

DIVISION OF CLEARING AND INTERMEDIARY OVERSIGHT

FINANCIAL AND SEGREGATION INTERPRETATION NO. 3-1

Interpretation Relating to Receivables Secured by Warehouse Receipts or Electronic Shipping  
Certificates or Secured by Commissions Withheld from Customer Account Executives

The net capital treatment that Commission Regulation 1.17<sup>1</sup> requires for certain secured receivables was addressed by the Division of Trading and Markets, the predecessor to the Division of Clearing and Intermediary Oversight (“Division”) in Financial and Segregation Interpretation No. 3 – Interpretation Relating to Secured Receivables, issued on May 9, 1979 (hereinafter, “Interpretation No. 3”). Interpretation No. 3 is hereby withdrawn and superseded in its entirety by this Financial and Segregation Interpretation No. 3-1, which the Division is issuing to provide more comprehensive guidance to futures commission merchants (“FCMs”) with respect to receivables arising from customer and noncustomer<sup>2</sup> financing described below, and which is secured by commodity warehouse receipts (“warehouse receipts”) or electronic shipping certificates (“shipping certificates”) deliverable for futures contracts on a designated contract market (“DCM”).<sup>3</sup> This Financial and Segregation Interpretation 3-1 also reconfirms the Division’s earlier interpretation as to receivables secured by commissions withheld from customer account executives.

**I. Background**

Subject to enumerated exceptions, *unsecured* receivables are excluded from current assets by FCMs and introducing brokers (“IBs”) in computing their adjusted net capital under Commission Regulation 1.17(c)(2). FCMs and IBs are permitted, however, to include *secured* receivables as current assets in computing adjusted net capital. For a receivable to be considered secured under Commission Regulation 1.17(c)(3), the receivable must be secured by readily marketable collateral that is otherwise unencumbered and can be readily converted into cash. In

---

<sup>1</sup> Commission regulations cited herein may be found at 17 C.F.R. Ch 1 (2010).

<sup>2</sup> The term noncustomer is defined in Regulation 1.17(b)(4), and refers generally to certain affiliates of the FCM.

<sup>3</sup> The Chicago Board of Trade, a DCM, has adopted rules to implement shipping certificates as the sole instrument of delivery for certain contracts traded on the exchange. These DCM rules include requirements for the applicable commodities and approved shippers, including requirements for letters of credit and/or or bond deposits of cash, treasuries, or other collateral from the shippers to the DCM.

addition, the FCM either must have possession or control of the collateral, or must have a perfected security interest in the collateral within the meaning of the laws of the state in which the collateral is located. Further, the amount of the receivable that is considered secured is limited to the market value of the collateral, less any applicable percentage deductions under Regulation 1.17(c)(5) (which specifies applicable net capital haircuts for various classes of assets).

## **II. Receivables Secured by Warehouse Receipts**

The Division has received an inquiry from the Joint Audit Committee regarding the proper net capital treatment of receivables secured by warehouse receipts. Such receivables may arise when an FCM finances a delivery on a futures contract for a customer or noncustomer, or when it makes a loan to its customer or noncustomer -- crediting the proceeds to the customer's or noncustomer's commodity futures trading account -- and the loan is secured by warehouse receipts that DCM rules permit the FCM to accept as margin.<sup>4</sup> Consistent with the preceding discussion concerning 1.17(c)(3), the Division notes that receivables from customers and noncustomers secured by warehouse receipts or shipping certificates may be classified as current assets, subject to the conditions and limitations described below:

- The warehouse receipt must be deliverable on a futures contract listed by a DCM, and also must be issued by a warehouse that is located within the United States and certified by a DCM for delivery on its futures contracts. A warehouse receipt that does not meet these conditions is not deemed readily marketable. These conditions, in addition to the existence of a ready market for the spot commodity underlying the receipt, help ensure that there are alternate methods of liquidating the warehouse receipt including the delivery of the warehouse receipt at the expiration of a futures contract for the commodity, or by factoring such receipt to a commercial entity. In particular, by requiring that the warehouse receipt be deliverable on a futures contract listed by a DCM,

