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This section of the FEDERAL REGISTER contains notices to the public of the proposed issuance of rules and regulations. The purpose of these notices is to give interested persons an opportunity to participate in the rule making prior to the adoption of the final rules.

COMMODITY FUTURES TRADING COMMISSION

17 CFR Parts 23 and 190

RIN 3038–AD28

Protection of Collateral of Counterparties to Uncleared Swaps; Treatment of Securities in a Portfolio Margining Account in a Commodity Broker Bankruptcy

AGENCY: Commodity Futures Trading Commission.

ACTION: Notice of proposed rulemaking.

SUMMARY: The Commodity Futures Trading Commission (the "Commission") hereby proposes rules to implement new statutory provisions enacted by Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"). Specifically, the proposed rules contained herein impose requirements on swap dealers ("SDs") and major swap participants ("MSPs") with respect to the treatment of collateral posted by their counterparties to margin, guarantee, or secure uncleared swaps. Additionally, such proposed rules ensure that, for purposes of subchapter IV of chapter 7 of the Bankruptcy Code: Securities held in a portfolio margining account that is a futures account constitute "customer property"; and owners of such account constitute "customers".

DATES: Submit comments on or before February 1, 2011.

ADDRESSES: You may submit comments, identified by RIN number 3038–AD28, by any of the following methods:

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

Please submit your comments by only one method.

All comments must be submitted in English, or if not, accompanied by an English translation. Comments will be posted as received to *http://www.cftc.gov.* You should submit only information that you wish to make available publicly. If you wish the Commission to consider information that you believe is exempt from disclosure under the Freedom of Information Act, a petition for confidential treatment of the exempt information may be submitted according to the procedures established in CFTC Regulation 145.9, 17 CFR 145.9.

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

FOR FURTHER INFORMATION CONTACT: Robert B. Wasserman, Associate Director, Division of Clearing and Intermediary Oversight (DCIO), at 202–418–5092 or *rwasserman@cftc.gov;* Martin White, Assistant General Counsel, at 202–418–5129 or *mwhite@cftc.gov;* Nancy Liao Schnabel, Special Counsel, DCIO, at 202–418–5344 or *nschnabel@cftc.gov;* in each case, also at the Commodity Futures Trading Commission, Three Lafayette Centre, 1155 21st Street, NW., Washington, DC 20581.

SUPPLEMENTARY INFORMATION:

I. Background

On July 21, 2010, President Obama signed the Dodd-Frank Act.[1] Title VII of the Dodd-Frank Act[2] amended the Commodity Exchange Act ("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: (i) Providing for the registration and comprehensive regulation of SDs and MSPs;[4] (ii) imposing mandatory clearing and trade execution requirements on clearable swap contracts; (iii) creating robust recordkeeping and real-time reporting regimes; and (iv) enhancing the rulemaking and enforcement authorities of the Commission with respect to, among others, all registered entities and intermediaries subject to the oversight of the Commission.

Section 724(c) of the Dodd-Frank Act amends the CEA to add, as section 4s(l) thereof, provisions concerning the rights of counterparties to SDs and MSPs with respect to the treatment of margin for uncleared swaps. As discussed further in Part II of this preamble, these changes are implemented in proposed new Subpart L to Part 23 of Title 17, §§ 23.600 through 23.609.

Section 713(c) of the Dodd-Frank Act amends the CEA to add, as section 20(c) thereof, a provision that requires the Commission to exercise its authority to clarify the legal status, in the event of a commodity broker[5] bankruptcy, of (i)

[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, Section 721(c) of the Dodd-Frank Act directs the Commission to promulgate rules to further define, among other terms, "swap dealer" and "major swap participant." The Commission anticipates that such rulemaking will be completed by the statutory deadline of July 15, 2011. *See, e.g., Http://Www.Cftc.Gov/Lawregulation/Otcderivatives/OTC_2_Definitions.Html.*

[5] Commission regulation ("Regulation") 190.01(f) defines "commodity broker" as "any person who is registered or required to register as a futures commission merchant under the Commodity Exchange Act including a person registered as such under Parts 32 and 33 of this chapter, and a 'commodity options dealer,' 'foreign futures commission merchant,' 'clearing organization,' and 'leverage transaction merchant' with respect to which there is a 'customer' as those terms are defined in this section, but excluding a person registered as a futures commission merchant under section 4f(a)(2) of the Commodity Exchange Act." Pursuant to the Bankruptcy Code, 11 U.S.C. 101 *et*

securities in a portfolio margining account held as a futures account, and (ii) an owner of such account. As discussed further in Part III of this preamble, these changes are implemented in proposed amendments to §§ 190.01(k) and 190.08(a)(1)(i).

Part IV below describes proposed technical amendments to Regulation part 190 that are not required by the Dodd-Frank Act, but rather address the changes to 11 U.S.C. 764(b) implemented by Public Law 111–16, the Statutory Time-Periods Technical Amendments Act of 2009. Specifically, such act changed the time period (*i.e.,* from five (5) business days to seven (7) calendar days) during which a transfer of "commodity contracts" [6] and "customer property" [7] becomes not avoidable by the trustee in a commodity broker bankruptcy.

The Commission requests comment on all aspects of this release.

