such futures commission merchant intermediates for such customer'' is unclear as to whether it covers the collateral supporting such positions.[188] CME stated that it ''read[s] the proposed regulations as requiring a DCO to allocate to each non-defaulting customer its specific *required* margin only * * *,'' and that it intends to ''allocate to any defaulting customer the difference between its specific required margin and the collateral within the DCO's access and control * * * .''[189]

AII, SIFMA, and Vanguard requested that the Commission require DCOs to carefully monitor clearing member compliance with DCO rules, including through periodic audits, by amending regulation 22.11(e) to provide specific and concrete examples of the steps a DCO must take to confirm that information from an FCM is accurate, complete and timely. In addition, AII, SIFMA, and Vanguard requested that the words ''appropriate steps'' in regulation 22.11(e) be replaced with ''all steps necessary.'' [190] CME argued that regulation 22.11 should specify the contents of the daily FCM report to the DCO,[191] and that the Commission should clarify the intent behind the language ''take additional steps,'' specifically with respect to what the Commission ''intends each DCO to accomplish under the verification requirement.'' [192]

FIA noted that the proposed rule does not require the information to be provided by any specific time each business day, and recommended that the Commission specify such a deadline.[193] Vanguard, SIFMA and AII also suggested that the Commission consider requiring information to be provided ''as frequently as necessary'' rather than ''at least once each business day.'' [194] Finally, CME stated that it ''presume[d] that the Commission's intention is to continue to treat omnibus accounts of a foreign broker clearing through an FCM as a single 'customer' for purposes of the requirements of Part 22.''[195]

The Commission notes that under the Complete Legal Segregation Model, DCOs must, in the event of the insolvency of a clearing member carrying Cleared Swaps Customer positions, either return to the Trustee, or transfer to another FCM, the value of the collateral associated with each Cleared Swaps Customer's positions (as adjusted in accordance with Commission regulations). This requirement corresponds to the margin required for the Cleared Swaps Customer's swaps cleared through that DCO, including any individualized surcharge or voluntary contribution.[196] Thus, a DCO has no responsibility to monitor the nature or amount of collateral each Cleared Swaps Customer actually posts with the FCM, or the provenance of the specific items of collateral the DCO receives from the FCM. Rather, the DCO should take the steps appropriate, in the professional judgment of its staff, to verify that FCM members have and are using systems and appropriate procedures to track accurately, and to provide to the DCO accurately, the positions of each customer. Furthermore, the Commission is clarifying that the responsibilities of a DCO under Part 22 are analogous to the responsibilities of a DCM under regulation 1.52 with respect to margin (the calculation of which requires an accurate accounting of the customer's positions). As noted by one commenter, FCMs are already subject to DSRO

[184] *See* ISDA at 9.

[185] *See, e.g.,* ICI at 5; SIFMA at 8; and FHLB at 4.

[186] FHLB also argues that this information should be provided to Cleared Swaps Customers on a daily basis so that they can correct any discrepancies in the records, which would, in turn, reduce operational risk. *See* FHLB at 4.

[187] CME at 15, n. 30. *Cf.* FHLB at 3, n. 2 (stating FHLB's understanding that LCH has the technology necessary to track individual customer collateral on a real-time basis, but acknowledging that it is ''not in a position to calculate the costs associated with such technology.'').

[188] CME at 6–7.

[189] *Id.* at 7 (emphasis in original).

[190] *See* AII at 3; SIFMA at 8; and Vanguard at 6.

[191] *See* CME at 3–4, and 13–15.

[192] CME at 15.

[193] *See* FIA at 12. FIA cites to ''Proposed Rule 22.12,'' but it is regulation § 22.11 that requires FCMs to provide information to a clearing FCM or DCO.

[194] AII at 3; SIFMA at 8; and Vanguard at 6–7.

[195] CME at 8, n. 20.

[196] *See* regulation 22.13(a)(1)(C).

audits on an approximately annual basis.[197]

At this time, the Commission is not requiring that information be provided ''as frequently as necessary'' or by a specific time. Regulation 22.11 requires information to be provided ''*at least* once a day,'' thereby permitting DCOs to require by rule the collection of this information more frequently. If more frequent collection of such information becomes an industry standard at a later point in time, the Commission might then consider increasing the frequency of this reporting requirement. In addition, the Commission notes that a DCO may set, by rule, the time or times by which such information must be provided.

Finally, the Commission confirms the presumption ''that the Commission's intention is to continue to treat omnibus accounts of a foreign broker clearing through an FCM as a single 'customer' for purposes of the requirements of Part 22.'' [198] However, to the extent a foreign broker is required to provide individual protection for swaps customer collateral under the laws of another jurisdiction, the Commission intends that the regulations under Part 22 foster compliance with such other laws.

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

As proposed, regulation 22.12 required DCOs and Collecting FCMs to use the information provided pursuant to proposed regulation 22.11 to calculate and record, no less frequently than once each business day, the amount of collateral required (i) for each relevant Cleared Swaps Customer (including each such customer of a Depositing FCM), based on the portfolio of rights and obligations arising from its Cleared Swaps; and (ii) for all relevant Cleared Swaps Customers.

SIFMA argued that DCOs and FCMs should be required to perform the calculations specified in regulation 22.12 ''as frequently as technologically possible'' rather than ''no less frequently than once each business day.'' [199] The Commission is adopting regulation 22.12 as proposed. The calculations required by regulation 22.12 are based on information provided under regulation 22.11, which is sent to the DCOs and FCMs ''at least once each business day.'' It would be anomalous for the Commission to require a more frequent calculation of collateral requirements when the information on which such calculation is based is only required to be provided once each business day. However, if more frequent collection of such information becomes an industry standard at a later point in time, the Commission might then consider requiring more frequent calculation of collateral requirements by regulation.

FIA and ISDA observed that the reference in the NPRM in the discussion of regulation 22.12 to an advance by the FCM to a Cleared Swaps Customer as a ''loan'' combined with regulation 22.10, which, among other things, prohibits an FCM from granting unsecured loans to customers, could be read to prohibit unsecured short-term advances of margin funds to Cleared Swaps Customers by FCMs. They asked that the Commission clarify that unsecured short term advances of margin are permissible.[200] The Commission clarifies that, consistent with current practice, unsecured short term advances of margin are not considered ''loans'' for purposes of existing regulation 1.30, or new regulation 22.10. The Commission notes, however, that such advances should be either promptly repaid or promptly replaced with a secured loan.

M. Regulation 22.13—Additions to Cleared Swaps Customer Collateral

Regulation 22.13 proposed two tools that DCOs or Collecting FCMs may use to manage the risk they incur with respect to individual Cleared Swaps Customers. Because the proposed tools were not intended to be mandatory or exclusive, the Commission sought comment on how it could enable DCOs or Collecting FCMs to use other tools to manage such risk. In addition, proposed regulation 22.13(a) clarified that a DCO or Collecting FCM could increase the collateral required of a particular Cleared Swaps Customer or group of such customers, based on an evaluation of the credit risk posed by such customer(s). The proposed clarification was not intended to interfere with the right of any FCM to increase the collateral requirements with respect to any of its customers, and the Commission requested comment regarding whether a DCO or a Collecting FCM wished to increase the collateral required for any reason other than credit risk. Similarly, proposed regulation 22.13(b) provided that collateral deposited by an FCM that is identified as collateral in which such FCM has a residual financial interest (*i.e.,* the FCM's own funds) may, to the extent of such residual financial interest, be used by the DCO or Collecting FCM to secure the Cleared Swaps of any or all Cleared Swaps Customers.

ISDA suggests that the final rule attribute the collateral deposited by an FCM that is identified as collateral in which such FCM has a residual financial interest to individual Cleared Swaps Customers to determine which Cleared Swaps Customers have a credit balance and which have a debit balance.[201] The Commission notes that collateral attributable to an FCM's residual financial interest is, by definition, not the property of any Cleared Swaps Customer. Accordingly, there is no customer-protection-based reason to deny a DCO or Collecting FCM the ability to use such collateral to meet the default of any Cleared Swaps Customer. In addition, as mentioned above, the Commission is adding a new section 22.13(c), which states that, subject to certain requirements, collateral posted by a Cleared Swaps Customer in excess of the amount required by a DCO (the ''excess collateral'') may be transmitted by the Cleared Swaps Customer's FCM to the DCO.[202]

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

Proposed regulation 22.14 required a defaulting FCM to transmit to the DCO or Collecting FCM, as applicable, Cleared Swaps Customer Collateral on deposit at the FCM for each Cleared Swaps Customer whose swaps contributed to the call, and the identity and the amount transmitted on behalf of, each such customer. Regulation 22.14 also proposed a detailed sequence of events following an FCM's default. Specifically, proposed regulations 22.14(e) and (f) addressed the issue of allocation of the loss of value of collateral (also known as Investment Risk) [203] despite the application of haircuts. The Commission sought comment on the proposed allocation of Investment Risk.

FIA suggested that the regulations make clear that the DCO or Collecting FCM may reasonably rely on the information provided by the defaulting FCM (or on information previously provided if the defaulting FCM does not promptly provide information on the day of the default).[204] In response, the Commission is amending regulation 22.14 to add subsection (2) to specifically permit such reliance on

[197] *See* CME at 15.

[198] *See id.* at 8, n. 20.

[199] SIFMA at 9. *See also* AII at 3.

[200] *See* ISDA at 9; FIA at 11–12.

[201] *See* ISDA at 9–10.

[202] For further detail, *see* the discussion above in section IV.A.4. under the definition of ''Cleared Swaps Customer Collateral.''

[203] *See supra* at n. 28.

[204] *See* FIA at 12; SIFMA at 10.

information provided by a defaulting FCM.

Vanguard and SIFMA requested clarification regarding how a DCO should handle simultaneous defaults in a futures and Cleared Swaps Customer Account, and how the FCM and DCO resources should be allocated between the two accounts.[205] The Commission notes that defaults in multiple accounts are already addressed in the Commission's regulations and, in particular, Part 190, which treats account classes separately. For example, in the event of a default in a futures customer account, the default would be treated in accordance with the Futures Model, and the FCM would be permitted to apply all customer collateral to meet that default and would, after liquidation of positions, return any remaining customer collateral to the Trustee for distribution as above. A default in the Cleared Swaps Customer Account, on the other hand, would be treated in accordance with the Complete Legal Segregation Model, with remaining positions and collateral either transferred to another FCM or returned to the Trustee. Thus, swaps customer accounts and futures customer accounts are treated separately by the DCO, with balances that are not transferred being returned to the Trustee for distribution.[206] The Trustee would distribute customer property, including collateral received from a DCO, pari passu within each account class. Any surplus in any account class would be re-distributed in accordance with regulation 190.08. In addition, the Commission notes that a separate proprietary account for swaps is not required under Commission regulations. Thus, a clearing member's own swaps and futures (and related collateral) may be held together in a proprietary account and a default in such account should proceed in accordance with existing Commission regulations. For example, if there is a default only in the proprietary account, property in either customer account will not be liable for that default, and such customer property will either be transferred along with customer positions to another FCM or, after the liquidation of customer positions, would be returned to the Trustee for distribution as part of the appropriate account classes pursuant to regulation 190.08.

With respect to the application of DCO resources, the Commission notes that if there is a shortfall in more than one account class, after the application of collateral as permitted in the proposed and existing rules, the DCO would apply its default resources to the remaining shortfalls in each account in accordance with its then-existing rules.

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

As proposed, regulation 22.15 set forth the basic principle of individual collateral protection. It required each DCO and each Collecting FCM to treat the amount of collateral required with respect to the portfolio of rights and obligations arising out of the Cleared Swaps intermediated for each Cleared Swaps Customer as belonging to that customer, which amount could not be used to margin, guarantee or secure the Cleared Swaps, or any other obligations, of an FCM, or of any other customer.

FIA urged the Commission to confirm that, in the event of an FCM default, clearing FCMs and DCOs have flexibility to liquidate all positions in an omnibus account (with the restriction that proceeds of positions of non-defaulting customers may not be used to offset sums owed by defaulting customers to the FCM or by the clearing FCM to the DCO).[207] SIFMA stated that proposed regulation 22.15 required that ''any temporary misallocation of non-defaulting customer property due to [intra-day price movements on the day of a default] * * * be rectified as promptly as possible so that the property of non-defaulting customers is fully restored.''[208] ICI argued that if at the time of an FCM default there is a misallocation of Cleared Swaps Customer Collateral, the Commission should require such misallocation to be corrected as soon as practicable.[209] Similarly, Vanguard requested that the Commission clarify that any initial misallocation related to delayed recordkeeping be rectified as promptly as possible such that the property of the non-defaulting parties is fully restored.[210] CME cautioned that errors in the § 22.11 information from an FCM could heighten the risk of misallocating Cleared Swaps Customer Collateral in a default scenario, because a DCO will not have the time or legal ability to resolve discrepancies in a portfolio.[211] CME asked the Commission to clarify the allocation of this risk among Cleared Swaps Customers.[212] In addition, CME questioned how to allocate excess collateral that is posted to a DCO for purposes of daily reporting and in response to customer default,[213] and sought confirmation that the Commission intended to preserve the finality of the clearing cycle.[214]

The Commission has amended regulation 22.15 to make clear that clearing FCMs and DCOs have the flexibility to liquidate all positions in an omnibus account in the event of the default of a depositing FCM or clearing member respectively. In addition, the Commission notes that there will not be any unallocated excess collateral because such collateral is either collateral in which the FCM has a residual interest and does not belong to a customer, or collateral that must be attributed to individual Cleared Swaps Customers. Furthermore, any temporary misallocation of non-defaulting Cleared Swaps Customer property or excess collateral would be resolved by the Trustee, in computing the claims by such customers against the estate (or, where appropriate, by the estate against such customers). In addition, these discrepancies would not be the responsibility of the DCO, even if the DCO transferred an amount on behalf of a Cleared Swaps Customer that was later found to be too much, nor would such a transfer be subject to avoidance.[215] Finally, it is not the Commission's intent to disrupt or unwind a complete and final settlement cycle, and northing in these regulations should be construed to do so.

P. Regulation 22.16—Disclosures to Customers

As proposed, regulation 22.16 requires each FCM to disclose, to each of its Cleared Swaps Customers, the governing provisions of each DCO (or the provisions of the customer agreement with respect to a Collecting FCM) relating to use of Cleared Swaps Customer Collateral and related matters.

The FIA advocated that these FCM disclosures be the subject of a uniform disclosure document prepared by the industry, subject to Commission approval.[216] Given the diversity of industry practice in the swaps market, the Commission is reluctant to mandate the use of a uniform disclosure document. Nonetheless, the Commission sees no reason to object to an FCM's use of a document prepared

[205] *See* Vanguard at 7.

[206] Pursuant to regulation 190.06(b)(3)(iii), for a particular customer, a negative equity balance in one account class must be offset against a positive equity balance in any other account class.

[207] *See* FIA at 12–13.

[208] SIFMA at 10.

[209] *See* ICI at 5.

[210] *See* Vanguard at 7.

[211] *See* CME at 14.

[212] *See id.*

[213] *See id.* at 7–8.

[214] *See id.* at 9.

[215] *Cf.* 11 U.S.C. 764(b).

[216] *See* FIA at 12.

by a committee, so long as the document accurately provides the required information for each DCO on which the customer's positions are cleared.

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

A. Background

In April of 2010, prior to the enactment of the Dodd-Frank Act, the Commission promulgated rules to establish an account class for cleared OTC derivatives (and related collateral).[217] At that time, there were questions concerning the Commission's authority to require the segregation of cleared OTC derivatives (and related collateral) or to establish a separate account class for cleared OTC derivatives in a DCO insolvency. As a result, protection for cleared OTC derivatives (and related) collateral was limited to those cases where such derivatives and collateral were required to be segregated pursuant to the rules of a DCO, and the reach of the account class was limited to cases of the bankruptcy of a commodity broker that is an FCM. Moreover, while section 4d(a)(2) of the CEA permitted the inclusion in the domestic futures account class of transactions and related collateral from outside that class, there was no similar provision permitting the inclusion in the cleared OTC account class of transactions and related collateral from outside that latter class.

Section 724 of the Dodd-Frank Act has resolved these questions. As mentioned above, section 4d(f) of the CEA, as amended by the Dodd-Frank Act, requires, among other things, segregation of Cleared Swaps and Cleared Swaps Customer Collateral. Section 4d(f)(3)(B) of the CEA permits the inclusion of positions in other contracts (such as exchange-traded futures) and related collateral with Cleared Swaps and Cleared Swaps Customer Collateral. Section 724(b) of the Dodd-Frank Act amends the Bankruptcy Code to include in the definition of ''commodity contracts'' Cleared Swaps with respect to both FCMs and DCOs. Thus, this section V proposes amendments to regulation Part 190, pursuant to Commission authority under section 20 of the CEA, in order to give effect to section 724 of the Dodd-Frank Act, to implement Public Law 111–16, the Statutory Time-Periods Technical Amendments Act of 2009, and to provide technical clarifications. Such amendments conform to proposed Part 22.

[217] *See* Account Class, 75 FR 17297, Apr. 6, 2010.

B. Definitions

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

The Commission proposed amendments to regulation 190.01(a) to change the definition of account class to include a class for cleared swaps accounts, delete commodity option accounts from the definition, make clear that options on futures and options on commodities should not be grouped into one account class, clarify that Commission orders putting futures contracts and related collateral in the cleared swaps account class (pursuant to new section 4d(f)(3)(B) of the CEA) are treated, for bankruptcy purposes, in a manner analogous to orders putting Cleared Swaps and related collateral in the futures account class (pursuant to CEA section 4d(a)(2)), and clarify that if, pursuant to a Commission rule, regulation or order (or a DCO rule approved pursuant to regulation 39.15(b)(2)), positions or transactions that would otherwise belong to one class are associated with positions and related collateral in commodity contracts in another account class, then the former positions and related collateral shall be treated as part of the latter account class. The Commission did not receive any comments on proposed regulation 190.01(a) and is adopting regulation 190.01(a) as proposed.

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

The Commission proposed defining the term ''calendar day'' to include the time from midnight to midnight. The Commission did not receive any comments on proposed regulation 190.01(e) and is adopting regulation 190.01(e) as proposed.

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

The Commission proposed to amend the definition of clearing organization to remove, as unnecessary, the reference to commodity options traded on or subject to the rules of a contract market or board of trade. The Commission did not receive any comments on proposed regulation 190.01(f) and is adopting regulation 190.01(f) as proposed.

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

The Commission proposed to amend the definition of non-public customer to include references to non-public customers under regulation 30.1(c) (with respect to foreign futures and options customers) and in the definition of Cleared Swaps Proprietary Aaccount. The Commission did not receive any comments on proposed regulation 190.01(cc) and is adopting regulation 190.01(cc) as proposed.

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

The Commission proposed to amend the definition of principal contract to include an exclusion for cleared swaps contracts. The Commission did not receive any comments on proposed regulation 190.01(hh) and is adopting regulation 190.01(hh) as proposed.

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

The Commission proposed to amend the definition of specifically identifiable property to update references and change terms to conform to other proposed changes to Part 190 and other business practices. The Commission did not receive any comments on proposed regulation 190.01(ll) and is adopting regulation 190.01(ll) as proposed.

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

Proposed regulation 190.01(pp) replaced the definition of ''Cleared OTC Derivative'' that the Commission previously adopted with a definition of cleared swap that includes the definition of that term in regulation 22.1. The Commission did not receive any comments on proposed regulation 190.01(pp) and is adopting regulation 190.01(pp) as proposed.

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

The Commission proposed certain clarifications as well as technical amendments to § 190.02 to (1) expand the regulation to apply to Cleared Swaps (and related collateral) and (2) change references to ''business days'' to ''calendar days,'' and require transfer instructions by the sixth calendar day after the order for relief and instruct transfers to be completed by the seventh calendar day after the order for relief, in order to fall within the protection of section 764(b) of the U.S. Bankruptcy Code. The Commission did not receive any comments on proposed regulation 190.02. However, in light of a recent demonstration of the efficiency of transfer arrangements, it appears that a full calendar day may not be necessary to execute such instructions. Accordingly, the Commission is changing the amendment to require transfer instructions to be provided by the *seventh* calendar day after the order

for relief, at an hour to be specified by the trustee.

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

The Commission proposed certain technical amendments to regulation 190.03 to clarify that maintenance margin refers to the maintenance margin requirements of the applicable designated contract market or swap execution facility. The Commission did not receive any comments on proposed regulation 190.03 and is adopting regulation 190.03 as proposed.

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

Proposed amendments to regulation 190.04 would extend the liquidation of open commodity contracts to commodity contracts traded on swap execution facilities.[218] These commodity contracts would be liquidated in accordance with the rules of the relevant SEF or DCM. Open commodity contracts that are liquidated by book entry may also be offset using the settlement price as calculated by the relevant clearing organization pursuant to its rules, which rules are required to be submitted to the Commission for approval pursuant to section 5c(c) of the CEA, or approved by the Commission (or its delegate) pursuant to regulation 190.10(d). The Commission did not receive any comments on proposed regulation 190.04 and is adopting regulation 190.04 as proposed.

