



## U.S. COMMODITY FUTURES TRADING COMMISSION

Three Lafayette Centre  
1155 21st Street, NW, Washington, DC 20581  
Telephone: (202) 418-5430  
Facsimile: (202) 418-5547  
[aradhakrishnan@cftc.gov](mailto:aradhakrishnan@cftc.gov)

Division of Clearing and Risk

Ananda Radhakrishnan  
Director

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Interpretation  
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Division of Clearing and Risk

### Staff Interpretation Regarding Part 22

On February 7, 2012 the Commodity Futures Trading Commission (the “Commission”) published final rules implementing the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”) statutory provisions regarding the treatment of cleared swaps customer contracts (and related collateral) by futures commission merchants (“FCMs”) and derivatives clearing organizations (“DCOs”), and making conforming amendments to bankruptcy provisions applicable to commodity brokers under the Commodity Exchange Act (the “Final Rules”).<sup>1</sup> In approving those Final Rules, the Commission set a November 8, 2012 compliance date<sup>2</sup> for the Part 22<sup>3</sup> rules, which implement the statutory segregation requirements of Section 4d(f) of the Commodity Exchange Act (“CEA”)<sup>4</sup> for Cleared Swaps and Cleared Swaps Customer Collateral.

As market participants prepare to meet the Commission’s compliance date, the staff of the Division of Clearing and Risk (the “Division”) has been asked to interpret several Part 22 provisions. To assist in the understanding and application of the regulations set forth in Part 22, the Division is publishing this interpretive letter in a question and answer format.

#### *Definition of Cleared Swaps Customer Collateral*

#### **Question 1: What does Cleared Swaps Customer Collateral include?**

**Answer:** Cleared Swaps Customer Collateral is defined as “all money, securities, or other property received by [an FCM] or by a [DCO] from, for, or on behalf of a Cleared Swaps Customer, which money, securities, or other property: (i) is intended to or does margin,

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<sup>1</sup> See Protection of Cleared Swaps Customer Contracts and Collateral; Conforming Amendments to the Commodity Broker Bankruptcy Provisions, 77 FR 6336 (Feb. 7, 2012) (the “Adopting Release”).

<sup>2</sup> See 77 FR at 6362.

<sup>3</sup> 17 CFR Part 22.

<sup>4</sup> 7 U.S.C. § 6d(f).

guarantee, or secure a Cleared Swap; or (ii) constitutes, if a Cleared Swap is in the form or nature of an option, the settlement value of such option.”<sup>5</sup> Cleared Swaps Customer Collateral also includes “accruals” that are “incident to or result[] from a Cleared Swap,”<sup>6</sup> and thus includes *all* of a Cleared Swaps Customer’s property that margins, guarantees, or secures Cleared Swaps, regardless of whether the value of such collateral exceeds the Cleared Swaps Customer’s margin requirement as determined by its FCM or DCO.

### *Limitations on the Use of Cleared Swaps Customer Collateral*

#### **Question 2.1: Can an FCM post the Cleared Swaps Customer Collateral of one Cleared Swaps Customer to meet a margin call for another customer’s Cleared Swaps?**

**Answer:** No. FCMs are prohibited from “us[ing] or permit[ing] the use of, the Cleared Swaps Customer Collateral of one Cleared Swaps Customer to purchase, margin, or settle the Cleared Swaps or any other trade or contract of, or to secure or extend the credit of, any person other than such Cleared Swaps Customer.”<sup>7</sup> Where a Cleared Swaps Customer is undermargined,<sup>8</sup> then the FCM must ensure that, to the extent of such shortfall, its own money, securities, or other property – and not that of other Cleared Swaps Customers – is used to cover a margin call (whether initial or variation) attributable to that Cleared Swaps Customer’s portfolio of rights and obligations.<sup>9</sup>

#### **Question 2.2: Can a DCO or an FCM use one Customer’s Excess<sup>10</sup> to margin, secure, or guarantee the Cleared Swaps of another Cleared Swaps Customer?**

**Answer:** No. The limitation on the use of Cleared Swaps Customer Collateral in Part 22 applies to *all* money, securities, and other property, including Customer Excess. In addition, this prohibition applies even if such Customer Excess is generated solely because of a decrease in

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<sup>5</sup> 17 CFR 22.1.

