The Commodity Futures Trading Commission (CFTC or Commission) is adopting rules concerning the protection of the cleared swaps and associated collateral belonging to cleared swaps customers of futures commission merchants (FCM), and other matters.

Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act)

Section 724(a) of the Dodd-Frank Act amends the Commodity Exchange Act (CEA) by inserting a new section 4d(f), which requires, among other things, the segregation of cleared swaps pertaining to customers, as well as associated collateral. The rules adopted by the Commission concern, in large part, enhancing protection for, and facilitating the portability of, the cleared swaps and associated collateral of FCM cleared swaps customers.

Rulemaking Process

Following nearly a year of consultation, including a roundtable, multiple meetings between industry and agency officials, and an advanced notice of proposed rulemaking (ANPR), the Commission issued a notice of proposed rulemaking (NPRM) that proposed the Legally Segregated Operationally Commingled Model (LSOC Model, also known as the Complete Legal Segregation Model) because it was the best balance between benefits and costs in order to protect market participants and the public. To further inform the Commission regarding the feasibility, costs and benefits of the various models, staff continued to meet with market participants and held a second roundtable on June 3, 2011.

After carefully considering all comments during the rulemaking process, the Commission is adopting the LSOC model.

Segregated Account Pre-Bankruptcy

The LSOC Model requires that cleared swaps customer collateral be segregated from the FCM’s own property, but permits the cleared swaps collateral of all FCM cleared swaps customers to be kept together pre-bankruptcy in one account. The rules, to the extent applicable, parallel (in updated language) the regulations governing the segregated accounts in which FCMs currently hold futures customer collateral pre-bankruptcy.

Segregated Account Post-Bankruptcy

Following an FCM’s bankruptcy, where there is a shortfall in the cleared swaps customer account due to a cleared swaps customer loss that exceeds both the cleared swaps customer’s collateral and the FCM’s ability to pay, the DCO could only use the collateral attributable to the cleared swaps customers whose portfolios of positions at the DCO suffered losses to meet the loss. Thus, all collateral attributable to cleared swaps customers whose portfolios of positions gained or were “flat” (neither gained nor lost), and the remaining collateral attributable to cleared swaps customers whose portfolios of positions lost...
customers whose portfolios of positions lost, would be immediately available for transfer. Moreover, the DCO would have information that is no more than one business day old tying cleared swaps customers to portfolios of positions, and the DCO itself would maintain the margining methodology that would tie such portfolios of positions to the collateral requirement associated with such portfolios. Even if the DCO decided to liquidate all cleared swaps customer positions, non-defaulting cleared swaps customers would be exposed to less loss. However, if following an FCM's bankruptcy there is a shortfall in the cleared swaps customer account due to an operational issue (for example, there is a shortfall due to negligence, theft or some other mishap), cleared swaps customer positions and related collateral at a DCO may be delivered to the Trustee, or may transferred by the DCO, but, as the Bankruptcy Code requires, each cleared swaps customer would only receive its pro rata share.

**Investment of Customer Collateral**

The rules provide that cleared swaps customer collateral may only be invested pursuant to Commission Regulation 1.25 (as it may be amended from time to time), which governs the investment of customer property of futures customers. The regulations do not, however, limit the types of collateral that a cleared swaps customer may post, though such customers must comply with the rules of its FCM and DCO.

**Other Matters**

The Commission amended Regulation Part 190 to implement changes wrought by the Dodd-Frank Act, including the inclusion of swaps cleared with a DCO as customer contracts for all commodity brokers, the inclusion of swaps execution facilities as a category of trading venue, and to implement additional statutory changes to time periods. The rules also include changes to conform Regulation Part 190 to current swaps market practices.