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

The Commission proposed technical amendments to regulation 190.05 to change a reference to ''contract market'' to ''designated contract market, swap execution facility, or clearing organization,'' and require the submission of rules for approval subject to section 5c(c) of the CEA. The Commission did not receive any comments on proposed regulation 190.05 and is adopting regulation 190.05 as proposed.

G. Proposed Amendments to Regulation 190.06—Transfers

The Commission proposed amendments to regulation 190.06 to (i) Clarify that nothing in subparagraph (a) would constrain the contractual right of the DCO to liquidate open commodity contracts, (ii) permit the trustee to transfer accounts with no open commodity contracts, as the Commission has permitted in a number of recent FCM bankruptcies, (iii) prohibit the trustee from avoiding pre-petition transfers made by a clearing organization as long as the money, securities, or other property accompanying such transfer would not exceed the funded balance of accounts held for or on behalf of customers based on information available as of the close of business on the calendar day immediately preceding such transfer minus the value on the date of return or transfer of any property previously returned or transferred thereto, and (iv) change ''business day'' to ''calendar day.'' The Commission did not receive any comments on proposed regulation 190.06 and is adopting regulation 190.06 as proposed.

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

Proposed amendments to regulation 190.07 clarify that individual Cleared Swaps Customer Accounts within an omnibus account are to be treated individually, correct a typographical error, change the valuation of an open commodity contract so that the value of the commodity contract would be derived from the settlement price as calculated by the relevant clearing organization pursuant to its rules, and change references to securities traded over-the-counter pursuant to the National Association of Securities Dealers Automated Quotation System to securities not traded on an exchange. The Commission did not receive any comments on proposed regulation 190.07. However, the Commission is adding ''paragraph (c)'' before ''(1)(ii)'' in regulation 190.7(c)(1)(i)(A) to clarify the cross reference.

I. Proposed Amendments to Regulation 190.09—Member Property

The Commission proposed amendments to regulation 190.09 to include references to an account excluded pursuant to the proviso in regulation 30.1(c) (referring to proprietary accounts in the context of foreign futures and options) and to the Cleared Swaps Proprietary Account. The Commission did not receive any comments on proposed regulation 190.09 and is adopting regulation 190.09 as proposed.

J. Proposed Amendments to Regulation 190.10—General

Proposed amendments to regulation 190.10 have been made to require notice by email and overnight mail. The Commission did not receive any comments on proposed regulation 190.10. However, the Commission is changing the reference to the ''Division of Clearing and Intermediary Oversight'' to the ''Division of Clearing and Risk'' in regulation 190.10(a) to reflect changes based on a structural reorganization within the Commission.

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

The Commission proposed changes to appendix A, form 1 to include references to ''transfers'' generally, and to make certain technical amendments to (i) Reflect the addition of section 4d(f) of the CEA by section 724 of the Dodd-Frank Act, (ii) clarify that Commission approval with respect to the rules of a registered entity that require Commission approval means Commission approval under section 5c(c) of the CEA, and (iii) conform certain time periods to the proposed changes made by the Commission to implement Public Law 111–16, the Statutory Time-Periods Technical Amendments Act of 2009. The Commission did not receive any comments on the proposed amendments to appendix A and is adopting appendix A as proposed.

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

The Commission proposed amendments to Framework 1 of Appendix B to clarify that the cross margining program is intended to apply only to futures customers and customer funds for futures contracts, and to Framework 2 of Appendix B to address shortfalls in Cleared Swaps Customer Collateral. The Commission did not receive any comments on the proposed amendments to appendix B. However, the Commission is making certain technical corrections to bring the language of the appendix in line with current statutory language.

VI. Effective Date

The Commission asked for comment, in the NPRM and at the Second Roundtable, on the appropriate timing of effectiveness for the final rules, and whether six months after the promulgation of final rules would be sufficient.

At the Second Roundtable, several panelists stated that it would take

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

approximately 18 months to 2 years after finalization of the segregation rules to complete all of the documentation and other infrastructure work that would be necessary to implement the segregation regime selected by the Commission.[219] These commenters indicated that this lead time would be the same for the Legal Segregation Models and the Full Physical Segregation Model, but may be longer if the Commission were to select the Futures Model.[220] In other words, this 18 month to 2 year time period is ''a cost of moving to the cleared world regardless of how it's done.'' Another panelist, however, did state that six months did not seem to provide sufficient time to complete all of the work that would need to be completed,[221] though this commenter acknowledged that ''the real constraining factor * * * is getting that final documentation with the clients.'' [222]

Comments to the NPRM generally reinforced the need for additional time. ISDA recommended that there be a minimum of 18 months between final promulgation of the rules and effectiveness.[223] In addition, FIA stated that, according to certain representatives from investment management firms, it would take one to two years to implement whatever model is chosen by the Commission.[224] ICE requested that, if a model other than the Futures Model is adopted, the Commission provide sufficient time to FCMs and DCOs to allow them ''to analyze, develop and implement the necessary systems and processes relating to'' the selected segregation model.[225] In addition, ICI stated that market participants need time to develop ''the operational and systems infrastructure necessary to facilitate a smooth transition to clearing.'' [226]

As acknowledged by some commenters, the 18 month to 2 year time period is the time period needed to transition to clearing. It is not the time period necessary to implement the Complete Legal Segregation Model. Because the Commission did not receive any specific comments regarding the time period needed to implement the Complete Legal Segregation model, the Commission considered adopting the effective date that was proposed in the NPRM. However, given representations from market participants regarding the amount and tenor of the work that would need to be completed to implement clearing, the Commission is extending the compliance date for the Part 22 rules to November 8, 2012, the compliance date set forth in the rules implementing DCO Core Principles for the gross margining requirement of Regulation 39.13(g)(8)(i).

Given the importance of implementing the time period changes in Part 190 as soon as possible, and because the implementation issues raised by Part 22 do not apply to Part 190, which imposes obligations primarily on bankruptcy trustees, the compliance date for the Part 190 rules is the effective date of these rules. However, during the period between the compliance date for Part 190 and the compliance date for Part 22, Commission rules will not require segregation of Cleared Swaps or Cleared Swaps Collateral. Accordingly, consistent with the approach applicable under current Part 190, where protection for cleared OTC derivatives (and related) collateral is limited to those cases where such derivatives and collateral are required to be segregated pursuant to the rules of a DCO, during that period, the definition of 190.01(pp) (''Cleared Swap'') shall be limited to transactions where the rules or bylaws of a derivatives clearing organization require that such transactions, along with the money, securities, and other property margining, guaranteeing or securing such transactions, be held in a separate account for Cleared Swaps only.

VII. Consideration of Costs and Benefits

A. Introduction

Section 15(a) of the CEA [227] requires the Commission to consider the costs and benefits of its actions before issuing a rulemaking under the CEA. Section 15(a) further specifies that the costs and benefits shall be evaluated in light of five broad areas of market and public concern: (1) Protection of market participants and the public; (2) efficiency, competitiveness, and financial integrity of futures markets; (3) price discovery; (4) sound risk management practices; and (5) other public interest considerations. To the extent that these new rules reflect the statutory requirements of the Dodd-Frank Act, they will not create costs and benefits beyond those mandated by Congress in passing the legislation. However, the rules may generate costs and benefits attributable to the Commission's determinations regarding implementation of the Dodd-Frank Act's statutory requirements. The costs and benefits of the Commission's determinations are considered in light of the five factors set forth in CEA section 15(a).

1. Business and Legal Context of the Segregation Requirement for Cleared Swaps Customer Collateral

The Commission's Part 22 rules are one component of the regulatory infrastructure for clearing [228] swaps transactions mandated by the Dodd-Frank Act. Though a significant fraction of swaps transactions may be required to be cleared through DCOs, many swaps transactions may voluntarily be cleared though DCOs. Swaps users and some swap dealers transact with the DCO through FCMs that the DCO admits as ''clearing members'' and who are subject to DCO rules. As described above in detail, for every transaction received by or matched through its facilities, a DCO acts as the buyer to every seller and the seller to every buyer, essentially guaranteeing financial performance.[229]

2. Overview of the Statute and Regulation

Proposed Part 22 implements the requirement of the newly enacted CEA section 4d(f) that property provided by Cleared Swaps Customers to FCMs to serve as collateral for Cleared Swaps transactions be treated as the property of the customers, not the FCM or DCO; and that such property be maintained in accounts separate from the property of the FCM or DCO, although such accounts can hold the commingled collateral of more than one Cleared Swaps Customer ''for convenience.'' [230] These basic requirements that Cleared

[219] Second Roundtable Tr. at 58, 1.14 to 61, 1.17.

[220] *Id.*

[221] Second Roundtable Tr. at 62, 1.11 to 62, 1.19 (Mr. Diplas stating that six months ''seems to live within the low side from the standpoint in terms of the work, the IT work that needs to take place between, like, FCMs and DCOs, the testing, et cetera, and also even the agreements that we might have to do in terms of consistency, of how these reports should look, and how the client IDs should be done, et cetera, so that we don't have—each DCO have a different methodology in that respect.'').

[222] Second Roundtable Tr. at 63, 1.2 to 63, 1.4.

[223] *See* ISDA at 11.

[224] *See* FIA at 6.

[225] ICE at 11.

[226] ICI at 2.

[227] 7 U.S.C. 19(a).

[228] As described above, clearing is the process by which transactions in derivatives are processed, guaranteed, and settled by a central clearing organization, the DCO. *See* section I.B.

[229] For a detailed discussion of clearing as it pertains to swap transactions, *see* section I.B.

[230] Though treating futures customer collateral on a collective basis may, at one time, have been practically necessary ''for convenience,'' such practice is not standard in the current swaps market nor is it as critical in an era where account information is stored and processed on an automated basis. For example, and as noted above, DCOs are already assessing risks posed by clearing members' customers at the individual customer level. *See supra* n.122.

Swaps Customer Collateral be treated as the property of customers and maintained in segregated accounts are imposed by the statute independently of the Commission's particular implementing regulations and, by the terms of the statute, would apply even if the Commission promulgated no implementing regulations. Generally, the core statutory segregation requirements serve two functions: (1) They help ensure that FCMs, DCOs, and other depositories of assets deposited by swaps customers to serve as collateral for their Cleared Swaps transactions treat such customer collateral as the property of the customers and not use it for their own proprietary business purposes; and (2) in conjunction with Subchapter IV of Chapter 7 of the Bankruptcy Code, they provide protection of Cleared Swaps Customer Collateral from the claims of other creditors in the event of the bankruptcy of an FCM.

Sections 22.2 through 22.10 implement the basic architecture of a system of segregation for swaps customer funds roughly comparable to the system used for customer funds for futures contracts under CEA sections 4d(a)(2) and 4d(b) and Commission regulations 1.20 through 1.30 and 1.49.[231] Some provisions of sections 22.2 through 22.10 essentially restate the statutory requirements. Other provisions of these sections set forth requirements intended to (a) ensure that the objectives of the statute are met and (b) clarify FCMs' and DCOs' duties under the statute and facilitate carrying out those duties in an efficient manner.[232] The basic architecture established by sections 22.2 through 22.10 is supplemented by section 22.16, a disclosure requirement designed to inform swaps customers of DCO and FCM policies regarding the handling of their collateral in case of default and by amendments to part 190 of the Commission's rules intended to ensure that cleared swaps customer accounts of the sort required by Part 22 are treated as a separate account class under bankruptcy law in the event the relevant FCM files for bankruptcy.[233]

Proposed sections 22.11 through 22.15 add to this basic segregation architecture provisions designed to implement the Complete Legal Segregation Model for protecting swaps customer funds against Fellow-Customer Risk.[234] Proposed sections 22.11, 22.12, and 22.14 are intended to ensure that DCOs have available information that will enable them to attribute the value of assets in an FCM's customer account to individual customers in the event of an FCM's default on obligations to the DCO arising in connection with swaps transactions cleared for customers.[235] Section 22.14 also requires certain transfers of customer collateral among FCMs in response to margin calls.[236] Section 22.5 prohibits the DCO from using asset value in an FCM's customer account attributable to one customer to margin, guarantee, or secure the Cleared Swaps or other obligations of the relevant FCM or of other customers.[237] Section 22.13 clarifies that DCO's have the right, at their election, to require (on the grounds of risk management) larger amounts of collateral from selected customers.[238]

3. Organization and Focus of the Consideration of Costs and Benefits

Section VII.B presents the Commission's considerations regarding the costs and benefits arising from the Commission's choice of the Complete Legal Segregation Model as set forth in sections 22.11 through 22.15.[239] The costs and benefits of the Commission's choice of model for addressing Fellow-Customer Risk are, in the view of the Commission, the most significant cost-benefit issues in this final rulemaking, as is reflected in the fact that discussions of cost-benefit issues in comments to the NPRM focused almost exclusively on the choice of model. This section of the discussion employs the Futures Model—in essence, the rule without sections 22.11 through 22.15—as a baseline for comparison because this model was favored by several commenters and because comparison with this model provides a useful and appropriate methodology for isolating, to the extent possible, the relative costs and benefits of the alternative models presented by the commenters and considered by the Commission.[240]

Notably, this comparative analysis pivots, in the first instance, on who bears the cost of the most significant cost driver—Fellow-Customer Risk. Where the risk is assigned to one constituency (*e.g.,* swap users in the Futures Model baseline) a virtually mirror image risk mitigation benefit is conferred on others (*e.g.,* DCOs and clearing members in the Futures Model baseline).

Under any model, however, once such risks are initially assigned, the affected entities and market participants, may then attempt to re-allocate or shift such assigned risks or costs to other entities or market participants. The LSOC Model, in the first instance places fellow risk on DCOs and clearing members with corresponding mitigation of risk to swaps users. However, as explained in detail below, market participants can be expected to adapt to the direct allocation of risk associated with one or another of the models in a variety of ways, and the ultimate costs and benefits of the rule will reflect both its direct allocation of risk and the effect of adaptations to that allocation.

For example, as described below, some, though not all, DCOs commented that they would be likely to adapt to the LSOC Model by increasing margin levels. To the extent that this occurs, the rule would have the effect of reducing the risks of losses to the DCO and the FCM because there would be a reduced

[231] *See* discussion in sections IV.B through IV.J.

[232] *See id.*

[233] *See* discussion above in section IV.P and section V.B.1.

[234] *See* discussion above in section IV.K through section IV.O.

[235] *See* discussion above in sections IV.K., IV.L. and IV.N. Having such information at the DCO can be quite valuable in a situation where the FCM is bankrupt.

[236] *See* discussion above in section IV.N.

[237] *See* discussion above in section IV.E.

[238] *See* discussion above in section IV.M.

[239] As discussed above, in addition to the Futures Model and the Complete Legal Segregation Model, the Commission gave consideration to other alternatives: the Legal Segregation with Recourse Model and the Physical Segregation Model. No commenters supported the Legal Segregation with Recourse Model on grounds that it involved the same costs as the Legal Segregation Model, but with fewer benefits. Accordingly, its costs and benefits are not considered further in this analysis. Several commenters did support the Physical Segregation Model; however, as noted above, the effectiveness of the Physical Segregation Model is limited due to the application of the ratable distribution requirements of section 766(h) of the Bankruptcy Code. As such, these limitations were disqualifying.

[240] CIEBA, FHLB, SIFMA, and Fidelity argue that the correct baseline for making cost and benefit comparisons should be the current practice in the uncleared swaps markets rather than the Futures Model (*See* CIEBA Original at 12; FHLB at 9; SIFMA at 7; and Fidelity at 7). In principle, using this benchmark rather than the Futures Model would change the absolute level of costs and benefits of the alternatives under consideration but would not change the relative ranking of those alternatives so long as comparisons to the benchmark were made in a consistent fashion. There are, however, practical advantages to using the Futures Model as a benchmark because current practice with regard to protection of collateral in the uncleared swaps market is unregulated and the level of protection provided varies considerably across transactions. Moreover, CEA, as amended by the Dodd-Frank Act, does not permit the Commission to retain the current practice regarding uncleared swaps. Because the appropriate baseline for the consideration of costs and benefits is the Futures Model rather than the uncleared swaps model, the costs and benefits of the basic requirement that swaps customer collateral be kept in segregated accounts and treated as the property of customers rather than the property of FCMs or DCOs are included within the baseline and not evaluated separately.

likelihood of any given customer incurring losses that exceed the margin posted by that customer. In return for the benefit of reduced fellow customer risk and legal allocation of the residual risk to DCOs and their members, swaps users would incur the opportunity cost of having to use more capital as collateral for their Cleared Swaps. Thus, to the extent that DCOs adapt to the LSOC Model in this fashion, the rule would function in a manner analogous to insurance, with swaps users incurring somewhat higher costs in their routine use of swaps in return for a lower risk of wholesale loss of collateral as a result of some other swaps user's market losses. As also described below, the LSOC Model is expected to alter behavioral incentives for market participants relative to the Futures Model in variety of other ways that will create costs and benefits but that the Commission believes will lead to a net increase in monitoring of risky behavior by FCMs and that, on balance, will facilitate transfer of customer positions and collateral in the event of the simultaneous default of an FCM and one or more customers.

B. Benefits and Costs of Complete Legal Segregation Model Relative to Futures Model

1. Introduction

As noted above, the Complete Legal Segregation Model is intended to provide swaps customers with protection against Fellow-Customer Risk.[241]

The basic difference between the Complete Legal Segregation Model and the Futures Model thus relates to a difference in the allocation of loss arising out of a double default of both a customer and the customer's FCM. Under the Futures Model, this risk is borne by customers in the form of ''Fellow-Customer Risk''— the risk that a customer will lose some or all of the value of its collateral due to the default of some other swaps customer or customers of the clearing FCM. Under the LSOC Model, this risk to customers is substantially, though not completely, eliminated. However, the corresponding loss, in the event of a double default, falls on the DCO and, through the guaranty fund, its non-defaulting members. In practice, under the LSOC Model, DCOs can be expected to take measures to protect themselves against the risk of loss from a double default, and some of the material benefits and costs are likely to flow from a DCO's adaptations to the rule.

The next section reviews, respectively, the material benefits and costs that the Commission believes will arise from the Commission's selection of the LSOC Model.

2. Material Benefits and Costs Arising From the Complete Legal Segregation Model

a. Benefits to Customers of Protection Against Fellow-Customer Risk

The primary benefit of the Complete Legal Segregation Model to customers is the protection of non-defaulting Cleared Swaps Customers against loss of the value of their collateral due to the use of such value by the relevant DCO in the event of a double default.[242] The associated cost to those customers is the payment they will be required to make for protection against this risk, where this payment will likely originate from some combination of the capital cost of posting higher initial margins and/or higher fees for swaps transactions (see subsection b below).

Comments regarding this rulemaking have indicated that, as a result of the statutory clearing requirements in the Dodd-Frank Act, once the cleared swaps market has matured, Cleared Swaps Customers would be posting upwards of $500 billion in collateral to secure their Cleared Swaps positions.[243] The Commission notes that the precise amount will depend on how the market evolves and can be expected to change over time.[244] Under the Futures Model, the value of this collateral will be exposed to greater Fellow-Customer Risk than under the other models considered. In addition, it does not appear possible to reliably quantify the probability of the actual loss of value of collateral by a given customer due to Fellow-Customer Risk for a number of reasons. By their nature, double defaults are rare events, though potentially important if they involve major FCMs. Because the mandatory clearing of swaps under the Dodd-Frank Act has not yet gone into effect, there is, as yet no body of experience with such clearing in practice, and a fortiori no experience with FCM defaults under the Dodd-Frank clearing regime.[245] There has been experience with FCM default in the futures industry, but the numbers are too small to permit reliable extrapolation.[246] In addition, a number of commenters suggested that Fellow-Customer Risk may be greater in the cleared swaps market than in the futures market because swaps are less liquid than exchange-traded futures (thereby resulting in greater volatility of prices, particularly in times of financial stress) and because the aggregate value of transactions in the swaps market is many times greater than the aggregate value of transactions in the futures market.[247] The Commission notes these commenters requested increased protection for their funds to guard against Fellow-Customer Risk.

Notwithstanding its inability to reasonably quantify the value of benefits associated with Fellow-Customer Risk elimination, the Commission, in light of comments received in response to both the ANPR and NPRM, believes that the Complete Legal Segregation Model confers benefits to swaps users. In fact, buy-side commenters represented that they desired the protection afforded through the Complete Legal Segregation Model, notwithstanding the costs associated with that protection.[248] The

[241] For a discussion of Fellow-Customer Risk, *see supra* section I.B.6.

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

[243] CME Comment on ANPR at 7 (estimated $500 billion in collateral for swaps expected to be cleared by CME); ISDA February 16, 2011 Comment on ANPR at 2 (estimated $833 billion industry-wide).

[244] *Id.*

[245] Several clearing houses do, however, have experience clearing swaps on a voluntary basis. For example, LCH has been clearing interest rate swaps for over a decade, and ICE actively clears credit default swaps. In addition, while there are examples of FCM defaults related to clearing futures (*e.g.,* Griffin Trading Co., Klein Futures, Inc. and Lehman Brothers, Inc.), there have been no FCM failures related to the clearing of swaps transactions.

