PROTECTION OF CUSTOMER FUNDS

FREQUENTLY ASKED QUESTIONS

Version 3.0

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This document, first issued in February 2012, has been prepared by members of the FIA Law and Compliance Division and contains questions and answers addressing the basics of (i) segregation, collateral management and investments, (ii) minimum financial and other requirements for futures commission merchants (FCMs) and joint FCM/broker-dealers, and (iii) derivatives clearing organization (DCO) guarantee funds.
By Federal Register Release dated November 14, 2013, the Commodity Futures Trading Commission (Commission) promulgated a package of rules and rule amendments designed to enhance the protections afforded customers and customer funds held by FCMs and DCOs. (78 Fed.Reg. 68506). The Frequently Asked Questions set out herein have been revised, as necessary, to reflect these enhanced customer protection rules. Except as may be noted herein, the enhanced customer protection rules were generally effective January 13, 2014.

GLOSSARY

As used herein, the following terms have the meaning set forth below:

30.7 Account means any account maintained by an FCM for or on behalf of 30.7 Customers to hold money, securities, or other property to margin, guarantee, or secure foreign futures or foreign option positions, and all money, securities, or other property accruing to 30.7 Customers as a result of foreign futures and foreign option positions.

30.7 Customer means any person that trades foreign futures or foreign options through an FCM, other than an owner or holder of a proprietary account of such FCM.

30.7 Customer Funds means any money, securities, or other property received by a futures commission merchant from, for, or on behalf of 30.7 Customers to margin, guarantee, or secure foreign futures or foreign option positions, or money, securities, or other property accruing to 30.7 Customers as a result of foreign futures and foreign option positions. 30.7 Customer Funds are also sometimes referred to as the ***Foreign Futures and Foreign Options Secured Amount.***

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Cleared Swap means any swap that is, directly or indirectly, submitted to and cleared by a derivatives clearing organization registered with the Commission.

Cleared Swaps Customer means any person that trades Cleared Swaps through an FCM, other than an owner or holder of a proprietary account of such FCM.

Cleared Swaps Customer Account means any account for the Cleared Swaps of Cleared Swaps Customers and associated Cleared Swaps Customer Collateral that an FCM maintains on behalf of Cleared Swaps Customers, or a DCO maintains for FCMs on behalf of such FCMs' Cleared Swaps Customers.

Cleared Swaps Customer Collateral means all money, securities, or other property received by an FCM or by a DCO from, for, or on behalf of a Cleared Swaps Customer to margin, guarantee, or secure a Cleared Swap, and money, securities, or other property accruing to Cleared Swaps Customers as a result of Cleared Swaps.

Customer Funds means, collectively, Customer Segregated Funds, Cleared Swaps Customer Collateral and 30.7 Customer Funds.

Customer Account means, collectively, a Customer Segregated Account, a Cleared Swaps Customer Account and a 30.7 Account.

Customer Segregated Account means any account maintained by an FCM for or on behalf of Segregated Customers to hold money, securities, or other property to margin, guarantee, or positions entered into on or subject to the rules of a designated contract market, *i.e.*, a US futures exchange, and money, securities, or other property accruing to Segregated Customers as a result of such positions.

Customer Segregated Funds means all money, securities, or other property received by an FCM or by a DCO from, for, or on behalf of a Segregated Customer to margin, guarantee, or secure a positions entered into on a designated contract market, and money, securities, or other property accruing to Segregated Customers as a result of such positions.

Designated Self-Regulatory Organization (DSRO) means a self-regulatory organization that has been delegated the responsibility for monitoring and examining an FCM for compliance with the minimum financial and related reporting requirements of the self-regulatory organizations of which the FCM is a member, and for receiving the financial reports required by such minimum financial and related reporting requirements from such FCM.

Proprietary Account means, generally, an account carried on the books and records of an FCM for (i) the FCM, or (ii) an affiliate that, directly or indirectly, is controlled by or is under common control with, such FCM. For the avoidance of doubt, a Customer Account of an affiliate of the FCM which is carried by the FCM (either on an omnibus or fully disclosed basis) is a Customer Account and not a Proprietary Account.

Residual Interest means the amount of an FCM's own funds that the FCM holds in a Customer Account.

Segregated Customer means any person that trades futures or options on futures entered into on or subject to the rules of a designated contract market through an FCM, other than an owner or holder of a proprietary account of such FCM.

Targeted Residual Interest means an amount of the FCM's own funds that the FCM holds in a Customer Account that an FCM determines will reasonably ensure that the FCM will remain in compliance with the requirements of the Commodity Exchange Act ***(Act)*** and the Commission's rules relating to the protection of Customer Funds at all times.

I. Basics of Segregation

1. What accounts do FCMs)maintain for customers that trade futures, options on futures contracts and Cleared Swaps? What is the difference among the accounts?

FCMs may maintain up to three different types of accounts for customers, depending on the products a customer trades:

(i) a **Customer Segregated Account** for customers that trade futures and options on futures listed on US futures exchanges;

(ii) a **30.7 Account** for customers that trade futures and options on futures listed on foreign boards of trade; and

(iii) **a Cleared Swaps Customer Account** for customers trading swaps that are cleared on a DCO registered with the Commission.

The requirement to maintain these separate accounts reflects the different risks posed by the different products. Cash, securities and other collateral (collectively, **funds**) required to be held in one type of account, *e.g.*, the Customer Segregated Account, may not be commingled with funds required to be held in another type of account, *e.g.*, the 30.7 Account, except as the Commission may permit by order.[2]

Customer Segregated Account. Funds that Segregated Customers deposit with an FCM, or that are otherwise required to be held for the benefit of customers, to margin futures and options on futures contracts traded on futures exchanges located in the US, *i.e.*, designated contract markets, are held in a **Customer Segregated Account** in accordance with section 4d(a)(2) of the Act and Commission Rule 1.20. Customer Segregated Funds held in the **Customer Segregated Account** may not be used to meet the obligations of the FCM or any other person, including another customer.

All Customer Segregated Funds may be commingled in a single account, *i.e.*, an omnibus Customer Account, and held with: (i) a bank or trust company located in the US; (ii) a bank or trust company located outside of the US that has in excess of $1 billion of regulatory capital; (iii) an FCM; or (iv) a DCO. Such commingled account must be properly titled to make clear that the funds belong to, and are being held for the benefit of, the FCM's Segregated Customers. Unless a customer provides instructions to the contrary, an FCM may hold Customer Segregated Funds only: (i) in the US; (ii) in a money center country;[3] or (iii) in the country of origin of the currency.