<sup>6</sup> *Id.*

<sup>7</sup> 17 CFR 22.2(d)(1). To be clear, this restriction applies to the value of the Cleared Swaps Customer Collateral as opposed to restricting the use of identified assets. *Cf.* 17 CFR 22.15 (protecting “*the value of collateral required with respect to the portfolio of rights and obligations arising out of the Cleared Swaps intermediated for each Cleared Swaps Customer*”) (emphasis supplied); 22.2(e)(1) (permitting “invest[ment of] Cleared Swaps Customer Collateral in accordance with [regulation] 1.25.”).

<sup>8</sup> In this context, a Cleared Swaps Customer is undermargined to the extent that (a) the minimum margin requirement, attributable to that Cleared Swaps Customer’s portfolio of rights and obligations, at the DCO (for an FCM that is clearing such Cleared Swaps Customer’s positions directly) or at the Collecting FCM (for a Depositing FCM) exceeds (b) the customer’s net liquidating value, including securities posted at margin value.

<sup>9</sup> In this letter, the Division may refer to the Cleared Swaps Customer’s “portfolio of rights and obligations” as the Cleared Swaps Customer’s “positions.”

<sup>10</sup> Customer Excess is Cleared Swaps Customer Collateral that exceeds the Cleared Swaps Customer’s initial margin requirement at an FCM or DCO.

that Cleared Swaps Customer's initial margin requirements, or because of an increase in the margin value of the Cleared Swaps Customer's posted collateral.

**Question 2.3: Can a DCO use a decrease from one completed settlement cycle to the next in the initial margin requirement attributable to one Cleared Swaps Customer of an FCM to meet the initial margin requirement of another Cleared Swaps Customer of that FCM?**<sup>11</sup>

**Answer:** No. A DCO must, as part of its daily settlement cycle, calculate any shortfalls in the initial margin requirement allocated by the DCO to each Cleared Swaps Customer and issue a margin call to the applicable FCM for each of its Cleared Swaps Customers with a shortfall. Upon receipt of money, securities, or other property from the FCM to meet the margin call, the DCO is permitted to allocate ratably the value of the assets received among the Cleared Swaps Customers with margin shortfalls.<sup>12</sup> Further, unless informed otherwise by the FCM, a DCO should assume that the value of Cleared Swaps Customer Collateral attributed to each Cleared Swaps Customer is equal to the Cleared Swaps Customer's initial margin requirement at that DCO. Once the margin call has been met, any Unallocated DCO Customer Excess may be returned to the FCM, or in the event of a default, to the trustee for the estate of the FCM. It is within the DCO's discretion to establish by rule or procedure whether to return excess collateral upon request by an FCM or on a routine basis as part of their daily settlement cycle.

Notwithstanding the foregoing, if the DCO has money, securities, or other property that the FCM has informed the DCO belong to it, and not its Cleared Swaps Customers, the DCO may, to the extent permitted by its rules, make use of that FCM's money, securities, or other property to meet a margin call.

### *Treatment of Variation Margin*

**Question 3.1: What impact does Part 22 have on the payment and collection of variation margin?**<sup>13</sup>

**Answer:** The Commission's Part 22 regulations permit, but do not obligate, a DCO to net variation margin across an FCM's entire origin of Cleared Swaps Customers. In the event of an FCM default, those regulations continue to permit, but do not obligate, such variation margin netting. It is only when a settlement cycle completes that variation margin is allocated and credited on a customer-by-customer basis and becomes part of that Cleared Swaps Customer's Cleared Swaps Collateral.<sup>14</sup> Accordingly, at the completion of a settlement cycle, variation

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<sup>11</sup> The requirements set forth in this answer apply to Collecting FCMs, as well as to DCOs.

<sup>12</sup> The DCO must make this margin call regardless of how much Unallocated DCO Customer Excess may be on deposit with the DCO. See the text under Question 6.4 for the definition of Unallocated DCO Customer Excess.

<sup>13</sup> The answer to this question applies to both DCOs and Collecting FCMs.

<sup>14</sup> Under regulation 22.1, Cleared Swaps Customer Collateral is defined to "include accruals, *i.e.*, all money, securities or other property that [an FCM or DCO] *receives*, directly or indirectly, which is incident to or results from a Cleared Swap." In addition, regulation 22.15 states that the value of Cleared Swaps Customer Collateral

losses reduce the value associated with the Cleared Swaps Customer's positions, while variation gains that are credited but not withdrawn remain protected as Cleared Swaps Customer Collateral.

