



# Commodity Futures Trading Commission

## Office of Public Affairs

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### Fact Sheet and Q&A – Notice of Proposed Rulemaking Regarding Regulations to Address Margin Adequacy and to Account for the Treatment of Separate Accounts by Futures Commission Merchants

The Commodity Futures Trading Commission (“Commission” or “CFTC”) is withdrawing its April 14, 2023 notice of proposed rulemaking (“First Proposal”) regarding treatment of a customer’s separate accounts by a futures commission merchant (“FCM”) clearing member (“clearing FCM”) of a derivatives clearing organization (“DCO”) under its Part 39 DCO regulations, and proposing regulations under its Part 1 FCM regulations to require an FCM to ensure that a customer does not withdraw funds from its account with the FCM if the balance in the account after the withdrawal would be insufficient to meet the customer’s initial margin requirements (the “Margin Adequacy Requirement”) and, relatedly, permit an FCM, in certain circumstances and under certain conditions, to treat a customer’s separate accounts as accounts of separate entities for purposes of the Margin Adequacy Requirement (*i.e.*, separate account treatment) (“Second Proposal”). The Margin Adequacy Requirement, and requirements for separate account treatment, would be codified in new Regulation 1.44. The Commission is also proposing amendments to Regulations 1.3, 1.17, 1.20, 1.32, 1.58, 1.73, 22.2, 30.2, 30.7, and 39.13 to facilitate implementation of the requirements for separate account treatment and to correct certain inconsistencies in existing Commission regulations.

#### Background

Regulation 39.13(g)(8)(iii) provides that a DCO shall require its clearing members to ensure that their customers do not withdraw funds from their accounts with such clearing members if the withdrawal would result in a customer initial margin shortfall. On July 10, 2019, staff in the Division of Clearing and Risk (“DCR”) and the Division of Swap Dealer and Intermediary Oversight (later renamed Market Participants Division (“MPD”)) issued CFTC Letter No. 19-17, which included a no-action position providing that DCOs may permit clearing FCMs to treat the separate accounts of a single customer as accounts of separate entities for purposes of Regulation 39.13(g)(8)(iii), provided the clearing FCM’s written internal controls and procedures require it to, and it in fact does comply, with certain risk-mitigating conditions.

Separate account treatment may be desirable for, among others, certain institutional customers who may allocate assets to investment managers, under investment management agreements that require each investment manager to invest a specified portion of the customer’s assets under management in accordance with an agreed trading strategy, independent of the trading that may be undertaken for the customer by the same or other investment managers acting on behalf of other accounts of the customer. In such situations, the investment manager may desire assurance that the portion of funds it has been allocated to manage is entirely available to the investment manager, and will not be affected by the activities of other investment managers who manage other portions of the customer’s assets and maintain separate accounts at the same FCM.

The First Proposal would have codified the no-action position by amending Regulation 39.13 to provide that, for purposes of Regulation 39.13(g)(8)(iii), a DCO could permit a clearing FCM to treat the separate accounts of a customer as accounts of separate entities if the clearing FCM’s written internal controls and procedures permitted it to do so, and the DCO required the clearing FCM to comply with certain requirements based on the no-action conditions. Following review of comments, the Commission determined to withdraw the First Proposal, and adopt in its place this Second Proposal which, consistent with feedback from commenters, proposes to codify the no-action position in Part 1 by, in proposed Regulation 1.44, applying directly to FCMs a Margin Adequacy Requirement similar to that of Regulation 39.13(g)(8)(iii) and setting forth requirements for separate account treatment, and, in other provisions of Part 1, as well as Parts 22, 30, and 39, making supporting amendments to facilitate implementation of proposed Regulation 1.44 and correcting inconsistencies in regulatory text.

## Summary of Proposal

Proposed Regulation 1.44 would apply a Margin Adequacy Requirement and requirements for separate account treatment directly to FCMs whether they are clearing or non-clearing FCMs, whereas, under the First Proposal, requirements for separate account treatment would have been applicable only to clearing FCMs, and only indirectly, through the operation of DCO rules.

Proposed Regulation 1.44 would be comprised of eight subsections. Proposed Regulation 1.44(a) would define key terms for purposes of proposed Regulation 1.44. Proposed Regulation 1.44(b) would incorporate for all FCMs, and for all accounts, the Margin Adequacy Requirement that Regulation 39.13(g)(8)(iii) currently requires DCOs to apply to their clearing FCMs. Proposed Regulation 1.44(c) would provide that an FCM can engage in separate account treatment during the “ordinary course of business,” as defined in the proposed regulation. Proposed Regulation 1.44(d) would allow an FCM to elect separate account treatment for one or more customers. Proposed Regulation 1.44(e) sets forth events that would be inconsistent with the ordinary course of business, and contains requirements for FCMs related to cessation of separate account treatment upon the occurrence of such events and resumption of separate account treatment upon the cure of such events. Proposed Regulations 1.44(f), (g), and (h) contain requirements for FCMs that maintain separate accounts related, respectively, to the timing of margin payments; capital, risk management, and segregation calculation requirements with which FCMs would be required to comply with respect to accounts for which the FCM has elected separate treatment; and information and disclosures that such FCMs must provide.