An FCM must hold sufficient US dollars in the US to meet all US dollar obligations and sufficient funds in each other currency to meet obligations in such currency. Notwithstanding the foregoing, assets denominated in a currency may be held to meet obligations denominated in another currency (other than the US dollar) as follows: (i) US dollars may be held in the US or in money center countries to meet obligations denominated in any other currency; and (ii) funds in money center currencies[4] may be held

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[2] For example, in August 2012, the Commission issued an order authorizing ICE Clear Europe Limited, which is registered with the Commission as a DCO, and its FCM clearing members to hold in Cleared Swaps Customer Accounts Customer Funds used to margin both (i) Cleared Swaps and (ii) foreign futures and foreign options traded on ICE Futures Europe, and to provide for portfolio margining of such Cleared Swaps and foreign futures and foreign options. In a separate order issued in October 2012, the Commission authorized ICE Clear Europe and its FCM clearing members to hold in Customer Segregated Accounts Customer Funds used to margin both (i) futures and options on futures traded on ICE Futures US and (ii) foreign futures and foreign options traded on ICE Futures Europe, and to provide for portfolio margining of such transactions.

[3] Money center countries means Canada, France, Italy, Germany, Japan, and the United Kingdom.

[4] Money center currencies mean the currency of any money center country and the Euro.

in the US or in money center countries to meet obligations denominated in currencies other than the US dollar.

30.7 Account. Funds that **30.7 Customers** deposit with an FCM, or that are otherwise required to be held for the benefit of 30.7 Customers, to margin futures and options on futures contracts traded on foreign boards of trade, *i.e.*, **30.7 Customer Funds,** and sometimes referred to as the **foreign futures and foreign options secured amount,** are held in a **30.7 Account** in accordance with Commission Rule 30.7.

Funds required to be held in the 30.7 Account for or on behalf of 30.7 Customers may be commingled in an omnibus 30.7 Account and held with: (i) a bank or trust company located in the US; (ii) a bank or trust company located outside the US that has in excess of $1 billion in regulatory capital; (iii) an FCM; (iv) a DCO; (v) the clearing organization of any foreign board of trade; (vi) a foreign broker; or (vii) such clearing organization's or foreign broker's designated depositories. Such commingled account must be properly titled to make clear that the funds belong to, and are being held for the benefit of, the FCM's 30.7 Customers. As explained below, Commission Rule 30.7 restricts the amount of such funds that may be held outside of the US.

Cleared Swaps Customer Account.[5] Funds deposited with an FCM, or otherwise required to be held for the benefit of customers, to margin swaps cleared through a registered DCO, *i.e.*, **Cleared Swaps Customer Collateral,** are held in a **Cleared Swaps Customer Account** in accordance with the provisions of section 4d(f) of the Act and Part 22 of the Commission's rules. Funds required to be held in a Cleared Swaps Customer Account may be commingled in an omnibus account and held with: (i) a bank or trust company located in the US; (ii) a bank or trust company located outside of the US that has in excess of $1 billion of regulatory capital; (iii) a DCO; or (iv) another FCM. Such commingled account must be properly titled to make clear that the funds belong to, and are being held for the benefit of, the FCM's Cleared Swaps Customers.

[5] Cleared Swaps Customer Accounts are sometimes referred to as **LSOC Accounts**. LSOC is an acronym for "legally separated, operationally commingled."

2. What is the FCM's Residual Interest? What is the purpose of the FCM depositing its own money in a Customer Account and how does the FCM determine how much that deposit should be?

An FCM deposits a portion of its own funds in Customer Accounts as a buffer to assure that the FCM is always in compliance with the relevant provisions of the Act and Commission rules governing the segregation of Customer Funds. Such excess funds represent the FCM's Residual Interest in the Customer Account. All FCM excess funds are held for the exclusive benefit of the FCM's customers while held in a Customer Account.

Each FCM is required to have written policies and procedures regarding the establishment and maintenance of the FCM's Targeted Residual Interest in each Customer Account. In establishing its Targeted Residual Interest, the FCM's board of directors or senior management must take into consideration a number factors, including: (i) the nature of the FCM's customers, their general creditworthiness, and their trading activity; (ii) the type of markets and products traded by the FCM's customers and the FCM itself; (iii) the general volatility and liquidity of those markets and products; (iv) the FCM's own liquidity and capital needs; and (v) historical trends in Customer Funds balances and customer debits.[6]

Commission rules require an FCM to notify the Commission immediately whenever the amount of Residual Interest in any Customer Account falls below the FCM's Targeted Residual Interest for such Customer Account. The FCM is required to file a copy of each notice concurrently with its DSRO.

3. Are there any restrictions on an FCM's ability to withdraw its Residual Interest from a Customer Account?

Commission rules provide that, on any day, an FCM may not withdraw funds comprising its

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[6] Effective July 12, 2014, Commission rules will require that the analysis and calculation of the FCM's Targeted Residual Interest be described in writing with the specificity necessary to allow the Commission and the FCM's DSRO to duplicate the analysis and calculation and test the assumptions made by the FCM. The adequacy of the Targeted Residual Interest and the process for establishing the Targeted Residual Interest must be reassessed periodically by the FCM's senior management and revised as necessary.

As described in greater detail in the response to Question 11, below, the Commission posts on its website a monthly report providing certain non-confidential financial information concerning each registered FCM, including each FCM's Targeted Residual Interest in each type of Customer Account that the FCM maintains.

Residual Interest from any Customer Account, in a single transaction or a series of transactions, that are not made to or for the benefit of customers, if such withdrawal would exceed 25 percent of the FCM's Residual Interest in such account, as reported on the daily segregation report as of the previous business day, unless: (i) the FCM's chief executive officer, chief finance officer or other senior official knowledgeable about the FCM's financial requirements and financial position pre-approves in writing the withdrawal, or series of withdrawals; and (ii) the FCM files written notice of the withdrawal, or series of withdrawals, with the Commission and with its DSRO immediately thereafter.

The written notice must: (i) be signed by the chief executive officer, chief finance officer or other senior official; (ii) include a description of the reasons for the withdrawal or series of withdrawals; (iii) list the amount of funds provided to each recipient and each recipient's name; (iv) include the current estimate of the amount of the FCM's Residual Interest in the Customer Account after the withdrawal; and (v) contain a representation by the chief executive officer, chief finance officer or other senior official that, after due diligence, to such person's knowledge and reasonable belief, the FCM remains in compliance with the applicable segregation requirements after the withdrawal.

