

MEMO# 35231

April 6, 2023

CFTC Proposes to Codify No-Action Relief Regarding Treatment of Separate Accounts by FCMs

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TO: Derivatives Markets Advisory Committee RE: CFTC Proposes to Codify No-Action Relief Regarding Treatment of Separate Accounts by FCMs

On March 15, the Commodity Futures Trading Commission (CFTC) unanimously voted to propose Regulation 39.13(j) ("Proposed Rule"),^[1] which would permit futures commission merchants (FCMs) that are clearing members of derivatives clearing organizations (DCOs) to treat the separate accounts of a single customer as accounts of separate entities for purposes of CFTC Regulation 39.13(g)(8)(iii), which limits customer withdrawal of funds based on the amount of initial margin required for a customer's account.^[2] The Proposed Rule would largely codify the no-action position, and stated conditions, in CFTC Staff Letter No. 19-17,^[3] with certain modifications. This memorandum focuses on some of the key modifications.

Comments on the Proposal are due to the CFTC 60 days after publication in the Federal Register.

At this time, ICI does not plan to submit comments on the Proposal. If you have comments or concerns about the Proposal, however, please contact Nhan Nguyen (nhan.nguyen@ici.org) or Nico Valderrama (nvalderrama@ici.org).

Overview of the Proposed Rule

The Proposed Rule establishes certain conditions under which a DCO may permit a clearing FCM to treat the separate accounts of customers^[4] as accounts of separate entities in connection with the withdrawal of customer initial margin for purposes of Regulation 39.13(g)(8)(iii).^[5] Specifically, DCO may permit such separate account treatment if the clearing member's written internal controls and procedures permit it to do so, and the DCO requires its clearing members to comply with conditions specified in proposed Regulation 39.13(j)(1)-(14),^[6] which are substantially similar to the conditions specified in Letter No. 19-17.^[7] The Proposed Rule, however, would modify the conditions to, among other things, add:

- Reporting requirements for clearing members that are required to cease separate account treatment;
- An explicit process for clearing members to resume separate account treatment;
- Provisions designed to further clarify the no-action condition that separate accounts be on a one-business day margin call; and
- Contact verification requirements for clearing members where the customer of separate accounts has appointed a third-party as the primary contact to the clearing member.

Disbursements on a Separate Account Basis During Ordinary Course of Business and Reporting Requirements When Ceasing Separate Account Treatment

Among the proposed requirements for FCMs, [\[8\]](#) proposed Regulation 39.13(j)(1) specifies that a clearing FCM may only permit disbursements on a separate account basis during the "ordinary course of business." Similar to the conditions in Letter No. 19-17, proposed Regulation 39.13(j)(1) would specify events that are inconsistent with the ordinary course of business ("Specified Events"), such that the occurrence a Specified Event would require the clearing member to cease permitting disbursements on a separate account basis as to one or more specific customers, or as to all customer accounts, depending on the type of event.

Under proposed Regulation 39.13(j)(1), a clearing member must communicate to its DSRO and to any DCO of which it is a clearing member the occurrence of any Specified Event. Notably, the clearing member would need to make such communication promptly in writing, and no later than the next business day following the date on which the clearing member identifies or is informed that such event has occurred. [\[9\]](#)

Resuming Separate Account Treatment

Unlike Letter No. 19-17, proposed Regulation 39.13(j)(1) would provide an explicit process for clearing members to resume separate account treatment after having ceased permitting disbursements on a separate account basis due to the occurrence of a Specified Event. [\[10\]](#) Specifically, a clearing member may resume permitting such disbursements if it reasonably believes, based on new information, that the circumstances leading it to cease separate account treatment have been cured. The clearing member would have to provide to its DSRO and any DCO of which it is a clearing member a written notification stating that it will resume separate account treatment, and the factual basis and rationale for concluding that the circumstances leading it to cease such treatment have been cured.