[246] In the past two decades, there have been only two cases of double defaults in the futures markets: Griffin Trading Co. and Klein Futures, Inc. *See Trustee* v. *Griffin,* 440 B.R. 148 (2010); CFTC Division of Trading and Markets, Report on Lessons Learned from the Failure of Klein & Co. Futures, Inc., July 2001, available at *http://www.cftc.gov/files/tm/tmklein_report071101.pdf.* With respect to FCM defaults generally in the futures markets, one commenter observed, ''The United States, fortunately has seen only a handful of FCM failures in recent decades. As a result, the FCM liquidation process, including the availability of porting, has not been tested under a wide variety of circumstances.'' ISDA at 3.

[247] *See, e.g.,* Second Roundtable Tr. at 165, 283–84 (characteristics of swaps may make it more difficult to liquidate or transfer customer positions in case of an FCM insolvency than for futures).

[248] *E.g.* MFA at 7–8; BlackRock at 7; Fidelity at 6; LCH at 2. The numerical estimates of higher margin and guaranty fund levels for Complete Legal Segregation relative to the Futures Model described in the text below were also described in the NPRM so swaps users who commented in response to the NPRM presumably were aware of them. However, some commenters who supported Complete Legal Segregation indicated that they did not give full

ability of a swaps customer to determine Fellow-Customer Risk at a particular FCM is limited, because confidentiality restraints inherently limit the amount of information that an FCM can provide customers with respect to the creditworthiness, swaps positions, and, in some cases, even identity of its other customers.[249] This, in turn, impairs (if not completely precludes) the customer's ability to evaluate Fellow-Customer Risk, hindering their ability to manage it, insure against it, or appropriately account for it in business decision-making.[250]

Both the benefit to customers of greater protection for their collateral provided under the Complete Legal Segregation Model as well as the associated costs depends, to an extent, on customer behavior in advance of a double default. Prior to an FCM insolvency, customers have the right to find another FCM to carry their accounts, and to have their existing FCM transfer their positions and collateral to that clearing FCM.[251] Under the extreme assumption that all customers costlessly anticipate the default and move their positions to another FCM before the default occurs, the Complete Legal Segregation Model offers no apparent greater benefit to customers over the Futures Model. However, on this assumption the Complete Legal Segregation model also imposes no additional losses to the DCO compared with the Futures Model since, in this instance, under neither model is the collateral of non-defaulting customers available to the DCO to cure the default. As a result, the extent to which customers can anticipate a fellow-customer default will tend to decrease both the benefits and the costs of the Complete Legal Segregation Model.

b. ''Risk Costs'' and Potential Effects on Margin Levels and DCO Guaranty Fund Levels in Response To Complete Legal Segregation.

Risk Costs refer to the costs associated with the allocation of loss in the event of a default under the Complete Legal Segregation Model relative to the Futures Model. This can usefully be divided into direct and indirect costs (and associated benefits). The direct cost of the Complete Legal Segregation Model is the increased risk the DCO will face when a Cleared Swaps Customer and its FCM default, which equals the probability of a default by a Cleared Swaps Customer and its FCM, multiplied by the expected contribution that fellow customers would have provided toward the uncovered loss. (As discussed in the previous section, there is a corresponding gain to Cleared Swaps Customers which is the value they place on avoiding this same cost, *i.e.,* the value of having the equivalent of insurance against Fellow-Customer Risk.)[252] Thus, the Complete Legal Segregation Model will potentially result in a decrease in the financial resources package available to the DCO in the event of default. Maintaining the same assurance of performance of the DCO's function as central counterparty in the circumstances of a double default may require the DCO to, therefore, raise additional financial resources.[253] The comments submitted to the Commission by DCOs and others have suggested two possible ways by which DCO's default resource structure under the Complete Legal Segregation Model might differ from the Futures Model: Either through higher initial customer margins or by increasing the size of the DCO's guaranty fund.[254] Of course, actual DCOs could use a mixture of adjustments to margins and guaranty funds. Commenters who estimated higher costs resulting from Complete Legal Segregation therefore estimated potential effects on margins and guaranty funds in isolation, while generally recognizing that this is a simplification of what actual practice is likely to be.[255]

Assuming no change in guaranty fund levels, ISDA suggested that the Complete Legal Segregation Model would require an increase of roughly 60% in initial margins relative to the Futures Model.[256] A number of other participants in the Commission's roundtables thought that the method used to arrive at the estimate was a reasonable way to roughly model the effect of Complete Legal Segregation on margin levels.[257]

CME estimated that Complete Legal Segregation would require an increase in margin in the range of 60% to 90%.[258] CME did not specify the quantitative assumptions underlying its estimate.[259] To illustrate effects on margin in dollar terms, CME made the assumption that, in a mature swaps market, it might expect to clear interest rate swaps with a notional value of $200 trillion. On this assumption, CME projected required margin from

credence to the higher of the cost estimates. *E.g.,* MFA at 7–8.

[249] *Id. See also* Second Roundtable Tr. at 183–185.

[250] *E.g.,* Tudor at 2; Fidelity at 3; MFA at 3–8. *See also supra* at 50–51.

[251] *See* 76 FR at 69442.

[252] In addition, as discussed in section VII.B.3.b.iv., there are efficiency gains in centralizing FCM monitoring in a small number of parties. Moreover, because of confidentiality considerations, among other things, DCOs have greater access to information from their Clearing Members than Cleared Swaps Customers do. As a result of this greater access to information and because of the increased incentive on DCOs to actively monitor the risks posed by their Clearing Member FCMs and Cleared Swaps Customers, the overall effectiveness of risk management may be increased.

[253] Section 725(c)(2)(B)(ii) of the Dodd-Frank Act requires that a DCO possess financial resources that, at a minimum, would allow the DCO to meet its financial obligations notwithstanding a default by the member or participant creating the largest financial exposure for that organization in extreme but plausible market conditions. *See also* 76 FR at 69344–45. In determining what financial resources are needed to comply with section 725(c)(2)(B)(ii) and its implementing regulations, a DCO will need to evaluate and take into consideration the effect of Complete Legal Segregation. However, within limits, the statute and regulations permit the exercise of judgment by the DCO as to the methods it will use to do this. As is indicated in the discussion in the text below, in comments to the proposed rulemaking, different DCOs have suggested that they may differ in their evaluation of the practical effects of Complete Legal Segregation, in the value they ascribe to fellow-customer collateral as a resource, and in the steps they will take to maintain adequate financial resources in light of their evaluation.

[254] A guaranty fund is a fund created by a DCO to which the clearing members contribute, in proportion generally set by DCO rule. *See supra* section I.B.4 and n. 27. The assets in the fund are then available to cover losses resulting from defaults by one or more clearing members, whether in their proprietary capacity or due to customer accounts, to the extent those losses are not covered by available collateral provided by the defaulting Clearing Member (limited to proprietary collateral for a default in the clearing member's proprietary account, or including customer collateral for a customer default). In addition, a DCO may retain by rule the right to call upon the members to contribute additional assets, up to a defined amount, if the pre-funded default resources are insufficient (referred to as an ''assessment power'').

[255] ICE contends that DCOs will choose to adjust to Complete Legal Segregation entirely by increasing margins rather than guaranty funds because Complete Legal Segregation increases the risk that assets in guaranty funds will actually be used to cover losses in the event of a double default. According to ICE, excessive reliance on margin is undesirable because guaranty funds offer the DCO more flexibility in responding to defaults and may be more liquid than assets used as margin. *See* ICE at 6–7. However, while ICE may be correct that clearing member FCMs, all other things being equal, would prefer less risk of loss of assets contributed to guaranty funds, there may be counterbalancing factors. For example, clearing customers may prefer a DCO with a larger guaranty fund and lower margin levels. Similarly, if a structure of default resources with an excessive ratio of margin to guaranty fund is, in fact, less effective or efficient for dealing with FCM defaults, a DCO that employs such a structure might be at a competitive disadvantage.

[256] ISDA January 18, 2011 Comment on ANPR at 9. The assumption that DCOs would use a 99.9% confidence level under Complete Legal Segregation was based on ''suggestions'' made at the Commission's First Roundtable. *See* First Roundtable Tr. at 110–111.

[257] *See, e.g.,* First Roundtable Tr. at 110–114; Second Roundtable Tr. at 255–57.

[258] CME Comment on ANPR at 7–8.

[259] *See* CME Comment on ANPR at 8 (describing methodology used in general terms).

customers clearing through CME of $500 billion under the Futures Model and $800–900 billion under Complete Legal Segregation.[260] ISDA estimated that, industry-wide, Complete Legal Segregation would require $581 billion more margin than the Futures Model (a 69.75% increase over a baseline, for the Futures Modal, of $833 billion). ISDA made clear that this estimate was based on a number of assumptions about future market activity and on data obtained from only four FCMs. Therefore, this figure is best construed as an estimate of the general magnitude of the effects expected by ISDA and not as a precise predicted dollar figure.[261] Nonetheless and notwithstanding this estimate of higher initial margin, ISDA concluded that Complete Legal Segregation was ''the most appropriate choice of holding model for cleared swaps collateral'' of the models proposed in the NPRM and supported this approach because it facilitated porting of customer positions in the event of an FCM default.[262]

Although the above estimates were based on data for interest rate swaps, commenters and participants in roundtable discussions indicated that somewhat higher margin levels might be needed to maintain adequate default resources in connection with credit default swaps because of the high volatility and idiosyncratic risks associated with this type of swap.[263] Using data concerning credit default swaps it currently clears, albeit not under the Dodd-Frank legal regime, ICE estimated that the required initial margin increases would range from 40% to 371%.

These estimates assume that the entire default resource shortfall resulting from the DCO's lost reliance on collateral posted as margin by non-defaulting customers is reflected in higher initial margins. To illustrate the other extreme, CME estimated the cost of responding to Complete Legal Segregation purely by means of an increase in its guaranty fund. According to CME, it would be necessary to double the size of the guaranty fund using this approach, although their comment indicates that this should be taken as a rough estimate likely to be adjusted based on experience in the future.[264] Under its assumption that in the future it might clear a notional value of $200 trillion in interest rate swaps, CME estimates that it would require a guaranty fund of $50 billion under the Futures Model and $100 billion under Complete Legal Segregation. CME also stated that it might prove possible to adapt to Complete Legal Segregation using ''what is traditionally called 'concentration' margin whereby the DCO sets a level of risk at which it would begin to charge higher margins based on indicative stress-test levels.'' According to CME, if it proved possible to implement such a system, likely ''concentration charges'' would fall in the range of $50-$250 billion.[265] However, CME stated that it currently lacked sufficient information to precisely assess an appropriate methodology using this approach and that this approach could have disadvantages which would need to be addressed before it was considered as a practical approach.[266] ISDA estimated that industry-wide guaranty funds under the Futures Model would come to $128 billion.[267] ISDA apparently did not independently estimate the effect of Complete Legal Segregation on guaranty funds, but, relying upon DCO estimates that they would approximately double, estimated an increment of an additional $128 billion for Complete Legal Segregation industry-wide.[268] If guaranty funds are larger as a result of Complete Legal Segregation, it is likely that some or all of the cost would be passed on by FCMs to their customers in the form of higher fees. However, in the absence of more information about future competitive conditions in the cleared swaps market and similar matters, it is not possible to reliably estimate the extent to which this would occur.

By contrast to CME, ICE, and ISDA, LCH stated that it is not appropriate to attribute higher margins and/or guaranty funds to the Complete Legal Segregation Model than to the Futures Model and that the appropriate level of default resources for DCOs, is the same under both models.[269] LCH has a more than a decade's worth of experience clearing OTC swaps. LCH states that a methodology in which no diversification of customer collateral is assumed represents their current practice, and is appropriately ''conservative'' in terms of capital adequacy.[270] LCH maintains that, even if it is legally permissible for a DCO to take advantage of fellow customer collateral, it is imprudent to assume that any funds in the omnibus Cleared Swaps Customer Account will remain at the time of default.[271] In the event that default occurs not as a sudden shock, but rather, as the end of a process of credit deterioration taking place over a number of days (potentially a number of weeks), the Cleared Swaps Customers may have time (and, if subject to Fellow-Customer Risk, strong incentive) to port (*i.e.,* transfer) their Cleared Swaps Contracts and associated collateral away from the defaulting FCM.[272] CME also has noted that an FCM default is likely to be preceded by a period of financial turmoil: ''In a situation where an FCM has defaulted on its obligations to one or more DCOs, it is entirely possible that the FCM or its parent company has been under severe financial stress for some period of time.''[273]

Thus, according to the logic of LCH's approach, the size of the guaranty fund and/or initial margin levels would need to be as high under the Futures Model as under the Complete Legal Segregation Model.[274]

The divergence in the approaches of LCH and the other two clearinghouse commenters is due in part to different implicit assumptions about fellow customer behavior, and how such behavior should affect a DCO's design of default resources. Under Complete Legal Segregation, such an approach likely requires an assessment of the largest stressed loss on a small (or concentrated) number of the largest customers of the given FCM since, in this instance, the DCO would not have access to the collateral of non-defaulting customers. Under the Futures Model, by contrast, consideration of the largest

[260] CME Comment on ANPR at 7–8.

[261] ISDA January 18, 2011 Comment on ANPR at 10.

[262] ISDA at 1. For a more detailed discussion of the benefits of Complete Legal Segregation for porting, *see* section VII.B.3.b.ii.

[263] Second Roundtable Tr. at 255.

[264] CME Comment on ANPR at 7–8. The comment states that under Complete Legal Segregation CME, in determining the size of the guaranty fund ''would likely change [from an approach treating customer margin accounts as diversified unitary pools] to an approach geared toward assessing the largest loss associated with a certain number of the largest individual customer accounts. Currently, we presume that five such customer accounts would be our target, although experience and prudence would be our guide. In any event, our stress-test loss profile of the largest customer accounts would almost certainly generate larger 'worst loss' results [under Complete Legal Segregation] than under [the Futures Model].'' *Id.*

[265] *Id.* at 8–9.

[266] *Id.*

[267] ISDA January 18, 2011 Comment on ANPR at 10. ISDA stated that this estimate referred to the funded component of guaranty funds and did not include DCO's right to call for more assets from member FCMs when needed.

[268] ISDA January 18, 2011 Comment on ANPR at 9–10 and n.8 (referring to CME estimate).

[269] Evaluating the Costs of Complete Legal Segregation, Aug. 2011, at 6–11 (''LCH White Paper'').

[270] 76 FR at 33847, n. 177.

[271] LCH White Paper at 8.

[272] LCH at 3.

[273] CME at 14. *See also id.* (describing a situation where ''an increasing number of customers were removing their assets and accounts.'').

[274] LCH White Paper at 8.

stressed loss might occur over an expanded (and, to a degree, more diversified) pool of customers because the DCO is permitted to use the mutualized pool of customer collateral. Hence, the Complete Legal Segregation Model effectively prohibits the DCO from using the mutualized pool of customer deposits as a resource in the event of double default. It follows that the extent to which the Complete Legal Segregation Model actually affects the DCO's resources relative to the Futures Model depends upon the degree to which non-defaulting Cleared Swaps Customers collateral will be present following a default. If all Cleared Swaps Customer Contracts remained with the defaulting FCM through the default, then the DCO could potentially measure the adequacy of guaranty funds based on a fully diversified pool of customer positions. Conversely, if all customers would transfer their positions to a different FCM in anticipation of the default, then the diversification (and its consequence for the DCO's financial resources package) would be eliminated.

More generally, the extent to which the Complete Legal Segregation Model leads to a higher guaranty fund or higher levels of margin per customer than the Futures Model depends on the extent to which Cleared Swaps Customer Contracts can be expected to remain with the defaulting FCM during the period immediately preceding a default. Since the circumstances of particular FCM defaults will vary, DCOs, in determining their financial resources package, should be expected to take into consideration the possibility that, at least for some FCM defaults, there will be warning signs, resulting in a portion of Cleared Swaps Customer Collateral being transferred out of the Cleared Swaps Customer Account maintained by the defaulting FCM.

While determining the appropriate assumptions regarding customer behavior under the Futures Model is central to the issue of the adequacy of a DCO's default resources, it may prove less central to the consideration of relative costs and benefits under this rule, since both of those costs and benefits depend on the extent to which Cleared Swaps Customers will transfer their Cleared Swaps Contracts. In general, the greater the extent to which customers will move their positions, the lower the benefits of the Complete Legal Segregation Model over the Futures Model. However, this benefit afforded the customer needs to be balanced against the cost to the DCO of insuring against the uncertainty.[275] Both the capital costs and associated benefits of the LSOC Model relative to the Futures Model will tend to be lower to the extent customers are likely to move their positions in advance of an FCM default and higher to the extent customers are unlikely to be able to do so. Differing assumptions about customer mobility in advance of default are, therefore, likely to have smaller implications for the relative costs and benefits between approaches than they do for the Risk Costs considered in isolation.

A distinct question in evaluating Risk Cost is how to translate a margin or guaranty fund increase into a cost increase. A customer that is required to post an additional $100 of margin is not adversely affected in the amount of $100. Moreover, the cost to the customer is, at least in part, offset by the benefit to the DCO. The cost to a customer of a margin increase of $100 is the difference between the gain he or she would have received by retaining that $100, and the return he or she will receive on the asset while it is on deposit with the FCM or DCO. For example, the customer might invest the $100 in buying and holding grain over the pendency of the swap if the initial margin were not increased, while he or she is limited to the return on assets the DCO will accept as margin payment (*e.g.,* the T-bill rate) under the new, higher margins. The exact difference in rate of returns is dependent on the individual customer's investment options as well as his/her risk tolerance, and hence is difficult to calculate precisely. Offsetting this cost are the statutory goal of protecting customer funds and the gain to the DCO of having additional assets available in the event of a combined Cleared Swaps Customer and FCM default, which may enable it to obtain a higher rate of return on some of its other assets.[276] Similarly, the cost to an FCM of a guaranty fund contribution increase is equal to the difference in return between acceptable instruments for deposit to the guaranty fund and the FCM's potential return on those additional funds if they were not deposited to the guaranty fund.[277]

c. Effects on Likelihood That Customer Swaps Positions Will Be ''Ported'' to New FCMs Rather Than Liquidated in the Event of an FCM Default

According to several commenters, a central issue to consider when designing a customer collateral protection regime is the ability of customers to ''port,'' *i.e.,* transfer, their swaps positions to a solvent FCM in the event that their current FCM defaults.[278] Following a default by an FCM, the swaps positions of the FCM's customers either have to be moved to another FCM, or closed. Moving a position to another FCM allows the DCO to maintain its net position in that contract at zero, which is generally a goal of a DCO. It also relieves the customer of the necessity of reestablishing a position, which potentially can be costly, especially in a stressed economic state.[279] Finally, according to commenters, the ability to port rather than liquidate customer positions can have important systematic benefits for the market at large, because the forced liquidation of the swaps cleared by a major FCM could have severe disruptive effects on prices and market conditions.[280]

Rules governing customer collateral accounts have an indirect, but potentially important, effect on the likelihood of successful porting in the event of an FCM default. If swaps positions are transferred to a new FCM, the new FCM will have to add to its customer account with the DCO enough collateral to secure the ''ported'' swaps. The most ready source of such collateral is the customer account of the defaulting FCM, which already contains collateral securing the relevant swaps. However, if collateral from the defaulting FCM's customer account cannot be transferred, then porting of market positions requires customers to, at least temporarily, provide the new FCM with new collateral. This is, at best, a burden, and may, in some cases, make porting infeasible—particularly the prompt porting of numerous customers with varied financial resources and liquidity.

From the perspective of porting, the Complete Legal Segregation Model has several related advantages over the Futures Model in circumstances of a double default. As discussed above, under the Futures Model, if even a

[275] In addition, and as discussed above, section 724(a) of the Dodd-Frank Act added a new paragraph (f) to section 4(d) of the CEA, which requires that neither an FCM nor a DCO may not use the collateral of one customer to cover the obligations of another customer or the obligations of the FCM or the DCO.

[276] An additional offset to this cost is the value that customers assign to the increased safety of their collateral from Fellow-Customer Risk, as discussed in section VII.B.2.

[277] There will also be an implicit cost to the FCM reflecting the risk that the contributed assets will need to be used by the DCO to cover losses in a default situation.

[278] Black Rock at 2; Fidelity at 5; FIA at 4; MFA at 4.

[279] *See* ISDA February 16, 2011 Comment on ANPR at 2.