4. **Is a customer at risk if another customer defaults on its obligations to the FCM?**
Commission rules prohibit an FCM from using the funds of one customer to meet the obligations of another customer; an FCM must use its own funds to meet a defaulting customer's obligations to a DCO or clearing FCM. To this end, as discussed earlier, each FCM is required to have written policies and procedures regarding the establishment and maintenance of the FCM's Targeted Residual Interest, which acts as a buffer to assure that the FCM is always in compliance with the relevant provisions of the Act and Commission rules governing the segregation of Customer Funds.[7]

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[7] As discussed below, in order to monitor an FCM's compliance with the Customer Funds requirements, Commission rules require each FCM to calculate as of the close of business each business day, and submit to the Commission and the FCM's DSRO no later than Noon the following business day, a report that sets out (i) the amount of Customer Funds required to be held in the Customer Account, (ii) the amount of Customer Funds actually held in the Customer Account, and (iii) the FCM's Residual Interest in the Customer Account. Separate calculations are required for the Customer Segregated Accounts, the 30.7 Accounts and the Cleared Swaps Customer Accounts. Commission rules further require an FCM to notify the Commission and the FCM's DSRO immediately whenever (i) the amount of Residual Interest in any Customer Account falls below the FCM's Targeted Residual Interest for such account, or (ii) the FCM knows or should know that the total amount of funds on deposit in Customer Accounts is less than the amount required to be held in such accounts.

Nonetheless, if one or more customers of an FCM defaults on their obligations to the FCM and the loss is so great that, notwithstanding the application of the FCM's available own funds, there is a shortfall in the amount of Customer Funds required to be held in one or more Customer Accounts, the FCM will likely default and be placed into bankruptcy. In these circumstances, the Bankruptcy Code and Commission rules provide that, in the event of an FCM's bankruptcy, funds allocated to each account class — the Customer Segregated Account, the 30.7 Account, and the Cleared Swaps Customer Account — or readily traceable to an account class must be allocated solely to that customer account class. The Bankruptcy Code also provides that non-defaulting customers in an account class that has incurred a loss, *e.g.*, the Customer Segregated Account, will share in any shortfall, *pro rata*. However, customers whose funds are held in another account class that has not incurred a loss, *e.g.*, the 30.7 Account, will not be required to share in such shortfall. A shortfall in a customer account class may also make the transfer of the accounts of non-defaulting customers to another FCM more difficult.[8]

For this reason, an FCM's excess adjusted net capital, which is available to satisfy a defaulting customer's obligations to a DCO or clearing FCM, is one of the factors that a customer should consider carefully in selecting an FCM to carry the customer's account.

5. **How does the treatment of the Cleared Swaps Customer Account differ from the Customer Segregated Account in the event of an FCM's bankruptcy?**

The Part 22 Rules governing the treatment of Cleared Swaps Customer Collateral incorporate by reference many of the rules governing the treatment of Customer Segregated Funds. Nonetheless, the regulatory requirements for Cleared Swaps Customer Collateral differ in several important respects from the requirements applicable to Customer Segregated Funds. In particular, the Part 22 Rules are designed to provide Cleared Swaps Customers enhanced protection from fellow customer risk in the event of an FCM's bankruptcy.

As with Customer Segregated Funds and 30.7 Customer Funds, the Part 22 Rules permit an FCM to maintain Cleared Swaps Customer Collateral in an omnibus account, on its own books and at the relevant DCO. However, the FCM carrying the Cleared Swaps Customer Account

[8] As discussed in detail immediately below in response to Question 5, the treatment of the Cleared Swaps Customer Account differs from the treatment of the Customer Segregated Account in the event of the default of the FCM carrying the Customer Account.

must provide the FCM through which the FCM clears Cleared Swaps Customer transactions (if different) with sufficient information to identify each Cleared Swaps Customer within the omnibus account, the portfolio of positions held by each Cleared Swaps Customer and the margin required to support such positions. The clearing FCM must provide the same information to the DCO that clears the positions. The DCO is required to treat the value of the Cleared Swaps Customer Collateral required to margin each Cleared Swaps Customer's positions as belonging to such Cleared Swaps Customer.

In the event the default of one or more Cleared Swaps Customers leads to the failure of an FCM, the Part 22 Rules require the FCM to advise the FCM through which the FCM clears Cleared Swaps Customer transactions (if different) or the DCO of the identity of the defaulting Cleared Swaps Customer(s). The clearing FCM (if different) and the DCO are prohibited from applying funds in an omnibus Cleared Swaps Customer Account attributable to non-defaulting Cleared Swaps Customers to meet the shortfall owing to the clearing FCM (if different) or the DCO.[9] In contrast to this provision of the Part 22 Rules, the Commission's rules governing Customer Segregated Accounts do not prohibit a clearing FCM (if different) or a DCO, following application of all assets of the defaulting FCM available to the clearing FCM (if different) or DCO, from using the funds of non-defaulting Segregated Customers held by the DCO to meet the shortfall owing to the DCO.

It is important to understand that the Part 22 Rules do not fully protect Cleared Swaps Customers from all loss in the event of a shortfall in the Cleared Swaps Customer Account following the bankruptcy of an FCM. For example, the rules would not protect such Cleared Swaps Customers: (i) if the bankrupt FCM's books and records are inaccurate; (ii) in the event of a shortfall in the Cleared Swaps Customer Account arising from FCM fraud or mismanagement; or (iii) in the event a bankruptcy trustee incurs losses in liquidating collateral held in the Cleared Swaps Customer Account in which the FCM had invested in accordance with Commission Rule 1.25.

[9] The Part 22 Rules also provide that an FCM may transmit to a DCO any collateral posted by a Cleared Swaps Customer in excess of the amount required by DCO if: (i) the rules of the DCO expressly permit the FCM to transmit collateral in excess of the amount required by the DCO; and (2) the DCO provides a mechanism by which the FCM is able to, and maintains rules pursuant to which the FCM 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 DCO. A DCO would be prohibited from applying such excess funds attributable to non-defaulting Cleared Swaps Customers to meet the shortfall owing to the DCO.

6. **Why is an FCM prohibited from commingling Customer Funds held in the Customer Segregated Accounts, the 30.7 Accounts and Cleared Swaps Customer Accounts?**

30.7 Accounts. Because customers trading on foreign markets assume additional risks, the Commission generally does not permit funds held to margin foreign futures and foreign options transactions to be held in the same account as Customer Segregated Funds or Cleared Swaps Customer Collateral. Laws or regulations will vary depending on the foreign jurisdiction in which the transaction occurs, and funds held in a 30.7 Account outside of the US may not receive the same level of protection as Customer Segregated Funds. If the foreign broker carrying 30.7 Customer positions fails, the broker will be liquidated in accordance with the laws of the jurisdiction in which it is organized, which laws may differ significantly from the US Bankruptcy Code. Return of 30.7 Customer Funds to the US will be delayed and likely will be subject to the costs of administration of the failed foreign broker in accordance with the law of the applicable jurisdiction, as well as possible other intervening foreign brokers, if multiple foreign brokers were used to process the US customers' transactions on foreign markets.

If the foreign broker does not fail but the 30.7 Customers' US FCM fails, the foreign broker may want to assure that appropriate authorization has been obtained before returning the 30.7 Customer Funds to the FCM's trustee, which may delay their return. If both the foreign broker and the US FCM were to fail, potential differences between the trustee for the US FCM and the administrator for the foreign broker, each with independent fiduciary obligations under applicable law, may result in significant delays and additional administrative expenses. Use of other intervening foreign brokers by the US FCM to process the trades of 30.7 Customers on foreign markets may cause additional delays and administrative expenses.

