



## U.S. COMMODITY FUTURES TRADING COMMISSION

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Division of  
Market Oversight

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Division of Market Oversight

### **Division of Market Oversight Guidance on Calculating Projected Operating Costs By Designated Contract Markets and Swap Execution Facilities**

The Division of Market Oversight (“Division”) of the Commodity Futures Trading Commission (“Commission”) is providing guidance (“Guidance”) regarding compliance by designated contract markets (“DCMs”) with the financial resources requirements of Section 5(d)(21) of the Commodity Exchange Act (“CEA”) and the Commission’s regulations thereunder, and compliance by swap execution facilities (“SEFs”) with the financial resources requirements of Section 5h(f)(13) of the CEA and the Commission’s regulations thereunder. Specifically, this Guidance addresses the calculation by DCMs and SEFs of their projected operating costs, pursuant to such financial resources requirements.<sup>1</sup>

Section 5(d)(21) of the CEA (“DCM Core Principle 21”) requires a DCM to have adequate financial, operational and managerial resources to discharge each of its responsibilities, and provides that a DCM’s financial resources will be considered to be adequate if their value exceeds the total amount that would enable the DCM to cover its operating costs for a one-year period, calculated on a rolling basis. The regulations that the Commission has adopted to implement DCM Core Principle 21 include Commission Regulation 38.1101(a), which states that a DCM must maintain financial resources sufficient to enable it to perform its functions in compliance with the statutory core principles for DCMs and the Commission’s regulations thereunder, and that a DCM’s financial resources will be considered sufficient if their value is at least equal to a total amount that would enable the DCM to cover its operating costs for a period of at least one year, calculated on a rolling basis. Section 5h(f)(13) of the CEA (“SEF Core

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<sup>1</sup> This Guidance applies only to the calculation by a DCM or SEF of its projected operating costs as a DCM or SEF and solely with respect to its operation as a DCM or SEF and does not apply to derivatives clearing organizations (“DCOs”). An entity that is registered as both a DCM and DCO, or as both a SEF and DCO, must also satisfy the financial resources requirements for DCOs under Commission Regulation 39.11(a)(2) and demonstrate that it has sufficient financial resources to operate the single, combined entity. This Guidance does not apply to such dually registered entities. *See* Commission Regulation 38.1101(a)(3) for DCMs and Commission Regulation 37.1301(b) for SEFs.

Principle 13”), and Commission Regulation 37.1301(a) thereunder, establish analogous requirements for SEFs.<sup>2</sup>

Pursuant to Commission Regulations 38.1101(c) and 37.1303, DCMs and SEFs must, on a quarterly basis, make a reasonable calculation of their projected operating costs over a twelve-month period, in order to determine the amount needed to meet the above-described financial resources requirements. Commission Regulations 38.1101(c) and 37.1303 further provide that DCMs and SEFs “shall have reasonable discretion in determining the methodology used to compute such projected operating costs. The Commission may review the methodology and require changes as appropriate.”<sup>3</sup> The Commission has delegated to the Division the authority to review and make changes to the methodology used by a DCM or SEF to compute its projected operating costs.<sup>4</sup>

As noted above, Commission Regulations 38.1101(c) and 37.1303 require DCMs and SEFs to make “a reasonable calculation” of their projected operating costs. The Division is issuing this Guidance in order to provide further clarity to DCMs and SEFs regarding this requirement. Division staff has had a number of discussions over the past several months with various DCMs and SEFs regarding their calculations of projected operating costs and the expenses that must be included in such calculations. Staff’s review of the DCM and SEF quarterly financial reports, as described more fully below, also indicates that there is a need for additional clarity regarding the expenses that such calculations must include.

The Division believes that a reasonable calculation of projected operating costs must include all expenses necessary for a DCM or SEF to discharge its responsibilities as a DCM or SEF in compliance with the CEA, the Commission’s regulations, and the DCM’s or SEF’s rulebook. Such a calculation should be based on the DCM’s or SEF’s current business model and current business volume, and should take into account any projected modification to, or projected increase or decrease in, business over the next 12 months.

The Division believes that it would be reasonable for a DCM or SEF not to include in its calculation of projected operating costs the following costs, as long as such costs are not triggered by any DCM or SEF regulatory requirement or responsibility under the CEA, Commission regulations, or the DCM’s or SEF’s rulebook: (1) costs attributable solely to sales,

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<sup>2</sup> SEF Core Principle 13 requires a SEF to have adequate financial, operational and managerial resources to discharge each of its responsibilities, and provides that a SEF’s financial resources will be considered to be adequate if their value exceeds the total amount that would enable the SEF to cover its operating costs for a one-year period, calculated on a rolling basis. Commission Regulation 37.1301(a) states that a SEF must maintain financial resources sufficient to enable it to perform its functions in compliance with the statutory core principles for SEFs, and that a SEF’s financial resources will be considered sufficient if their value is at least equal to a total amount that would enable the SEF to cover its operating costs for a period of at least one year, calculated on a rolling basis.

<sup>3</sup> The Division notes that while these provisions provide DCMs and SEFs with reasonable discretion to determine the methodology used to compute their projected operating costs, for purposes of determining their financial resources requirements, DCMs and SEFs are nonetheless required to calculate the value of any capital used to satisfy such financial resources requirements in accordance with generally accepted accounting principles, pursuant to Commission Regulation 38.1101(b) for DCMs and Commission Regulation 37.1302 for SEFs.