---

<sup>4</sup> As noted in the original Interpretation No. 3, such secured lending or financing for customers and noncustomers occasionally has been confused with the treatment of "advances on cash commodities" addressed in Commission Regulation 1.17(c)(2)(ii)(A). The Division's guidance in this area has not changed since the prior interpretation, and remains as follows:

"For purposes of clarification, an advance on cash commodities would arise only in a situation where an FCM has entered into a contract to purchase cash commodities for future delivery and in connection with that contract makes an unsecured advance to the seller representing a portion of the purchase price."

the Division aims to ensure that the commodity underlying the warehouse receipt is of commercially desirable grade and quality and that appropriate financial, insurance, and internal control safeguards will be in place at the issuing warehouse, to provide additional assurance as to the consistency of value of such warehouse receipt.<sup>5</sup>

- Although shipping certificates differ from warehouse receipts in that they are not documents of title, liquidity concerns are abated in the following circumstances, and shipping certificates are deemed equivalent to warehouse receipts with respect to their net capital treatment when:
  - the FCM is financing deliveries for its customers or noncustomers, or loaning proceeds credited to a customer's or noncustomer's futures trading account, and shipping certificates deposited by the customer or noncustomer are used to secure the resulting receivable;
  - the shipping certificate is the sole instrument deliverable against the futures contract for which the delivery is financed or loan proceeds deposited to the customer's or noncustomer's account; and
  - the delivery rules of the exchange or derivatives clearing organization ("DCO") provide that should there be a failure to load out on a shipping certificate the exchange or DCO itself shall provide 100% market value in the form of cash and/or warehouse receipts to the holder of the shipping certificate.
- The warehouse receipt or shipping certificate must be owned legally and beneficially by the person from whom the receivable is owed and otherwise be unencumbered.

---

<sup>5</sup> The Commission previously has determined that a warehouse receipt being deliverable on a futures contract listed by a contract market provided additional assurance as to the value of inventory. In adopting an amendment to Regulation 1.17, the Commission described a comment recommending, for inventory covered by futures that "receipted (registered) inventory which meets the contract specifications of the underlying futures be allowed full market value (not subject to a safety factor)." In adopting an amendment to reduce the applicable charge, the Commission stated that it believed the comment had merit, and the rationale provided by the contract market was "that such receipted inventory is specifically required to meet contract specifications and is readily available for delivery on futures contracts. Additionally, there is the added assurance of deliverability from the registration and inspection requirements of the contract market which employs such a system." 43 Fed. Reg. 39956 at 39964 (Sept. 8, 1978).

- Receivables from customers and noncustomers secured by qualifying warehouse receipts or shipping certificates will be deemed secured only to the extent of their “collateral market value”, as defined below. Any outstanding amount of the receivable in excess of the collateral market value of the warehouse receipts or shipping certificates must be classified as a non-current asset, and therefore excluded from the FCM’s net capital.
- The collateral market value of the warehouse receipt or shipping certificate shall be the spot market value of the commodities represented by the warehouse receipts or shipping certificates, less a deduction in the same amount as the inventory haircut specified in Commission Regulation 1.17(c)(5)(ii). For uncovered inventory, the required haircut under Commission Regulation 1.17(c)(5)(ii)(C) is twenty percent (20%). If, however, the customer or noncustomer that owns and deposits a warehouse receipt or shipping certificate also holds futures positions in its trading account with the FCM that are covered by the warehouse receipt or shipping certificate, and that trading account also is collateral for the financed delivery or loan, the applicable inventory haircut under Commission Regulation 1.17(c)(5)(ii)(A) or (B) is permitted. Only the futures positions of the customer or noncustomer, and not the proprietary futures positions of the FCM, may serve as cover for the warehouse receipt or shipping certificate, because the FCM does not own the warehouse receipt or shipping certificate held as collateral.<sup>6</sup>