[280] *See, e.g., id.* at 2–4; and MFA at 4.

single customer is in default, the DCO is entitled to as much of the customer account as is necessary to make up its loss. As a result, the DCO has incentives to postpone transfer of the customer account until the full ramifications of the customer default—and thus the size of the DCO's claim against the account—are resolved. By contrast, under Complete Legal Segregation, the DCOs claim against the customer account is limited by law to that portion of the account attributable to individual customers in default. The DCO will therefore have little or no incentive to resist transfer of that portion of the account attributable to other customers. At the same time, the Complete Legal Segregation Model, unlike the Futures Model, provides a legal framework for attributing the value of the customer account to individual customers. Further, it requires that FCMs provide DCOs with the necessary information and that DCOs make the attribution at least once daily, so as to be prepared for a possible FCM default. As a result, the Complete Legal Segregation Model, has clear advantages over the Futures Model in terms of facilitating the transfer of the collateral of non-defaulting customers in circumstances where one or more customers have defaulted.[281]

Because of the infrequent occurrence of double default situations it is not possible to predict how frequently Complete Legal Segregation will permit porting in circumstances where porting would not be possible, or would be delayed, under the Futures Model. Nevertheless, the structural advantages of Complete Legal Segregation for purposes of facilitating porting, and the analysis in ISDA's comment, imply that this is an important benefit of this model.

d. Effects on Incentives for DCOs and Customers to Monitor and Control Risky Behavior by FCMs

CME and other commenters have argued that the Complete Legal Segregation Model could potentially reduce the incentives of individual customers to carefully evaluate clearing FCMs and only do business with the least risky.[282] In effect, they argue that because the financial condition of the FCM, and of the FCM's other customers, will be less relevant to the customer's exposure to loss in the event of a fellow customer's default than under the Futures Model, the customer will devote less effort to monitoring the FCM and its other customers.

However, while it is possible that the protection against Fellow-Customer Risk provided by the Complete Legal Segregation Model may cause customers, on average, to devote less effort to monitoring the activities of their respective FCMs than under the Futures Model, that incentive is not removed. For example, customers remain exposed to Operational Risk.

Moreover, the Complete Legal Segregation Model creates offsetting increased monitoring incentives on the DCO and its member FCMs, to the benefit of customers. Because of the increased likelihood that a customer default would impact the guaranty fund under the Complete Legal Segregation Model, increased incentives exist to protect that fund through more careful monitoring by the suppliers of the guaranty fund and their agent (the DCO). Indeed, commenters observe that the availability of fellow-customer collateral as a buffer reduces the incentives of DCOs to provide vigorous oversight.[283] The net effect of these incentive changes on the incentive to monitor is difficult to quantify. However, the basic economics of monitoring suggest that there are efficiency gains to centralizing monitoring in a small number of parties.[284] This is because of ''free rider'' effects associated with diffuse exposure to risk of loss. When the risk of loss from the activities of a firm, such as an FCM, is spread over a large number of agents, each individual agent gains little from devoting resources to monitoring the firm relative to the total potential benefit of monitoring to the affected agents as a group.[285] This effect is compounded by an information effect; even if the incentive exists, it is difficult for individual customers to gain access to real-time information about the financial condition of the FCM, and even more so to gain real-time information about the financial condition of their fellow customers. In contrast, the DCO is in a position to obtain good information about the financial condition of FCMs and customers since, via its rules, it can require FCMs to provide such information as a condition for becoming and remaining clearing members. Based on these considerations, there is reason to believe that, while Complete Legal Segregation may reduce incentives for customers to monitor their FCMs, it will increase incentives for monitoring of FCMs by DCOs and, on balance is likely to increase the effectiveness and efficiency with which risk taking by clearing FCMs is monitored.

e. Operational Costs

As discussed above, in order for the Complete Legal Segregation Model to work better than the Futures Model in the event of a double default, the DCO must have information that will enable it to attribute the assets in the defaulting FCM's customer account to individual customers of the FCM.[286] Moreover, because the occurrence of a double default is rare, and because an FCM in the process of default may not (despite its regulatory obligations) be able to provide a DCO with accurate and timely information on its customers, section 22.11 requires clearing FCMs to provide the necessary information to DCOs on at least a daily basis. The Commission notes that section 22.12 similarly requires DCOs to use this information to calculate and record the amount of collateral required to support each customer's Cleared Swaps transactions on at least a daily basis. This daily information processing is not provided under the Futures Model and will add to the operational costs of clearing.

The NPRM discussed the likely magnitude of increased operational costs associated with the more extensive information requirement.[287] The Commission noted there that one estimate suggested the operational costs of the Complete Legal Segregation Model (relative to the Futures Model) were likely to be slightly less than $1 million per year per FCM, with one-time costs of about $700,000.[288] A DCO's cost of accommodating this additional information was estimated to be of the same general magnitude. Another comment observed that the operational costs would be the same across all models being considered given a requirement for DCOs to collect margin on a gross basis.[289] The Commission

[281] For a more detailed discussion of the operation of the segregation models in an FCM bankruptcy, *see supra* section I.D.

[282] Second Roundtable Tr. at 253, l.17; FIA at 5; Newedge at 4. Cf. MFA at 4–5; BlackRock at 8.

[283] Blackrock at 8; Freddie Mac at 2; Vanguard at 5.

[284] *See e.g.,* Kevin Dowd, *Re-Examining the Case for Government Deposit Insurance,* 59 S. Econ. J. 363, 370 (1993).

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

[286] *See* discussion at section VII.A.2; *supra* n.224.

[287] 76 FR at 33845–33846.

[288] *Id.* (citing ISDA estimates for operational costs received in response to the ANPR).

[289] LCH at 2 (''If the Commission adopts [the gross margining requirement for DCOs], any DCO offering any swaps clearing service under any of the models outlined by the Commission in the Proposed Rulemaking will be required to track margin on an individual client basis and FCMs will be required to do the same.''). *See also* 76 FR at 69374–76. In addition, some individual customer information already resides at the DCO. *See* CME at 9 (''At the

received no alternative quantitative estimates in response to the NPRM,[290] although Fidelity suggested that some of the operational costs associated with Complete Legal Segregation will be incurred regardless of the segregation model that is chosen because other CFTC rulemakings (*i.e.,* the real time reporting rulemaking and the reporting of certain post-enactment swap transactions rulemaking) require similar reporting.[291]

Based on estimates by CME and ISDA described above, the expected scale of the cleared swaps market will require hundreds of billions of dollars of collateral to adequately secure swaps positions under any segregation model, and will thus potentially expose this collateral to some degree of Fellow-Customer Risk. In light of the projected magnitude of the customer funds at stake, the Commission believes that operational costs of the Complete Legal Segregation Model are a relatively minor factor in choosing a model that would protect customer funds consistent with section 4d(f) of the CEA, and that this would be true even if operational costs proved to be considerably higher than the estimate described in the NPRM.

f. Additional Potential Sources of Costs and Benefits Arising From Complete Legal Segregation

As discussed in section I.D.1 above, the Complete Legal Segregation Model provides a significant advantage compared to the Futures Model with respect to fostering transfer. Specifically, under the Complete Legal Segregation Model, information about the Cleared Swaps Customers as a whole, and about each individual Cleared Swaps Customer's positions, are transmitted to the DCO every day, an information flow (and store) that is not present in the Futures Model. Thus, in the event of an FCM bankruptcy, each DCO will have important information on a customer by customer basis that can be used to facilitate and implement transfers, thereby making the DCO less reliant upon the FCM for that information.

3. Application to CEA Section 15(a) Considerations

a. Protection of Market Participants

As discussed above, the primary benefit of the Complete Legal Segregation Model is the protection of Cleared Swaps Customers from the risk of losing the value of their collateral as a result of a double default. Based on estimates by CME and ISDA, the cleared swaps market is likely to require upwards of $500 billion in customer collateral regardless of the segregation model chosen by the Commission.[292] These assets will be potentially exposed to Fellow-Customer Risk. It is not possible to reliably quantify the likelihood of fellow customer losses in the absence of Complete Legal Segregation for reasons discussed in section VII.B.2.a. above. In addition, the magnitude of Fellow-Customer Risk in particular default situations will be affected by the extent to which customers foresee or anticipate a default and accordingly move their accounts to other FCMs; and the extent to which a default is foreseeable or anticipated will vary in different defaults. The risk cost imposed on DCOs and their members by Complete Legal Segregation will be affected by the foreseeability of default in a roughly parallel way.

Notwithstanding these uncertainties, swaps users who participated in this rulemaking process, with only limited exceptions, consistently placed great value on protection against Fellow-Customer Risk and supported either Complete Legal Segregation or stronger measures to provide such protection despite estimates of high dollar costs in the form of the capital cost of higher margins or guaranty funds.[293] Since swaps users most likely ultimately will bear, directly or indirectly, most of the dollar costs of protection against Fellow-Customer Risk, the Commission places substantial weight on their valuation of such protection.

b. Efficiency, Competitiveness, and Financial Integrity of Markets

i. Dollar Costs and Swaps Usage

Complete Legal Segregation could add materially to the dollar cost of clearing swaps, affecting competitiveness in particular.[294] Moreover, there were estimates (albeit somewhat speculative estimates) that Complete Legal Segregation might require on the order of 70% higher margins, 100% higher DCO guaranty funds, or some combination of smaller increases in both. In light of the expected large scale of the cleared swaps market, these estimates imply industry wide increments in margin on the order of $500 billion or more, increments in guaranty funds of over $100 billion, or a combination of smaller increments of both.[295] The cost of these measures would not be the dollar amount of margin or guaranty fund contributions, but, rather, the opportunity cost of using capital for these purposes rather than other business purposes. Considerable uncertainty is added to the evaluation of these estimates of the dollar cost of Complete Legal Segregation by the fact that DCOs do not yet have experience clearing under the Dodd-Frank regime (although they do currently clear swaps pursuant to the rules of the exchanges) and by LCH's observation that, under the method it uses to determine needed financial resources to protect against default, the same level of resources is required under both Complete Legal Segregation and the Futures Model.[296]

If Complete Legal Segregation results in higher dollar costs to swaps users, this may discourage some use of swaps for hedging or other beneficial economic uses. The Commission does not have precise information about the price responsiveness of swaps usage that would make it possible to quantify this effect. A countervailing consideration is that comments to this rulemaking indicate that customers are already transacting in uncleared swaps, and are paying for full segregation of the collateral they are posting because of the importance to them of protection of that collateral against the defaults of others. Moreover, as some commenters noted, concern over exposure to Fellow-Customer Risk that they currently pay for and receive could discourage swaps usage in the absence of Complete Legal Segregation or other protection against such risk.[297] Comments by swaps users indicated that such effects would occur though they did not provide quantitative estimates. The evidence from the comments, specifically the statements of swap users regarding their willingness to pay for legal segregation, suggests that the demand-enhancing

end of each trading day, CME Clearing calculates, for each FCM's cleared swaps customer account* * * the net margin requirement for each customer in the account.'').

[290] In fact, FHLB states that the costs and risks associated with the additional operational complexity ''may be difficult to quantify.'' FHLB at 4.

[291] Fidelity at 6.

[292] *See supra* n. 243.

[293] *See, e.g.,* Second Roundtable Tr. at 245–249; Second Roundtable Tr. at 140, l.12 (Mr. MacFarlane stating that ''Tudor would happily pay the incremental costs, both in terms of collateral and operational costs [for greater protection].'').

[294] This analysis is also informed by the extent to which clearing certain types of swaps is mandatory, as well as by the cost already incurred in the uncleared swaps market.

[295] *See supra* n. 243.

[296] *See supra* n. 269.

[297] *See e.g.,* Second Roundtable at 141, l.3 (Mr. MacFarlane stating''the uncertainty that's created by not knowing who we're sharing risk in the omnibus pool would cause us to pull our capital back from the market.'').

effects of the increased safety associated with Complete Legal Segregation are larger than the demand-reducing effects of higher margins and/or fees associated with it.[298]

ii. Financial Integrity of Markets

Complete Legal Segregation is likely to have several effects on the financial integrity of markets, the specifics of which are discussed in more detail under other headings.[299] As explained above, Complete Legal Segregation is expected to lead to a net improvement in the monitoring of risky behavior by FCMs, with the effects of increased incentives for such monitoring by DCOs outweighing the effects of reduced incentives for such monitoring by customers. This net improvement in monitoring of FCMs can be expected to enhance the financial integrity of the markets in which clearing FCMs participate.

By facilitating porting, Complete Legal Segregation is expected to enhance the financial integrity of cleared swaps markets in financial stress situations involving FCMs by reducing the likelihood that a double default will result in the need to liquidate large volumes of swaps positions with resulting costs to customers and the DCO and the potential to seriously disrupt the market at large.

By prohibiting DCOs from using the collateral of non-defaulting customers in a double default situation, Complete Legal Segregation potentially could have a negative effect on the financial integrity of DCOs by reducing the financial resources available to apply to losses arising from double defaults. However, the record indicates that DCOs would substitute additional resources in the form of higher margin levels, larger guaranty funds, or a combination of both as need to maintain the ability to cover losses from FCM and customer defaults.[300] Importantly, prohibiting DCOs from using the collateral of non-defaulting customers to protect a DCO from risks within a DCO's control is consistent with the statute's goal of protecting customer funds. As a result, the loss of the ability to rely on the collateral of non-defaulting customers would be expected to translate to higher dollar costs than under the Futures Model rather than reduced financial integrity.

c. Price Discovery

Complete Legal Segregation is not expected to have a significant effect on price discovery under normal market conditions. In circumstances of a double default involving a large FCM, Complete Legal Segregation may help protect price discovery in the swaps markets by reducing the likelihood of the need for a large scale liquidation of swaps positions that would disrupt normal pricing.

d. Sound Risk Management Practices

As discussed above,[301] Complete Legal Segregation is expected to produce a net improvement in the monitoring of risky behavior by FCMs. While there may be some reduction in the incentives to Cleared Swaps Customers to monitor their FCMs, there is a corresponding increase in the incentives by DCOs to do so. There are efficiency gains in centralizing this responsibility in a small number of parties, and the DCOs (as membership organizations) have greater access to information from their Clearing Members, in contrast to Cleared Swaps Customers, who (due to considerations of confidentiality) may have little ability to obtain information about an FCM's activities with respect to fellow-customers.

e. Other Public Interest Considerations

By better protecting Cleared Swaps Customer Collateral against fellow-customer risk, the LSOC Model will enhance compliance with the values of CEA Section 4d(f), which requires that the property of each individual customer be protected.

C. Conclusion

The Commission has carefully considered the available evidence regarding the costs and benefits of Complete Legal Segregation Model and has concluded that the Complete Legal Segregation Model best accomplishes the statutory objective of protecting customer deposits. In terms of benefits, customers have much greater assurance of the safety of their margin deposits against Fellow-Customer Risk under the Complete Legal Segregation Model than under the Futures Model. In addition, Complete Legal Segregation will facilitate porting rather than liquidation of customer positions in double default situations with associated benefits to customers and, for defaults of large FCMs, reduced risk of disruption of markets as a result of large volumes of customer positions. Complete Legal Segregation also will increase incentives for DCOs to monitor risky behavior by member FCMs and that this effect can be expected to outweigh reduced incentives for customers to monitor their FCMs. In determining that Complete Legal Segregation is the appropriate model, the Commission has placed weight on, among other considerations, the comments of many swaps users that they place great value on assurance of their margins and their positions and are willing to incur substantial costs to achieve such assurance and on comments by a range of market participants placing great importance on porting of customer positions as a response to FCM defaults.

On the cost side, several DCOs that employ the Futures Model for the futures-side of their business and other commenters argued that Complete Legal Segregation will require some combination of substantially higher margin levels and guaranty fund contributions than the Futures Model. However, one major DCO reported that, under the approach it uses to establish margin and guaranty fund level, these levels would be the same under Complete Legal Segregation and the Futures Model. Complete Legal Segregation will impose some operational costs but such costs are small enough to be a minor consideration relative to the other aspects of cost; *e.g.,* the potential increases in margins and guaranty funds.

The Commission notes that, as discussed above, there are a number of sources of uncertainty in evaluating the costs and benefits of Complete Legal Segregation, such as market participants not yet having experience clearing swaps under the Dodd-Frank legal regime and the infrequency of double defaults. However, the costs and benefits of all the models considered by the Commission are subject to similar uncertainties as to the probability of double defaults and customer behavior in anticipation of such defaults. Accordingly, such uncertainties do not militate against the selection of the Complete Legal Segregation Model as the preferred alternative.

VIII. Related Matters

A. Paperwork Reduction Act

1. Introduction

Sections 22.2(g), 22.5(a), 22.11, 22.12, and 22.16 of these rules impose new information disclosure and recordkeeping requirements that constitute the collection of information

[298] *See e.g.,* Second Roundtable Tr. at 245 (Mr. Thum stating that "we're prepared to bear the cost to provide for the margin protection that our clients need.").

[299] *See* discussion at sections VII.B.2.b, VII.B.2.c, VII.B.2.d, and VII.B.3.b.i.

[300] *See supra* n. 255.

[301] *See supra* section VII.B.2.d.

within the meaning of the Paperwork Reduction Act of 1995 (''PRA'').[302] Under the PRA, an agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a currently valid control number.[303] The Commission therefore has requested that the Office of Management and Budget (''OMB'') assign a control number for this collection of information. The Commission has also submitted the NPRM, this final rule release, and supporting documentation to OMB for review in accordance with 44 U.S.C. 3507(d) and 5 CFR 1320.11. The title for this collection of information is ''Disclosure and Retention of Certain Information Relating to Cleared Swaps Customer Collateral,'' OMB Control Number 3038–0091. This collection of information will be mandatory. The information in question will be held by private entities and, to the extent it involves consumer financial information, may be protected under Title V of the Gramm-Leach-Bliley Act as amended by the Dodd-Frank Act.[304] OMB has not yet approved the collection of this information.

2. Comments Received on Collection of Information Proposed in NPRM

Sections 22.2(g), 22.5(a), 22.11, 22.12, and 22.16 and estimates of the expected information collection burden were published for comment in the NPRM. The collection of information required by the final versions of these rules and the associated information collection burden is identical to that of the rules as proposed. Comments were received regarding proposed sections 22.5(a), 22.11, 22.12, and 22.16. The substance of these comments and the Commission's response to them is set forth above in sections IV.E, IV.K, IV.L., and IV.P of this preamble.

In addition, in response to a comment on the definition of ''Cleared Swaps Customer Collateral'' by the FIA requesting that the Commission confirm that the term ''Cleared Swaps Customer Collateral'' includes all assets provided to an FCM by a Cleared Swaps Customer, including amounts in excess of the amount required to margin a Cleared Swap by the relevant DCO, the Commission has included in the final rule a new permissive provision, subsection 22.13(c)(2). Subsection 22.13(c)(2) provides that an FCM may transmit to a DCO collateral posted by a Cleared Swaps Customer in excess of the amount required by the DCO if (1) the rules of the DCO permit such transmission; and (2) the DCO provides a mechanism by which the FCM is able to, and maintains rules requiring the FCM to, identify each business day, for each Cleared Swaps Customer, the amount of collateral posted in excess of the amount required by the DCO. This rule subsection may have the effect of causing some FCMs to perform a daily computation of the amount of collateral posted in excess of the amount required by the relevant DCO. In the view of the Commission, this provision does not materially change, or add to the burden of, the information collection required by the Part 22 rules as proposed. This is so because the computation of the amount of collateral posted in excess of the amount required by the relevant DCO will be performed using same data sources that would be used for the information collections required by subsections 22.2(g), 22.11, and 22.12. Moreover, this burden would only be imposed (and enforced) by voluntary action of the DCO in permitting, and the FCM in transmitting, such additional collateral.

There were no comments specifically addressing the Commission's numerical estimates of information collection burden in section VII.B.2 of the NPRM.

B. Regulatory Flexibility Act

The Regulatory Flexibility Act (''RFA'')[305] requires that agencies consider whether their rules will have a significant economic impact on a substantial number of small entities and, if so, provide a regulatory flexibility analysis of that impact. These Part 22 rules and amendments to Part 190 apply to DCOs and FCMs. In the NPRM, the Chairman, pursuant to section 605(b) of the RFA, 5 U.S.C. 605(b), certified on behalf of the Commission that these rules and amendments will not have a significant economic impact on a substantial number of small entities based on previous determinations by the Commission that DCOs and FCMs are not small entities for purposes of the RFA.[306]

List of Subjects

17 CFR Part 22

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

17 CFR Part 190

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

IX. Text of Final Rules

For the reasons stated in this release, the Commission hereby amends Chapter 17 as follows:

■ 1. Add Part 22 to read as follows:

PART 22—CLEARED SWAPS

Sec.

22.1 Definitions.
22.2 Futures Commission Merchants: Treatment of Cleared Swaps Customer Collateral.
22.3 Derivatives Clearing Organizations: Treatment of Cleared Swaps Customer Collateral.
22.4 Futures Commission Merchants and Derivatives Clearing Organizations: Permitted Depositories.
22.5 Futures Commission Merchants and Derivatives Clearing Organizations: Written Acknowledgement.
22.6 Futures Commission Merchants and Derivatives Clearing Organizations: Naming of Cleared Swaps Customer Accounts.
22.7 Permitted Depositories: Treatment of Cleared Swaps Customer Collateral.
22.8 Situs of Cleared Swaps Customer Accounts.
22.9 Denomination of Cleared Swaps Customer Collateral and Location of Depositories.
22.10 Application of other Regulatory Provisions.
22.11 Information to be Provided Regarding Customers and their Cleared Swaps.
22.12 Information to be Maintained Regarding Cleared Swaps Customer Collateral.
22.13 Additions to Cleared Swaps Customer Collateral.
22.14 Futures Commission Merchant Failure to Meet a Customer Margin Call in Full.
22.15 Treatment of Cleared Swaps Customer Collateral on an Individual Basis.
22.16 Disclosures to Customers.