Because proposed Regulation 1.44 contains a number of requirements (namely, computation requirements) that would affect how FCMs that apply separate account treatment comply with other Commission requirements, the Commission is proposing supporting amendments to those other regulations to facilitate implementation of proposed Regulation 1.44.

While the requirements for separate account treatment in the First Proposal largely mirrored the conditions for separate account treatment in CFTC Letter No. 19-17, the Commission modified some of those conditions to provide for greater specificity or to improve the condition’s risk-mitigating effect. As explained in the proposed rulemaking, and in the Q&A below, the Commission further modified certain requirements for separate account treatment in light of comments received.

## Proposed Rulemaking Q&A

### 1. Who would be affected by the proposed rule?

Proposed Regulation 1.44’s Margin Adequacy Requirement would apply to all FCMs. FCMs may elect, but are not required, to apply separate account treatment for one or more customers. Proposed Regulation 1.44’s requirements for separate account treatment would apply only to those FCMs that have elected to provide such treatment.

### 2. What would be the requirements for separate account treatment?

Proposed Regulation 1.44 provides that an FCM may engage in separate account treatment during the ordinary course of business, meaning the standard day-to-day operation of the FCM’s business relationship with its separate account customer. Proposed Regulation 1.44 defines events that are inconsistent with the ordinary course of business. Such events are generally events that would indicate financial or operational distress at an FCM or one or more of its separate account customers. The occurrence of such an event would require cessation of separate account treatment, although an FCM could resume separate account treatment if the circumstances triggering the event are cured.

An FCM that engages in separate account treatment would be required to observe a one business day margin call standard for separate accounts. Proposed Regulation 1.44 would generally require a margin call for a separate account to be made and met on a same-day basis; however, the proposed regulation contains additional provisions designed to address margin paid in foreign currencies that may be unable to be received on a same-day basis, as well as delays caused by foreign banking holidays, and a limited exception for failure to pay margin timely due to an unusual administrative error or operational constraint with respect to a specific separate account.

Additional requirements concern calculations for capital, risk management, and segregation, as well as recordkeeping. These requirements relate to existing requirements for FCMs in parts 1, 22, and 30 related, respectively, to futures customer accounts, Cleared Swaps Customer Accounts, and accounts of foreign futures and foreign options customers. These requirements generally seek to ensure that FCMs consistently treat separate accounts on a separate and independent basis for purposes of certain Commission regulations.

Lastly, FCMs would be required to comply with requirements related to collecting information from customers and investment managers related to the value of assets dedicated to separate accounts and the identity of the customer's parent company, if any; collecting contact information for customer representatives; provision of disclosures under the Commission's Part 190 bankruptcy regulations, related to treatment of separate accounts in the event of an FCM bankruptcy; and notifications for customers regarding the potential for losses related to separate account customers to affect segregated funds of the FCM's customers generally, in the event that such losses exceed the FCM's ability to cover them.

**3. What notifications are required under the proposed rule?**

Proposed Regulation 1.44 would require an FCM applying separate account treatment to make two notifications to its designated self-regulatory organization and the Commission in accordance with Regulation 1.12(n)(3):

- A one-time notification of the election to allow separate account treatment. An FCM would be required to make this notification the first time it begins applying separate account treatment for a customer. The FCM would not need to identify the specific customer for whom separate account treatment is provided or repeat the notification with respect to additional separate account customers.
- A notification regarding the occurrence of any of the enumerated events considered inconsistent with the ordinary course of business, and thus requiring cessation of separate account treatment. The notification must identify the event and, if applicable, the customer. The notification must be provided promptly in writing and in any case no later than the next business day following the date on which the FCM identifies or has been informed that such event has occurred.

**4. What are the differences between the First Proposal and Second Proposal with respect to requirements for separate account treatment?**

As explained in greater detail in the notice of proposed rulemaking, the Commission's Second Proposal makes a number of modifications to the requirements for separate account treatment included in the First Proposal, generally either as a result of the change in location of proposed codification from Part 39 to Part 1, comments received in response to the First Proposal, or further consideration and analysis by DCR and MPD staff. Several of the most substantive changes are described below.

