

MEMO# 24737

November 26, 2010

CFTC Issues Proposals Related to Protection of Swap Customer Collateral

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TO: CLOSED-END INVESTMENT COMPANY COMMITTEE No. 27-10
ETF ADVISORY COMMITTEE No. 51-10
EQUITY MARKETS ADVISORY COMMITTEE No. 48-10
FIXED-INCOME ADVISORY COMMITTEE No. 32-10
SEC RULES COMMITTEE No. 58-10
SMALL FUNDS COMMITTEE No. 23-10 RE: CFTC ISSUES PROPOSALS RELATED TO
PROTECTION OF SWAP CUSTOMER COLLATERAL

The Commodity Futures Trading Commission has issued a proposal regarding the protection of collateral of counterparties to uncleared swaps and an advance notice of proposed rulemaking ("ANPR") on the treatment of collateral of cleared swaps customers. [\[1\]](#)

We will hold a conference call on Thursday, December 2, at 3:00 p.m. Eastern time to discuss the CFTC's proposal and ANPR and to determine whether ICI should comment. If you plan to participate on the call, please contact Ruth Tadesse by email at rtadesse@ici.org or by phone at 202-326-5836 to receive the dial-in information.

I. Proposal on Uncleared Swap Collateral

Section 724 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 ("Dodd-Frank Act") requires swap dealers and major swap participants to notify their swap counterparties of their right to segregate with an independent custodian any initial margin posted to guarantee their uncleared swaps. In implementing this requirement, the proposal would require that the custodian be independent of both the counterparty and the swap dealer or major swap participant and that there be a written custody agreement between the counterparties and the custodian. The proposal also would provide that segregated margin may only be invested pursuant to the CFTC's existing Rule 1.25 under the Commodity Exchange Act, which governs investment of customer property of futures customers. The proposal would not limit the types of collateral that a customer may post or

limit any commercial arrangements between the parties concerning allocation of any gains and losses from the investment of the counterparty's collateral.

In addition, the CFTC proposal would amend CFTC regulations concerning commodity broker bankruptcies. Specifically, it would clarify 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 the commodity broker liquidation provisions of the Bankruptcy Code. [2]

II. Advanced Notice of Proposed Rulemaking on Cleared Swap Collateral

The CFTC has issued an ANPR requesting comments on segregation of cleared swap collateral, in response to concerns raised at the CFTC's roundtable on segregation of swaps collateral about protection of commingled customer swap margin. Specifically, the CFTC has requested comments on the costs and benefits of various models for protecting swap customer collateral, including:

- individual segregation of each customer's collateral at the futures commission merchant ("FCM"), derivatives clearing organization, and custodian levels;
- commingling of collateral of multiple customers, but the value of each customer's collateral is treated on an individual basis;
- use of collateral of non-defaulting customers in the default of a FCM only after the derivatives clearing organization's default resources package is used (including the clearinghouse's own contribution and the clearing member-funded guarantee fund); and
- commingling of collateral of a FCM's customers on an omnibus basis, as in the current futures model.

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endnotes

[1] See CFTC Fact Sheet: Proposed Rule on Protection of Collateral of Counterparties to Uncleared Swaps, available at http://www.cftc.gov/ucm/groups/public/@newsroom/documents/file/ucs_factsheet.pdf, and CFTC Fact Sheet: Advanced Notice of Proposed Rulemaking on Protection of Cleared Swaps Customers Before and After Commodity Broker Bankruptcies, available at http://www.cftc.gov/ucm/groups/public/@newsroom/documents/file/cs_factsheet.pdf. Comments on the proposal are due to the CFTC within 60 days of publication in the Federal Register and comments on the ANPR are due to the CFTC within 45 days of publication in the Federal Register.

[2] These provisions distribute "customer property" to "customers" on the basis and to the extent of such customers' allowed net equity claims and in priority to all other claims, except expenses for the administration of such customer property.

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