II. Segregation of Margin for SD and MSP Counterparties With Respect to Uncleared Swaps

New Section 4s(l) of the CEA, enacted by Section 724(c) of the Dodd-Frank Act, sets forth certain requirements concerning the rights of counterparties of SDs and MSPs with respect to the segregation of collateral supplied for margining, guaranteeing, or securing uncleared swaps.[8] Such requirements [9] include:

- An SD or MSP must notify each counterparty at the beginning of a swap transaction that the counterparty has the right to require segregation of the funds or other property that it supplies to margin, guarantee, or secure its obligations; and
- At the request of the counterparty, the SD or MSP must segregate such funds or other property with an independent third party.

To implement the statute, the Commission proposes new subpart L to part 23 of title 17.

A. Regulation 23.600: Definitions

The Commission proposes to define "segregate" according to its commonly-understood meaning: To keep two or more items in separate accounts, and to avoid combining them in the same transfer between two accounts.

The Commission has never before defined "initial margin" (for which a counterparty has the right to segregation pursuant to CEA Section 4s(l)) or "variation margin" (for which a counterparty does not have such a right) in a regulation. The distinction between "initial margin" and "variation margin" established in proposed § 23.600 is temporally-based:

1. Initial Margin

"Initial margin" is defined as an amount calculated based on anticipated exposure to future changes in the value of a swap.

2. Variation Margin

"Variation margin" is defined as an amount calculated 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.

The Commission may also consider, in a future rulemaking, placing an expanded version of these definitions (to include initial and variation margin with respect to futures and options on futures) in Part 1, and incorporating those definitions by reference here.

The Commission seeks comment on the appropriateness of these definitions in this context, and on the potential use of such expanded definitions.

B. Regulation 23.601: Notification of Right to Segregation

1. Required Notification

Proposed Regulation 23.601(a) incorporates the statutory requirement of Section 4s(l)(1)(A) of the CEA that a SD or MSP must notify each counterparty with respect to an uncleared swap that the counterparty has the right to require that initial margin posted by that counterparty be segregated in accordance with these rules. The Commission interprets the language of Section 4s(l)(1)(A) of the CEA that the counterparty must be "notified * * * [of a] right to require segregation" to mean that this right can be grasped or renounced, at the election of the counterparty.[10] Congress's description as a "right" of what would otherwise be a simple matter for commercial negotiation suggests that this decision is an important one, with a certain degree of favor given to an affirmative election.

The Commission has not proposed any particular disclosure requirements with respect to this notification. Should the SD or MSP be required to disclose the cost of segregation, whether the cost of fees to be paid to the custodian (if the SD or MSP is aware of the amount of such fees), or differences in the terms of the swap that the SD or MSP is willing to offer to the counterparty (*e.g.,* differences in the fixed interest rate for an interest rate swap) if the counterparty elects or renounces the right to segregation?

2. Limitation of Right—Variation Margin

Proposed Regulation 23.601(b) incorporates the limitation in Section 4s(l)(2)(B)(i) of the CEA that the right to segregation does not apply to variation margin.

3. Counterparty Notification

The Commission regards the inclusion of the term "right to require segregation" as requiring that this decision is taken at an appropriate level of the counterparty organization. Proposed Regulation 23.601(c) requires that such notification be made to certain senior decisionmakers, in descending order of preference. Notification is made to the Chief Risk Officer, or the Chief Executive Officer, or to the highest level decisionmaker for the counterparty. The Commission seeks comment as to whether this list of decision-makers is appropriate, in particular, whether it is appropriate for "Special Entities" as such term is defined in Section 4s(h)(1)(C) of the CEA (*e.g.* a municipality).

4. Required Confirmation

Proposed § 23.601(d) requires that the SD or MSP must obtain from the counterparty confirmation of receipt of such notification by the specified decisionmaker, and the election to require segregation or not, before the terms of the swap are confirmed. The SD or MSP must maintain records of such confirmation and election as business records in accordance with Regulation 1.31.

5. Limitation of Responsibility To Notify

The requirement in Section 4s(l)(1)(A) of the CEA that notification be made "at

seq., if a commodity broker experiences bankruptcy, it must be liquidated in accordance with chapter 7, subchapter IV ("Subchapter IV"). In the event of such liquidation, Subchapter IV provides certain protections for collateral that customers deposit with the commodity broker. Pursuant to its authority under Section 20 of the CEA, the Commission has interpreted Subchapter IV in promulgating Regulation Part 190.

[6] Section 761(4) of the Bankruptcy Code, 11 U.S.C. 761(4), defines "commodity contract."

[7] Regulation 190.01(n) defines "customer property" as "the property subject to pro rata distribution in a commodity broker bankruptcy which is entitled to the priority set forth in Section 766(h) of the Bankruptcy Code and includes certain cash, securities, and other property as set forth in § 190.08(a)."

[8] It should be noted that this rulemaking addresses segregation of margin, and does not address what amount of margin, if any, a counterparty is required to post.

[9] Such requirements do not apply to "variation margin payments." Section 724(c) of the Dodd-Frank Act does not set forth a definition for such term. The Commission has proposed such a definition below.

[10] *See also* CEA Section 4s(l)(4) (referring to cases where the counterparty "does not choose to require segregation" of margin).

the beginning of a swap transaction" could be read to require such notification at the beginning of each swap transaction. Such repetitive notification could, however, be redundant. On the other hand, the importance of the decision discussed above suggests that some periodic reconsideration might be appropriate. Proposed § 23.601(e) seeks to balance these considerations by providing that notification of a particular counterparty by a particular SD or MSP need only be made once in any calendar year.