One Business Day Margin Call Requirement

Similar to Letter No. 19-17, proposed Regulation 39.13(j)(4) provides that each separate account must be on a "one business day margin call" to ensure that margin shortfalls are timely corrected and that a customer's inability to meet a margin call is timely identified. The CFTC, however, proposes additional requirements to define "timely payment of margin" for this requirement to address the mechanics of international payment systems and reflect industry best practices among DCOs, clearing members, and customers.

Specifically, a "one business day margin call" issued by 11:00 a.m. ET on a US business day [\[11\]](#) would need to be met by the applicable customer by the close of the Fedwire Funds Service ("Fedwire") on the day it is issued, if margin is paid in US Dollars (USD) or Canadian Dollars (CAD). However, proposed Regulation 39.13(j)(4) also specifies that a one

business day margin call must be received by the applicable clearing member:

- By 12:00 p.m. ET on the next US business day after the margin call is issued, where margin is paid in fiat currencies other than USD, CAD, or Japanese Yen (JPY); and
- By 12:00 p.m. ET on the second US business day after the margin call is issued, where margin is paid in JPY.[\[12\]](#)

The CFTC additionally proposes to prohibit clearing members from contractually agreeing to delay calling for margin until after 11:00 a.m. ET on any given US business day, and from engaging in practices designed to circumvent proposed Regulation 39.13(j)(4) by causing such delay. Further, under the Proposal, a clearing member would not be in compliance if it contractually agrees to provide customers with periods of time to meet margin calls that extend beyond the time periods specified in this proposed regulation.[\[13\]](#)

Lastly, proposed Regulation 39.13(j)(4)(v) provides that a failure to deposit, maintain, or pay margin or option premium would not constitute a failure to comply with the requirements of proposed Regulation 39.13(j)(4), if such failure is due to unusual administrative error or operational constraints that a customer or investment manager acting diligently and in good faith could not have reasonably foreseen.[\[14\]](#) The CFTC also proposes a new reasonableness standard for a clearing member's determination that a failure to deposit, maintain, or pay margin or option premium is due to such administrative error or operational constraint.[\[15\]](#)

Contact Verification Requirements for Clearing Members Regarding Third-Parties

Similar to Letter No. 19-17, proposed Regulation 39.13(j)(11) provides that where the customer of separate accounts subject to separate treatment has appointed a third-party as the primary contact to the clearing member, the clearing member must obtain and maintain current contact information of an authorized representative(s) at the customer. The CFTC, however, proposes to also require the clearing member to take reasonable steps to verify that the authorized representative's contact information is accurate and that the person is in fact an authorized representative of the customer. The clearing member would be required to review and, if necessary, update such information no less than annually.

Nicolas Valderrama
Counsel

Notes

[\[1\]](#) Amendments to Derivatives Clearing Organization Risk Management Regulations to Account for the Treatment of Separate Accounts by Futures Commission Merchants (Mar. 15, 2023) ("Proposing Release"), available at <https://www.cftc.gov/media/8306/federalregister031523/download>.

[\[2\]](#) Under Regulation 39.13(g)(8)(iii), a DCO must require its clearing members to ensure that their customers do not withdraw funds from their accounts with such clearing members unless the net liquidating value plus the margin deposits remaining in the customer's account after the withdrawal would be sufficient to meet the customer initial margin requirements for the products or portfolios in the customer's account, which are cleared by the DCO.

[3] CFTC Staff Letter No. 19-17 (July 10, 2019) ("Letter No. 19-17"), available at [https://www.cftc.gov/csl/19-17/download.Letter 19-17](https://www.cftc.gov/csl/19-17/download.Letter%2019-17). Letter No. 19-17 was supplemented and extended by CFTC Staff Letter No. 20-28 (Sept. 15, 2020), and further extended by CFTC Staff Letters Nos. 21-29 (Dec. 21, 2021) and 22-11 (Sept. 15, 2022).