**Question 3.2: How are variation margin gains and losses allocated following the default of an FCM?<sup>15</sup>**

**Answer:** If a DCO elects to net variation margin following the default of an FCM, the first resource that the DCO should use to offset variation losses is the value of the Cleared Swaps Customer Collateral attributed to the defaulting FCM's Cleared Swaps Customers whose positions have generated variation losses following the close of the previous settlement cycle. Once that collateral has been depleted, the DCO, if it chooses to net variation margin, should offset any remaining losses on a pro rata basis against any variation margin gains generated by the positions of the defaulting FCM's Cleared Swaps Customers.<sup>16</sup> Any variation margin gains remaining after such pro rata netting should be attributed to the Cleared Swaps Customers of the defaulting FCM whose positions generated such gains following the close of previous settlement cycle. To the extent that a Cleared Swaps Customer's variation margin gains are used to offset the losses of other Cleared Swaps Customers, a Cleared Swaps Customer with such gains retains a claim against the estate of the defaulting FCM for the amount of variation margin gains that it did not receive.

A DCO may, through its own rules, elect to forego variation margin netting following the default of an FCM and credit variation margin gains to the Cleared Swaps Customers whose positions generate such gains. Such a practice would serve to decrease fellow customer risk. The DCO's risk management and default resources would, of course, need to accommodate this voluntarily assumed obligation.

***Commingling of Cleared Swaps Customer Collateral***

**Question 4: Can an FCM keep firm money, securities, or other property in the Cleared Swaps Customer Account at the DCO to timely meet all margin calls and other payment obligations to the DCO?**

**Answer:** Yes. Regulation 22.2(e)(3)(i) expressly permits an FCM to deposit its own money, securities, or other property into a Cleared Swaps Customer Account to ensure that it is always in compliance with regulation 22.2(f). In addition, regulation 22.3 requires DCOs to

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"collected" by the DCO or Collecting FCM must be treated as belonging to each Cleared Swaps Customer on an individual basis.

<sup>15</sup> The answer to this question applies to both DCOs and Collecting FCMs.

<sup>16</sup> In addition, the DCO may, by its rules, choose to apply other resources of the defaulting FCM (*e.g.*, the defaulting FCM's proprietary account or its default fund contribution) before netting variation.

physically separate the Cleared Swaps Customer Collateral it holds from, among other things, the property of any FCM.<sup>17</sup>

Regulation 22.3 does not conflict with regulation 22.2(e)(3)(i). When an FCM deposits its own money, securities or other property into the Cleared Swaps Customer Account at a DCO to ensure compliance with regulation 22.2(f), such money, securities, or other property is received by the DCO on behalf of the FCM's Cleared Swaps Customers, and therefore may be used by the DCO to meet the obligations of any Cleared Swaps Customer. Thus, because such money, securities, or other property is intended to margin, guarantee, or secure a Cleared Swap, by definition, that money, securities, or other property is "Cleared Swaps Customer Collateral" under regulation 22.1, and may therefore be held in the Cleared Swaps Customer Account.

### ***Reporting of Portfolio of Rights and Obligations***

#### **Question 5.1: When must an FCM submit reports regarding the portfolio of rights and obligations for each Cleared Swaps Customer arising from the Cleared Swaps that the FCM intermediates for its Cleared Swaps Customers?**

**Answer:** "At least once each Business Day," an FCM must "provide information to the relevant [DCO or Collecting FCM, as applicable,] sufficient to identify, for each Cleared Swaps Customer, the portfolio of rights and obligations arising from the Cleared Swaps that [such FCM] intermediates for such customer."<sup>18</sup> Further, each DCO is required to "[t]ake appropriate steps to confirm that the information it receives" regarding the portfolio of rights and obligations for each Cleared Swaps Customer "is accurate and complete" and is being provided by the FCM "on a timely basis."<sup>19</sup>

Thus, the reporting requirement set forth in Part 22 obligates an FCM to provide position-specific information, at least once each day, to each DCO or Collecting FCM, as applicable, that holds Cleared Swaps Collateral on behalf of the FCM's Cleared Swaps Customers. As noted in the Adopting Release, "DCOs [may] require by rule the collection of this information more frequently."<sup>20</sup> Moreover, by a parity of reasoning, DCOs may also permit the collection of this information more frequently, and accordingly, may act on the most up to date information received from the FCM.