6. Power To Change Election With Regard to Segregation

Proposed § 23.601(f) makes clear that a counterparty's election to require segregation of initial margin, or not to require such segregation, may be changed at the discretion of the counterparty upon delivery of written notice, and shall be applicable with respect to swaps entered into between the parties after such delivery.

The Commission seeks comments on the issues referred to in this section I(B).

C. Regulation 23.602: Requirements for Segregated Collateral

1. Independent Custodian and Separate Account

Pursuant to Section 4s(l)(3) of the CEA, proposed Regulation 23.602(a)(1) requires initial margin segregated in accordance with an election under proposed Regulation 23.601 to be segregated with a custodian that is independent of both the SD or MSP and the counterparty. Proposed § 23.602(a)(2) requires the initial margin to be held in an account designated as a segregated account for and on behalf of the counterparty. While, as noted above, the right to segregation does not apply to variation margin, the regulation provides the swap dealer or major swap participant and the counterparty may agree that variation margin may also be held in such an account.

Proposed § 23.602(a)(1) does *not* require that the initial margin be held in an account that is independent of any *affiliate* of the SD or MSP or the counterparty, in order to permit parties to engage in swaps transactions with affiliates of their usual depositories. Comment is requested as to whether this approach is appropriate. Moreover, the proposed regulation does not specify which party (the counterparty, or the SD or MSP) has the right to designate a custodian, thus, by implication, leaving the choice to the agreement of the parties. Is this approach appropriate? Should either party be entitled to choose a custodian? If so, what restrictions, if any, should be placed on that choice?

2. Requirements for Custody Agreement

Proposed § 23.602(b) is intended to provide a balance between the minimum interests of (i) the counterparty posting the initial margin, (ii) the SD or MSP for whom the initial margin is posted, and (iii) the custodian, while avoiding the necessity for time-consuming and expensive interpleader proceedings.[11] The custody agreement applicable to such initial margin must be in writing, and must include the custodian as a party. To ensure that the SD or MSP receives the initial margin promptly in case it is entitled to do so, and that the initial margin is returned to the counterparty in case it is entitled to such return, the agreement must provide that turnover of control shall be made promptly upon presentation of a statement in writing, signed by an authorized person under penalty of perjury, that one party is entitled to such turnover pursuant to an agreement between the parties. The requirement of a signature under oath or under penalty of perjury pursuant to 28 U.S.C. 1746 is intended to ensure that such statement is not lightly made.[12] Otherwise, withdrawal of collateral may only be made pursuant to the agreement of both the counterparty and the SD or MSP, with the non-withdrawing party also receiving immediate notice of such withdrawal.[13] The Commission requests comment on whether the foregoing approach is appropriate, including on whether a statement under penalty of perjury should be required, and on whether such a statement, if required, should be required to be based on personal knowledge.

D. Regulation 23.603: Investment of Segregated Collateral

1. Limitations on Investments

Section 4s(l)(2)(B)(ii)(I) of the CEA refers to "commercial arrangements regarding the investment of segregated funds or other property *that may only be invested in such investments as the Commission may permit by rule or regulation*." Proposed § 22.603(a) accordingly provides that segregated initial margin may only be invested consistent with the standards for investment of customer funds that the Commission applies to exchange-traded futures, Regulation § 1.25. That regulation has been designed to permit an appropriate degree of flexibility in making investments with segregated property, while safeguarding such property for the parties who have posted it, and decreasing the credit, market, and liquidity risk exposures of the parties who are relying on that margin.[14]

This regulation governs only investments of initial margin posted by the counterparty, and does not govern what collateral is eligible to be posted as such margin.

2. Commercial Arrangements Regarding Investments and Allocations

As required by new Section 4s(l)(2)(B)(ii) of the CEA, proposed Regulation 22.603(b) provides that the SD or MSP and the counterparty may enter into any commercial arrangement, in writing, regarding the investment of segregated initial margin and the related allocation of gains and losses resulting from such investment.

E. Regulation 23.604: Requirements for Non-Segregated Collateral

Section 4s(l)(4) of the CEA mandates that, if the counterparty does not choose to require segregation, the SD or MSP shall report to the counterparty, on a quarterly basis, "that the back office procedures of the swap dealer or major swap participant relating to margin and collateral requirements are in compliance with the agreement of the counterparties." This provision is implemented in proposed § 22.604(a), which requires that such reports be made no later than the fifteenth (15th) business day of each calendar quarter for the preceding calendar quarter. Proposed Regulation 22.604(a) makes the Chief Compliance Officer of the SD or MSP required by Section 4s(k) of the CEA responsible for such report.

[11] If the SD or MSP and the counterparty were to make competing claims to the collateral, and if the custodian did not have a means under the agreement among the parties to decide between such claims without risking legal liability, the custodian would likely choose to interplead the collateral.

[12] *See* 18 U.S.C. 1621 (Perjury Generally).

[13] The importance of taking steps to ensure that unauthorized withdrawals are not made is enhanced by the findings of the Commission's Division of Clearing and Intermediary Oversight in Financial and Segregation Interpretation 10–1, 20 FR 24768, 24770 (May 11, 2005) ("Findings by both Commission audit staff and the SROs of actual releases of customer funds [from third-party custodial accounts], without the required knowledge or approval of the FCMs, further demonstrate that the risks associated with third-party custodial accounts are real and material, not merely theoretical.").