To reduce the potential risk to 30.7 Customer Funds held outside of the US, Commission Rule 30.7 generally provides that an FCM may not deposit or hold 30.7 Customer Funds in permitted accounts outside of the US except as necessary to meet margin requirements, including prefunding margin requirements, established by rule, regulation, or order of the relevant foreign boards of trade or foreign clearing organizations, or to meet margin calls issued by foreign brokers carrying the 30.7 Customers' positions. The rule further provides, however, that, in order to avoid the daily transfer of funds from accounts in the US, an FCM may maintain in accounts located outside of the US an additional amount of up to 20 percent of the total amount of funds necessary to meet margin and prefunding margin requirements to avoid daily transfers of funds.

Cleared Swaps Customer Accounts. Similarly, because the rules regarding Cleared Swaps

Customer Collateral provide Cleared Swaps Customers enhanced protection from fellow customer risk in the event of an FCM's bankruptcy, Commission rules generally do not permit Cleared Swaps Customer Collateral from being held in the same account with Customer Segregated Funds (or 30.7 Customer Funds).[10]

7. How does an FCM segregate Customer Funds? Who oversees this process?

Customer Funds are required to be held in Customer Accounts at a bank or trust company, a DCO or another FCM (each, a **depository**).[11] In accordance with Commission rules, each account holding Customer Funds must be properly titled to identify it as holding Customer Funds and segregated as required by the relevant provisions of the Act and the Commission's rules.[12] Except as noted below, Customer Funds may not be commingled with the funds of any other person, including (and in particular) the carrying FCM. Each depository is required to provide the depositing FCM with a written acknowledgment that the depository was informed that such funds held in the Customer Account belong to customers and are being held in accordance with the Act and the Commission's rules.[13] Among other representations, the depository must acknowledge that it cannot use any portion of Customer Funds to satisfy any obligations that the FCM may owe the depository.[14]

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[10] Although FCMs are generally prohibited from commingling Customer Funds held in the Customer Segregated Accounts, the 30.7 Accounts and Cleared Swaps Customer Accounts, it should be noted that an FCM's agreement with its customers typically includes a provision that, at a minimum, authorizes the FCM to transfer from one account of the customer, *e.g.*, the Customer Segregated Account, to any other account of the customer, *e.g.*, the 30.7 Account, such excess funds as may be required to avoid a margin call in such other account.

[11] Certain assets that may be permitted to be maintained in Customer Accounts, *e.g.*, warehouse receipts, may be held by the FCM.

[12] Consequently, as explained earlier, an FCM must maintain separate Customer Segregated Accounts, 30.7 Accounts and Cleared Swaps Customer Accounts at a depository.

[13] An FCM is not required to obtain a written acknowledgment from a DCO that has adopted rules providing for the segregation of Customer Funds in accordance with the provisions of the Act and the Commission rules and orders promulgated thereunder.

[14] Except as explained in footnote 13 immediately above, a depository that holds Customer Funds must execute an acknowledgment letter in the form prescribed by the Commission in the enhanced customer protection rules. A copy of the letter must be filed with the Commission and the FCM's DSRO. Among other provisions, the depository must agree that that it will reply promptly and directly to any request for confirmation of account balances or any other information regarding or related to the Customer Account from authorized members of the Commission staff, or an appropriate representative of the FCM's DSRO. In addition, the depository will provide the Commission with the technological capability to obtain direct, read-only access to account and transaction information.

In order to monitor an FCM's compliance with the Customer Funds requirements, Commission rules require each FCM to calculate as of the close of business each business day, and submit to the Commission and the FCM's DSRO no later than Noon the following business day, a report that sets out (i) the amount of Customer Funds required to be held in the Customer Account, (ii) the amount of Customer Funds actually held in the Customer Account, and (iii) the FCM's Residual Interest in the Customer Account. Separate calculations are required for the Customer Segregated Accounts, the 30.7 Accounts and the Cleared Swaps Customer Accounts.

Commission rules require an FCM to notify the Commission immediately whenever (i) the amount of Residual Interest in any Customer Account falls below the FCM's Targeted Residual Interest for such account, or (ii) the FCM knows or should know that the total amount of funds on deposit in Customer Accounts is less than the amount required to be held in such accounts. The FCM is required to file a copy of each notice concurrently with its DSRO.

In addition, each FCM must submit a Segregated Investment Detail Report (**SIDR**) to the Commission and the FCM's DSRO on the fifteenth and last business day of each month listing the names of all banks, trust companies, FCMs, DCOs, or any other depository or custodian holding Customer Funds. This report must include: (1) the name and location of each entity holding Customer Funds; (2) the total amount of Customer Funds held by each entity; and (3) the total amount of Customer Funds, cash and investments that each entity holds.[15] The FCM must also indicate whether any such depository is affiliated with the FCM.[16]

Separately, DSRO rules require each FCM to instruct each depository, whether located in the US or outside the US, that holds Customer Funds to confirm to the DSRO all account balances daily. DSRO programs compare the daily balances reported by the depositories with the balances reported by the FCMs in their daily segregation reports. Any material discrepancies would generate an immediate alert.

[15] Separate reports are required for the Customer Segregated Accounts, the 30.7 Accounts and the Cleared Swaps Customer Accounts.

[16] As discussed below, certain non-confidential financial information, including a substantial portion of the information described herein, is available on either the Commission's website or NFA's website. Effective July 12, 2014, each FCM will be required to provide detailed financial information on its website.

Finally, an FCM's DSRO conducts periodic examinations of the FCM and, in connection with such examinations, confirms that Customer Funds are being held in properly designated accounts. The Commission may also conduct an examination of the FCM for this purpose.

8. Would a separate Customer Account maintained solely for the benefit of one customer allow such customer, in the event an FCM were to become insolvent, to avoid sharing *pro rata* in any shortfalls as required under the Bankruptcy Code?

No. In adopting rules for the protection of Cleared Swaps Customer Collateral, the Commission determined that any increased protection that might be provided by requiring an FCM to maintain separate accounts for each customer would be minimal. In particular, the Bankruptcy Code provides that non-defaulting public customers of an FCM will share in any shortfall in customer segregated funds *pro rata*. Under the existing segregation models, therefore, separate accounts would not allow a customer to avoid sharing *pro rata* in any shortfalls, as required under the Bankruptcy Code.[17]

Although the Commission has stated that an FCM may agree to maintain a third-party custodial account on behalf of a Cleared Swaps Customer, third-party custodial accounts would require an FCM to use its own capital to post initial margin with a DCO on behalf of a customer.[18] Consequently, such accounts may adversely affect an FCM's liquidity and would impose additional costs on customers. Importantly, as noted above, the Commission has emphasized that third-party custodial accounts do not provide any greater protection to customers in the event that an FCM fails when there is a shortfall in one or more Customer Accounts.