### **III. Warehouse Receipts Deposited as Margin or Performance Bond**

The Division is also clarifying the appropriate treatment of warehouse receipts and shipping certificates that have been deposited by the customer and accepted by the FCM as performance bond or margin for the customer’s regulated trading account. Such warehouse receipts and electronic shipping certificates are required to be held in segregated or secured amount accounts together with other property deposited as performance bond or margin, and are reported accordingly in the financial statements and schedules of the FCM’s Form 1-FR-FCM

---

<sup>6</sup> The FCM’s own proprietary futures positions may serve as cover for warehouse receipts and shipping certificates that are owned by the FCM. The inventory haircuts in Commission Regulation 1.17 apply to warehouse receipts owned by the FCM for cash commodities, and also apply to those shipping certificates owned by the FCM that meet the criteria described above, including being the sole instrument of delivery and subject to payment by the exchange or DCO upon failure of the shipper to load out. Shipping certificates owned by the FCM that do not meet such criteria are subject to the haircuts specified for fixed price commitments in Regulation 1.17(c)(5)(ii)(F) and (G).

financial report. However, CFTC Regulation 1.32 does not permit any debit deficit in a customer's regulated trading account to be reduced or offset by such warehouse receipts or shipping certificates.<sup>7</sup>

Any customer-owned warehouse receipt or shipping certificates that collateralizes a loan made by the FCM to the customer, the cash proceeds of which are actually deposited to the customer's regulated trading account, should not be included in the FCM's segregation requirement or as assets held in segregation. Such warehouse receipts or shipping certificates are being used to secure the loan, and not as performance bond or margin for the customer's regulated account.

#### **IV. Withheld Commissions**

Customer deficits normally represent debts of the customers to the FCM and are not the debts of those customers' account executives. The Division believes that an FCM may properly withhold commissions to secure customers' deficits only by agreement with account executives. Consequently, the commissions owed to account executives cannot be considered adequate security for customer deficits unless there are legally enforceable written agreements between the FCM and the account executives that specifically provide the FCM the right to withhold commissions due the account executives to secure customer deficits. These arrangements also must specify the manner in which commissions will be withheld and the extent to which they may be withheld.

In order to treat account executives' commissions payable as security for customers' deficits, the FCM must demonstrate its ability to withhold commissions, and that it actually has withheld the applicable commissions in order for the Division to consider the Commission's requirement of possession or perfection of the security interest satisfied. The FCM must continue to withhold the commissions until the customer has repaid the deficit. Deficits only can be considered secured to the extent that commissions can be and have been withheld. For example, if an FCM has a customer account that is in deficit by \$30,000 and has withheld

---

<sup>7</sup> As discussed above, for net capital purposes under Regulation 1.17, warehouse receipts and shipping certificates deposited to margin an account may under certain circumstances secure the customer receivable resulting from a debit deficit in the account to the extent of the collateral market value of the warehouse receipts or shipping certificates.

commissions of \$10,000 from the customer's account executive pursuant to a legally enforceable written agreement, the FCM may treat only \$10,000 of the deficit as secured for net capital purposes.

Commissions withheld from account executives to secure deficits must be earned and reflected as liabilities whenever the FCM prepares a capital computation. In addition, commissions withheld from account executives cannot be used to offset or reduce the applicable safety factor charges for under-margined accounts required by Regulation 1.17(c)(5)(viii) because the commissions do not represent margin payments made by customers.

\*\*\*\*\*

The statements made in this interpretation are not rules or interpretations of the Commodity Futures Trading Commission, nor are they published as bearing the Commission's approval. Rather, they are interpretations and practices followed by the Division of Clearing and Intermediary Oversight in administering the Commodity Exchange Act and the regulations thereunder.

FOR FURTHER INFORMATION CONTACT: Thomas Smith, Deputy Director and Chief Accountant, Thelma Diaz, Associate Director, or Jennifer Bauer, Special Counsel, Division of Clearing and Intermediary Oversight, Commodity Futures Trading Commission, 1155 21<sup>st</sup> St, N.W., Washington, D.C. 20581.

Issued in Washington, D.C. on June 21, 2010 by the Division of Clearing and Intermediary Oversight.

ANANDA K. RADHAKRISHNAN

DIRECTOR