[14] *See generally Investment of Customer Funds and Funds Held in an Account for Foreign Futures and Foreign Options Transactions,* 75 FR 67642, 67652–53 (Nov. 3, 2010) (Release proposing amendments to Commission Regulation 1.25).

Proposed § 22.604(b) provides that this obligation shall apply no earlier than the 90th calendar day after the first swap is transacted between the counterparties.

F. Effective Date

The Commission requests comment on the appropriate timing of effectiveness for the final rules for Part 23. Specifically, is six months after the promulgation of final rules sufficient? If not, please specify a recommended time period, and explain in detail the reasons why a shorter period will not be sufficient.

III. Portfolio Margining Accounts

Section 713(c) of the Dodd-Frank Act added Section 20(c) of the CEA, which specifies that the Commission "shall exercise its authority to ensure that securities held in a portfolio margining account carried as a futures account are customer property and the owners of those accounts are customers for the purposes of" Subchapter IV. To implement this provision, the Commission proposes changes to §§ 190.01(k) and 190.08(a)(1)(i).

A. Regulation 190.01(k): Definition of Customer

The "customer" portion of this provision is implemented in the proposed amendment to § 190.01(k), which adds to the definition of "customer" the sentence "To the extent not otherwise included, customer shall include the owner of a portfolio margining account carried as a futures account."

B. Regulation 190.08(a)(1)(i)(F): Definition of Customer Property

The "customer property" portion of this provision is implemented in proposed § 190.08(a)(1)(i)(F), which adds to the definition of "customer property" the sentence "To the extent not otherwise included, securities held in a portfolio margining account carried as a futures account."

C. Effective Date of Proposal

The Commission believes that these rule amendments clarify existing law, and thus may be made effective immediately upon promulgation of a final rule. Comment is solicited with respect to these conclusions.

IV. Statutory Time-Periods Technical Amendments Act of 2009

The purpose of this portion of the rulemaking is to implement Public Law 111–16, the Statutory Time-Periods Technical Amendments Act of 2009, which (in relevant part) changed the time period in 11 U.S.C. 764(b), discussed below, from five (business) days to seven (calendar) days. As noted above, these changes are not related to the Dodd-Frank Act.

Certain sections of the Bankruptcy Code [15] provide the trustee of a debtor the power to avoid (*i.e.,* retract) certain transfers of property from the debtor, whether shortly before or after the bankruptcy filing, that would otherwise allow a creditor to obtain more than that creditor would in a bankruptcy distribution. Section 764(b) of the Bankruptcy Code provides that a trustee may not avoid a transfer of "commodity contracts" [16] or "customer property" [17] that is authorized by the Commission, whether before or after the transfer, before the specified time period after the bankruptcy "order for relief."

The change in the statutory deadline should be reflected in the relevant Commission regulations. Moreover, under current business and legal practice, emergency matters (such as transfers during a bankruptcy) may be accomplished outside of business hours. Accordingly, the words "the close of business on the fourth business day after the order for relief" are replaced by the words "11:59 P.M. on the seventh day after the order for relief" in proposed § 190.02(e)(1) (trustee to use best efforts to effect transfer before this time), § 190.02(f)(1) (deadline for transfer of dealer option contracts), § 190.06(g)(2)(i)(A) (prohibition of avoidance of transfers of which the Commission is notified prior to the transfer pursuant to § 190.02(a)(2) and does not disapprove), and § 190.06(g)(2)(ii) (prohibition of avoidance of transfers at the direction of the Commission).

These amendments would only affect "commodity brokers" [18] in bankruptcy, and are meant to make Part 190 consistent with amendments to the Bankruptcy Code. Accordingly, the Commission proposes to make the foregoing amendments to part 190 effective immediately upon promulgation of a final rule.

V. Related Matters

A. Regulatory Flexibility Act

The Regulatory Flexibility Act ("RFA") was adopted to address the concerns that government regulations may have a significant and/or disproportionate effect on small businesses. To mitigate this risk, the RFA requires agencies to conduct an initial and final regulatory flexibility analysis for each rule of general applicability for which the agency issues a general notice of proposed rulemaking.[19] These analyses must describe the impact of the proposed rule on small entities, including a statement of the objectives and the legal bases for the rulemaking; an estimate of the number of small entities to be affected; identification of federal rules that may duplicate, overlap, or conflict with the proposed rules; and a description of any significant alternatives to the proposed rule that would minimize any significant impacts on small entities.[20]

The proposed Regulations will impose regulatory obligations on SDs and MSPs. The Commission has already established certain definitions of "small entities" to be used in evaluating the impact of its rules on such small entities in accordance with the RFA.[21] SDs and MSPs are new categories of registrant. Accordingly, the Commission has not previously decided whether such persons are, in fact, small entities for purposes of the RFA.

The Commission previously has determined that FCMs should not be considered to be small entities for purposes of the RFA. The Commission's determination was based in part upon their obligation to meet the minimum financial requirements established by the Commission to enhance the protection of customers' segregated funds and protect the financial condition of FCMs generally.[22] Like FCMs, SDs will be subject to minimum capital and margin requirements, and are expected to comprise the largest global financial firms. The Commission is required to exempt from designation entities that engage in a *de minimis* level of swaps dealing in connection with transactions with or on behalf of customers. Accordingly, for purposes of the RFA, the Commission is hereby determining that SDs not be considered "small entities" for essentially the same reasons that FCMs have previously been determined not to be small entities.