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[17] As discussed above, the Bankruptcy Code and Commission rules provide that funds allocated to each account class — the Customer Segregated Account, the 30.7 Account, and the Cleared Swaps Customer Account — or readily traceable to an account class must be allocated to that customer account class. Therefore, a loss arising from one account class, *e.g.*, the Customer Segregated Account, should not endanger Customer Funds held in the other account classes, *e.g.*, the 30.7 Account.

[18] It should be noted that, in May 2005, Commission staff prohibited the use of third-party custodial accounts on behalf of Segregated Customers and 30.7 Customers, except in limited circumstances. The staff expressed concern that such accounts "may create unnecessary confusion on the part of the customer and create the potential risk that third party custodial accounts might receive priority or preference over other customers in an FCM's bankruptcy proceeding, or at least cause additional administrative expenses to be incurred, in a manner inconsistent with the Commission regulations and regulatory objectives." 70 Fed.Reg. 24768, 24770 (May 11, 2005).

9. Are funds that comprise customer excess margin or the FCM's Residual Interest protected if the FCM becomes insolvent?

The Bankruptcy Code broadly defines customer property to mean cash, a security, or other property, or the proceeds of such cash, security or property received, acquired, or held by or for the account of the FCM from or for the account of a customer. Customer property is not limited only to the funds required by the relevant exchange or DCO to margin open contracts. Consequently, in the event of an FCM's insolvency, customer excess margin deposited with the FCM and the FCM's Residual Interest held in a Customer Segregated Account, a 30.7 Account or a Cleared Swaps Customer Account, as applicable, would be entitled to the same protections as margin that is required by a DCO.

The Commission's Part 22 Rules relating to the protection of Cleared Swaps Customer Collateral permit a DCO to establish a procedure pursuant to which a Cleared Swaps Customer's excess Cleared Swaps Customer Collateral, *i.e.*, Cleared Swaps Customer Collateral not required by the DCO to margin open positions, may be held by the DCO. The DCO must provide a mechanism by which the FCM is able to, and maintains rules pursuant to which the FCM 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 DCO. This process assures that, in the event of an FCM default, the DCO will not use the excess value attributed to one customer to meet the losses of another customer.

It should be noted that excess funds, wherever held, are subject to the *pro rata* distribution provisions of the Bankruptcy Code in the event of a shortfall in a defaulting FCM's Cleared Swaps Customer Account.

10. Is there insurance for any shortfall in Customer Funds?

There is no industry-wide insurance fund to compensate customers in the event of a shortfall in Customer Funds upon the insolvency of an FCM. However, the CME Group has established a $100 million fund to further protect US family farmers and ranchers who hedge their business in CME Group futures markets. The Family Farmer and Rancher Protection Fund will provide up to $25,000 to individual farmers and ranchers and $100,000 to co-ops that hedge their risk in CME Group futures markets as a means to help offset losses arising from the failure of a CME Group clearing member or other market participant.

11. What type of financial information concerning an FCM is publicly available?

Since March 2002, the Commission has posted on its website a monthly report providing certain non-confidential financial information concerning each registered FCM. Beginning with the month ending January 31, 2014, the report includes the following information: (i) the FCM's adjusted net capital; (ii) the FCM's required net capital; (iii) the FCM's excess net capital; (iv) the total amount of funds held in the Customer Segregated Account; (v) the amount of Customer Segregated Funds required to be segregated in accordance with section 4d(a) of the Act; (vi) the amount of excess held by the FCM in the Customer Segregated Account; (vii) the FCM's targeted Residual Interest for the Customer Segregated Account; (viii) the total amount of funds held in the 30.7 Account; (ix) the amount of 30.7 Customer Funds required to be held in the 30.7 Account; (x) the amount of excess funds held by the FCM in the 30.7 Account; (xi) the FCM's targeted Residual Interest for the 30.7 Account; (xii) the total amount of funds held in the Cleared Swaps Customer Account; (xiii) the amount of Cleared Swaps Customer Collateral required to be segregated in accordance with section 4d(f) of the Act; (xiv) the amount of excess held by the FCM in the Cleared Swaps Customer Account; (xv) the FCM's targeted Residual Interest for the Cleared Swaps Customer Account; and (xvi) the total amount of the FCM's retail foreign exchange obligation.

The report is created from financial reports that each FCM must file with the Commission within 17 business days following each month end and is generally posted on the Commission's website within six weeks following each month end. The reports may be found on the Commission's website at http://www.cftc.gov/MarketReports/FinancialDataforFCMs/index.htm.

NFA publishes similar financial information on its website with respect to each FCM. The FCM Capital Report provides each FCM's most recent month-end adjusted net capital, required net capital, and excess net capital. (Information for a twelve-month period is available.) In addition, NFA publishes twice-monthly a Customer Segregated Funds report, which shows for each FCM: (i) total funds held in Customer Segregated Accounts; (ii) total funds required to be held in Customer Segregated Accounts; and (iii) excess segregated funds, *i.e.*, the FCM's Residual Interest. This report also shows the percentage of Customer Segregated Funds that are held in cash and each of the permitted investments under Commission Rule 1.25. Finally, the report indicates whether the FCM held any Customer Segregated Funds during that month at a depository that is an affiliate of the FCM.

The report shows the most recent semi-monthly information, but the public will also have the ability to see information for the most recent twelve-month period. A 30.7 Customer Funds report and a Customer Cleared Swaps Collateral report provides the same information with respect to the 30.7 Account and the Cleared Swaps Customer Account.

The above financial information reports can be found by conducting a search for a specific FCM in NFA's BASIC system (http://www.nfa.futures.org/basicnet/) and then clicking on "View Financial Information" on the FCM's BASIC Details page.[19]

II. Collateral Management and Investments

12. Can a customer select the depository at which its funds are held? Can a customer find out which depositories an FCM uses to hold Customer Funds?

An FCM may agree to hold a portion of its Customer Funds at a depository selected by the customer, provided the FCM determines that the depository is otherwise an acceptable depository.[20] However, the customer must recognize that Commission rules provide that such funds must held in the name of the FCM for the benefit of its customers generally and not for the benefit of the requesting customer. Further, for operational efficiency, an FCM may limit the number of banks at which it maintains Customer Accounts. In the event of the FCM's bankruptcy and a shortfall in Customer Funds available for distribution, the requesting customer would receive no greater protection than all other customers of the FCM in the same account class.