- The First Proposal included a three-tiered framework for meeting a one business day margin call standard, specifying times by which a margin call must be met, depending on the currency in which margin is paid, either on a same-day, next business day, or next two business days basis. The Second Proposal retains the three-tiered framework, but eliminates specific time of day requirements with respect to making or meeting a margin call, and expands the list of currencies subject to a next two business days standard, set forth in proposed Appendix A to Part 1.

First Proposal	Second Proposal
Except as explicitly provided ... if the margin call is issued by 11:00 a.m. Eastern Time on a United States business day, it must be met by the applicable customer no later than the close of the Fedwire Funds Service on the same United States business day.	Except as explicitly provided in this paragraph (f), if, as a result of market movements or changes in positions on the previous business day, a separate account is undermargined (i.e., the undermargined amount for that account is greater than zero), the futures commission merchant shall issue a margin call for the separate account for at least the undermargined amount, and that call must be met by the applicable separate account customer no later than the close of the Fedwire Funds Service on the same business day.
Payment of margin in Japanese Yen shall be considered in compliance with the [one business day margin call standard] if received by the applicable clearing member by 12:00 p.m., Eastern Time, on the second United States business day after the business day on which the margin call is issued.	Payment of margin in currencies listed in Appendix A to this part shall be considered in compliance with the requirements of this paragraph (f) if received by the applicable futures commission merchant no later than the end of the second business day after the day on which the margin call is issued.
Payment of margin in fiat currencies other than U.S. Dollars, Canadian Dollars, or Japanese Yen shall be considered in compliance with the [one business day margin call standard] if received by the applicable clearing member by 12:00 p.m., Eastern Time, on the United States business day after the business day on which the margin call is issued.	Payment of margin in currencies listed in Appendix A to this part shall be considered in compliance with the requirements of this paragraph (f) if received by the applicable futures commission merchant no later than the end of the second business day after the day on which the margin call is issued.

- The First Proposal provided that a failure to deposit, maintain, or pay margin or option premium 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 does not constitute a failure to comply with the one business day margin call standard. The Second Proposal clarifies that such failure must be with respect to a specific separate account. The Commission adds this language to make clear that an “unusual administrative error or operational constraint” must be unusual as to a particular separate account, rather than the FCM’s business with respect to separate accounts as a general matter.
- The Second Proposal provides that if an election to apply separate account treatment for a separate account customer is revoked; *e.g.*, as a result of the occurrence of a non-ordinary course of business event, then the election may not be reinstated for 30 days following the revocation. The Commission proposes this “cooling off” period to ensure that FCMs will conduct a thorough review to confirm that the circumstances leading to cessation of separate account treatment have in fact been cured, and to discourage an FCM from toggling between separate account and non-separate account treatment for one or more separate account customers for purposes that would be inconsistent with such customers’ bona fide commercial purposes.

##### **5. What supporting amendments are included in the proposed rule?**

The proposed rule would make a number of changes to existing provisions in Parts 1, 22, 30, and 37 to facilitate implementation of separate account treatment. These changes generally do not add new requirements but rather modify existing requirements to accommodate proposed Regulation 1.44’s provisions for separate account treatment and to specify how FCMs are to comply with such requirements with respect to separate accounts. These changes include:

- Amendments to Regulation 1.17 to account for separate account treatment in calculation of risk margin, determining current assets and liabilities that the FCM may recognize and include in computing net capital, and determining funds required to meet maintenance margin requirements in computing adjusted net capital.
- Amendments to Regulations 1.32, 22.2, and 30.7 to account for separate account treatment in preparing daily segregation calculations and statements for futures customers, and provide that an FCM, in computing its segregation obligations, may offset a net deficit in a particular separate account customer’s separate account against the current value of any readily marketable securities held by the FCM for the separate customer account, provided such securities are held as margin collateral for the specific separate account in deficit.
- Amendments to Regulation 1.58 to provide that, where an FCM has established an omnibus account that is carried by another FCM, and the depositing FCM has elected separate account treatment, then the depositing FCM must calculate initial and maintenance margin separately for each separate account for purposes of Regulation 1.58(a)’s margin deposit requirements.
- Amendments to Regulation 1.73, containing risk management requirements for clearing FCMs, to provide that a non-clearing FCM that engages in separate account treatment shall comply with Regulation 1.73 with respect to accounts and separate accounts of separate account customers receiving separate treatment, as if the FCM were a clearing member of a DCO.
- Amendments to Regulation 39.13 to clarify that separate accounts of a separate account customer shall be treated as an account of a separate individual customer with respect to gross margin collection requirements in Regulation 39.13(g)(8)(i), and make clear that Regulation 39.13(g)(8)(iii)’s margin adequacy requirement continues to apply, except to the extent provided for in proposed Regulation 1.44.