The Commission has also previously determined that large traders are not "small entities" for RFA purposes.[23] The Commission considered the size of a trader's position to be the only appropriate test for purposes of large trader reporting.[24] MSPs maintain substantial positions in swaps, creating substantial counterparty exposure that

[15] *See* 11 U.S.C. 544, 545, 547, 548, 724(a).

[16] *See supra* note 6.

[17] *See supra* note 7.

[18] *See supra* note 5.

[19] 5 U.S.C. 601 *et seq.*

[20] 5 U.S.C. 603, 604.

[21] 47 FR 18618 (Apr. 30, 1982).

[22] *Id.* at 18619.

[23] *Id.* at 18620.

[24] *Id.*

could have serious adverse effects on the financial stability of the United States banking system or financial markets. Accordingly, for purposes of the RFA, the Commission is hereby determining that MSPs not be considered "small entities" for essentially the same reasons that large traders have previously been determined not to be small entities.

Accordingly, the Chairman, on behalf of the Commission, hereby certifies pursuant to 5 U.S.C. 605(b) that the proposed rules will not have a significant economic impact on a substantial number of small entities.

B. Paperwork Reduction Act

Provisions of proposed new Regulation Part 23 include new information disclosure and recordkeeping requirements that constitute the collection of information within the meaning of the Paperwork Reduction Act of 1995 ("PRA").[25] The Commission therefore is submitting this proposed collection of information to the Office of Management and Budget ("OMB") for review in accordance with 44 U.S.C. 3507(d) and 5 CFR 1320.11. Under the PRA, an agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a currently valid control number.[26] The title for this collection of information is "Disclosure and Retention of Certain Information Relating to Swaps Customer Collateral," OMB Control Number 3038–NEW. The 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.[27] 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 OMB control number. This collection of information has not yet been assigned an OMB control number.

1. Information Provided by Reporting Entities

Proposed § 23.601 requires SDs and/or MSPs to notify each counterparty to an uncleared swap transaction that the counterparty may require that the counterparty's initial margin be held in a segregated account. The notification must be provided at the beginning of each swap transaction. However, notification need only be given once a year to any particular counterparty. The SD or MSP must provide the notification to the chief risk officer of the counterparty, if such an officer exists; and otherwise to another appropriate official of the counterparty as specified in the regulation. The SD or MSP must obtain a receipt of the notification and maintain it as a business record. The purpose of proposed § 23.601 is to implement Section 4s(l)(1)(A) of the CEA which requires SDs and MSPs in uncleared swaps transactions to notify counterparties that they have the right to require segregation of their initial margin deposits.

Proposed § 23.604 requires the chief compliance officer of each SD or MSP to report on a quarterly basis to each counterparty that does not choose to require segregation of initial margin on whether or not the back-office procedures of the SD or MSP relating to margin and collateral requirements were, at any point during the previous quarter, not in compliance with the agreement of the counterparties. The purpose of this requirement is to implement Section 4s(1)(4) of the CEA, which requires these reports.

The disclosure requirement of proposed § 23.601 is expected to apply to about 300 entities.[28] Each such entity will be required to make the required disclosure once each year to each of its counterparties in uncleared swaps transactions. It is expected that each disclosure would require approximately 0.3 hours of staff time by staff with a salary level of approximately $20 per hour. Because of the absence of experience under the new requirements of the Dodd-Frank Act, it is uncertain what average number of uncleared swaps counterparties will be dealt with annually by swap dealers and major swap participants. Assuming that each of 14 major swap dealers or major swap participants makes the required disclosure to 5,000–10,000 counterparties per year, and each of the 286 remaining swap dealers or major swap participants makes the required disclosure to 200 counterparties per year, there would be a total of approximately 130,000–200,000 disclosures per year, and thus the estimated total annual burden would be approximately 40,000–60,000 hours and $800,000–$1,200,000.[29]

The disclosure requirement of proposed Regulation 23.604 will apply to the same 300 entities as the requirement of proposed Regulation 23.601. Each such entity will be required to make the required disclosure four times each year to each of its uncleared swaps counterparties that does not choose to require segregation of capital. Because there is as yet no experience with the effect of the disclosure of the right to segregation of collateral and other requirements of the Dodd-Frank Act, it is uncertain how many uncleared swaps counterparties will decline such segregation. Assuming that half of all uncleared swaps counterparties do not choose segregation of collateral, proposed § 23.604 would require a total of approximately 260,000–400,000 disclosures annually. It is expected that each disclosure would, on average, require approximately 0.3 hours of staff time by staff with a salary level of about $30 per hour.[30] The estimated total annual burden would be approximately 80,000–120,000 hours and $2,400,000–$3,500,000.

2. Information Collection Comments

The Commission invites the public and other federal agencies to comment on any aspect of the reporting and recordkeeping burdens discussed above. Pursuant to 44 U.S.C. 3506(c)(2)(B), the Commission solicits comments in order to: (i) Evaluate whether the proposed collection of information is necessary for the proper performance of the functions of the Commission, including whether the information will have practical utility; (ii) evaluate the accuracy of the Commission's estimate of the burden of the proposed collection of information; (iii) determine whether there are ways to enhance the quality, utility, and clarity of the information to be collected; and (iv) minimize the burden of the collection of information on those who are to respond, including through the use of automated collection techniques or other forms of information technology.

[25] 44 U.S.C. 3501 *et seq.*

[26] *Id.*

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

[28] This estimate is based on the assumption that there will be about 250 SDs and 50 MSPs.