<sup>4</sup> See Commission Regulation 38.1101(g)(1)(ii) for DCMs and Commission Regulation 37.1307(a)(2) for SEFs.

marketing, business development, product development, or recruitment;<sup>5</sup> (2) compensation and related taxes and benefits for DCM or SEF employees whose functions are not necessary to meet the DCM's or SEF's regulatory responsibilities under the CEA, the Commission's regulations and the DCM's or SEF's rulebook; (3) costs for acquiring and defending patents and trademarks for DCM or SEF products and related intellectual property; (4) magazine, newspaper, and online periodical subscription fees; (5) tax preparation and audit fees; and (6) consistent with the Division's previous *Guidance on Calculating Projected Operating Costs by SEFs* (and to the extent not covered by item (2) above), the variable commissions that a voice-based SEF may pay to its employee-brokers, calculated as a percentage of transaction revenue generated by the voice-based SEF.<sup>6</sup>

The Division recognizes that, in the normal course of a DCM's or SEF's business, there may be expenses that are only partially attributable to the operation of the DCM or SEF in compliance with the CEA, Commission regulations or the DCM's or SEF's rulebook. For example, if an office of a DCM or SEF houses sales and marketing personnel, along with compliance personnel, then the rent for that office may be pro-rated in the DCM's or SEF's calculation of its projected operating costs to the extent the office is used by sales and marketing personnel. Common allocation methodologies include actual use, headcount, or square footage. A DCM or SEF may pro-rate such expenses as long as the DCM or SEF (i) maintains sufficient documentation that reasonably shows the extent to which an expense is not attributable to compliance with the CEA, Commission regulations or the entity's rulebook,<sup>7</sup> (ii) identifies the expense in its quarterly financial reports to the Commission, as a pro-rated expense, and (iii) provides in such quarterly financial reports a sufficient explanation of why such expense was pro-rated.

The Division also notes that a parent entity may operate other subsidiaries in addition to a DCM or SEF, and that the parent entity may allocate shared expenses among its several subsidiaries (*e.g.*, a DCM or SEF may share employees that perform similar tasks for affiliated entities or office space with affiliated entities). In this situation, the Division believes it would be reasonable for a DCM or SEF, when calculating its projected operating costs, to pro-rate such shared expenses to the extent that an expense is attributable to and paid for by the DCM's or SEF's affiliated entities. A DCM or SEF may pro-rate such shared expenses as long as the DCM or SEF (i) maintains sufficient documentation that reasonably shows the extent to which the expense is attributable to and paid for by affiliated entities,<sup>8</sup> (ii) identifies the expense in its quarterly financial reports to the Commission as a pro-rated expense that is shared with affiliates,

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<sup>5</sup> For clarity, the costs listed in this item (1) include costs for travel, entertainment, events and conferences to the extent that such costs are not triggered by any DCM or SEF regulatory requirement or responsibility under the CEA, Commission regulations, or the DCM's or SEF's rulebook.

<sup>6</sup> See CFTC Letter 15-26, Division of Market Oversight Guidance on Calculating Projected Operating Costs by Swap Execution Facilities (Apr. 23, 2015).

<sup>7</sup> DCMs and SEFs may provide documentation, such as copies of service agreements, other legal documents, firm policies, audit statements or allocation methodologies, that reasonably show how expenses are not attributable to compliance with the CEA, Commission regulations or the DCM's or SEF's rulebook.

<sup>8</sup> DCMs and SEFs may provide documentation, such as copies of service agreements, other legal documents, firm policies, audit statements or allocation methodologies, that reasonably show how expenses are attributable to and paid for by the DCM's or SEF's affiliated entities.

and (iii) provides in such quarterly financial reports a sufficient explanation of why such expense was pro-rated.

Commission Regulations 38.1101(f)(1)(i) and 37.1306(a)(1) require each DCM and each SEF to report to the Commission, each fiscal quarter and upon request, the amount of its financial resources requirements, as well as the value of each acceptable financial resource available to meet such requirements. Commission Regulations 38.1101(f)(3)(i) and 37.1306(c)(1) require each DCM and each SEF to provide the Commission with sufficient documentation explaining the methodology used to compute its financial resources requirements. The Division underscores that pursuant to Commission Regulations 38.1101(f)(3)(i) and 37.1306(c)(1), quarterly financial reports submitted by DCMs and SEFs to the Commission should make clear the methodology used by the DCM or SEF to compute its projected operating costs for purposes of determining the amount of its financial resources requirements, including by identifying any expense that has not been included (or has been pro-rated) in the computation and providing a sufficient explanation of why such expense was not included (or was pro-rated). The Division emphasizes that a DCM's or SEF's quarterly financial reports must provide sufficient information such that Division staff can reliably determine, without additional requests for information from the DCM or SEF, the sufficiency of a DCM's or SEF's financial resources, including whether the DCM or SEF has made a reasonable calculation of its projected operating costs. The Division will, pursuant to its delegated authority under Commission Regulations 38.1101(g)(1)(ii) and 37.1307(a)(2), review each quarterly financial report. To this end, Division staff will work with DCMs and SEFs to provide additional clarity or answer any questions or concerns regarding a DCM's or SEF's computation of its projected operating costs.

This Guidance supersedes any previous guidance issued by the Division on this particular matter to the extent that it is inconsistent with such guidance. This Guidance, and the positions taken herein, represent the views of the Division only and do not necessarily represent the views of the Commission or of any other office or division of the Commission. If you have any questions concerning this Guidance, please contact Nancy Markowitz, Deputy Director, Division of Market Oversight, at (202) 418-5453 or [nmarkowitz@cftc.gov](mailto:nmarkowitz@cftc.gov).

Sincerely,

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