[19] Effective July 12, 2014, each FCM must make the following financial information available on its website: (i) the daily Statement of Segregation Requirements and Funds in Segregation for the most current 12-month period; (ii) the daily Statement of Secured Amounts and Funds Held in Separate Accounts for 30.7 Customers for the most current 12-month period; (iii) the daily Statement of Cleared Swaps Customer Segregation Requirements and Funds in Cleared Swaps Customer Accounts for the most current 12-month period; (iv) a summary schedule of the FCM's adjusted net capital, net capital and excess net capital, reflecting balances as of the month-end for the 12 most recent months; (v) the Statement of Financial Condition, the Statement of Segregation Requirements and Funds in Segregation, the Statement of Secured Amounts and Funds Held in Separate Accounts for 30.7 Customers, the Statement of Cleared Swaps Customer Segregation Requirements and Funds in Cleared Swaps Customer Accounts, and all related footnotes to the above schedules that are part of FCM's most current certified annual report; and (vi) the Statement of Segregation Requirements and Funds in Segregation, the Statement of Secured Amounts and Funds Held in Separate Accounts for 30.7 Customers, and the Statement of Cleared Swaps Customer Accounts that are part of the FCM's unaudited Form 1-FR-FCM or FOCUS Report for the most current 12-month period.

[20] Effective July 12, 2014, each FCM must have written policies and procedures setting out a process by which the FCM will evaluate the depositories at which the FCM holds Customer Funds, including, at a minimum, documented criteria that any depository that will hold Customer Funds, including an entity affiliated with the FCM, must meet, including criteria addressing the depository's capitalization, creditworthiness, operational reliability, and access to liquidity.

Customer statements generally do not indicate where a customer's funds are held. However, upon request of a customer, an FCM should identify for the customer the depositories at which the FCM holds Customer Funds.[21]

13. Can a customer maintain its own custody account at the bank as long as it is in the name of the FCM?

Such an account would be similar in effect to a third-party custodial account. As discussed above, although third-party custodial accounts are permitted for Cleared Swaps Customer Accounts, they are not permitted for Customer Segregated and 30.7 Accounts.

14. If a customer does not trade foreign futures, can the customer require that the FCM hold all Customer Funds and collateral in the United States?

Assuming that the customer is located in the US and has deposited US dollars or securities denominated in US dollars to margin futures and options on futures contracts traded on US futures exchanges or Cleared Swaps, the FCM is required under Commission Rule 1.49 to hold such funds or securities in depositories located in the US and may not transfer funds outside of the US, except as a customer may otherwise instruct the FCM.

15. When an FCM opens a 30.7 Account with a foreign broker, what steps does the FCM take to protect those funds?

When an FCM opens a 30.7 Account with a foreign broker, the FCM obtains from the broker a written acknowledgment, as required by Commission Rule 30.7, pursuant to which the foreign broker confirms that it has been advised that the 30.7 Customer Funds are held for and on behalf of the FCM's 30.7 Customers and agrees that the funds will be held in accordance with the Act and

[21] Effective July 12, 2014, each FCM must prepare and make available on the FCM's website a disclosure document that provides customers with such information regarding the FCM's business, operations, risk profile and affiliates that would be material to the customer's decision to entrust funds and otherwise do business with the FCM. Among other information required to be provided, the FCM must describe its policies and concerning the choice of bank depositories, custodians and counterparties to permitted transactions under Commission Rule 1.25.

applicable Commission rules. In particular, the foreign broker confirms that such 30.7 Customer Funds will not be used to secure or guarantee the obligations of, or extend credit to, the FCM or any proprietary account of the FCM.[22]

In addition, Commission Rule 30.7 provides that an FCM must deposit 30.7 Customer Funds under the laws and regulations of the foreign jurisdiction that provide the greatest degree of protection to such funds. An FCM may not by contract or otherwise waive any of the protections afforded customer funds under the laws of the foreign jurisdiction.

16. Are there any special factors or risks that a customer should take into consideration before choosing to trade futures and options on futures contracts listed for trading on foreign boards of trade?

As with trading on US futures exchanges, the risk of loss in trading foreign futures and foreign options can be substantial. Consequently, a customer should carefully consider whether such trading is appropriate in light of the customer's financial condition and investment goals. Customers trading on foreign markets also assume additional risks and, therefore, should understand those risks before trading.

Customer Funds protections may be different. 30.7 Customer Funds used to margin transactions on foreign markets are deposited with a foreign broker or other permitted depository located outside of the US. Although an FCM is required to deposit Customer Funds under the laws and regulations of the foreign jurisdiction that provide the greatest degree of protection to such funds, it is important to understand that 30.7 Customer Funds held outside of the US to margin transactions on foreign boards of trade will not receive the same protections under the Act and the US Bankruptcy Code as Customer Segregated Funds or Cleared Swaps Customer Collateral. If the foreign broker carrying the US customers' positions fails, the broker will be

[22] A foreign broker that holds Customer Funds must execute an acknowledgment letter in the form prescribed by the Commission in the enhanced customer protection rules. A copy of the letter must be filed with the Commission and the FCM's DSRO. Among other provisions, the foreign broker must agree that that it will reply promptly and directly to any request for confirmation of account balances or any other information regarding or related to the 30.7 Account from authorized members of the Commission staff, or an appropriate representative of the FCM's DSRO. In addition, the foreign broker will provide the Commission with the technological capability to obtain direct, read-only access to account and transaction information. If an FCM opens a 30.7 Account directly with a foreign depository, the FCM must obtain a similar acknowledgment letter from the foreign depository.

liquidated in accordance with the laws of the jurisdiction in which it is located. If the foreign broker does not fail but the customer's US FCM fails, the return of the funds held outside of the US may nonetheless be delayed.

It is also important to understand that, in the event of an FCM's bankruptcy, 30.7 Customers comprise a single account class under the Bankruptcy Code and the Commission's Bankruptcy Rules. Therefore, if a US FCM were to fail and there was a shortfall in 30.7 Customer Funds arising from losses in one foreign jurisdiction, those losses would be shared *pro rata* by all 30.7 Customers, including customers that did not engage in trading in that jurisdiction.

A 30.7 Customer that chooses to effect transactions on foreign boards of trade, therefore, is encouraged to consider carefully the client assets protection regimes in the jurisdictions in which the customer's 30.7 Customer Funds will be held.

NOTE: Transactions on certain foreign boards of trade are cleared through a clearing organization that is registered with the Commission as a DCO. In these circumstances, funds held for or on behalf of customers to margin contracts executed on the foreign board of trade may not always be held in the 30.7 Account maintained by the FCM and clearing organization. Rather, at the request of the DCO and pursuant to Commission order, the funds deposited by customers to margin such transactions executed on the foreign board of trade and cleared by a registered FCM may be permitted to be held in a Customer Segregated Account under section 4d(a)(2) of the Act. In the event of the default of a US FCM, such funds will receive the same protections under the Act and the US Bankruptcy Code as funds held by a US FCM to margin transactions on US futures exchanges.

For example, pursuant to Commission order, certain futures contracts listed for trading on the ICE Futures Europe and cleared through ICE Clear Europe are treated as Customer Segregated Funds and held in a Customer Segregated Account.