[29] The estimate of the number of counterparties receiving disclosure from each swap dealer or major swap participant takes into consideration the possibility that a single counterparty may deal with more than one swap dealer or major swap participant in a year. Thus, the total number of required disclosures may exceed the total number of counterparties making use of uncleared swaps subject to the disclosure requirement.

[30] The time and level of personnel required for the disclosure required by proposed § 23.604 in particular transactions will depend, to some extent, on the specifics of the agreement of the parties with regard to the back-office procedures of the SD relating to margin and collateral requirements, and the extent to which such agreements with regard to procedures are standardized at a particular SD. The average burden figure thus reflects a varying level of burden in particular transactions.

Comments may be submitted directly to the OMB Office of Information and Regulatory Affairs, by fax at (202) 395–6566 or by e-mail at *OIRAsubmissions@omb.eop.gov.* Please provide the Commission with a copy of submitted comments so that all comments can be summarized and addressed in the final rule preamble. Refer to the **ADDRESSES** section of this notice of proposed rulemaking for comment submission instructions to the Commission. A copy of the supporting statements for the collections of information discussed above may be obtained by visiting *RegInfo.gov.* OMB is required to make a decision concerning the collection of information between 30 and 60 days after publication of this release. Consequently, a comment to OMB is most assured of being fully effective if received by OMB (and the Commission) within 30 days after publication of this notice of proposed rulemaking.

C. Cost-Benefit Analysis

Section 15(a) of the CEA [31] requires the Commission to consider the costs and benefits of its actions before issuing a rulemaking under the CEA. By its terms, Section 15(a) of the CEA does not require the Commission to quantify the costs and benefits of a rule or to determine whether the benefits of the rulemaking outweigh its costs; rather, it requires that the Commission "consider" the costs and benefits of its actions. Section 15(a) of the CEA 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. The Commission may in its discretion give greater weight to any one of the five enumerated areas and could in its discretion determine that, notwithstanding its costs, a particular rule is necessary or appropriate to protect the public interest or to effectuate any of the provisions or accomplish any of the purposes of the CEA.

1. Cost-Benefit Analysis of Proposed Part 23

a. Summary of Proposed Requirements

Proposed Part 23 of the Commission's regulations implements the requirement of newly-enacted Section 4s(l) of the CEA that counterparties to uncleared swaps transactions with SDs and MSPs be given the right to require to require segregation of their initial margin in an account separate from those of the SD or MSP. Proposed Part 23 also implements the statutory requirement that SDs and MSPs notify their counterparties of this right. Additionally, amendments are being made to Part 190 of the Commission's regulations that would clarify existing law, particularly that (i) "customer property," for purposes of Regulation Part 190, includes securities held in a portfolio margining account carried as a futures account, and (ii) "customers," for purposes of Regulation part 190, includes owners of such a portfolio margining account. Technical amendments also are being proposed for part 190. These amendments would change the deadline for certain actions in bankruptcy proceedings to conform with recent amendments to the Bankruptcy Code, as well as current business and legal practice.

b. Costs

The costs directly imposed by proposed part 23 and the amendments to Part 190 relate to the protection of market participants, the risk management practices of market participants, and the efficiency of bankruptcy proceedings. If proposed part 23 and the proposed amendments to Part 190 are not implemented, it will be less likely that a market participant will be informed of their option to require segregation of their initial margin from the assets of the SD or MSP opposite which the market participant will be transacting swaps. The segregation option is intended to preserve the assets of the market participant in the event of an insolvency of the SD or MSP.

c. Benefits

The benefits of proposed part 23 relate to the protection of market participants and the financial integrity of the futures and swap markets. The proposed regulatons would ensure that segregated accounts for initial margin are available in all uncleared swaps transactions involving SDs or MSPs and that counterparties are informed of their availability. This could result in the increased use of segregated accounts with resulting reduced risk of loss of collateral by counterparties in the event of the insolvency of an SD or MSP and reduced chance of counterparty assets being intentionally or inadvertently misused. In addition proposed Regulation Part 23 can be expected to increase the likelihood that any lack of use of segregated collateral accounts by uncleared swaps counterparties is the result of genuine choices by counterparties and reduce the likelihood that it is the result of inertia, market power, or other market imperfections.

The definitions and technical amendments being proposed for Part 190 similarly are intended to relate to the protection of market participants, as well as to efficiency associated with bankruptcy proceedings. The definitional changes are expected to increase legal certainty in some circumstances. The technical amendments are intended to increase the efficiency with which certain acts in bankruptcy proceedings of commodity brokers are carried out by insuring consistency between the Regulations, the Bankruptcy Code, and current bankruptcy practice.

3. Public Comment

The Commission invites public comment on its cost-benefit considerations. Commenters are also are invited to submit any data or other information that they may have quantifying or qualifying the costs and benefits of the proposal with their comment letters.

List of Subjects

17 CFR Part 23

Consumer protection, Reporting and recordkeeping requirements, Swaps.

17 CFR Part 190

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

For the reasons stated in this release, the Commission hereby proposes to amend 17 CFR part 23 as previously proposed in FR Doc. 2010–29024, published on November 23, 2010 (75 FR 71379) and part 190 as follows:

PART 23—SWAP DEALERS AND MAJOR SWAP PARTICIPANTS

1. The authority citation for Part 23 continues to read as follows:

Authority: 7 U.S.C. 1a, 2, 6, 6a, 6b, 6c, 6p, 6s, 9, 9a, 13b, 13c, 16a, 18, 19, 21 as amended by Pub. L. 111–203, 124 Stat. 1376 (Jul. 21, 2010).

