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Gary Barnett
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Division of Swap Dealer and Intermediary Oversight

CFTC Letter No. 14-138
No-Action
Interpretation
November 13, 2014
Division of Swap Dealer and Intermediary Oversight

Barbara Wierzynski
Futures Industry Association
2001 Pennsylvania Avenue, NW
Suite 600
Washington, DC 20006-1823

Re: **No-Action Relief Concerning the Holding of Customer Funds by a Futures Commission Merchant under Commission Regulation 30.7(c)**

Dear Ms. Wierzynski:

This letter responds to your letter dated October 31, 2014, to the Division of Swap Dealer and Intermediary Oversight (the "Division") of the Commodity Futures Trading Commission (the "Commission"). By your letter, you request, on behalf of the Futures Industry Association's ("FIA") member futures commission merchants ("FCMs") and similarly situated FCMs, that the Division confirm that it will not recommend that the Commission initiate an enforcement action against an FCM for excluding 30.7 customer funds[1] deposited by an FCM with foreign banks or trust companies from the calculation of 30.7 customer funds that an FCM is permitted to maintain in accounts with non-United States ("U.S.") depositories under Regulation 30.7.

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[1] The term "30.7 customer" is defined in Regulation 30.1(f) to mean both U.S.-domiciled customers and foreign-domiciled customers of an FCM that trade foreign futures and foreign options on, or subject to the rules of, a foreign board of trade.

The term "30.7 customer funds" is defined in Regulation 30.1(h) to mean any money, securities, or other property received by an FCM from, for, or on behalf of 30.7 customers to margin, guarantee, or secure foreign futures or foreign option positions, or money, securities, or other property accruing to 30.7 customers as a result of foreign futures and foreign options positons.

Commission regulations may be found at 17 CFR Ch. I, and are available on the Commission's website, www.cftc.gov.

Background

In November 2013, the Commission adopted regulations enhancing customer protections (the "Customer Protection Final Rulemaking").[2] In the Customer Protection Final Rulemaking, the Commission amended Regulations 30.7(b) and (c).

Regulation 30.7(b) sets forth an exclusive list of depositories that may hold 30.7 customer funds. Specifically, Regulation 30.7(b) provides that an FCM shall deposit 30.7 customer funds only with: (1) a bank or trust company located in the U.S.; (2) a bank of trust company located outside of the U.S. that maintains in excess of $1 billion of regulatory capital; (3) an FCM; (4) a derivatives clearing organization; (5) the clearing organization of any foreign board of trade; (6) a member of any foreign board of trade; or (7) the designated depositories of a member of a foreign board of trade or a foreign clearing organization.

Furthermore, Regulation 30.7(c) limits the amount of 30.7 customer funds that an FCM may deposit in accounts maintained outside of the U.S. with the depositories listed in Regulation 30.7(b). In this regard, Regulation 30.7(c) prohibits an FCM from holding 30.7 customer funds in accounts maintained outside of the U.S. in an amount in excess of 120 percent of the required margin on 30.7 customers' foreign futures and foreign options positions (the "120 percent limit").

The Commission adopted the revisions to Regulation 30.7(c) in an effort to provide greater assurance that 30.7 customer funds would be recovered and returned to the 30.7 customers in a timely manner in the event of the insolvency of an FCM. The regulation supports this objective by requiring an FCM to maintain as much of the 30.7 customer funds as reasonably practicable in the U.S. and, therefore, under the potential control of a trustee in the event of the bankruptcy of the FCM.

The amendments were a direct response to the Commission's experience in a recent FCM insolvency where 30.7 customer funds deposited by an FCM with an affiliated foreign broker in an amount that was significantly greater than the required margin for the foreign futures and option positions were not immediately returned by the affiliated foreign broker to the FCM in a

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[2] *See* Enhancing Protections Afforded Customers and Customer Funds Held by Futures Commission Merchants and Derivatives Clearing Organizations; Final Rule, 78 FR 68,506 (Nov. 14, 2013).

bankruptcy proceeding. By limiting the amount of funds that an FCM is permitted to deposit in non-U.S. accounts to the required margin on open foreign futures and foreign options positions, plus a 20 percent cushion, the Commission was balancing its desire to provide greater assurances that 30.7 customers would have access to their margin funds in a timely manner and the need for 30.7 customer funds to be deposited with foreign brokers, banks, and clearing organizations as margin for foreign futures and foreign options positions.

No-Action Relief Requested

In your letter, and in conversations with Division staff, you request no-action relief from Regulation 30.7(c) to permit FCMs to exclude 30.7 customer funds deposited with foreign banks and trust companies in computing the 120 percent limit. In support of your request, you state that the inclusion of foreign banks and trust companies in the 120 percent limit computation creates significant operational burdens on FCMs that carry 30.7 customer accounts and exposes 30.7 customers and FCMs to additional costs and foreign exchange risk.

In support of your request, you note that as part of the Customer Protection Final Rulemaking, the Commission amended Regulation 30.7 to require, for the first time, funds deposited by foreign-domiciled customers to be included by FCMs in 30.7 accounts with funds deposited by U.S.-domiciled customers.[3] You represent that as a result of this change, a significant amount of foreign currencies have become subject to the requirements of the rule. You further represent that many FCMs maintain accounts with foreign banks and trust companies for the purpose of accepting deposits from non-U.S. customers to margin foreign futures and foreign options positions. These deposits are generally in local currency. In addition, the foreign-domiciled 30.7 customers generally deposit an amount of funds in excess of the required margin necessary to support the customers' open foreign futures and foreign options positions.