Transactions on foreign boards of trade are not governed by US law. Transactions entered into on a foreign board of trade are governed by applicable foreign laws and regulations. Moreover, such laws or regulations will vary depending on the country in which the foreign futures or foreign options transaction occurs. Neither the Commission nor the National Futures Association regulates activities of any foreign board of trade, including the execution, delivery and clearing of transactions. Similarly, they have no the power to compel enforcement of the rules of a foreign board of trade or any applicable foreign laws.

Foreign brokers are not subject to US law. Generally, foreign brokers are not subject to the jurisdiction of the Commission or any other US regulatory body; nor is the Commission able to compel a foreign jurisdiction or foreign board of trade to enforce applicable foreign laws or regulations. It is especially important, therefore, that an FCM carefully choose the foreign broker that will carry and clear transactions executed on behalf of the FCM's customers. A customer may request an FCM to (i) identify the foreign brokers that will carry and clear its customers' transactions in the applicable foreign jurisdiction, and (ii) explain the criteria the FCM follows in selecting such foreign brokers, including any affiliates of the FCM.

NOTE: Pursuant to an exemption issued under Commission Rule 30.10, certain foreign brokers are authorized to solicit or accept orders directly from 30.7 Customers for execution on foreign boards of trade without being registered with the Commission as an FCM. Such foreign brokers consent to the jurisdiction of the US with respect to any activities of such foreign brokers otherwise subject to regulation under Part 30. Foreign brokers that have received an exemption from registration under Rule 30.10 are identified as such on NFA's Background Affiliation Status Information Center System (BASIC), which may be accessed at http://www.nfa.futures.org/basicnet/.

Foreign brokers that have received an exemption from registration under Commission Rule 30.10 are not authorized to solicit from customers located in the US orders for execution on a US futures exchange or transactions in Cleared Swaps.

The use of affiliates to carry and clear foreign transactions provides benefits but also presents risks. Provided the affiliate meets the criteria the FCM has established for depositories holding Customer Funds,[23] an FCM may use one or more affiliates to carry and clear transactions on foreign boards of trade, including in major markets such as the United Kingdom, Hong Kong and Singapore. A customer is encouraged to consider the risks as well as the benefits of effecting transactions on foreign boards of trade through the FCMs' affiliates.

[23] *See* footnote 14, above.

Many FCMs believe customers receive significant benefits if trades are executed through affiliated foreign brokers. FCMs will necessarily have far more information about an affiliated foreign broker, *e.g.*, its internal controls, investment policies, customer protection regime, finances and systems, and are better able to exert influence over an affiliated foreign broker. Customers, for their part, often prefer to deal with one integrated company, whose unified balance sheet and financial statement permit the customers to assess more easily the potential risk of trading through that FCM.

In addition, an FCM generally is able to provide services to its customers more efficiently and more effectively if trades are executed and cleared through one or more affiliates. An FCM and its affiliates customarily use the same systems, which permit straight-through processing of trades, thereby enhancing certainty of execution (including give-up transactions), facilitating reconciliations and reducing errors (or the time necessary to resolve errors). Straight-through processing also facilitates an FCM's ability to (i) manage the risks of carrying its customers' positions, and (ii) comply with position limit and large trader reporting requirements, both in the US and in foreign jurisdictions. Moreover, an FCM that executes transactions on foreign boards of trade through an affiliate may be able to offer certain value-added services, including a platform for direct access to certain markets and single currency margining.

Nonetheless, the use of affiliates also poses certain risks. Because the activities of a US FCM and its affiliates are integrated, the failure of one such entity may cause all of the affiliated companies to fail or be placed in administration within a relatively brief period of time. As is the case if an unaffiliated foreign broker were to fail, each of these companies would be liquidated in accordance with the bankruptcy laws of the local jurisdiction. 30.7 Customer Funds held with such entities would not receive the same protections afforded Customer Funds under the Act and the US Bankruptcy Code. If, on the other hand, a defaulting US FCM had cleared its 30.7 Customers' foreign futures and foreign options transactions through unaffiliated foreign brokers, the foreign broker likely would not have failed as a result of the FCM's failure, and the defaulting FCM's trustee in bankruptcy could have directed the foreign broker to liquidate all customer positions and return the balance to the trustee for distribution to customers.

In either case, however, in the event of the failure of a foreign broker, return of 30.7 Customer Funds to the US will be delayed and likely will be subject to the costs of administration of the failed foreign broker in accordance with the law of the applicable jurisdiction, as well as possible other intervening foreign brokers, if multiple foreign brokers were used to process the US customers' transactions on foreign markets.

17. What types of investments may an FCM make with Customer Segregated Funds? With 30.7 Customer Funds? With Cleared Swaps Customer Collateral?

Section 4d(a)(2) of the Act authorizes FCMs to invest Customer Segregated Funds in obligations of the United States, in general obligations of any State or of any political subdivision thereof, and in obligations fully guaranteed as to principal and interest by the United States. Section 4d(f) authorizes FCMs to invest Cleared Swaps Customer Collateral in similar instruments. Commission Rule 1.25 authorizes FCMs to invest Customer Segregated Funds, Cleared Swaps Customer Collateral and 30.7 Customer Funds in instruments of a similar nature. Commission rules further provide that the FCM may retain all gains earned and is responsible for investment losses incurred in connection with the investment of Customer Funds. However, the FCM and customer may agree that the FCM will pay the customer interest on the funds deposited.

Permitted investments include:

(i) Obligations of the United States and obligations fully guaranteed as to principal and interest by the United States (U.S. government securities);

(ii) General obligations of any State or of any political subdivision thereof (municipal securities);

(iii) Obligations of any United States government corporation or enterprise sponsored by the United States government (U.S. agency obligations);[24]

(iv) Certificates of deposit issued by a bank (certificates of deposit) as defined in section 3(a)(6) of the Securities Exchange Act of 1934, or a domestic branch of a foreign bank that carries deposits insured by the Federal Deposit Insurance Corporation;

(v) Commercial paper fully guaranteed as to principal and interest by the United States under the Temporary Liquidity Guarantee Program as administered by the Federal Deposit Insurance Corporation (commercial paper);

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[24] Obligations issued by the Federal National Mortgage Association or the Federal Home Loan Mortgage Association are permitted only while these entities operate under the conservatorship or receivership of the Federal Housing Finance Authority with capital support from the United States.

(vi) Corporate notes or bonds fully guaranteed as to principal and interest by the United States under the Temporary Liquidity Guarantee Program as administered by the Federal Deposit Insurance Corporation (corporate notes or bonds); and
(vii) Interests in money market mutual funds.

The duration of the securities in which an FCM invests Customer Funds cannot exceed, on average, two years.