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<sup>17</sup> 17 CFR 22.3(b)(2)(i). DCOs may, however, commingle Cleared Swaps Customer Collateral received from, or on behalf of, multiple Cleared Swaps Customers. See 17 CFR 22.3(c)(1).

<sup>18</sup> See generally 17 CFR 22.11.

<sup>19</sup> See 17 CFR 22.11(e).

<sup>20</sup> 77 FR at 6358.

**Question 5.2: Can a DCO receive Cleared-Swaps-Customer-position-specific information from a SEF, DCM, affirmation platform, or trading venue instead of directly from an FCM?**

**Answer:** Yes. The purpose of the position information collection requirement is to help ensure that the FCM and DCO have consistent Cleared-Swaps-position-specific information for each of the FCM's Cleared Swaps Customers with positions at that DCO. By DCO rule, a DCO may permit an FCM to, in effect, provide information regarding a Cleared Swaps Customer's positions from a SEF, DCM, affirmation platform, or trading venue, so long as two conditions are met. First, the FCM must provide confirmation that the information provided from one of these sources to the DCO regarding the Cleared Swaps Customers' positions is accurate. Second, the DCO must take appropriate steps to confirm the FCM's compliance.

**Question 5.3: What impact does a reporting error have on the finality of payments following the completion of a settlement cycle?**

**Answer:** Even in the event of a default, regulation 22.14 permits a DCO or Collecting FCM, as applicable, to rely on the Cleared Swaps Customer position information that is reported by, or on behalf of, an FCM.<sup>21</sup> A DCO or Collecting FCM is equally entitled to rely upon such reported information in the course of the daily settlement cycle, and to rely upon the FCM's compliance with regulation 22.2 in connection with its payments to the DCO or Collecting FCM. If a reporting error is discovered after the close of the daily settlement cycle, transactions that have been finalized may not be unwound and any corresponding payments that have been made or collected may not be clawed back.<sup>22</sup>

Nevertheless, a DCO must take appropriate steps to ensure that FCMs are accurately reporting the Cleared Swaps Customers' position information on at least a daily basis, and that it and its FCM members are complying with relevant Commission regulations, including regulations 22.2 and 22.15. Thus, if a DCO discovers that an FCM's reporting regarding its Cleared Swaps Customers' positions or Cleared Swaps Customer Collateral is inaccurate, it must take appropriate actions to remedy the FCM's deficiency and to ensure that future reporting is accurate.<sup>23</sup>

***Customer Excess Collateral***

**Question 6.1: Under what circumstances does Part 22 permit a DCO to accept Cleared Swaps Customer Collateral in excess of the initial margin requirements set by the DCO?**

**Answer:** DCOs are permitted, though they are not required, to accept and hold Cleared Swaps Customer Collateral in excess of the Cleared Swaps Customer's initial margin

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<sup>21</sup> See 17 CFR 22.14(g).

<sup>22</sup> See 11 U.S.C. § 546(e). The only exception to this "safe harbor" is in a case where there is an actual intent to hinder, delay, or defraud. See 11 U.S.C. § 548(a)(1)(a).

<sup>23</sup> See generally 17 CFR 22.11(e).

requirement at the DCO (“DCO Customer Excess”).<sup>24</sup> If the DCO elects to accept and hold such DCO Customer Excess (1) the DCO must have rules that “expressly permit the [FCM] to transmit” DCO Customer Excess, and (2) the DCO must “provide[] a mechanism by which the [FCM] is able to, and maintain[] rules pursuant to which the [FCM] is required to, identify each Business Day, for each Cleared Swaps Customer, the amount of [DCO Customer Excess].”<sup>25</sup> As a practical matter, the DCO should also track the amount of FCM money, securities, or other property in the DCO’s Cleared Swaps Customer Accounts for that FCM.