You also state that although U.S. banks may be authorized to maintain accounts denominated in a foreign currency, it is your understanding that, with limited exception, banks

[3] The term "30.7 account" is defined in Regulation 30.1(g) to mean any account maintained by an FCM for or on behalf of 30.7 customers to hold money, securities, or other property to margin, guarantee, or secure foreign futures or foreign options positions.

located in the U.S. do not offer to maintain such accounts. Moreover, you state that banks that offer to maintain accounts denominated in a foreign currency do not actually hold the foreign currency in the U.S. Rather, the funds are held at a correspondent bank located in the jurisdiction of the foreign currency.

You further state that in order to comply with the requirement in Regulation 30.7(c) to maintain 30.7 customer funds in accounts with depositories in the U.S., many FCMs would be required to convert 30.7 customers' foreign currency deposits to U.S. dollars and to transfer those deposits from foreign banks and trust companies to U.S. depositories. This conversion and transfer increase operational risk to the FCMs, increase costs to both the FCMs and their customers, and expose the FCMs to foreign currency risk as the FCMs are required to return foreign currency to the customers when they withdraw funds from their accounts. You also note that FCMs may be required to return excess margin funds to foreign 30.7 customers in order to limit the amount of funds held in foreign depositories to no more than 120 percent of required margin, which increases risk to the FCMs and their customers by reducing the amount of funds held by the FCMs that would be available in the event of significant market moves that adversely impact customers' portfolios.

You also state that a limitation on holding 30.7 customer funds with foreign banks and trust companies is impractical when the FCMs are direct clearing members of a foreign board of trade or foreign clearing organization. You represent that in such situations, foreign clearing organizations have direct debit authority to withdraw funds from the FCMs' accounts with settlement banks to meet both initial and variation margin obligations at the foreign clearing organizations. You further state that such withdrawals are not fixed amounts and may vary significantly from day-to-day depending on numerous factors, including market movements. As a result, the FCMs need to ensure that they always maintain adequate funds in the settlement accounts to cover any potential market moves that would result in material payment obligations to the foreign clearing organizations, or rely on the settlement banks to advance funds to the FCMs, which you state such banks are increasing reluctant to provide.

Grant of No-Action Relief

The Division has considered your request and, based upon the foregoing, will not recommend that the Commission initiate an enforcement action against an FCM for excluding 30.7 customer funds deposited with foreign banks or trust companies in calculating the 120 percent of the total margin requirements that the FCM may hold with depositories in accounts maintained outside of the U.S. The Division's position is based upon the FCM complying with all other requirements regarding the holding of 30.7 customer funds contained in Regulation 30.7 including that:

(1) The foreign bank or trust company maintains a minimum of $1 billion of regulatory capital (17 CFR. § 30.7(b)); and

(2) the FCM obtains a written acknowledgment letter from the foreign bank or trust company in the form required by Appendix E to part 30 of the Commission's regulations prior to, or contemporaneously with, the opening of the account (17 CFR § 30.7(d)).

Staff Interpretation

Staff also has received the following requests for interpretation of the Customer Protection Final Rulemaking.

1. As a result of timing differences between U.S. and non-U.S. markets, particularly Asian markets, an FCM's request to a foreign broker or clearing organization to transfer 30.7 customer funds back to the FCM may not be processed by the foreign broker or clearing organization until the next business day. If, however, prior to the foreign broker or clearing organization transferring the 30.7 customer funds on the next business day to the FCM, market or other events cause the foreign broker or clearing organization to require additional margin from the FCM for its 30.7 customers' position, the FCM may net the funds it requested from the foreign broker or clearing organization with the amount of funds the foreign broker or clearing organization is requesting from the FCM. The Division does not believe that Regulation 30.7 would require two separate transactions in such situations.

2. Certain 30.7 customers that trade across multiple foreign jurisdictions request single currency margining from their FCM. In such situations, the 30.7 customers deposit U.S. dollars with the FCM and rely on the FCM to deposit the appropriate foreign currency with foreign brokers or clearing organizations as necessary to margin foreign futures and foreign options transactions that settle in a foreign currency. As the 30.7 customers' positions change in value or are liquidated, the FCM receives foreign currencies into its 30.7 customer accounts from foreign brokers or clearing organizations. Periodically, the FCM is required to convert some of the foreign currencies to U.S. dollars to maintain the single margin currency for the 30.7 customers. To rebalance the 30.7 accounts, the FCM will first deposit U.S. dollars into 30.7 accounts and, only after the deposit of the U.S. dollars, will withdraw the equivalent amount in foreign currencies from the 30.7 accounts. Staff believes that this transaction is a transaction that is for the benefit of customers as envisioned under Regulation 30.7(g), and not a transaction that is subject to the restrictions in Regulation 30.7(g) on the withdrawal of funds from the 30.7 account that are not for the benefit of the FCM's 30.7 customers. Therefore, the FCM, while rebalancing the 30.7 account, does not have to wait, as a result of depositing U.S. dollars into the account, until after the completion of certain daily computations and possibly filing regulatory notices with the Commission and obtain high level, senior management preapproval before withdrawing the equivalent amount out of the 30.7 account.

This letter, and the positions taken herein, represent the view of this Division only, and does not necessarily represent the position or view 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 Commodity Exchange

Act or in the regulations issued thereunder. Further, this letter, and the relief contained herein, is based upon the facts represented to the Division. Any different, changed, or omitted material facts or circumstances might render this no-action relief void.

Should you have any questions, please do not hesitate to contact me at 202-418-5977, Thomas Smith, Deputy Director, at 202-418-5495, or Francis Kuo, Attorney Advisor, at 202-418-5695.

Very truly yours,

Gary Barnett