



U.S. COMMODITY FUTURES TRADING COMMISSION

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Division of Swap Dealer and
Intermediary Oversight

Eileen T. Flaherty
Director

CFTC Letter No. 17-03
No-Action
January 26, 2017
Division of Swap Dealer and Intermediary Oversight

Ms. Allison Lurton
Senior Vice President and General Counsel
Futures Industry Association
2001 Pennsylvania Avenue, NW Suite 600
Washington, DC 20006

Re: No-Action Position Regarding Regulation 22.17(b) Withdrawals of Residual Interest

Dear Ms. Lurton:

This is in response to your letter dated December 2, 2016 to the Division of Swap Dealer and Intermediary Oversight (“Division”) of the Commodity Futures Trading Commission (“Commission”). By your letter, you request, on behalf of the Futures Industry Association (“FIA”) and member futures commission merchants (“FCMs”) an interpretation regarding withdrawals of FCM excess residual interest from “Cleared Swaps Customer Accounts” and compliance with Commission Regulation 22.17(b).¹ After review of the request, the Division has determined that no-action relief from Commission Regulation 22.17(b) is appropriate with respect to withdrawals of FCM excess residual interest in the amount and at the times as described below, subject to the conditions set forth herein.

¹ The Commodity Exchange Act (“Act”) may be found at 7 U.S.C. 1 et seq., and the Commission’s regulations may be found at 17 CFR Ch. 1.

The terms “Cleared Swaps Customer” and “Cleared Swaps Customer Account,” as used in this letter, are as defined in Commission Regulation 22.1.

I. Regulatory Background and Analysis

Commission Regulation 22.2(f)(6)(iii)(A) requires, for cleared swaps, that prior to the time of clearing settlement with a Derivatives Clearing Organization (“DCO”) an FCM is required to maintain residual interest in Cleared Swaps Customer Accounts that is equal to or exceeds the aggregate amount by which each Cleared Swaps Customer is undermargined. The undermargined amount is the total amount of collateral required for a Cleared Swaps Customer’s Cleared Swaps that exceeds the value of the Cleared Swaps Customer Collateral. The aggregate undermargined amount in the Cleared Swaps Customer Account may be reduced by payments received from Cleared Swaps Customers prior to the time of settlement.

For Cleared Swaps, this requirement means that FCMs must have funds or investments in the Cleared Swaps Customer Accounts to cover the aggregate undermargined amount before the time of settlement with DCOs. Margin calls relating to the Cleared Swaps undermargined amounts are made by FCMs and margin payments from the Cleared Swaps Customers are generally thereafter received throughout the day.

Commission Regulation 22.17(b) prohibits an FCM from making withdrawals from its residual interest in Cleared Swaps Customer Accounts prior to preparing its daily Cleared Swaps segregation calculation as of the close of business the prior business day. As margin payments from Cleared Swaps Customers are received, the sum of the undermargined amount decreases. However, due to the express provision of Regulation 22.17(b), FCMs are restricted from withdrawing corresponding amounts of excess residual interest, until the daily Cleared Swaps segregation calculation as of the prior business day has been performed. For many FCMs that carry Cleared Swaps Customer Accounts, this timing gap results in significant amounts of FCM liquid capital, above the Cleared Swaps targeted residual interest amount, being held in Cleared Swaps Customer Accounts for the duration of the day.

You have requested that FCMs be permitted to withdraw excess residual interest to the extent that margin payments have been deposited by Cleared Swaps Customers to reduce the undermargined amount in the Cleared Swaps Customer Accounts. You have further indicated that such amounts of excess residual interest would only be reduced to the extent that the FCM can demonstrate that it corresponds to the amounts deposited by Cleared Swaps Customers to satisfy the undermargined amounts.

II. DSIO No-Action Position

The Division has determined that under appropriate conditions as set forth herein, relief from the requirements of Regulation 22.17(b) is warranted for withdrawals which directly correspond to Cleared Swaps Customer margin payments received, prior to the completion of the requisite daily Cleared Swaps segregation calculation.