If a DCO does not expressly permit an FCM to transmit DCO Customer Excess, the FCM is not 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].”<sup>26</sup>

**Question 6.2: May a DCO, consistent with regulation 22.13(c)(2), require or permit an FCM to report the total collateral value<sup>27</sup> attributed to each Cleared Swaps Customer?**

**Answer:** Yes. Regulation 22.13(c)(2) states that, in order for an FCM to transmit excess collateral to a DCO, the DCO must, *inter alia*, require that the FCM “identify each Business Day, for each Cleared Swaps Customer, the amount of collateral posted in excess of the amount required by the [DCO].” As a practical matter, such excess may in fact be positive (*e.g.*, where the amount of funds posted by the customer is in excess of that required for the customer’s positions by the DCO) or negative (*e.g.*, where the amount of funds posted by the customer is less than that required for the customer’s positions by the DCO).

Since the DCO will calculate and record the amount of collateral required for each Cleared Swaps Customer of the FCM,<sup>28</sup> the excess will be the difference between the total collateral attributed to a Cleared Swaps Customer and the amount of collateral required for such Cleared Swaps Customer, and thus reporting of the total collateral value for a Cleared Swaps Customer is equivalent to reporting the DCO Customer Excess for that customer.

**Question 6.3: Where a DCO permits the posting of excess Cleared Swaps Customer Collateral, how are differences in haircuts, market values, and FX rates treated in an FCM’s daily report to the DCO?**

**Answer:** If a DCO permits (pursuant to regulation 22.13(c)) the posting of DCO Customer Excess, it will, depending upon the types of assets it accepts as collateral, need to

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<sup>24</sup> See 17 CFR 22.13(c). See also n.7 *supra*.

<sup>25</sup> *Id.*

<sup>26</sup> 17 CFR 22.13(c)(2).

<sup>27</sup> The term “total collateral value” is the value of collateral, after haircuts, attributable to a Cleared Swaps Customer.

<sup>28</sup> See 17 CFR 22.12(c).

address the issue of how to value those assets. A DCO is required to (i) use prudent valuation practices to value assets posted as margin, and (ii) apply appropriate haircuts to such assets.<sup>29</sup>

The Commission's regulations do not require FCMs to use the same haircuts, market values, and FX rates that are used by DCOs to value Cleared Swaps Customer Collateral. Accordingly, if permitted by the rules of the DCO, an FCM may report Cleared Swaps Customer Collateral value information to a DCO using its own haircuts, market values, and FX rates, as long as the DCO is able to determine how the FCM calculated the value of such collateral.

The Division recognizes that due to differences in haircuts, market values, and FX rates, it is possible that an FCM may calculate and report a value, after haircuts, for aggregate Cleared Swaps Customer Collateral that is different than that which the DCO calculates. The steps which a DCO will need to take in this circumstance depends upon whether or not the DCO's calculation (based on its own haircuts, market values and rates) of aggregate haircutted Cleared Swaps Customer Collateral that it is holding in a FCM's Cleared Swaps Customer Account at the DCO is greater than, or less than, the sum of the amounts of Cleared Swaps Customer Collateral the FCM reports for its customers.

Where the FCM seeks to allocate more value at the DCO to its Cleared Swaps Customers than the total value the DCO credits the FCM with having on deposit, including the FCM's own property, the DCO must reject the report. In the event that a report is rejected, the FCM must – and the DCO must require the FCM to – as promptly as practicable, and in any event within the same Business Day<sup>30</sup> – resolve the discrepancy, either by correcting the report, or by depositing additional property with the DCO.<sup>31</sup>

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<sup>29</sup> See 17 CFR 39.13(g)(11), (12).

<sup>30</sup> Regulation 22.13(c)(2) states that a DCO must have rules requiring an FCM to “identify each Business Day, for each Cleared Swaps Customer, the amount of collateral posted in excess of the amount required by the [DCO].”

<sup>31</sup> The Division also recognizes that the Commission's regulations in Part 22 do not require a Depositing FCM to use the same haircuts, market values, and FX rates that are used by the Collecting FCM. Accordingly, if permitted by a Collecting FCM, a Depositing FCM may report Cleared Swaps Collateral information using its own haircuts, market values, and FX rates. In the event that a Collecting FCM permits this alternate valuation, such Collecting FCM must comply with the requirements set forth for DCOs in this answer.