An FCM may also engage in repurchase and reverse repurchase transactions with non-affiliated registered broker-dealers, provided such transactions are made on a delivery versus payment basis and involve only permitted investments. All funds or securities received in repurchase and reverse repurchase transactions with Customer Funds must be held in the appropriate Customer Account, *i.e.*, Customer Segregated Account, 30.7 Account or Cleared Swaps Customer Account. Further, in accordance with the provisions of Commission Rule 1.25, all such funds or collateral must be received in the appropriate Customer Account on a delivery versus payment basis in immediately available funds.[25]

18. Can a customer direct the investment of its funds or impose restrictions on their use?
A customer is not able to direct the investment of the Customer Funds it deposits with an FCM. Investments of Customer Funds are made on an omnibus basis and FCMs cannot identify specific investments for the benefit of specific customers.

19. Why does the FCM need the ability to pledge, hypothecate and re-hypothecate customer securities? What limitations are there on the FCM's ability to do so?
An FCM must have the ability to pledge, hypothecate and re-hypothecate customer securities in order to post such securities with a DCO to margin the customer's futures or Cleared Swaps transactions. Moreover, to the extent a customer posts securities as margin that are not permitted to be deposited with a DCO to margin the customer's positions, an FCM must have the ability to pledge, hypothecate and re-hypothecate such securities in order to convert customer-

[25] As described in response to Question 11, above, NFA publishes twice-monthly a report, which shows for each FCM, *inter alia*, the percentage of Customer Funds that are held in cash and each of the permitted investments under Commission Rule 1.25. The report also indicates whether the FCM held any Customer Funds during that month at a depository that is an affiliate of the FCM.

owned securities to securities that are accepted by the DCO. This process is commonly referred to as collateral transformation. Such transactions must be completed on a delivery versus payment **("DVP")** basis and will not be recognized as completed until the funds and/or securities are received by the custodian of the FCM's Customer Account. Therefore, the Customer Account will be fully collateralized at all times.

Finally, an FCM must have the authority to hypothecate and re-hypothecate securities in order to enter into repurchase and reverse repurchase transactions with permitted third-parties, *i.e.*, a bank or a broker-dealer, in accordance with the provisions of Commission Rule 1.25. In this latter regard, it is important to note that, as with collateral transformation transaction described above, all such repurchase and reverse repurchase transactions must be completed on a DVP basis; a transaction will not be recognized as completed until the funds and/or securities are received by the custodian of the FCM's Customer Account.

Because Customer Funds are held in an omnibus account, an FCM must have the authority to hypothecate and re-hypothecate the funds and securities of all customers whose funds are held in that account.

III. Basics of FCMs

20. What is the purpose of the FCM's capital requirement? Can it be used to cover a shortfall in Customer Funds?

The Commission's minimum financial requirements are designed to assure that FCMs are able meet their financial obligations in a regulated marketplace, including their financial obligations to customers in the event of an inadequacy in Customer Funds arising from the default of one or more customers, adverse market conditions, or for any other reason. As discussed above, Commission rules provide that an FCM is required to use its own capital to make up any deficiency, if the customer fails to have sufficient funds on deposit with the FCM to meet the customer's obligations. In the event an FCM's capital is insufficient to make up for the shortfall caused by one or more defaulting customers or for any other reason, non-defaulting customers (or all customers) should share in any loss *pro rata*.

The FCM's capital is also designed to assure that the FCM has the resources to maintain the infrastructure, *e.g.*, personnel, recordkeeping systems, risk management systems, and supervisory and compliance procedures, necessary to operate its business in accordance with applicable laws and rules for the protection of customers.

21. When are customers expected to meet margin calls? What are consequences if a customer fails to meet a margin call within the time prescribed?

As discussed above, if a customer does not have sufficient funds on deposit with the FCM to meet the DCO's margin requirements with respect to the customer's open positions, the FCM must use its own funds until the customer has met the FCM's margin call. In order to reduce the potential risk to the FCM and its other customers, therefore, institutional customers are generally expected meet margin calls by wire transfer within one business day following the trade date. An FCM may also require a customer to meet a margin call intraday.[26]

If a Customer Account has been undermargined for more than three business days, an FCM may only accept orders from the customer that reduce the risk of existing positions in the customer's account. In addition, an FCM generally is required to take a capital charge with respect to a Customer Account that has been undermargined for more than three business days. Notwithstanding this general rule, an FCM must take a capital charge with respect to cleared credit default swaps (CDS), if a customer does not meet a margin call within one business day[27] following the date on which the call is made.

IV. Joint FCM/Broker-Dealers

22. If an FCM is also a BD, is there a single capital pool or is there a separate capital requirement for each function?

If an FCM is also a broker-dealer, the FCM is required to maintain capital equal to or greater than the higher of its capital requirement as an FCM and its capital requirement as a broker-dealer. An FCM-broker-dealer, therefore, maintains a single pool of capital.

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[26] CME Group exchange rules provide that an FCM clearing member may require a customer to meet a margin call within one hour.

[27] Effective November 14, 2014, an FCM will be required to take a capital charge if the margin call has been outstanding more than one business day following the date on which the margin call is made. In addition, the FCM will be required to maintain Residual Interest at least equal to any margin deficits that have not been met by 6:00 pm (eastern) on the business day following trade date.

23. If a customer has a securities account and a futures account at a joint BD/FCM, is a customer permitted to leave the funds in the securities account but allow the FCM to count the funds as covering a futures margin call so that the funds will be covered by SIPC?

No. The Act and Commission rules require an FCM to hold funds deposited to margin futures and options on futures contracts traded on US designated contract markets in Customer Segregated Accounts. Similarly, FCMs must hold funds deposited to margin Cleared Swaps and futures and options on futures contracts traded on foreign boards of trade in a Cleared Swaps Customer Account or a 30.7 Account, respectively. In computing its Customer Funds requirements under the Act and relevant Commission rules, an FCM may only consider those Customer Funds actually held in the applicable Customer Accounts. In this regard, the Joint Audit Committee's Margins Handbook confirms that an FCM may not apply free funds in an account under identical ownership but of a different classification or account type (*e.g.*, securities, Customer Segregated, 30.7) to an account's margin deficiency. In order to be used for margin purposes, the funds must actually transfer to the identically-owned undermargined account.

V. DCO Guarantee Fund

24. Will a DCO's guarantee fund compensate a customer in the event the customer's FCM becomes insolvent and there is a shortfall in the Customer Account maintained by the insolvent FCM?

A DCO's guarantee fund does not compensate customers of a defaulting FCM for shortfalls that result in the *pro rata* sharing of losses among non-defaulting customers. The primary purpose of the guarantee fund is to meet the DCO's obligations to other clearing members arising from the default of the clearing member FCM. [28]

[28] LCH.Clearnet Limited and LCH.Clearnet LLC, in connection with their SwapClear services, provide for "VM segregation" in which the DCO's guarantee fund will be used to cover variation margin losses of Cleared Swaps Customers within a defaulting FCM's Cleared Swaps Customer Account.

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