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

§ 22.1 Definitions.

For the purposes of this part:

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

(1) This term shall exclude any swap (along with money, securities, or other property received to margin, guarantee, or secure such a swap) that, pursuant to a Commission rule, regulation, or order, is (along with such money, securities, or other property) commingled with a commodity future or option (along with money, securities, or other property

[302] 44 U.S.C. 3501 *et seq.*

[303] *Id.*

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

[305] 5 U.S.C. 601 *et seq.*

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

received to margin, guarantee, or secure such a future or option) that is segregated pursuant to section 4d(a) of the Act.

(2) This term shall include any trade or contract (along with money, securities or other property received to margin, guarantee, or secure such a trade or contract), that

(i) Would be required to be segregated pursuant to section 4d(a) of the Act, or

(ii) Would be subject to § 30.7 of this chapter, but which is, in either case, pursuant to a Commission rule, regulation, or order (or a derivatives clearing organization rule approved in accordance with § 39.15(b)(2) of this chapter), commingled with a swap (along with money, securities, or other property received to margin, guarantee, or secure such a swap) in an account segregated pursuant to section 4d(f) of the Act.

Cleared Swaps Customer. This term refers to any person entering into a Cleared Swap, but shall exclude:

(1) Any owner or holder of a Cleared Swaps Proprietary Account with respect to the Cleared Swaps in such account; and

(2) A clearing member of a derivatives clearing organization with respect to Cleared Swaps cleared on that derivatives clearing organization. A person shall be a Cleared Swaps Customer only with respect to its Cleared Swaps.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

(B) The handling, on behalf of such partnership, of:

(*1*) The Cleared Swaps of Cleared Swaps Customers or

(*2*) The Cleared Swaps Customer Collateral;

(C) The keeping, on behalf of such partnership, of records pertaining to

(*1*) the Cleared Swaps of Cleared Swaps Customers or

(*2*) the Cleared Swaps Customer Collateral; or

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

(d) *Limitations on Use.* (1) No futures commission merchant shall use, or permit the use of, the Cleared Swaps Customer Collateral of one Cleared Swaps Customer to purchase, margin, or settle the Cleared Swaps or any other trade or contract of, or to secure or extend the credit of, any person other than such Cleared Swaps Customer. Cleared Swaps Customer Collateral shall not be used to margin, guarantee, or secure trades or contracts of the entity constituting a Cleared Swaps Customer other than in Cleared Swaps, except to the extent permitted by a Commission rule, regulation or order.

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

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

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

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

(e) *Exceptions.* Notwithstanding the foregoing:

(1) *Permitted Investments.* A futures commission merchant may invest money, securities, or other property constituting Cleared Swaps Customer Collateral in accordance with § 1.25 of this chapter, which section shall apply to such money, securities, or other property as if they comprised customer funds or customer money subject to segregation pursuant to section 4d(a) of the Act and the regulations thereunder.

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

(3) *Deposits of Own Money, Securities, or Other Property.*

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

(ii) Money, securities, or other property deposited by a futures commission merchant pursuant to 22.13(b) and available to a derivatives clearing organization or Collecting Futures Commission Merchant to meet the obligations of the futures commission merchant's Cleared Swaps Customers collectively, shall be maintained in an account separate from the Cleared Swaps Customer Account.

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

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

(iii) The futures commission merchant may withdraw money, securities, or other property from the FCM Physical

Location or Cleared Swaps Customer Account, to the extent of its residual financial interest therein. At the time of such withdrawal, the futures commission merchant shall ensure that the withdrawal does not cause its residual financial interest to become less than zero.

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

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

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

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

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

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

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

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

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

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

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

(iii) To determine the amount secured by ''readily marketable securities,'' the futures commission merchant shall:

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

(B) Reduce such market value by applicable percentage deductions (*i.e.,* ''securities haircuts'') as set forth in Rule 15c3–1(c)(2)(vi) of the Securities and Exchange Commission (§ 240.15c3–1(c)(2)(vi) of this title). The portion of the debit balance, not exceeding 100 per cent, that is secured by the reduced market value of such readily marketable securities shall be included in calculating the sum referred to in paragraph (f)(4) of this section.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

(d) *Exceptions; Permitted Investments.* Notwithstanding the foregoing and § 22.15 of this part, a derivatives clearing organization may invest the money, securities, or other property constituting Cleared Swaps Customer Collateral in accordance with § 1.25 of this chapter, which section shall apply to such money, securities, or other property as if they comprised customer funds or customer money subject to segregation pursuant to section 4d(a) of the Act and the regulations thereunder.

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

In order for a depository to be a Permitted Depository:

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

(1) A bank located in the United States;

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

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

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

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

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

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

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

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

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

The name of each Cleared Swaps Customer Account that a futures commission merchant or a derivatives clearing organization maintains with a Permitted Depository shall:

(a) Clearly identify the account as a ''Cleared Swaps Customer Account'' and

(b) Clearly indicate that the collateral therein is ''Cleared Swaps Customer Collateral'' subject to segregation in accordance with the Act and this part.

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

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

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

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

§ 22.8 Situs of Cleared Swaps Customer Accounts.

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

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

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

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

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

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

(b) Notwithstanding the requirements set forth in § 1.49 of this chapter, a futures commission merchant's obligations to a Cleared Swaps Customer may be denominated in a currency in which funds have accrued to the customer as a result of a Cleared Swap carried through such futures commission merchant, to the extent of such accruals.

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

§ 22.10 Application of other Regulatory Provisions.

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

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

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

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

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

§ 22.11 Information To Be Provided Regarding Customers and Their Cleared Swaps.

(a) Each Depositing Futures Commission Merchant shall:

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

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

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

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

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

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

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

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

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

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

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

(e) Each derivatives clearing organization shall:

(1) Take appropriate steps to confirm that the information it receives pursuant to paragraphs (c)(1) or (c)(2) of this section is accurate and complete, and

(2) Ensure that the futures commission merchant is providing the derivatives clearing organization the information required by paragraphs (c)(1) or (c)(2) of this section on a timely basis.

§ 22.12 Information To Be Maintained Regarding Cleared Swaps Customer Collateral.

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

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

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

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

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

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

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

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

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

(f) The collateral requirement referenced in paragraph (a) of this

section with respect to a Collecting Futures Commission Merchant shall be no less than that imposed by the relevant derivatives clearing organization with respect to the same portfolio of rights and obligations for each relevant Cleared Swaps Customer.

§ 22.13 Additions to Cleared Swaps Customer Collateral.

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

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

(b) Any collateral deposited by a futures commission merchant (including a Depositing Futures Commission Merchant) pursuant to § 22.2(e)(3)(ii) of this part, which collateral is identified as such futures commission merchant's own property may be used by the derivatives clearing organization or Collecting Futures Commission Merchant, as applicable, to margin, guarantee or secure the Cleared Swaps of any or all of such Cleared Swaps Customers.

(c) A futures commission merchant may transmit to a derivatives clearing organization any collateral posted by a Cleared Swaps Customer in excess of the amount required by the derivatives clearing organization if:

(1) the rules of the derivatives clearing organization expressly permit the futures commission merchant to transmit collateral in excess of the amount required by the derivatives clearing organization; and

(2) the derivatives clearing organization provides a mechanism by which the futures commission merchant is able to, and maintains rules pursuant to which the futures commission merchant is required to, identify each Business Day, for each Cleared Swaps Customer, the amount of collateral posted in excess of the amount required by the derivatives clearing organization.

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

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

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

(i) The amount called for; or

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

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

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

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

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

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

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

(i) The amount called for; or

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

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

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

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

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

(e) If,

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

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

(f) If:

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

rules and procedures of such derivatives clearing organization, and

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

(g) A derivatives clearing organization or Collecting Futures Commission Merchant is entitled to reasonably rely upon any information provided by a defaulting futures commission merchant under § 22.14. If the defaulting futures commission merchant does not provide such information on the date of the futures commission merchant's default, a derivatives clearing organization or Collecting Futures Commission Merchant may rely on the information previously provided to it by the defaulting futures commission merchant.

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

Subject to § 22.3(d) of this part, each derivatives clearing organization and each Collecting Futures Commission Merchant receiving Cleared Swaps Customer Collateral from a futures commission merchant shall treat the value of collateral required with respect to the portfolio of rights and obligations arising out of the Cleared Swaps intermediated for each Cleared Swaps Customer, and collected from the futures commission merchant, as belonging to such customer, and such amount shall not be used to margin, guarantee, or secure the Cleared Swaps or other obligations of the futures commission merchant or of any other Cleared Swaps Customer or Customer. Nothing contained herein shall be construed to limit, in any way, the right of a derivatives clearing organization or Collecting Futures Commission Merchant to liquidate any or all positions in a Cleared Swaps Customer Account in the event of default of a clearing member or Depositing Futures Commission Merchant.

§ 22.16 Disclosures to Customers.

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

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

(1) Such futures commission merchant or

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

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

PART 190—BANKRUPTCY

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

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

§§ 190.01, 190.02, 190.03, 190.05, 190.06, 190.07, 190.10 [Amended]

■ 3. In 17 CFR part 190:

■ a. Remove the words ''commodity account'' and add, in their place, the words ''commodity contract account'' in:

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

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

■ iii. Section 190.06(g)(3); and

■ iv. Section 190.10(d)(1).

■ b. Remove the words ''commodity futures account'' and add, in their place, the words ''commodity contract account'' in:

■ i. Section 190.03(a)(2); and

■ ii. Section 190.10(h).

■ c. Remove the words ''commodity transactions'' and add, in their place, the words ''commodity contract transactions'' in § 190.02(d)(3).

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

■ e. Remove the words ''commodity accounts'' and add, in their place, the words ''commodity contract accounts'' in § 190.06(g)(1)(i) and (ii).

■ f. Remove the words ''board of trade'' and add, in their place, the words ''designated contract market'' in § 190.07(e)(1).

■ g. Remove the words ''contract market'' and add, in their place, the words ''designated contract market'' in § 190.07(e)(2)(ii)(B).

■ 4. In § 190.01,

■ a. Redesignate paragraphs (e) through (oo) as (f) through (pp);

■ b. Add a new paragraph (e); and

■ c. Revise paragraphs (a), and newly redesignated paragraphs (f), (cc), (hh), (ll)(2)(ii), (ll)(4), (ll)(5), and (pp) to read as follows:

§ 190.01 Definitions.

* * * * *

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

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

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

(iii) If positions or transactions in commodity contracts that would otherwise belong to one account class (and the money, securities, or other property margining, guaranteeing, or securing such positions or transactions), are, pursuant to a Commission rule, regulation, or order (or a derivatives clearing organization rule approved in accordance with § 39.15(b)(2) of this chapter), held separately from other positions and transactions in that account class, and are commingled with positions or transactions in commodity

contracts of another account class (and the money, securities, or other property margining, guaranteeing, or securing such positions or transactions), then the former positions (and the relevant money, securities, or other property) shall be treated, for purposes of this part, as being held in an account of the latter account class.

* * * * *

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

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

* * * * *

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

* * * * *

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

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

(2) Cleared swaps contracts.

* * * * *

(ll) * * *

(2) * * *

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

* * * * *

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

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

* * * * *

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

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

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

* * * * *

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

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

(2) *Of transfers under section 764(b) of the Bankruptcy Code.* As soon as possible, but in no event later than the close of business on third calendar day after the order for relief, the trustee, the applicable self-regulatory organization, or the commodity broker must notify the Commission in accordance with § 190.10(a) whether such entity or organization intends to transfer or to apply to transfer open commodity contracts on behalf of the commodity broker in accordance with section 764(b) of the Bankruptcy Code and § 190.06 (e) or (f).

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

(2) *Request for instructions regarding transfer of open commodity contracts.* The trustee must use its best efforts to request promptly, but in no event later than two calendar days after entry of an order for relief, customer instructions concerning the transfer or liquidation of the specifically identifiable open commodity contracts, if any, not required to be liquidated under paragraph (f)(1) of this section. The request for customer instructions required by this paragraph (b)(2) must state that the trustee is required to liquidate any such commodity contract for which transfer instructions have not

been received on or before the seventh calendar day after entry of the order for relief, at an hour specified by the trustee, and any such commodity contract for which instructions have been received which has not been transferred in accordance with § 190.08(d)(2) on or before the seventh calendar day after entry of the order for relief. A form of notice is set forth in the appendix to this part.

* * * * *

(d) * * *

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

* * * * *

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

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

(f) * * *

(1) * * *

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

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

* * * * *

(g) * * *

(2) * * *

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

* * * * *

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

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

* * * * *

(a) * * *

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

* * * * *

(b) * * *

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

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

(5) The commodity contract would otherwise remain open (*e.g.,* because it cannot be settled in cash) beyond the last day of trading in such contract (if applicable) or the first day on which notice of delivery may be tendered with respect to such contract, whichever occurs first.

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

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

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

* * * * *

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

(ii) *Book entry.* Notwithstanding paragraph (d)(1) of this section, in appropriate cases, upon application by

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

* * * * *

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

§ 190.05 Making and taking delivery on commodity contracts.

* * * * *

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

* * * * *

■ 9. In § 190.06,

■ a. Remove paragraph (e)(1)(iv) and redesignate paragraph (e)(1)(v) as (e)(1)(iv);

■ b. Revise paragraphs (a), (e)(1)(iii), (e)(2), (f)(3)(i), (g)(2) and

■ c. Add paragraph (g)(1)(iii) to read as follows:

§ 190.06 Transfers.

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

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

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

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

* * * * *

(e) * * *

(1) * * *

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

* * * * *

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

(f) * * *

(3) * * *

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

* * * * *

(g) * * *

(1) * * *

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

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

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

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

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

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

* * * * *

■ 10. In § 190.07,

■ a. Redesignate paragraph (b)(2)(xiii) as paragraph (b)(2)(xiv);

■ b. Add a new paragraph (b)(2)(xiii); and

■ c. Revise paragraphs (b)(2)(viii), (b)(2)(ix), (b)(3)(v), (c)(1)(i), (e) introductory text, (e)(1) and (e)(4) to read as follows:

§ 190.07 Calculation of allowed net equity.

* * * * *

(b) * * *

(2) * * *

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

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

* * * * *

(xiii) With respect to the cleared swaps account class, each individual customer account within each omnibus customer account referred to in

paragraph (ix) of this section shall be deemed to be held in a separate capacity from each other such individual customer account; subject to the provisions of paragraphs (b)(2)(i) through (xii) of this paragraph (b)(2).

* * * * *

(3) * * *

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

* * * * *

(c) * * *

(1) * * *

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

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

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

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

* * * * *

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

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

* * * * *

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

* * * * *

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

§ 190.09 Member property.

* * * * *

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

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

§ 190.10 General.

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

* * * * *

■ 13. Revise appendix A to part 190 to read as follows:

Appendix A to Part 190—Bankruptcy Forms

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

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

All Cases

Date of Order for Relief

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

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

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

a. The trustee should:

i. Contact the DSRO (if any) and the clearing organizations and attempt to effectuate a transfer with such shortfall under section 764(b) of the Code; notify the Commission for assistance (§ 190.02(a)(2) and

(e)(1), § 190.06(b)(2), (e), (f)(3), (g)(2), and (h)) but recognize that if there is a substantial shortfall, a transfer of such funds or amounts is highly unlikely.

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

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

4. Whether or not a transfer has occurred, liquidate or offset open commodity contracts not eligible for transfer (*e.g.,* deficit accounts) (§ 190.06(e)(1)).

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

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

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

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

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

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

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

First Calendar Day After the Entry of an Order for Relief

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

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

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

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

3. Provide the clearing organization or Collecting Futures Commission Merchant (as such term is defined in § 22.1) with assurances to prevent liquidation of open commodity contract accounts available for transfer at the customer's instruction or liquidate all open commodity contracts except those available for transfer at a customer's instruction and dealer options.

Second Calendar Day After the Entry of an Order for Relief

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

Third Calendar Day After the Entry of an Order for Relief

1. Second publication date for customer instructions (§ 190.02(b)(1)) (publication is to be made on two consecutive days, whether or not the second day is a business day).

2. Last day on which to notify the Commission with regard to whether a transfer in accordance with section 764(b) of the Bankruptcy Code will take place (§ 190.02(a)(2) and § 190.06(e)).

Sixth Calendar Day After the Entry of an Order for Relief

Last day for customers to instruct the trustee concerning open commodity contracts (§ 190.02(b)(2)).

Seventh Calendar Day After the Entry of an Order for Relief

1. If not previously concluded, conclude transfers under § *190.06(e)* and (f). (See § 190.02(e)(1) and § 190.06(g)(2)(i)(A)).

2. Transfer all open dealer option contracts which have not previously been transferred (§ 190.06(f)(3)(i)).

3. Primary liquidation date (§ 190.01(ff)) (assuming no transfers and liquidation effected for all open commodity contracts for which no customer instructions were received by the sixth calendar day).

4. Establishment of transfer accounts (§ 190.03(a)(1)) (assuming this is the primary liquidation date); mark such accounts to market (§ 190.03(a)(2)) (daily thereafter until closed).

5. Liquidate or offset all remaining open commodity contracts (§ 190.02(b)(2)).

6. If not done previously, notify customers of bankruptcy and request customer proof of claim (§ 190.02(b)(4)).

Eighth Calendar Day After the Entry of an Order for Relief

Customer instructions due to trustee concerning specifically identifiable property (§ 190.02(b)(1)).

Ninth Calendar Day After the Entry of an Order for Relief

Commence liquidation of specifically identifiable property for which no arrangements for return have been made in accordance with customer instructions (§§ 190.02(b)(1), 190.03(c)).

Tenth Calendar Day After the Entry of an Order for Relief

Complete liquidation to the extent reasonably possible of specifically identifiable property which has yet to be liquidated and for which no customer instructions have been received (§ 190.03(c)).

Separate Procedures for Involuntary Petitions for Bankruptcy

1. Within one calendar day after notice of receipt of filing of the petition in bankruptcy, the trustee should assure that proper notification has been given to the Commission, the commodity broker's designated self-regulatory organization (*§ 190.02(a)(1)*) (if any), and all applicable clearing organizations; margin calls should be issued if necessary (*§ 190.02(g)(2)*).

2. On or before the seventh calendar day after the filing of a petition in bankruptcy, the trustee should use his best efforts to effect a transfer in accordance with *§ 190.06(e)* and (*f*) of all open commodity contracts and equity held for or on behalf of customers of the commodity broker (*§ 190.02(e)(2)*) unless the debtor can provide certain assurances to the trustee.

Bankruptcy Appendix Form 2— Request for Instructions Concerning Non-Cash Property Deposited With (Commodity Broker)

Please take notice: On (date), a petition in bankruptcy was filed by [against] (commodity broker). Those customers of (commodity broker) who deposited certain kinds of non-cash property (see below) with (commodity broker) may instruct the trustee of the estate to return their property to them as provided below.

As no customer may obtain more than his or her proportionate share of the property available to satisfy customer claims, if you instruct the trustee to return your property to you, you will be required to pay the estate, as a condition to the return of your property, an amount determined by the trustee. If your property is not margining an open contract, this amount will approximate the difference between the market value of your property and your *pro rata* share of the estate, as estimated by the trustee. If your property is margining an open commodity contract, this amount will be approximately the full fair market value of the property on the date of its return.

Kinds of Property to Which This Notice Applies

1. Any security deposited as margin which, as of (date petition was filed), was securing an open commodity contract and is:

—registered in your name,
—not transferrable by delivery, and
—not a short-term obligation.

2. Any fully-paid, non-exempt security held for your account in which there were no open commodity contracts as of (date

petition was filed). (Rather than the return, at this time, of the specific securities you deposited with (commodity broker), you may instead request now, or at any later time, that the trustee purchase ''like-kind'' securities of a fair market value which does not exceed your proportionate share of the estate).

3. Any warehouse receipt, bill of lading or other document of title deposited as margin which, as of (date petition was filed), was securing an open commodity contract and—can be identified in (commodity broker)'s records as being held for your account, and—is neither in bearer form nor otherwise transferable by delivery.

4. Any warehouse receipt bill of lading or other document of title, or any commodity received, acquired or held by (commodity broker) to make or take delivery or exercise from or for your account and which—can be identified in (commodity broker)'s records as received from or for your account as held specifically for the purpose of delivery or exercise.

5. Any cash or other property deposited to make or take delivery on a commodity contract may be eligible to be returned. The trustee should be contacted directly for further information if you have deposited such property with (commodity broker) and desire its return.

Instructions must be received by (the 5th calendar day after 2d publication date) or the trustee will liquidate your property. (If you own such property but fail to provide the trustee with instructions, you will still have a claim against (commodity broker) but you will not be able to have your specific property returned to you).