**Question 6.4: How should a DCO that elects not to accept DCO Customer Excess treat excess that is created at the DCO?**

**Answer:** The Division recognizes that DCO Customer Excess may be created at a DCO in at least two ways. First, a Cleared Swaps Customer's initial margin requirement may decrease from the end of one settlement cycle to the next, in which event the amount of collateral attributable to that customer would exceed the amount of collateral required by the DCO to secure, margin, or guarantee that customer's Cleared Swaps positions. Second, the post-haircut value of the Cleared Swaps Customer Collateral held by the DCO for a Cleared Swaps Customer may increase from the end of one settlement cycle to the next, in which event the amount of collateral attributable to that customer would exceed the amount of collateral required by the DCO to secure, margin, or guarantee that customer's Cleared Swaps positions.

Nonetheless, if a DCO holds this generated DCO Customer Excess instead of passing the excess back to the Cleared Swaps Customer's FCM, the DCO would effectively be holding DCO Customer Excess. Because a DCO that does not affirmatively elect to accept and hold DCO Customer Excess would not be receiving daily Cleared Swaps Customer Collateral value reports for each of the FCM's Cleared Swaps Customers, the DCO would be unable to allocate such generated excess ("Unallocated DCO Customer Excess"). Moreover, although a DCO may hold Unallocated DCO Customer Excess as a Permitted Depository pursuant to regulation 22.4(a)(4), the DCO may not use any such Unallocated DCO Customer Excess to margin, guarantee, or secure the positions of any Cleared Swaps Customer. In the event of an FCM's default and bankruptcy, all such Unallocated DCO Customer Excess attributable to the defaulting FCM's Cleared Swaps Customers must be available to be returned to the estate of the FCM for allocation and distribution by the FCM's bankruptcy trustee pursuant to Subchapter IV of Chapter 7 of the U.S. Bankruptcy Code, Part 190 of the Commission's rules, and other applicable bankruptcy law.

***Determination of the Value of Cleared Swaps Customer Collateral in the Event of an FCM Default***

**Question 7.1: In the event of an FCM default, how is the value of Cleared Swaps Customer Collateral determined for the purpose of protecting Cleared Swaps Customers?**

**Answer:** Where a DCO *does not* elect to hold and accept DCO Customer Excess, the Commission's regulations in Part 22 do not require an FCM to report the value of Cleared Swaps Customer Collateral allocated to each of its Cleared Swaps Customers. Thus, the DCO will not know how much of the initial margin requirement for any Cleared Swaps Customer's positions might in fact have been provided by the FCM. In that event, the value that is protected for a Cleared Swaps Customer of the defaulting FCM is the initial margin requirement for that customer calculated as of the last completed settlement cycle, less any subsequent variation losses associated with that Cleared Swaps Customer's positions, plus any subsequent variation gains associated with such positions that have been credited,<sup>32</sup> unless updated data has been

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<sup>32</sup> As discussed in response to Question 3 above, variation gains may be subject to reduction because of netting.

provided by the defaulting FCM.<sup>33</sup> In the event that the Cleared Swaps Customer's positions are transferred while the Cleared Swaps Customer is in margin deficiency to the FCM, the trustee for the defaulting FCM's estate will have a claim against the customer for the amount of FCM funds that were used to meet the Cleared Swaps Customer's initial margin requirement and transferred.

Where a DCO *does* elect to hold and accept DCO Customer Excess, the value that transfers for a non-defaulting Cleared Swaps Customers of the defaulting FCM is the value, after application of any applicable haircuts, in the DCO's books and records that is assigned to the Cleared Swaps Customer Collateral of that customer, adjusted for subsequent variation losses and gains as discussed above. Any discrepancies between amounts attributed to a Cleared Swaps Customer on the books and records of the applicable DCOs and the amount of the Cleared Swaps Customer's net liquidating equity at a (bankrupt) FCM would be resolved as part of the bankruptcy claims process. If a Cleared Swaps Customer is in margin deficiency to the FCM, such that the FCM is using its own money, securities, or other property to meet the margin requirement at the DCO, then the protected value for that Cleared Swaps Customer is limited to the actual value of Cleared Swaps Customer Collateral that is assigned to that customer in the DCO's books and records.