Accordingly, the Division will not recommend enforcement action under Regulation 22.17(b) for FCMs that withdraw residual interest from Cleared Swaps Customer Accounts related to undermargined amount payments received from customers, prior to the completion of the computation required under Regulation 22.17(b); provided the FCM and any such withdrawal comply with the following conditions:

1. FCMs may withdraw excess residual interest to the extent that margin payments have been deposited by Cleared Swaps Customers to reduce the undermargined amount in the Cleared Swaps Customer Accounts. Further, such amounts of excess residual interest may only be reduced to the extent that the FCM can demonstrate that it corresponds to the amounts deposited by Cleared Swaps Customers to satisfy the undermargined amounts.
2. Although a full segregation computation pursuant to Regulation 22.17(b) will not have been completed, an FCM must have robust risk management processes and controls in place to provide assurance that withdrawals would not result in any risk of intraday undersegregation in the Cleared Swaps Customer Accounts. Any examination finding or exception noted by a self-regulatory organization (“SRO”) or the Division identifying any deficiency related to an FCM’s segregation risk management controls designed to address such risks would disqualify such FCM from relying on this no-action position until resolved.
3. As part of the risk management processes and controls discussed in the foregoing item #2, an FCM must document its consideration of the impact on Cleared Swaps segregation of any other disbursements not made for the benefit of Cleared Swaps Customers, intraday margin calls, intraday volatility and expected Cleared Swaps Customer debit deficits and any other activity which the FCM should reasonably expect to impact its residual interest in Cleared Swaps Customer Accounts throughout the day, which will serve as a pro-forma segregation computation, prior to the withdrawal taking place.

4. The withdrawal may not result in an FCM holding less than 110% of its current targeted residual interest balance in Cleared Swaps Customer Accounts.

The staff notes that regardless of the no-action position herein, FCMs are required to maintain sufficient funds in segregation for Cleared Swaps Customers at all times.

As an ancillary issue, Regulation 22.17(c) requires an FCM to provide certain notices to the Commission and designated self-regulatory organizations regarding withdrawals from the Cleared Swaps Customer Accounts that exceed 25% of the residual interest as calculated for the prior trade date. With respect to the deposits of residual interest into Cleared Swaps segregation which are necessitated by Regulation 22.2(f)(6)(iii)(A), the related withdrawal notifications thereafter are so frequent they have ceased to provide the intended useful information to highlight something that was expected to be infrequent, versus what has become a day to day treasury function. Accordingly, for any withdrawals that meet all of the conditions set forth above, and which are made prior to the Cleared Swaps segregation computation required under Regulation 22.17(b), the Division will not recommend enforcement action under Regulation 22.17(c) for failure to provide the notifications. The staff believes that such notices relating to the withdrawals made pursuant to the no-action relief herein may not provide useful information to the SRO or the CFTC given their expected frequency. The staff notes, however, any examination finding or exception noted by an SRO or the Division identifying any deficiency in the FCM's segregation risk management controls (described in the foregoing items #2 and #3) would disqualify such FCM from relying on this no-action position of the Division until resolved.

This letter, and the positions taken herein, represent the views of Division staff and do not necessarily represent the positions or views of the Commission or of any other office or division of the Commission. The relief issued by this letter does not excuse persons relying on it from compliance with any other applicable requirements contained in the Act or in the regulations issued thereunder. This letter does not create or confer any rights or obligations on any person or persons subject to compliance with the Act that bind the Commission or any of its other offices or divisions. As with all no-action letters, the Division retains the authority to condition further, modify, suspend, terminate, or otherwise restrict the terms of the no-action relief provided herein, at its discretion.

Ms. Lurton
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Should you have any questions, please contact me at (202) 418-5326, or Jennifer Bauer, Special Counsel, at (202) 418-5472.

Very truly yours,

Eileen T. Flaherty
Director