Note: Prior to receipt of your instructions, circumstances may require the trustee to liquidate your property, or transfer your property to another broker if it is margining open commodity contracts. If your property is transferred and your instructions were received within the required time, your instructions will be forwarded to the new broker.

Instructions should be directed to: (Trustee's name, address, and/or telephone).

Even if you request the return of your property, you must also pay the trustee the amount he specifies and provide the trustee with proof of your claim before (the 7th calendar day after 2d publication date) or your property will be liquidated. (Upon receipt of customer instructions to return property, the trustee will mail the sender a form which describes the information he must provide to substantiate his claim).

Note: The trustee is required to liquidate your property despite the timely receipt of your instructions, money, and proof of claim if, for any reason, your property cannot be returned by (close of business on the 7th calendar day after 2d publication date).

Bankruptcy Appendix Form 3—Request for Instructions Concerning Transfer of Your Hedge Contracts Held by (Commodity Broker)

United States Bankruptcy Court ____District of ____In re ____, Debtor, No. ____.

Please take notice: On (date), a petition in bankruptcy was filed by [against] (commodity broker).

You indicated when your hedge account was opened that the commodity contracts in your hedge account should not be liquidated automatically in the event of the bankruptcy of (commodity broker), and that you wished to provide instructions at this time concerning their disposition.

Instructions to transfer your commodity contracts and a cash deposit (as described below) must be received by the trustee by (the 6th calendar day after entry of order for relief) or your commodity contracts will be liquidated.

If you request the transfer of your commodity contracts, prior to their transfer, you must pay the trustee in cash an amount determined by the trustee which will approximate the difference between the value of the equity margining your commodity contracts and your *pro rata* share of the estate plus an amount constituting security for the nonrecovery of any overpayments. In your instructions, you should specify the broker to which you wish your commodity contracts transferred.

Be further advised that prior to receipt of your instructions, circumstances may, in any event, require the trustee to liquidate or transfer your commodity contracts. If your commodity contracts are so transferred and your instructions are received, your instructions will be forwarded to the new broker.

Note also that the trustee is required to liquidate your positions despite the timely receipt of your instructions and money if, for any reason, you have not made arrangements to transfer and/or your contracts are not transferred by (7 calendar days after entry of order for relief).

Instructions should be sent to: (Trustee's or designee's name, address, and/or telephone). [Instructions may also be provided by phone].

Bankruptcy Appendix Form 4—Proof of Claim

[Note to trustee: As indicated in § 190.02(d), this form is provided as a guide to the trustee and should be modified as necessary depending upon the information which the trustee needs at the time a proof of claim is requested and the time provided for a response.]

Proof of Claim

United States Bankruptcy Court ____District of ____In re ____, Debtor, No. ____.

Return this form by ____ or your claim will be barred (unless extended, for good cause only).

I. [If claimant is an individual claiming for himself] The undersigned, who is the claimant herein, resides at ____.

[If claimant is a partnership claiming through a member] The undersigned, who resides at ____, is a member of ____, a partnership, composed of the undersigned and ____, of ____, and doing business at ____, and is duly authorized to make this proof of claim on behalf of the partnership.

[If claimant is a corporation claiming though a duly authorized officer] The undersigned, who resides at ____ is the ____ of ____, a corporation organized under the laws of ____ and doing business at ____, and is duly authorized to make this proof of claim on behalf of the corporation.

[If claim is made by agent] The undersigned, who resides at ____, is the agent of ____, and is duly authorized to make this proof of claim on behalf of the claimant.

II. The debtor was, at the time of the filing of the petition initiating this case, and still is, indebted to this claimant for the total sum of $ ____.

III. List EACH account on behalf of which a claim is being made by number and name of account holder[s], and for EACH account, specify the following information:

a. Whether the account is a futures, foreign futures, leverage, option (if an option account, specify whether exchange-traded, dealer or cleared swap), ''delivery'' account, or a cleared swaps account. A ''delivery'' account is one which contains only documents of title, commodities, cash, or other property identified to the claimant and deposited for the purposes of making or taking delivery on a commodity underlying a commodity contract or for payment of the strike price upon exercise of an option.

b. The capacity in which the account is held, as follows (and if more than one is applicable, so state):

1. [The account is held in the name of the undersigned in his individual capacity];

2. [The account is held by the undersigned as guardian, custodian, or conservator for the benefit of a ward or a minor under the Uniform Gift to Minors Act];

3. [The account is held by the undersigned as executor or administrator of an estate];

4. [The account is held by the undersigned as trustee for the trust beneficiary];

5. [The account is held by the undersigned in the name of a corporation, partnership, or unincorporated association];

6. [The account is held as an omnibus customer account of the undersigned futures commission merchant];

7. [The account is held by the undersigned as part owner of a joint account];

8. [The account is held by the undersigned in the name of a plan which, on the date the petition in bankruptcy was filed, had in effect a registration statement in accordance with the requirements of § 1031 of the Employee Retirement Income Security Act of 1974 and the regulations thereunder]; or

9. [The account is held by the undersigned as agent or nominee for a principal or beneficial owner (and not described above in items 1–8 of this II, b)].

10. [The account is held in any other capacity not described above in items 1–9 of this II, b. Specify the capacity].

c. The equity, as of the date the petition in bankruptcy was filed, based on the commodity contracts in the account.

d. Whether the person[s] (including a general partnership, limited partnership, corporation, or other type of association) on whose behalf the account is held is one of the following persons OR whether one of the following persons, alone or jointly, owns 10% or more of the account:

1. [If the debtor is an individual—

A. Such individual;

B. Relative (as defined below in item 8 of this III.d) of the debtor or of a general partner of the debtor;

C. Partnership in which the debtor is a general partner;

D. General partner of the debtor; or

E. Corporation of which the debtor is a director, officer, or person in control];

2. [If the debtor is a partnership—

A. Such partnership;

B. General partner in the debtor;

C. Relative (as defined in item 8 of this III.d) of a general partner in, general partner of, or person in control of the debtor;

D. Partnership in which the debtor is a general partner;

E. General partner of the debtor; or

F. Person in control of the debtor];

3. [If the debtor is a limited partnership—

A. Such limited partnership;

B. A limited or special partner in such partnership whose duties include:

i. The management of the partnership business or any part thereof;

ii. The handling of the trades or customer funds of customers of such partnership;

iii. The keeping of records pertaining to the trades or customer funds of customers of such partnership; or

iv. The signing or co-signing of checks or drafts on behalf of such partnership];

4. [If the debtor is a corporation or association (except a debtor which is a futures commission merchant and is also a cooperative association of producers)—

A. Such corporation or association;

B. Director of the debtor;

C. Officer of the debtor;

D. Person in control of the debtor;

E. Partnership in which the debtor is a general partner;

F. General partner of the debtor;

G. Relative (as defined in item 8 of this III.d) of a general partner, director, officer, or person in control of the debtor;

H. An officer, director or owner of ten percent or more of the capital stock of such organization];

5. [If the debtor is a futures commission merchant which is a cooperative association of producers—

Shareholder or member of the debtor which is an officer, director or manager];

6. [An employee of such individual, partnership, limited partnership, corporation or association whose duties include:

A. The management of the business of such individual, partnership, limited partnership, corporation or association or any part thereof;

B. The handling of the trades or customer funds of customers of such individual, partnership, limited partnership, corporation or association;

C. The keeping of records pertaining to the trades or funds of customers of such individual, partnership, limited partnership, corporation or association; or

D. The signing or co-signing of checks or drafts on behalf of such individual, partnership, limited partnership, corporation or association];

7. [Managing agent of the debtor];

8. [A spouse or minor dependent living in the same household of ANY OF THE FOREGOING PERSONS, or any other relative, regardless of residency, (unless previously described in items 1–B, 2–C, or 4–G of this III.d) defined as an individual related by affinity or consanguinity within the third degree as determined by the common law, or individual in a step or adoptive relationship within such degree];

9. [''Affiliate'' of the debtor, defined as:

A. Entity that directly or indirectly owns, controls, or holds with power to vote, 20 percent or more of the out-standing voting securities of the debtor, other than an entity that holds such securities—

i. In a fiduciary or agency capacity without sole discretionary power to vote such securities; or

ii. Solely to secure a debt, if such entity has not in fact exercised such power to vote;

B. Corporation 20 percent or more of whose outstanding voting securities are directly or indirectly owned, con-trolled, or held with power to vote, by the debtor, or by an entity that directly or indirectly owns, controls, or holds with power to vote, 20 percent or more of the outstanding voting securities of the debtor, other than an entity that holds such securities—

i. In a fiduciary or agency capacity without sole discretionary power to vote such securities; or

ii. Solely to secure a debt, if such entity has not in fact exercised such power to vote;

C. Person whose business is operated under a lease or operating agreement by the debtor, or person substantially all of whose property is operated under an operating agreement with the debtor;

D. Entity that otherwise, directly or indirectly, is controlled by or is under common control with the debtor];

E. Entity that operates the business or all or substantially all of the property of the debtor under a lease or operating agreement; or

F. Entity that otherwise, directly or indirectly, controls the debtor; or

10. [Any of the persons listed in items 1–7 above of this III.d if such person is associated with an affiliate (see item 9 above) of the debtor as if the affiliate were the debtor].

e. Whether the account is a discretionary account. (If it is, the name in which the ''attorney in fact'' is held).

f. If the account is a joint account, the amount of the claimant's percentage interest in the account. (Also specify whether participants in a joint account are claiming separately or jointly).

g. Whether the claimant's positions in security futures products are held in a futures account or securities account, as those terms are defined in § 1.3 of this chapter.

IV. Describe all claims against the debtor not based upon a commodity contract account of the claimant (*e.g.,* if landlord, for rent; if customer, for misrepresentation or fraud).

V. Describe all claims of the DEBTOR against the CLAIMANT not already included in the equity of a commodity contract account[s] of the claimant (see III.c above).

VI. Describe any deposits of money, securities or other property held by or for the debtor from or for the claimant, and indicate if any of this property was included in your answer to III.c above.

VII. Of the money, securities, or other property described in VI above, identify any which consists of the following:

a. With respect to property received, acquired, or held by or for the account of the debtor from or for the account of the claimant to margin, guarantee or secure an open commodity contract, the following:

1. Any security which as of the filing date is:

A. Held for the claimant's account;

B. Registered in the claimant's name;

C. Not transferable by delivery; and

D. Not a short term obligation; or

2. Any warehouse receipt, bill of lading or other document of title which as of the filing date:

A. Can be identified on the books and records of the debtor as held for the account of the claimant; and

B. Is not in bearer form and is not otherwise transferable by delivery.

b. With respect to open commodity contracts, and except as otherwise provided below in item g of this VII, any such contract which:

1. As of the date the petition in bankruptcy was filed, is identified on the books and records of the debtor as held for the account of the claimant;

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

3. Is in an account designated in the accounting records of the debtor as a hedging account.

c. With respect to warehouse receipts, bills of lading or other documents of title, or physical commodities received, acquired, or held by or for the account of the debtor for the purpose of making or taking delivery or exercise from or for the claimant's account, any such document of title or commodity which as of the filing date can be identified on the books and records of the debtor as received from or for the account of the claimant specifically for the purpose of delivery or exercise.

d. Any cash or other property deposited prior to bankruptcy to pay for the taking of physical delivery on a long commodity contract or for payment of the strike price upon exercise of a short put or a long call option contract on a physical commodity, which cannot be settled in cash, in excess of the amount necessary to margin such commodity contract prior to the notice date or exercise date which cash or other property is identified on the books and records of the debtor as received from or for the account of the claimant within three or less days of the notice date or three or less days of the exercise date specifically for the purpose of payment of the notice price upon taking delivery or the strike price upon exercise.

e. The cash price tendered for any property deposited prior to bankruptcy to make physical delivery on a short commodity contract or for exercise of a long put or a short call option contract on a physical commodity, which cannot be settled in cash,

to the extent it exceeds the amount necessary to margin such contract prior to the notice exercise date which property is identified on the books and records of the debtor as received from or for the account of the claimant within three or less days of the notice date or of the exercise date specifically for the purpose of a delivery or exercise.

f. Fully paid, non-exempt securities identified on the books and records of the debtor as held by the debtor for or on behalf of the commodity contract account of the claimant for which, according to such books and records as of the filing date, no open commodity contracts were held in the same capacity.

g. Open commodity contracts transferred to another futures commission merchant by the trustee.

VIII. Specify whether the claimant wishes to receive payment in kind, to the extent possible, for any claim for securities.

IX. Attach copies of any documents which support the information provided in this proof of claim, including but not limited to customer confirmations, account statements, and statements of purchase or sale.

This proof of claim must be filed with the trustee no later than __, or your claim will be barred unless an extension has been granted, available only for good cause.

Return this form to:
(Trustee's name (or designee's) and address)

_____

Dated: _____
(Signed) _____

Penalty for Presenting Fraudulent Claim.
Fine of not more than $5,000 or imprisonment for not more than five years or both—Title 18, U.S.C. 152.

(Approved by the Office of Management and Budget under control number 3038–0021)

■ 14. Revise appendix B to part 190 to read as follows:

Appendix B to Part 190—Special Bankruptcy Distributions

Framework 1—Special Distribution of Customer Funds for Futures Contracts When FCM Participated in Cross-Margining

The Commission has established the following distributional convention with respect to ''customer funds'' (as § 1.3 of this chapter defines such term) for futures contracts held by a futures commission merchant (FCM) that participated in a cross-margining (XM) program which shall apply if participating market professionals sign an agreement that makes reference to this distributional rule and the form of such agreement has been approved by the Commission by rule, regulation or order:

All customer funds for futures contracts held in respect of XM accounts, regardless of the product that customers holding such accounts are trading, are required by Commission order to be segregated separately from all other customer segregated funds. For purposes of this distributional rule, XM accounts will be deemed to be commodity interest accounts and securities held in XM accounts will be deemed to be received by the FCM to margin, guarantee or secure commodity interest contracts. The maintenance of property in an XM account will result in subordination of the claim for such property to certain non-XM customer claims and thereby will operate to cause such XM claim not to be treated as a customer claim for purposes of the Securities Investors Protection Act and the XM securities to be excluded from the securities estate. This creates subclasses of futures customer accounts, an XM account and a non-XM account (a person could hold each type of account), and results in two pools of segregated funds belonging to futures customers: An XM pool and a non-XM pool. In the event that there is a shortfall in the non-XM pool of customer class segregated funds and there is no shortfall in the XM pool of customer segregated funds, all futures customer net equity claims, whether or not they arise out of the XM subclass of accounts, will be combined and will be paid *pro rata* out of the total pool of available XM and non-XM customer funds for futures contracts. In the event that there is a shortfall in the XM pool of customer segregated funds and there is no shortfall in the non-XM pool of customer segregated funds, then futures customer net equity claims arising from the XM subclass of accounts shall be satisfied first from the XM pool of customer segregated funds, and futures customer net equity claims arising from the non-XM subclass of accounts shall be satisfied first from the non-XM customer segregated funds. Furthermore, in the event that there is a shortfall in both the non-XM and XM pools of customer segregated funds: (1) If the non-XM shortfall as a percentage of the segregation requirement in the non-XM pool is greater than or equal to the XM shortfall as a percentage of the segregation requirement in the XM pool, all futures customer net equity claims will be paid *pro rata;* and (2) if the XM shortfall as a percentage of the segregation requirement in the XM pool is greater than the non-XM shortfall as a percentage of the segregation requirement of the non-XM pool, non-XM futures customer net equity claims will be paid *pro rata* out of the available non-XM segregated funds, and XM futures customer net equity claims will be paid *pro rata* out of the available XM segregated funds. In this way, non-XM customers will never be adversely affected by an XM shortfall.

The following examples illustrate the operation of this convention. The examples assume that the FCM has two customers, one with exclusively XM accounts and one with exclusively non-XM accounts. However, the examples would apply equally if there were only one customer, with both an XM account and a non-XM account.

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1. Sufficient Funds to Meet Non-XM and XM Customer Claims:

	Non-XM	XM	Total
Funds in 4d(a) segregation	150	150	300
4d(a) Segregation requirement	150	150	300
Shortfall (dollars)	0	0	
Shortfall (percent)	0	0	
Distribution	150	150	300

There are adequate funds available and both the non-XM and the XM customer claims will be paid in full.

2. Shortfall in Non-XM Only:

	Non-XM	XM	Total
Funds in 4d(a) segregation	100	150	250
4d(a) Segregation requirement	150	150	300
Shortfall (dollars)	50	0	
Shortfall (percent)	50/150=33.3	0	
Pro rata (percent)	150/300=50	150/300=50	
Pro rata (dollars)	125	125	
Distribution	125	125	250

Due to the non-XM account, there are insufficient funds available to meet both the non-XM and the XM customer claims in full. Each customer will receive his pro rata share of the funds available, or 50% of the $250 available, or $125.

3. Shortfall in XM Only:

	Non-XM	XM	Total
Funds in 4d(a) segregation	150	100	250
4d(a) Segregation requirement	150	150	300
Shortfall (dollars)	0	50	
Shortfall (percent)	0	50/150=33.3	
Pro rata (percent)	150/300=50	150/300=50	
Pro rata (dollars)	125	125	
Distribution	150	100	250

Due to the XM account, there are insufficient funds available to meet both the non-XM and the XM customer claims in full. Accordingly, the XM funds and non-XM funds are treated as separate pools, and the non-XM customer will be paid in full, receiving $150 while the XM customer will receive the remaining $100.

4. Shortfall in Both, With XM Shortfall Exceeding Non-XM Shortfall:

	Non-XM	XM	Total
Funds in 4d(a) segregation	125	100	225
4d(a) Segregation requirement	150	150	300
Shortfall (dollars)	25	50	
Shortfall (percent)	25/150=16.7	50/150=33.3	
Pro rata (percent)	150/300=50	150/300=50	
Pro rata (dollars)	112.50	112.50	
Distribution	125	100	225

There are insufficient funds available to meet both the non-XM and the XM customer claims in full, and the XM shortfall exceeds the non-XM shortfall. The non-XM

customer will receive the $125 available with respect to non-XM claims while the XM customer will receive the $100 available with respect to XM claims.

5. Shortfall in Both, With Non-XM Shortfall Exceeding XM Shortfall:

	Non-XM	XM	Total
Funds in 4d(a) segregation	100	125	225
4d(a) Segregation requirement	150	150	300
Shortfall (dollars)	50	25	
Shortfall (percent)	50/150=33.3	25/150=16.7	
Pro rata (percent)	150/300=50	150/300=50	
Pro rata (dollars)	112.50	112.50	
Distribution	112.50	112.50	225

There are insufficient funds available to meet both the non-XM and the XM customer claims in full, and the non-XM shortfall exceeds the XM shortfall. Each customer will receive 50% of the $225 available, or $112.50.

6. Shortfall in Both, Non-XM Shortfall = XM Shortfall:

	Non-XM	XM	Total
Funds in 4d(a) segregation	100	100	200
4d(a) Segregation requirement	150	150	300
Shortfall (dollars)	50	50	
Shortfall (percent)	50/150=33.3	50/150=33.3	
Pro rata (percent)	150/300=50	150/300=50	
Pro rata (dollars)	100	100	
Distribution	100	100	200

There are insufficient funds available to meet both the non-XM and the XM customer claims in full, and the non-XM shortfall equals the XM shortfall. Each customer will receive 50% of the $200 available, or $100.

These examples illustrate the principle that pro rata distribution across both accounts is the preferable approach except when a shortfall in the XM account could harm non-XM customers. Thus, pro rata distribution occurs in Examples 1, 2, 5 and 6. Separate treatment of the XM and non-XM accounts occurs in Examples 3 and 4.

FRAMEWORK 2 —SPECIAL ALLOCATION OF SHORTFALL TO CUSTOMER CLAIMS WHEN CUSTOMER FUNDS FOR FUTURES CONTRACTS AND CLEARED SWAPS CUSTOMER COLLATERAL ARE HELD IN A DEPOSITORY OUTSIDE OF THE UNITED STATES OR IN A FOREIGN CURRENCY

The Commission has established the following allocation convention with respect to customer funds (as §1.3 of this chapter defines such term) for futures contracts and Cleared Swaps Customer Collateral (as §22.1 of this chapter defines such term) segregated pursuant to the Act and Commission rules thereunder held by a futures commission merchant ("FCM") or derivatives clearing organization ("DCO") in a depository outside the United States ("U.S.") or in a foreign currency. The maintenance of customer funds for futures contracts or Cleared Swaps Customer Collateral in a depository outside the U.S. or denominated in a foreign currency will result, in certain circumstances, in the reduction of customer claims for such funds. For purposes of this proposed bankruptcy convention, sovereign action of a foreign government or court would include, but not be limited to, the application or enforcement of statutes, rules,

regulations, interpretations, advisories, decisions, or orders, formal or informal, by a federal, state, or provincial executive, legislature, judiciary, or government agency. If an FCM enters into bankruptcy and maintains customer funds for futures contracts or Cleared Swaps Customer Collateral in a depository located in the U.S. in a currency other than U.S. dollars or in a depository outside the U.S., the following allocation procedures shall be used to calculate the claim of each futures customer or Cleared Swaps Customer (as §22.1 of this chapter defines such term). The allocation procedures should be performed separately with respect to each futures customer or Cleared Swaps Customer.