**Question 7.2: In the event of an FCM default, what Cleared Swaps Customer Collateral is available to a DCO to cover losses?**

**Answer:** In the event of an FCM default, to the extent that Cleared Swaps Customers have losses, a DCO must first use the Cleared Swaps Customer Collateral that is attributable to the Cleared Swaps Customers with such losses (to the extent of such losses). As explained above, where a DCO *does not* choose to hold and accept DCO Customer Excess, the value attributable to the collateral of each Cleared Swaps Customer is the initial margin requirement for that customer calculated as of the last completed settlement cycle, unless updated data has been provided by the defaulting FCM. In contrast, where a DCO *does* choose to hold and accept DCO Customer Excess, the value attributable to the collateral of each Cleared Swaps Customer is the value, after application of any applicable haircuts, in the DCO's books and records that is assigned to the Cleared Swaps Customer Collateral of that customer.

To the extent that the Cleared Swaps Customer Collateral attributable to the Cleared Swaps Customers with losses is insufficient to cover such losses,<sup>34</sup> a DCO may use variation margin gains during that clearing cycle that are attributable to the positions of other Cleared

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<sup>33</sup> An FCM may choose to voluntarily report the value of Cleared Swaps Customer Collateral allocated to each of its Cleared Swaps Customers, even if the applicable DCOs have not elected to hold and accept DCO Customer Excess. In the event of the FCM's default, the Commission's regulations expressly permit DCOs and Collecting FCMs to rely on upon any information, including information that was voluntarily submitted by the defaulting FCM. *See generally* regulation 22.14(g).

<sup>34</sup> As noted above, a DCO may, by its own rules, choose to apply other resources of the defaulting FCM before netting variation. *See* n.16 *supra*.

Swaps Customers of the defaulting FCM. In the event that additional losses remain, a DCO would use its default resources in the order pre-determined by that DCO's rules.<sup>35</sup>

### ***Distribution of Liquidation Gains or Losses in a Default***

#### **Question 8.1: In the event of an FCM default, what effect does Part 22 have on the liquidation of Cleared Swaps Customer positions?**

**Answer:** In the event of an FCM default, DCOs and Collecting FCMs retain their right "to liquidate any or all positions in a Cleared Swaps Customer Account in the event of default of a clearing member or [Futures Commission Merchant]."<sup>36</sup>

#### **Question 8.2: In the event of an FCM default, what happens if the liquidation value of Cleared Swaps Customer Collateral is different than the haircutted value?**

**Answer:** It is possible that when a DCO or Collecting FCM, as applicable, liquidates non-cash Cleared Swaps Collateral or converts cash Cleared Swaps Collateral from one currency to another, that there will be gains and losses as compared to the haircutted value that was reflected on the DCO's or Collecting FCM's books and records prior to the default resulting from the actual liquidated value. Neither a DCO nor a Collecting FCM is required to maintain records reflecting the specific collateral owned by each of a defaulting FCM's individual Cleared Swaps Customers. Thus, in determining the value attributable to each Cleared Swaps Customer, the DCO or Collecting FCM must share any such gains or losses ratably among the Cleared Swaps Customers. By contrast, any customer claims of a Cleared Swaps Customer against the bankruptcy estate of the defaulting FCM will be based on the collateral actually owned by such customer.

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<sup>35</sup> As noted in Question 6.4 above, where a DCO *does not* elect to hold and accept DCO Customer Excess, Unallocated DCO Customer Excess may not be used to cover customer losses even though Unallocated DCO Customer Excess may include a defaulting FCM's money, securities, and other property. Rather, Unallocated DCO Customer Excess must be returned to the bankruptcy trustee of the defaulting FCM so that such excess may be allocated and distributed by the trustee in accordance with applicable bankruptcy laws and procedures.

<sup>36</sup> 17 CFR 22.15.

***Other Matters***

The information provided above is intended to assist in the understanding and application of the regulations set forth in Part 22. This letter represents the position of the Division only and does not necessarily represent the views of the Commission or those of any other division or office of the Commission. The Division may update this information periodically.

Should you have questions regarding this letter, please contact Robert Wasserman, Chief Counsel (rwasserman@cftc.gov, 202-418-5092), M. Laura Astrada, Associate Chief Counsel (lastrada@cftc.gov, 202-418-7622) or Kirsten Robbins, Attorney-Advisor (krobbins@cftc.gov, 202-418-5313).

Very truly yours,

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Ananda Radhakrishnan  
Director, DCR