

**MEMO# 29918**

May 17, 2016

## **CFTC Staff Issues Residual Interest Deadline Report**

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TO: DERIVATIVES MARKETS ADVISORY COMMITTEE No. 21-16 RE: CFTC STAFF ISSUES  
RESIDUAL INTEREST DEADLINE REPORT

On May 13th, the staff of the Commodity Futures Trading Commission (“CFTC”) issued a report (“Report”) on whether the deadline should be changed by which futures commission merchants (“FCMs”) must demonstrate compliance with the residual interest requirements under the CFTC’s futures rules. The staff concluded that the current deadline of 6:00 p.m. Eastern Time on the date of settlement should not be changed at this time. The Report, which is attached, [\[1\]](#) is summarized briefly below.

### **Background**

In late 2013, the CFTC adopted final rules to enhance protections provided to customers and customer funds held by FCMs. [\[2\]](#) As part of the final rules, the CFTC amended Regulation 1.22, which prohibits an FCM from using the funds of one customer to purchase, margin, secure or settle positions for another customer. The amendments require an FCM to maintain its own capital (“residual interest”) in customer segregated accounts in an amount equal to or greater than its customers’ aggregate undermargined amounts. [\[3\]](#) Regulation 1.22 defines the “residual interest deadline,” which is the time by which an FCM must ensure that the required residual interest amount is satisfied.

While the CFTC had proposed that FCMs would be required to meet the residual interest requirement “at all times,” in response to significant pushback from FCMs and others, the final rules established a phased-in compliance schedule for rule 1.22 under which the initial residual interest deadline was 6 p.m. Eastern Time on the date of settlement. [\[4\]](#) The final rules required, however, that the CFTC publish a report for public comment by May 16 of this year regarding the practicability of moving the deadline up to the time of settlement (or some other time of day), including whether and on what schedule it would be feasible to do so, and any associated costs and benefits of such potential alternatives. [\[5\]](#) The CFTC was also required to solicit public input and hold a roundtable prior to preparing the Report, which the CFTC held on March 2, 2016 (“Roundtable”).

# Report

The Report first discusses views expressed at the Roundtable. Roundtable participants expressed the view that the industry had adapted well to the current residual interest deadline, but that moving up the deadline further would likely create additional costs to end users and additional operational risks for FCMs without any commensurate benefit. Specific concerns with imposing an earlier deadline included that FCM customers would be required to pre-fund their margin or, alternatively, that FCMs and their customers would need to finance the increased residual interest obligations. The Report also states that Roundtable participants cited other of the enhanced customer protections implemented by the CFTC as mitigating the need to move up the residual interest deadline. One participant noted that in light of the absence of legally segregated operationally commingled (LSOC) protection in the futures markets, his firm would be unwilling to pre-fund margin.

The Report also discusses comment letters on the Roundtable, which expressed similar views. A number of Roundtable participants and an industry trade association in its comment letter stressed that the CFTC should consider the issue of whether to change the residual interest deadline in the context of the additional customer protections that are already in place and which mitigate operational risks at an FCM, including those adopted as part of the CFTC's customer protection rulemaking. Roundtable participants provided examples including: (1) minimum capital requirements for FCMs; (2) targeted residual interest requirements applicable to FCMs and the requirement for an FCM to notify its designated self-regulatory organization ("DSRO") if the residual interest goes below the designated targeted amount; (3) the requirement for FCMs to input their daily segregation calculations into a reporting system for monitoring; (4) DSROs' performance of daily checks of daily segregation reports using messages through the SWIFT payment system confirming depository bank balances; and (5) the reduction of the period for capital charges for margin deficiencies from three days to one. [6]

Based on information from the Roundtable and written comments, the CFTC staff concludes that it has no basis to believe that changing the residual interest deadline to the time of settlement or to some other time of day would be practicable for FCMs and their customers at this time. The staff states that it will continue to monitor the issues addressed by the Report, and that if it appears any changes to the residual interest deadline may be appropriate based on new or changed information, such proposed changes would be made through the rulemaking process.

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## endnotes

[1] Staff of the Commodity Futures Trading Commission, Residual Interest Deadline for Futures Commission Merchants (May 13, 2016), available at <http://www.cftc.gov/idc/groups/public/@newsroom/documents/file/residualinterestreport050616.pdf>. The CFTC staff requests any comments on the Report by June 13, 2016.

[2] Enhancing Protections Afforded Customers and Customer Funds Held by Futures Commission Merchants and Derivatives Clearing Organizations, Final Rule, 78 FR 68506 (Nov. 14, 2013).

[3] See 17 CFR 1.22(c)(3)(i).

[4] See 17 CFR 1.22(c)(5)(ii). Amended Rule 1.22 provided that if the CFTC didn't take action to change the residual interest deadline, the phased-in compliance period for the deadline would terminate automatically on December 31, 2018, and would shift to the time of settlement on the settlement date. The CFTC, however, removed the automatic termination date from the regulation on March 24, 2015. Residual Interest Deadline for Futures Commission Merchants, 80 FR 15507 (March 24, 2015).

[5] See 17 CFR 1.22(c)(5)(iii)(A).

[6] See Report, *supra* note 1, at nn. 25-27 and accompanying text.

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