I. Reduction in Claims for General Shortfall

A. Determination of losses not attributable to sovereign action

1. Convert the claim of each futures customer or Cleared Swaps Customer in each currency to U.S. Dollars at the exchange rate in effect on the Final Net Equity Determination Date, as defined in §190.01(s) (the "Exchange Rate").

2. Determine the amount of assets available for distribution to futures customers or Cleared Swaps Customers. In making this calculation, include customer funds for futures contracts and Cleared Swaps Customer Collateral that would be available for distribution but for the sovereign action.

3. Convert the amount of customer funds for futures contracts and Cleared Swaps Customer Collateral available for distribution to U.S. Dollars at the Exchange Rate.

4. Determine the Shortfall Percentage that is not attributable to sovereign action, as follows:

$$\textit{Shortfall}\ \text{Percentage} = \left(1 - \left[\frac{\textit{Total}\ \text{Customer Assets}}{\textit{Total}\ \text{Customer Claims}}\right]\right)$$

B. Allocation of Losses Not Attributable to Sovereign Action

1. Reduce the claim of each futures customer or Cleared Swaps Customer by the Shortfall Percentage.

II. Reduction in Claims for Sovereign Loss

A. Determination of Losses Attributable to Sovereign Action ("Sovereign Loss")

1. If any portion of the claim of a futures customer or Cleared Swaps Customer is required to be kept in U.S. dollars in the U.S., that portion of the claim is not exposed to Sovereign Loss.

2. If any portion of the claim of a futures customer or Cleared Swaps Customer is authorized to be kept in only one location and that location is:

a. The U.S. or a location in which there is no Sovereign Loss, then that portion of the claim is not exposed to Sovereign Loss.

b. A location in which there is Sovereign Loss, then that entire portion of the claim is exposed to Sovereign Loss.

3. If any portion of the claim of a futures customer or Cleared Swaps Customer is authorized to be kept in only one currency and that currency is:

a. U.S. dollars or a currency in which there is no Sovereign Loss, then that portion of the claim is not exposed to Sovereign Loss.

b. A currency in which there is Sovereign Loss, then that entire portion of the claim is exposed to Sovereign Loss.

4. If any portion of the claim of a futures customer or Cleared Swaps Customer is authorized to be kept in more than one location and:

a. There is no Sovereign Loss in any of those locations, then that portion of the claim is not exposed to Sovereign Loss.

b. There is Sovereign Loss in one of those locations, then that entire portion of the claim is exposed to Sovereign Loss.

c. There is Sovereign Loss in more than one of those locations, then an equal share of that portion of the claim will be exposed to Sovereign Loss in each such location.

5. If any portion of the claim of a futures customer or Cleared Swaps Customer is authorized to be kept in more than one currency and:

a. There is no Sovereign Loss in any of those currencies, then that portion of the claim is not exposed to Sovereign Loss.

b. There is Sovereign Loss in one of those currencies, then that entire portion of the claim is exposed to Sovereign Loss.

c. There is Sovereign Loss in more than one of those currencies, then an equal share of that portion of the claim will be exposed to Sovereign Loss.

B. Calculation of Sovereign Loss

1. The total Sovereign Loss for each location is the difference between:

a. The total customer funds for futures contracts or Cleared Swaps Customer Collateral deposited in depositories in that location and

b. The amount of customer funds for futures contracts or Cleared Swaps Customer Collateral in that location that is available to be distributed to futures customers or Cleared Swaps Customers, after taking into account any sovereign action.

2. The total Sovereign Loss for each currency is the difference between:

a. The value, in U.S. dollars, of the customer funds for futures contracts or Cleared Swaps Customer Collateral held in that currency on the day before the sovereign action took place and

b. The value, in U.S. dollars, of the customer funds for futures contracts or Cleared Swaps Customer Collateral held in that currency on the Final Net Equity Determination Date.

C. Allocation of Sovereign Loss

1. Each portion of the claim of a futures customer or Cleared Swaps Customer exposed to Sovereign Loss in a location will be reduced by:

$$\textit{Total}\ \text{Sovereign Loss} \times \frac{\text{Portion of the customer's claim exposed to loss in that location}}{\textit{All}\ \text{portions of customer claims exposed to loss in that location}}$$

2. Each portion of the claim of a futures customer or Cleared Swaps Customer exposed to Sovereign Loss in a currency will be reduced by:

$$\textit{Total}\ \text{Sovereign Loss} \times \frac{\text{Portion of the customer's claim exposed to loss in that currency}}{\textit{All}\ \text{portions of customer claims exposed to loss in that currency}}$$

3. A portion of the claim of a futures customer or Cleared Swaps Customer exposed to Sovereign Loss in a location or currency will not be reduced below zero. (The above calculations might yield a result below zero where the FCM kept more customer funds for futures contracts or Cleared Swaps Customer Funds in a location or currency than it was authorized to keep.)

4. Any amount of Sovereign Loss from a location or currency in excess of the total amount of customer funds for futures contracts or Cleared Swaps Customer Funds authorized to be kept in that location or currency (calculated in accord with section II.1 above) ("Total Excess Sovereign Loss") will be divided among all futures customers or Cleared Swaps Customer who have authorized funds to be kept outside the U.S., or in currencies other than U.S. dollars, with each such futures customer or Cleared Swaps Customer claim reduced by the following amount:

$$\textit{Total}\ \text{Excess Sovereign Loss} \times \left[\frac{\left(\begin{array}{c}\text{This customer's total claim} - \text{The portion of this Customer's claim}\\ \text{required to be kept in U.S. dollars, in the U.S.}\end{array}\right)}{\begin{array}{c}\textit{Total}\ \text{customer claims} - \text{Total of all customer claims}\\ \text{required to be kept in U.S. dollars, in the U.S.}\end{array}}\right]$$

The following examples illustrate the operation of this convention.

Example 1. No shortfall in any location.

Customer	Claim	Location(s) customer has consented to having funds held
A	$50	U.S.
B	€50	U.K.
C	€50	Germany
D	£300	U.K.

Location	Actual asset balance
U.S.	$50
U.K.	£300
U.K.	€50
Germany	€50

Note: Conversion Rates: £1 = $1; £1=$1.5.

Convert the claim of each futures customer or Cleared Swaps Customer in each currency to U.S. Dollars:

Customer	Claim	Conversion rate	Claim in U.S. dollars
A	$50	1.0	$50
B	€50	1.0	50
C	€50	1.0	50
D	£300	1.5	450
Total			$600.00

Determine assets available for distribution to futures customers or Cleared Swaps Customers, converting to U.S. dollars:

Location	Assets	Conversion rate	Assets in U.S. dollars	Shortfall due to sovereign action percentage	Actual shortfall due to sovereign action	Amount actually available
U.S.	$50	1.0	$50			$50
U.K.	£300	1.5	450			450
U.K.	€50	1.0	50			50
Germany	€50	1.0	50			50
Total			$600.00		0	$600.00

There are no shortfalls in funds held in any location. Accordingly, there will be no reduction of futures customer or Cleared Swaps Customer claims.

Claims:

Customer	Claim in U.S. dollars after allocated non-sovereign shortfall	Allocation of shortfall due to sovereign action	Claim after all reductions
A	$50	$0	$50
B	50	0	50
C	50	0	50
D	450	0	450
Total	600.00	0.00	600.00

Example 2. Shortfall in funds held in the U.S.

Customer	Claim	Location(s) customer has consented to having funds held
A	$100	U.S.
B	€50	U.K.
C	€100	U.K., Germany, or Japan

Location	Actual asset balance
U.S.	$50
U.K.	€100
Germany	€50

Note: Conversion Rates: €1=$1.

REDUCTION IN CLAIMS FOR GENERAL SHORTFALL

There is a shortfall in the funds held in the U.S. such that only1/2 of the funds are available. Convert the claim of each futures customer or Cleared Swaps Customer in each currency to U.S. Dollars:

Convert each customer's claim in each currency to U.S. Dollars:

Customer	Claim	Conversion rate	Claim in US$
A	$100	1.0	$100
B	€50	1.0	50
C	€100	1.0	100
Total			250.00

Determine assets available for distribution to futures customers or Cleared Swaps Customers, converting to U.S. dollars:

Location	Assets	Conversion rate	Assets in U.S. dollars	Shortfall due to sovereign action percentage	Actual shortfall due to sovereign action	Amount actually available
U.S.	$50	1.0	$50.00			$50
U.K.	€100	1.0	100			100
Germany	€50	1.0	50			$50
Total			200.00			200.00

Determine the percentage of shortfall that is not attributable to sovereign action: Shortfall Percentage = (1−(200/250)) = (1−80%) = 20%.

Reduce each futures customer or Cleared Swaps Customer claim by the Shortfall Percentage:

Customer	Claim in US$	Allocated shortfall (non-sovereign)	Claim in U.S. dollars after allocated shortfall
A	$100	$20.00	$80.00
B	50	10.00	40.00
C	100	20.00	80.00
Total	250.00	50.00	200.00

REDUCTION IN CLAIMS FOR SHORTFALL DUE TO SOVEREIGN ACTION

There is no shortfall due to sovereign action. Accordingly, the futures customer or Cleared Swaps Customer claims will not be further reduced.

CLAIMS AFTER REDUCTIONS

Customer	Claim in U.S. dollars after allocated non-sovereign shortfall	Allocation of shortfall due to sovereign action	Claim after all reductions
A	$80		$80.00
B	40		40.00
C	80		80.00
Total	200.00	0	200.00

Example 3. Shortfall in funds held outside the U.S., or in a currency other than U.S. dollars, not due to sovereign action.

Customer	Claim	Location(s) customer has consented to having funds held
A	$150	U.S.
B	€100	U.K.
C	€50	Germany
D	$100	U.S.
D	€100	U.K. or Germany

Location	Actual asset balance
U.S.	$250
U.K.	€50
Germany	€100

Note: Conversion Rates: €1=$1.

REDUCTION IN CLAIMS FOR GENERAL SHORTFALL

Convert the claim of each futures customer or Cleared Swaps Customer in each currency to U.S. Dollars:

Customer	Claim	Conversion rate	Claim in US$
A	$150	1.0	$150
B	€100	1.0	100
C	€50	1.0	50
D	$100	1.0	100
D	€100	1.0	100
Total			500.00

Determine assets available for distribution to futures customers or Cleared Swaps Customers, converting to U.S. dollars:

Location	Assets	Conversion rate	Assets in U.S. dollars	Shortfall due to sovereign action percentage	Actual shortfall due to sovereign action	Amount actually available
U.S.	$250	1.0	$250			$250
U.K.	€50	1.0	50			50
Germany	€100	1.0	100			100
Total			400.00		0	400.00

Determine the percentage of shortfall that is not attributable to sovereign action: Shortfall Percentage = (1−400/500) = (1−80%) = 20%.

Reduce each futures customer or Cleared Swaps Customer by the shortfall percentage:

Customer	Claim in US$	Allocated shortfall (non-sovereign)	Claim in U.S. dollars after allocated shortfall
A	$150	$30.00	120.00
B	100	20.00	80.00
C	50	10.00	40.00
D	200	40.00	160.00
Total	500.00	100.00	400.00

REDUCTION IN CLAIMS FOR SHORTFALL DUE TO SOVEREIGN ACTION

There is no shortfall due to sovereign action. Accordingly, the claims will not be further reduced.

CLAIMS AFTER REDUCTIONS

Customer	Claim in U.S. dollars after allocated non-sovereign shortfall	Allocation of shortfall due to sovereign action	Claim after all reductions
A	$120.00		$120
B	80.00		80
C	40.00		40
D	160.00	0	160
Total	400.00	0	400

Example 4. Shortfall in funds held outside the U.S., or in a currency other than U.S. dollars, due to sovereign action.

Customer	Claim	Location(s) where customer has consented to have funds held
A	$50	U.S.
B	€50	U.K.
C	€50	Germany
D	$100.	U.S.
D	€100	U.K. or Germany

Location	Actual asset balance
U.S.	$150
U.K.	100
Germany	100

Notice: Conversion Rates: €1 = $1; ¥1= $0.01, £1= $1.5.

REDUCTION IN CLAIMS FOR GENERAL SHORTFALL

Convert each futures customer or Cleared Swaps Customer claim in each currency to U.S. Dollars:

Customer	Claim	Conversion rate	Claim in US$
A	$50	1.0	$50
B	€50	1.0	50
C	€50	1.0	50
D	$100	1.0	100
D	€100	1.0	100
Total			350.00

Determine assets available for distribution to futures customers or Cleared Swaps Customers, converting to U.S. dollars:

Location	Assets	Conversion rate	Assets in U.S. dollars	Shortfall due to sovereign action percentage	Actual shortfall due to sovereign action	Amount actually available
U.S.	$150	1.0	$150			$150
U.K.	€100	1.0	100			100
Germany	€100	1.0	100	50%	50	50
Total			350.00		50.00	300.00

Determine the percentage of shortfall that is not attributable to sovereign action: Shortfall Percentage = (1−350/350) = (1−100%) = 0%.

Reduce each futures customer or Cleared Swaps Customer claim by the shortfall percentage:

Customer	Claim in US$	Allocated shortfall (non-sovereign)	Claim in U.S. dollars after allocated shortfall
A	$50	0	$50.00
B	50	0	50.00
C	50	0	50.00
D	200	0	200.00
Total	350.00	0.00	350.00

REDUCTION IN CLAIMS FOR SHORTFALL DUE TO SOVEREIGN ACTION

Due to sovereign action, only1/2of the funds in Germany are available.

Customer	Presumed location of funds		
	U.S.	U.K.	Germany
A	$50		
B		$50	
C			$50
D	100		100
Total	150.00	50.00	150.00

Calculation of the allocation of the shortfall due to sovereign action—Germany ($50 shortfall to be allocated):

Customer	Allocation share	Allocation share of actual shortfall	Actual shortfall allocated
C	$50/$150	33.3% of $50	$16.67
D	$100/$150	66.7% of $50	33.33
Total			50.00

CLAIMS AFTER REDUCTIONS:

Customer	Claim in U.S. dollars after allocated non-sovereign shortfall	Allocation of shortfall due to sovereign action from Germany	Claim after all reductions
A	$50		$50
B	50		50
C	50	$16.67	33.33
D	200	33.33	166.67
Total	350.00	50.00	300.00

Example 5. Shortfall in funds held outside the U.S., or in a currency other than U.S. dollars, due to sovereign action and a shortfall in funds held in the U.S.

Customer	Claim	Location(s) customer has consented to having funds held
A	$100	U.S.
B	€50	U.K.
C	€150	Germany
D	$100	U.S.
D	£300	U.K.
D	€150	U.K. or Germany

Location	Actual asset balance
U.S.	$100
U.K.	£300
U.K.	€200
Germany	€150

Conversion Rates: €1=$1; £1=$1.5.

REDUCTION IN CLAIMS FOR GENERAL SHORTFALL

Convert each futures customer or Cleared Swaps Customer claim in each currency to U.S. Dollars:

Customer	Claim	Conversion rate	Claim in US$
A	$100	1.0	$100
B	€50	1.0	50
C	€150	1.0	150
D	$100	1.0	100
D	£300	1.5	450
D	€150	1.0	150
Total			1000.00

Determine assets available for distribution to futures customers or Cleared Swaps Customers, converting to U.S. dollars:

Location	Assets	Conversion rate	Assets in U.S. dollars	Shortfall due to sovereign action percentage	Actual shortfall due to sovereign action	Amount actually available
U.S.	$100	1.0	$100			$100
U.K.	£300	1.5	450			450
U.K.	€200	1.0	200			200
Germany	€150	1.0	150	100%	$150	0
Total			900.00		150.00	750.00

Determine the percentage of shortfall that is not attributable to sovereign action: Shortfall Percentage = (1 − 900 / 1000) = (1 − 90%) = 10%.

Reduce each futures customer or Cleared Swaps Customer claim by the shortfall percentage:

Customer	Claim in US$	Allocated shortfall (non-sovereign)	Claim in U.S. dollars after allocated shortfall
A	$100	$10.00	$90.00
B	50	5.00	45.00
C	150	15.00	135.00
D	700	70.00	63.00
Total	1000.00	100.00	900.00

REDUCTION IN CLAIMS FOR SHORTFALL DUE TO SOVEREIGN ACTION

Due to sovereign action, none of the money in Germany is available.

Customer	Presumed location of funds		
	U.S.	U.K.	Germany
A	$100		
B		$50	
C			$150
D	100	450	150
Total	200.00	500.00	300.00

Calculation of the allocation of the shortfall due to sovereign action Germany ($150 shortfall to be allocated):

Customer	Allocation share	Allocation Share of actual shortfall	Actual shortfall allocated
C	$150/$300	50% of $150	$75
D	150/$300	50% of $150	75
Total			150.00

CLAIMS AFTER REDUCTIONS

Customer	Claim in U.S. dollars after allocated non-sovereign shortfall	Allocation of shortfall due to sovereign action from Germany	Claim after all reductions
A	$90		$90
B	45		45
C	135	$75	60
D	630	75	555
Total	900.00	150.00	750.00

Example 6. Shortfall in funds held outside the U.S., or in a currency other than U.S. dollars, due to sovereign action, shortfall in funds held outside the U.S., or in a currency other than U.S. dollars, not due to sovereign action, and a shortfall in funds held in the U.S.

Customer	Claim	Location(s) customer has consented to having funds held
A	$50	U.S.
B	€50	U.K.
C	$20	U.S.
C	€50	Germany
D	$100.	U.S.
D	£300	U.K.
D	€100	U.K., Germany, or Japan
E	$80	U.S.
E	¥10,000	Japan

Location	Actual asset balance
U.S.	$200
U.K.	£200
U.K.	€100
Germany	€50
Japan	¥10,000

Conversion Rates: £1 = $1; ¥1=$0.01, £1=$1.5.

REDUCTION IN CLAIMS FOR GENERAL SHORTFALL

Convert each futures customer or Cleared Swaps Customer claim in each currency to U.S. Dollars:

Customer	Claim	Conversion rate	Claim in US$
A	$50	1.0	$50
B	€50	1.0	50
C	$20	1.0	20
C	€50	1.0	50
D	$100.	1.0	100
D	€300	1.5	450
D	£100	1.0	100
E	$80	1.0	80
E	¥10,000	0.01	100
Total			1000.00

Determine assets available for distribution to futures customers or Cleared Swaps Customers, converting to U.S. dollars:

Location	Assets	Conversion rate	Assets in U.S. dollars	Shortfall due to sovereign action percentage	Actual shortfall due to sovereign action	Amount actually available
U.S.	$200	1.0	$200			$200
U.K.	£200	1.5	300			300
U.K.	€100	1.0	100			100
Germany	€50	1.0	50	100%	$50	0
Japan	¥10,000	0.01	100	50%	50	50
Total			750		100.00	650.00

Determine the percentage of shortfall that is not attributable to sovereign action: Shortfall Percentage = (1–750/1000) = (1–75%) = 25%.

Reduce each futures customer or Cleared Swaps Customer claim by the shortfall percentage:

Customer	Claim in U.S.$	Allocated shortfall (non-sovereign)	Claim in U.S. dollars after allocated shortfall
A	$50	$12.50	$37.50
B	50	12.50	37.50
C	70	17.50	52.50
D	650	162.50	487.50
E	180	45.00	135.00
Total	1000.00	250.00	750.00

REDUCTION IN CLAIMS FOR SHORTFALL DUE TO SOVEREIGN ACTION

Due to sovereign action, none of the money in Germany and only1/2of the funds in Japan are available.

Customer	Presumed location of funds			
	U.S.	U.K.	Germany	Japan
A	$50			
B		$50		
C	20		$50	
D	100	450	50	$50
E	80			100
Total	250.00	500.00	100.00	150.00

Calculation of the allocation of the shortfall due to sovereign action—Germany ($50 shortfall to be allocated):

Customer allocation	Allocation share	Allocation share of actual shortfall	Actual shortfall allocated
C	$50/$100	50% of $50	$25
D	50/100	50% of 50	25
Total			50

Japan ($50 shortfall to be allocated):

Customer	Allocation share	Allocation share of actual shortfall	Actual shortfall allocated
D	$50/$150	33.3% of $50	$16.67
E	100/150	66.6% of 50	33.33
Total			50.00

CLAIMS AFTER REDUCTIONS

Customer	Claim in US dollars after allocated non-sovereign shortfall	Allocation of shortfall due to sovereign action from Germany	Allocation of shortfall due to sovereign action from Japan	Claim after all reductions
A	$37.50			37.50
B	37.50			37.50
C	52.50	$25		27.50
D	487.50	25	16.67	445.83
E	135.00		33.33	101.67
Total	750.00	50.00	50.00	650.00

Example 7. Shortfall in funds held outside the U.S., or in a currency other than U.S. dollars, due to sovereign action, where the FCM kept more funds than permitted in such location or currency.