[4] The Proposed Rule uses only the term "customer" to avoid confusion (e.g., regarding the terms "owner" or "ownership," as used in Forms 40 and 102, or parts 17-20, or regarding the term "beneficial owner," as that term may be used by other agencies). By contrast, CFTC Letter No. 19-17 used the terms "beneficial owner" and "customer" synonymously, to refer to the customer that is financially responsible for an account at an FCM.

[5] The CFTC notes that the Proposed Rule is intended to provide an alternative means of achieving the risk management goals served by Regulation 39.13(g)(8)(iii). Thus, the Proposed Rule would not prohibit the application of portfolio margining or cross-margining treatment within a particular separate account. Proposing Release at 14.

[6] The CFTC explains that the Proposed Rule is also intended to establish a minimum set of risk-mitigating conditions that DCOs that wish to permit separate account treatment must require of their FCMs that choose to engage in such treatment, so nothing would preclude DCOs from setting more stringent conditions. Id. at 13-14.

[7] The proposed conditions are designed to ensure that clearing FCMs: (i) carry out such separate account treatment in a consistent and documented manner; (ii) monitor customer accounts on a separate and combined basis; (iii) identify and act upon instances of financial or operational distress that necessitate a cessation of separate account treatment; (iv) provide appropriate disclosures to customers regarding separate account treatment; and (v) apprise their designated SROs (DSRO) when they apply separate account treatment or an event has occurred that would necessitate cessation of separate account treatment. Id. at 13.

[8] For instance, consistent with Letter No. 19-17, proposed Regulation 39.13(j)(6) would also require a clearing member to record each separate account independently in its books and records. This proposed regulation, however, would additionally require a clearing member to treat each separate account of a customer independently from the customer's other separate accounts for purposes of determining whether a receivable from a separate account that represents a debit or deficit ledger balance may be included in the clearing member's current assets in computing its adjusted net capital required under Commission regulations.

[9] This contrasts with the condition under Letter No. 19-17, which stated only that "the occurrence of [an event that is inconsistent with ordinary course of business] should be communicated promptly to the FCMs' DSRO."

[10] The Proposing Release explains that by explicitly providing a process to resume separate account treatment, while requiring disclosure of the basis for doing so, the CFTC seeks to incentivize transparency between clearing members and their DSROs and DCOs with respect to (a) conditions at clearing members or customers that could indicate operational or financial distress, and (b) more generally, the risk management program at the clearing member.

[11] A "US business day" would mean weekdays not including Federal holidays (per 5 U.S.C. 6103). Moreover, a margin call issued after 11:00 a.m. ET on a US business day, or on a

Saturday, Sunday, or a Federal holiday, would be considered to have been issued before 11:00 a.m. ET on the next day that is a US business day.

[\[12\]](#) Proposed Regulation 39.13(j)(4)(iv) additionally provides that the relevant deadline for payments of margin in fiat currencies other than USD may be extended by up to one US business day, if payment is delayed due to a banking holiday in the jurisdiction of issue of the currency in which margin is paid. The CFTC "expects that clearing FCM risk management decisions, including the use of any extension under proposed Regulation 39.13(j)(4)(iv), will be made in consideration of a client's risk profile, market conditions, and other relevant factors, evaluated at the time the risk management decisions are made." Proposing Release at 31.

[\[13\]](#) Letter No. 19-17 states only that "[i]n no case can customers and FCMs contractually arrange for longer than a one business day period for a margin call to be met."

[\[14\]](#) Letter No. 19-17 states that "a failure to deposit, maintain, or pay margin or option premium due to administrative errors or operational constraints would not constitute a failure" to timely (i.e., as set out in the one-business-day margin call condition) deposit or maintain initial or variation margin that would place a customer out of the ordinary course of business.

[\[15\]](#) Specifically, the determination would need to be based on the clearing member's reasonable belief in light of information known to it, at the time it learns of the relevant administrative error or operational constraint.