2. Add subpart L to read as follows:

Subpart L—Segregation of Assets Held as Collateral in Uncleared Swap Transactions

Sec.
23.600 Definitions.
23.601 Notification of right to segregation.
23.602 Requirements for segregated margin.
23.603 Investment of segregated initial margin.
23.604 Requirements for non-segregated margin.

[31] 7 U.S.C. 19(a).

Subpart L—Segregation of Assets Held as Collateral in Uncleared Swap Transactions

§ 23.600 Definitions.

"*Initial Margin*" means money, securities, or property posted by a party to a swap as performance bond to cover potential future exposures arising from changes in the market value of the position.

"*Margin*" means both Initial Margin and Variation Margin.

"*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.

"*Variation Margin*" means a payment made by a party to a 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.

§ 23.601 Notification of right to segregation.

(a) At the beginning of each swap transaction that is not submitted for clearing, a swap dealer or major swap participant shall notify each counterparty to such transaction that the counterparty has the right to require that any Initial Margin the counterparty provides in connection with such transaction be segregated in accordance with §§ 23.602 and 23.603 of this part.

(b) The right referred to in paragraph (a) of this section does not extend to Variation Margin.

(c) The notification referred to in paragraph (a) of this section shall be made to the Chief Risk Officer, or, if there is no such Officer, the Chief Executive Officer, or if none, the highest-level decisionmaker for the counterparty.

(d) Prior to confirming the terms of any such swap, the swap dealer or major swap participant shall obtain from the counterparty confirmation of receipt by the person specified in paragraph (c) of this section of the notification specified in paragraph (a) of this section, and an election to require such segregation or not. The swap dealer or major swap participant shall maintain such confirmation and such election as business records pursuant to § 1.31 of this chapter.

(e) Notification pursuant to paragraph (a) of this section to a particular counterparty by a particular swap dealer or major swap participant need only be made once in any calendar year.

(f) A counterparty's election to require segregation of initial margin, or not to require such segregation, may be changed at the discretion of the counterparty upon written notice delivered to the swap dealer or major swap participant, which changed election shall be applicable to all swaps entered into between the parties after such delivery.

§ 23.602 Requirements for segregated margin.

(a) Initial margin that is segregated pursuant to an election under § 23.601 of this part must be:

(1) Segregated with a custodian that is independent of both the swap dealer or major swap participant and the counterparty, and

(2) Held in an account segregated, and designated as such, for and on behalf of the counterparty. Such an account may, if the swap dealer or major swap participant and the counterparty agree, also hold Variation Margin.

(b) Any agreement for the segregation of Margin pursuant to this section shall be in writing, shall include the custodian as a party, and shall provide that:

(1) Turnover of control of such margin, either to the counterparty or to the swap dealer or major swap participant, shall be made promptly upon presentation to the custodian of a statement in writing, made under oath or under penalty of perjury as specified in 28 U.S.C. 1746, by an authorized representative of either such party, stating that such party is entitled to such control pursuant to an agreement between such parties. The other party shall be immediately notified of such turnover, and

(2) Any withdrawal of such margin, other than pursuant to paragraph (b)(1) of this section, shall only be made pursuant to the agreement of both the counterparty and the swap dealer or major swap participant, and notification of such withdrawal shall be given immediately to the non-withdrawing party.

§ 23.603 Investment of segregated initial margin.

(a) Initial Margin that is segregated pursuant to an election under § 23.601 may only be invested consistent with § 1.25 of this chapter.

(b) Subject to paragraph (a) of this section, the swap dealer or major swap participant and the counterparty may enter into any commercial arrangement, in writing, regarding the investment of such Initial Margin, and the related allocation of gains and losses resulting from such investment.

§ 23.604 Requirements for non-segregated margin.

(a) The chief compliance officer of each swap dealer or major swap participant shall report to each counterparty that does not choose to require segregation of Initial Margin pursuant to § 23.601(a), no later than the fifteenth business day of each calendar quarter, on whether or not the back office procedures of the swap dealer or major swap participant relating to margin and collateral requirements were, at any point during the previous calendar quarter, not in compliance with the agreement of the counterparties.

(b) The obligation specified in paragraph (a) of this section shall apply with respect to each counterparty no earlier than the 90th calendar day after the date on which the first swap is transacted between the counterparty and the swap dealer or major swap participant.

PART 190—BANKRUPTCY

3. 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.

4. Amend § 190.01(k) to read as follows:

§ 190.01 Definitions.

* * * * *

(k) *Customer* shall have the same meaning as that set forth in section 761(9) of the Bankruptcy Code. To the extent not otherwise included, *customer* shall include the owner of a portfolio margining account carried as a futures account.

* * * * *

§ 190.02 [Amended]

5. In § 190.02, amend paragraphs (e)(1) and (f)(1)(i) by removing the words "the close of business on the fourth business day after the order for relief" and adding, in their place, the words "11:59 P.M. on the seventh day after the order for relief."

§ 190.06 [Amended]

6. In § 190.06, amend paragraph (g)(2)(i)(A) by removing the words "the close of business on the fourth business day after the entry of the order for relief" and adding, in their place, the words "11:59 P.M. on the seventh day after the order for relief"; and amend paragraph (g)(2)(ii) by removing the words "the close of business on the fourth business day after the order for relief" and adding, in their place, the words "11:59 P.M. on the seventh day after the order for relief".