Customer	Claim	Location(s) customer has consented to having funds held
A	$50	U.S.
B	50	U.S.
B	€50	U.K.
C	€50	Germany.
D	100.	U.S.
D	€100	U.K. or Germany.
E	50	U.S.
E	€50	U.K.

Location	Actual asset balance
U.S.	$250
U.K.	€50
Germany	€200

Conversion Rates: 1 = $1.

REDUCTION IN CLAIMS FOR GENERAL SHORTFALL

Convert each futures customer or Cleared Swaps Customer claim in each currency to U.S. Dollars:

Customer	Claim	Conversion rate	Claim in US$
A	$50	1.0	$50
B	50	1.0	50
B	€50	1.0	50
C	€50	1.0	50
D	€100.	1.0	100
D	€100	1.0	100
E	50	1.0	50
E	€50	1.0	50
Total			500.00

Determine assets available for distribution to futures customers or Cleared Swaps Customers, converting to U.S. dollars:

Location	Assets	Conversion rate	Assets in U.S. dollars	Shortfall due to sovereign action percentage	Actual shortfall due to sovereign action	Amount actually available
U.S.	$250	1.0	$250			$250
U.K.	€50	1.0	50			50
Germany	€200	1.0	200	100%	200	0
Total			500.00		200	300.00

Determine the percentage of shortfall that is not attributable to sovereign

Shortfall Percentage = (1–500/500) = (1–100%) = 0%.

Reduce each futures customer or Cleared Swaps Customer claim by the shortfall percentage:

Customer	Claim in US$	Allocated shortfall (non-sovereign)	Claim in U.S. dollars after allocated shortfall
A	$50	$0	$50.00
B	100	0	100.00
C	50	0	50.00
D	200	0	200.00
E	100	0	100.00
Total	500.00	0.00	500.00

REDUCTION IN CLAIMS FOR SHORTFALL DUE TO SOVEREIGN ACTION

Due to sovereign action, none of the money in Germany is available.

Customer	Presumed location of funds		
	U.S.	U.K.	Germany
A	$50		
B	50	50	
C			50
D	100		100
E	50	50	
Total	250.00	100.00	150.00

Calculation of the allocation of the shortfall due to sovereign action—Germany ($200 shortfall to be allocated):

Customer	Allocation share	Allocation share of actual shortfall	Actual shortfall allocated
C	$50/$150	33.3% of $200	$66.67
D	$100/$150	66.7% of $200	$133.33
Total			$200.000

This would result in the claims of customers C and D being reduced below zero.

Accordingly, the claims of customer C and D will only be reduced to zero, or $50 for C and $100 for D. This results in a Total Excess Shortfall of $50.

Actual shortfall	Allocation of shortfall for customer C	Allocation of shortfall for customer D	Total excess shortfall
$200	$50	$100	$50

This shortfall will be divided among the remaining futures customers or Cleared Swaps Customers who have authorized funds to be held outside the U.S. or in a currency other than U.S. dollars.

Customer	Total claims of customers permitting funds to be held outside the U.S.	Portion of claim required to be in the U.S.	Allocation share (column B-C/column B Total—all customer claims in U.S.)	Allocation share of actual total excess shortfall	Actual total excess shortfall allocated
B	$100	$50	$50/$200	25% of $50	$12.50
C	50	0	(1)		0
D	200	100	$100/200	50% of $50	25
E	100	50	50/100	25% of $50	12.50
Total	450.00				50.00

[1]Claim already reduced to $0.

CLAIMS AFTER REDUCTIONS

Customer	Claim in U.S. dollars after allocated non-sovereign shortfall	Allocation of shortfall due to sovereign action Germany	Allocation of total excess shortfall	Claim after all reductions
A	$50			$50.00
B	100		12.50	87.50
C	50	50		0
D	200	100	25	75.00
E	100		12.50	87.50
Total	500.00	150.00	50.00	300.00

Issued in Washington, DC on January 11, 2012, by the Commission.

David A. Stawick,

Secretary of the Commission.

Appendices to Protection of Cleared Swaps Customer Contracts and Collateral; Conforming Amendments to the Commodity Broker Bankruptcy Provisions—Commission Voting Summary and Statements of Commissioners

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

Appendix 1—Commission Voting Summary

On this matter, Chairman Gensler and Commissioners Chilton, O'Malia and Wetjen voted in the affirmative; Commissioner Sommers voted in the negative

Appendix 2—Statement of Chairman Gary Gensler

I support the final rules on segregation of customer funds for cleared swaps. These rules are an important step forward in protecting customers and reducing the risk of swaps trading. The rules carry out the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) mandate that futures commission merchants (FCMs) and derivatives clearing organizations (DCOs) segregate customer collateral supporting cleared swaps. FCMs and DCOs must hold customer collateral in a separate account from that belonging to the FCM or DCO. It prohibits clearing organizations from using the collateral of non-defaulting, innocent customers to protect themselves and their clearing members. For the first time, customer money must be protected individually all the way to the clearinghouse.

We received a tremendous amount of public input on this rule, including through two roundtables, as well as through comments on an advanced notice of proposed rulemaking and a proposal. This rule builds on customer protections included in the clearinghouse core principles rule we finalized in October requiring DCOs to collect initial margin on a gross basis for their clearing members' customer accounts.

Appendix 3—Statement of Commissioner Scott D. O'Malia

Today, the Commodity Futures Trading Commission (the ''Commission'') is voting to finalize a rulemaking on protection of cleared swaps customer collateral.[307] Whereas I support this rulemaking, I believe that it is important to detail its limitations, so that we do not offer market participants a misleading sense of comfort in light of the collapse of MF Global, Inc. (''MF Global''). As I will explain further, the Commission has much more work to do to increase confidence in the customer protections that our regulations offer.

This rulemaking does not address MF Global.

First, this rulemaking does not address MF Global. The rulemaking is entitled, in part, *Protection of Cleared Swaps Customer Contracts and Collateral.* Therefore, it benefits cleared swaps customers, and not futures customers (who are bearing the brunt of MF Global). This rulemaking would not have prevented a shortfall in the customer funds of the ranchers and farmers that transact daily in the futures market. Nor would it have expedited the transfer of positions and collateral belonging to such customers in the event of a collapse similar to that of MF Global.

This rulemaking may expose swaps customers to more risk.

Second, this rulemaking only addresses one of three categories of risk that an intermediary—like MF Global—can pose to its customers. The three categories of risk are (i) ''fellow-customer'' risk, (ii) operational risk, and (iii) investment risk. By its own admission, this rulemaking only protects against ''fellow-customer'' risk. It does not protect against operational risk—namely, the risk that an intermediary improperly segregates cleared swaps customer collateral.[308] Moreover, it does not protect against investment risk—namely, the risk that an intermediary experiences losses on its investment of cleared swaps customer collateral, which it cannot cover using its capital.[309] To be plain, I support limiting intermediaries from investing customer collateral in risky instruments—regardless of whether such collateral margins futures or swaps contracts.[310] However, I am not naïve enough to believe that such limitations—without additional Commission oversight or action—would be sufficient. I have warned against complacency in the past.[311] I reiterate such warning here.

Under this rulemaking, what happens if an intermediary—like MF Global—becomes insolvent as operational or investment irregularities are revealed? Basically, under the Bankruptcy Code,[312] cleared swaps customers would share *pro rata* in any shortfall. A shortfall would complicate the porting of cleared swaps customer contracts and associated collateral, notwithstanding the enhanced recordkeeping and reporting requirements of this rulemaking.

By not protecting against operational and investment risk, this rulemaking may have the effect of exposing some swaps customers to more risk than they currently bear in the over-the-counter markets. Since December 2, 2011, we have received eight comment letters from end-users, many of which explicitly asked the Commission to not finalize this rulemaking until it explores other alternatives that may provide greater protection.[313] These end-users include Fidelity Investments, the Committee on Investment of Employee Benefit Assets (''CIEBA''), and the Federal Home Loan Banks. According to many of these comment letters, swaps customers in the over-the-counter markets currently have the option to enter into tri-party custody agreements. In general, these agreements may provide superior protection to this rulemaking against not only fellow-customer risk, but also operational and investment risk.[314]

I understand that staff has been directed to ''carefully analyze'' various proposals that commenters have advanced ''with the goal of developing proposed rules that provide additional protection for collateral belonging to market participants.'' [315] This is a laudable goal. I only hope that we achieve this goal before mandatory clearing becomes effective.[316] Otherwise, we may be subjecting

[307] Protection of Cleared Swaps Customer Contracts and Collateral; Conforming Amendments to the Commodity Broker Bankruptcy Provisions (to be codified at 17 CFR parts 22 and 190) (referenced herein as the ''rulemaking''), available at: *http://www.cftc.gov/PressRoom/Events/opaevent_cftcdoddfrank011112.*

[308] *See* section I(D)(2) of the preamble to this rulemaking.

[309] *Id.*

[310] *See* sections 22.2(e)(1) and 22.3(d) of the rule text to this rulemaking (to be codified at 17 CFR 22.2(e)(1) and 22.3(d)) (limiting an FCM and a DCO to investing cleared swaps customer collateral in instruments enumerated in regulation 1.25).

[311] *See* ''Opening Statement of Commissioner Scott D. O'Malia'', dated December 5, 2011, available at: *http://www.cftc.gov/PressRoom/SpeechesTestimony/omaliastatement120511.*

[312] *See* section 766(h) of the Bankruptcy Code, 11 U.S.C. 766(h).

[313] *See* comment letters from (i) Managed Funds Association, dated December 2, 2011; (ii) Fidelity Investments, dated December 8, 2011; (iii) Och-Ziff Capital Management Group, dated circa December 12, 2011; (iv) State Street Corporation, dated December 14, 2011; (v) the Committee on Investment of Employee Benefit Assets, dated December 22, 2011; (vi) the European Federation for Retirement Provision (''EFRP'') and APG Algemene Pensioen Groep, N.V. (''APG''), dated December 23, 2011; (vii) the Federal Home Loan Banks, dated January 9, 2012; and (viii) BlueMountain Capital Management, LLC, Elliot Management Corporation, Moore Capital Management, LP, Paulson & Co. Inc., and Tudor Investment Corporation, dated January 9, 2012 (the ''Moore *et. al.* letter''). In each case, the comment letters were filed in answer to the notice of proposed rulemaking on the Protection of Cleared Swaps Customer Contracts and Collateral; Conforming Amendments to the Commodity Broker Bankruptcy Provisions, 76 FR 33818, Jun. 9, 2011. All comment letters to such notice are available at: *http://www.cftc.gov/ucm/groups/public/@lrfederalregister/documents/file/2011-10737a.pdf.*

[314] *See, e.g.,* comment letters from (i) Fidelity Investments, dated December 8, 2011; (ii) Och-Ziff Capital Management Group, dated circa December 12, 2011; and (iii) CIEBA, dated December 22, 2011.

[315] Section I(F) of the preamble to this rulemaking.

[316] *See* comment letter from CIEBA, dated December 22, 2011 (stating that ''* * * *the Commission should not permit mandatory clearing of swaps to become effective until a physical segregation option, such as the individual settlement account * * * or another satisfactory structure, has been made available to swaps customers.''* [emphasis original]).

This rulemaking does attempt to resolve one request repeated in the comment letters filed since December 2, 2011. In section I(F) of the preamble, the rulemaking makes clear that the Commission's 2005 Amendment to Financial and Segregation Interpretation No. 10, 70 FR 24768, May 11, 2005 (''Segregation Interpretation 10–1''), does not apply to cleared swaps. Therefore, Segregation Interpretation 10–1 would not prohibit an intermediary from entering into a tri-party custody agreement with a cleared swaps customer. However, this rulemaking similarly makes clear that Segregation Interpretation No. 10, which the Commission issued in 1984, would continue to

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a substantial portion of cleared swaps customer collateral to operational risk and investment risk. To provide some context, such collateral—in the aggregate—may amount to anywhere from $500 billion to $833 billion.[317] As one commenter stated, ''[i]t would seem to be a perverse result that, because of rulemaking promulgated under the Dodd-Frank * * * Act, which was * * * meant to enhance the safety of the over-the-counter markets by reducing systemic and counterparty risks, market participants were to be placed [in] [*sic*] a worse position with regard to risk than they are currently.''[318] Other commenters supported this statement.[319]

This rulemaking may imperfectly address fellow-customer risk.

Let me now say a few words on ''fellow-customer'' risk. Preliminarily, what is it? According to this rulemaking, it is the risk that a derivatives clearing organization (''DCO'') will access the collateral of non-defaulting cleared swaps customers to cure the default of an intermediary.[320] Under what circumstances could a DCO access such collateral? Under this rulemaking, there are two circumstances and they have to occur simultaneously. First, a swaps customer would need to default to an intermediary. Second, as a result of such default, the intermediary must be unable to meet its DCO obligations. In short, swaps customer losses must exceed the capitalization of the intermediary.[321] As this rulemaking acknowledges, ''fellow-customer'' risk is rare.[322] In comparison, according to notices received by the Commission, operational risk is far more prevalent.[323]

Of course, just because a risk is rare does not mean that the Commission should not protect against it. But let us take a closer look at the protection that this rulemaking is offering. First, although it is close to 230 pages, with nearly 100 pages in rule text, only a couple of the provisions of this rulemaking address ''fellow-customer'' risk. They are regulations 22.11 to 22.16.[324] The remainder of regulation Part 22, as well as the majority of changes to regulation Part 190 (*Bankruptcy*), simply aligns the cleared swaps segregation regime with the existing futures segregation regime.[325] As MF Global reveals, the futures segregation regime may have some vulnerabilities. In this rulemaking, the Commission is unthinkingly replicating these vulnerabilities.

Second, this rulemaking only offers protection to a portion of the cleared swaps customer collateral that an intermediary holds. In general, cleared swaps customer collateral may fall within two categories: (i) collateral needed to support contracts; and (ii) collateral in excess of that needed to support contracts (''Excess Collateral''). The Commission, in its final rulemaking on *Derivatives Clearing Organization General Provisions and Core Principles,* states that a DCO must require its clearing members to collect Excess Collateral.[326] However, as certain commenters have astutely observed, and as this rulemaking readily admits, this rulemaking does not protect Excess Collateral deposited outside of the DCO.[327] So, the Commission has required cleared swaps customers to provide collateral that it then does not protect.

Third, this rulemaking cites, as a major benefit, the possibility of enhanced portability of cleared swaps customer contracts, as well as associated collateral, after an intermediary defaults due to ''fellow-customer'' risk.[328] The rulemaking sets forth more stringent recordkeeping and reporting requirements as a foundation for enhanced portability. As commenters have identified, these requirements have two significant weaknesses.

Preliminarily, to maximize portability, each intermediary must (i) keep complete and accurate records and (ii) comply with reporting requirements. As MF Global and earlier intermediary collapses have demonstrated, a distressed intermediary may not prioritize recordkeeping and reporting.[329]

Secondarily, despite requests from various commenters (including the Association of Institutional Investors and Vanguard), this rulemaking does not provide guidance on the concrete steps that a DCO should take to ensure that an intermediary is providing accurate and complete information. Instead, the rulemaking states: ''* * * the DCO should take the steps appropriate, in the professional judgment of its staff, to verify that [intermediaries] have and are using systems and appropriate procedures to track accurately, and to provide to the DCO accurately, the positions of each customer.''[330] In light of MF Global, the Commission should give this provision—and the requests of commenters—more thought.

Finally, this rulemaking is silent on one important factor that may affect the portability of cleared swaps customer contracts, as well as associated collateral—namely, whether the intermediary is both a futures commission merchant and a securities broker-dealer. I am touching on this issue in the interest of full disclosure.

A comprehensive solution is needed.

Despite its limitations, I ultimately support this rulemaking. As I have stated previously, the Commission must immediately take action to renew public confidence in our customer protection regime.[331] Although this rulemaking largely replicates futures segregation, this rulemaking—if it works as promised in an intermediary bankruptcy—may enhance portability for cleared swaps customers in the event of ''fellow-customer'' risk. Even the possibility of such enhancement is non-negligible—especially in the volatile economic environment that exists today.

However, this rulemaking also vividly illustrates some of my concerns regarding our Dodd-Frank rulemaking process. First, the Commission has a duty to regulate the swaps market. It also owes a duty to futures customers. Right now, it is unclear from this rulemaking how the Commission means to address futures customer concerns. I understand that the investigation into the MF Global collapse is ongoing. However, the Commission could examine the manner in

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apply to collateral segregated according to a tri-party custody agreement. In other words, cleared swaps customers could not avoid the *pro rata* distribution provisions of the Bankruptcy Code (as well as regulation Part 190). Therefore, the resolution in this rulemaking may provide commenters with cold comfort.

[317] Section VII(B)(2) of the preamble to this rulemaking (citing estimates provided by CME Group, Inc. and the International Swaps and Derivatives Association, Inc.).

[318] Comment letter from Och-Ziff Capital Management Group, dated circa December 12, 2011.

[319] *See* the Moore *et. al.* letter (stating ''[g]iven the crucial role that central clearing will play in reducing systemic risk in the swaps market, we see no valid argument to suggest that customers to cleared swaps should be subject to weaker regulatory protections than those afforded counterparties to uncleared swaps.''); and comment letter from EFRP and APG, dated December 23, 2011 (stating ''EFRP and APG support the CFTC's efforts to reduce risk, enhance transparency, and promote market integrity, as the U.S. Congress intended by enacting Title VII of the Dodd-Frank * * * Act. It should be clear though that such reform will only improve financial stability, if it is prudent from the perspective of end users, such as pension funds. However, as currently framed the Proposed Rules subject us to increased risks.'').

[320] Section I(B)(6) of the preamble to this rulemaking.

[321] *Id.*

[322] Section VII(B)(2) of the preamble to this rulemaking (stating that ''double defaults are rare events.'').

[323] Regulation 1.12(h) requires an intermediary that knows or should know that it is under-segregated to report to the Commission and its designated self-regulatory organization. Usually, under-segregation results from minor operational failure, and does not lead to the collapse of an intermediary. However, a pattern of operational failure would draw greater attention and inquiry.

[324] Sections 22.11 to 22.16 of the rule text to this rulemaking (to be codified at 17 CFR 22.11 (*Information to be Provided Regarding Customers and Their Cleared Swaps*), 22.12 (*Information to be Maintained Regarding Cleared Swaps Customer Collateral*), 22.13 (*Additions to Cleared Swaps Customer Collateral*), 22.14 (*Futures Commission Merchant Failure to Meet a Customer Margin Call in Full*), 22.15 (*Treatment of Cleared Swaps Collateral on an Individual Basis*), 22.16 (*Disclosures to Customers*)).

[325] *See, e.g.,* section 22.10 to the rule text of this rulemaking (to be codified at 17 CFR 22.10 Application of other Regulatory Provisions).

[326] *See* Derivatives Clearing Organization General Provisions and Core Principles, 76 FR 69334, 69438, Nov. 8, 2011 (to be codified at 17 CFR 39.13(g)(8)).

[327] *See* section III(B) of the preamble to this rulemaking (stating ''CME notes that a portion of the Cleared Swaps Customer Collateral will be held at the FCM, not the DCO, and that this collateral will not be protected by Complete Legal Segregation in the event that an FCM becomes insolvent. This proposition is true but is of little or no relevance to the comparison of Complete Legal Segregation with the Futures Model favored by these commenters.'').

[328] Section I(D)(2) of the preamble to this rulemaking. To be fair, this rulemaking does make the point that enhanced recordkeeping and reporting requirements may also foster portability in the event of operational or investment risk.

[329] *See, e.g.,* comment letters from (i) the Federal Home Loan Banks, dated January 9, 2012 and (ii) CIEBA, dated December 22, 2011. *See also* the Moore *et. al.* letter.

[330] Section IV(K) of the preamble to this rulemaking.

[331] *See Statement on MF Global: Next Steps,* dated November 16, 2011, available at: *http://www.cftc.gov/PressRoom/SpeechesTestimony/omaliastatement111611.*

which operational and investment risks contribute to undersegregation. Our undersegregation reports would help us with such an examination, as well as the detection of potential causal patterns for undersegregation.[332]

Second, instead of rushing to complete this rulemaking, I would have preferred that the Commission focus on providing a more comprehensive solution to operational, investment, and ''fellow-customer'' risk. Moreover, I would have preferred that the Commission more fully explore the alternatives that various commenters have advanced, which may provide greater protection for futures, as well as cleared swaps customer, collateral. Further, it would have been helpful for the Commission to have weighed, in one analysis, the benefits and costs of offering a combination of (i) this rulemaking and (ii) one or more alternatives.

Finally, the Commission needs to contemplate whether any alternative would be workable in light of the *pro rata* distribution provisions of the Bankruptcy Code. If not, the Commission should contemplate recommending to Congress changes to the Bankruptcy Code.

After MF Global, the Commission needs to provide market participants with real, fully developed reforms. I look forward to the Commission taking such action.

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[332] *See supra note* 17.