7. Amend § 190.08 by redesignating paragraph (a)(1)(i)(F) as

§ 190.08(a)(1)(i)(G), and by adding a new paragraph (a)(1)(i)(F):

§ 190.08 Allocation of property and allowance of claims.

* * * * *

(a) * * *

(1) * * *

(i) * * *

(F) To the extent not otherwise included, securities held in a portfolio margining account carried as a futures account;

* * * * *

Issued in Washington, DC, on November 19, 2010, by the Commission.

David A. Stawick,

Secretary of the Commission.

Statement of Chairman Gary Gensler

Protection of Collateral of Counterparties to Uncleared Swaps; Treatment of Securities in a Portfolio Margining Account in a Commodity Broker Bankruptcy

I support the proposed rulemaking concerning protection of collateral of counterparties to uncleared swaps. The proposal includes important protections for end-users when entering into bilateral or customized swaps. The proposal follows the Congressional direction that end-users must have a choice to have any initial margin that they post with a swap dealer to be kept in a segregated account and with a third party custodian. The proposed rules would protect market participants while promoting the financial integrity of the marketplace. The proposal also includes necessary housekeeping details with regard to the Bankruptcy code.

[FR Doc. 2010–29831 Filed 12–2–10; 8:45 am]

BILLING CODE 6351–01–P

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Parts 1 and 301

[REG–100194–10]

RIN 1545–BJ52

Specified Tax Return Preparers Required To File Individual Income Tax Returns Using Magnetic Media

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking and notice of public hearing.

SUMMARY: This document contains proposed regulations relating to the requirement for "specified tax return preparers," generally tax return preparers who reasonably expect to file more than 10 individual income tax returns in a calendar year, to file individual income tax returns using magnetic media pursuant to section 6011(e)(3) of the Internal Revenue Code (Code). The proposed regulations reflect changes to the law made by the Worker, Homeownership, and Business Assistance Act of 2009. The proposed regulations affect specified tax return preparers who prepare and file individual income tax returns, as defined in section 6011(e)(3)(C). For calendar year 2011, the proposed regulations define a specified tax return preparer as a tax return preparer who reasonably expects to file (or if the preparer is a member of a firm, the firm's members in the aggregate reasonably expect to file) 100 or more individual income tax returns during the year, while beginning January 1, 2012 a specified tax return preparer is a tax return preparer who reasonably expects to file (or if the preparer is a member of a firm, the firm's members in the aggregate reasonably expect to file) 11 or more individual income tax returns in a calendar year. The proposed regulations are unrelated to and are not intended to address the requirements for obtaining a preparer tax identification number (PTIN) under section 6109. See the final regulations under section 6109 published in the **Federal Register** (75 FR 60309–01). This document also provides a notice of a public hearing on these proposed regulations.

DATES: Written or electronic comments must be received by January 3, 2011. Outlines of topics to be discussed at the public hearing scheduled for January 7, 2011 must be received by January 3, 2011.

ADDRESSES: Send submissions to: CC:PA:LPD:PR (REG–100194–10), room 5205, Internal Revenue Service, P.O. Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand-delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to CC:PA:LPD:PR (REG–100194–10), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW., Washington, DC 20224, or sent electronically via the Federal eRulemaking Portal at *http://www.regulations.gov* (IRS—REG–100194–10). The public hearing will be held in the auditorium, Internal Revenue Building, 1111 Constitution Avenue, NW., Washington, DC 20224.

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Keith L. Brau, (202) 622–4940; concerning submissions of comments, the hearing, and/or to be placed on the building access list to attend the hearing, Oluwafunmilayo Taylor of the Publications and Regulations Branch at (202) 622–7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collection of information contained in this notice of proposed rulemaking has been submitted to the Office of Management and Budget for review in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)). Comments on the collection of information should be sent to the Office of Management and Budget, Attn: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503, with copies to the Internal Revenue Service, Attn: IRS Reports Clearance Officer, SE:CAR:MP:T:T:SP, Washington, DC 20224. Comments on the collection of information should be received by January 3, 2011. Comments are specifically requested concerning:

Whether the proposed collection of information is necessary for the proper performance of the Internal Revenue Service, including whether the information will have practical utility;

The accuracy of the estimated burden associated with the proposed collection of information (*see below*) or of the certification contained under the heading "Special Analyses";

How the quality, utility, and clarity of the information to be collected may be enhanced;

How the burden of complying with the proposed collection of information may be minimized; and

Estimates of capital or start-up costs and costs of operation, maintenance, and purchases of service to provide information.

The collection of information in this proposed regulation is in § 301.6011–6(a)(4)(ii). This information can be used by tax return preparers and specified tax return preparers, if necessary, to demonstrate to the IRS that the related individual income tax returns filed in paper format were not required to be filed electronically pursuant to section 6011(e)(3) and § 301.6011–6. The collection of information is voluntary to obtain a benefit. The likely respondents are the individuals and small businesses who prepare individual income tax returns in exchange for compensation. It is estimated that 5 minutes of preparation time is needed for a tax return preparer to explain the purpose of the information and obtain it from the taxpayer in the manner prescribed by the IRS and 6 minutes for recordkeeping, consisting of maintaining a copy of the information submitted for the respondent's records.