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VIA ELECTRONIC DELIVERY

Natise Stowe
Office of the Secretariat
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street NW
Washington, DC 20581

Re: Proposed Rule Regarding Enhancing Protections Afforded Customers and Customer Funds Held by Futures Commission Merchants and Derivative Clearing Organizations (RIN 3038-AD88)

Ladies and Gentlemen:

We are pleased to submit comments on the Commodity Futures Trading Commission's (the "Commission") notice of proposed rulemaking regarding customer protections for futures commission merchants ("FCMs").[1] The Commission states that the purpose of the Proposal is to enhance customer protections by bolstering procedures FCMs must employ for safeguarding customer funds. Among the changes called for is a revised form of written acknowledgement letter FCMs would be required to obtain from depositories into which FCMs deposit customer funds under §§ 1.20, 30.7 and Part 22 of the Commission's rules.

Schwartz & Ballen LLP is legal counsel to banks that act as depositories for customer funds held by custodians such as FCMs for the benefit of their customers. As a result of comments we have received from financial institutions that we represent and our extensive experience with deposit arrangements and addressing issues that arise in connection with current forms of acknowledgement letters, we believe that the Commission should make significant changes to the Proposal and the proposed revised form of acknowledgement letter to address serious issues raised by the proposed acknowledgment letter.[2]

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[1] 77 *Fed. Reg.* 67866 (November 14, 2012) (the "Proposal").

[2] For ease of presentation, the remaining comments refer only to § 1.20 of the Commission's rules and the form of acknowledgment letter thereunder. Our comments, however, are applicable as well to the proposed changes to § 30.7 and Part 22 and the acknowledgment letters required thereunder.

A. SUMMARY

1. PROVIDING ACCESS TO ACCOUNT INFORMATION

The Proposal requires a bank that maintains an FCM's customer funds to agree to provide the Commission and the FCM's designated self regulatory organization ("SRO") with direct read-only access to information about the FCM's account on a 24-hour a day basis without further consent from the FCM. Such a requirement is contrary to established bank procedures which, because of security and privacy considerations, require an accountholder to consent to providing third parties with such access and to authorize designated persons to whom access to account information should be granted. Accordingly, we believe that the Commission should expressly provide in the final rule that banks may apply their established procedures, including execution of appropriate documentation, in order to grant access to account information to designated staff of the Commission and SROs.

It should also be noted that the Commission's position that online viewing of FCM accounts will increase the likelihood that any discrepancy between balances reported by the FCM on its daily customer segregation account reports and balances actually held by the depository would be identified quickly fails to take into account that an account balance at any point during the day does not reflect the actual balance in the account. The actual amount of funds in an account is determined only after all credits and debits for the day are posted to the account at the close of business at the end of the day.

2. RELEASING FUNDS AT THE DIRECTION OF THE COMMISSION OR SROS

The Proposal provides that banks must agree to release funds in segregated accounts when instructed to do so by the Commission or an SRO. Banks are concerned that such a requirement conflicts with security procedures banks have established to authenticate parties making funds transfers from client accounts. Accordingly, we strongly recommend that the Commission state that in connection with FCMs authorizing the Commission staff and SROs to instruct the bank to make transfers from the accounts containing customer funds, banks may require FCMs to execute in advance all documentation the bank may require under its standard procedures.

3. PRESUMPTION REGARDING ACCOUNT WITHDRAWALS

The proposed acknowledgment letter states that banks may conclusively presume that any withdrawal by the FCM from the account and the balances maintained in the account are in conformity with the Commodity Exchange Act ("CEA") and Commission regulations without any further inquiry, provided that the bank has no notice of, or actual knowledge of, or could not reasonably know of, a violation of the CEA or other provision of law by the FCM.

The proposed proviso exposes banks to undue and unreasonable risk. Given their size, it is impossible for banks to determine at the time the FCM is making a withdrawal whether any employee has knowledge or could reasonably know that the FCM's withdrawal is a violation of the CEA or other provision of law. Banks should not incur any liability for impermissible FCM withdrawals from the accounts. This is the responsibility of the FCMs, not the depository banks. We therefore urge the Commission to delete the proviso language from the acknowledgement letter.

4. MONITORING FCM TRANSACTIONS

The proposed acknowledgement letter appears to require banks to monitor accounts FCMs establish to ensure that their actions comply with the CEA, Commission rules and other applicable laws and to "treat and maintain [customer] funds in accordance with the provisions of the [CEA] and CFTC regulations." Any such requirement would be highly inappropriate to impose on depository banks. It should be the responsibility of FCMs, not the depository banks, to ensure compliance with Commission rules and other applicable law. Accordingly, we urge the Commission to revise this language to make it clear that FCMs are responsible for complying with these requirements and not depository banks.

5. ACKNOWLEDGE AND AGREE

The proposed acknowledgement letter requires that banks "acknowledge and agree" that the FCM has opened the accounts for the purpose of depositing funds of customers. Banks have no ability to determine what uses an FCM is making of funds it withdraws from the account. Accordingly, the words "and agree" should be deleted from the phrase "acknowledge and agree" wherever that phrase appears, with the exception of the "no lien" provision.

6. RECOVERY OF BANK ADVANCES

The Proposal states that banks may recover funds advanced in the form of cash in lieu of liquidating non-cash assets held in the account. Because many FCMs hold only cash assets in the accounts, the language should be expanded to permit banks to recover funds they advance that result in overdrafts in the accounts. Failure to permit banks to recover such advances whether or not there are non-cash assets in the account will likely lead to banks incurring losses as a result of their inability to recover such advances.

7. ADDITIONAL ISSUES

We also present below comments on additional matters regarding why a form acknowledgment letter should not be mandated, why new acknowledgment letters should not be immediately required, obtaining consent for examination of accounts, and why a specific account title should not be mandated.

B. DISCUSSION

1. PROVIDING ACCESS TO ACCOUNT INFORMATION

Section 1.20(d)(3) of the Commission's rules as proposed provides that a depository bank must agree to provide the Commission and its SRO with direct read-only access to information about a bank account in which customer funds are maintained on a 24-hour a day basis without further consent or authorization from the FCM. The Proposal would require banks to provide the Commission and the FCM's SRO with necessary software, a user log-in, and password that will allow the Commission and the SRO to have read-only access to the FCM's accounts via the bank's Web site or an alternative electronic medium on a 24-hour a day basis.

This approach conflicts with well-established procedures banks have in place for obtaining client consent to authorize the bank to provide account information to third parties. Currently, many banks provide their customers' designated administrators with the authority to grant individuals access to account information. The decision as to who will be granted such access is determined by the customer, not the bank.

The Commission's proposal conflicts with the existing protocols banks have established with customers and runs the risk that banks will be unable to authenticate the identity of the person at the Commission or SRO who is seeking such access, thereby exposing the Bank to undue potential liability. Our suggestion is for the Commission to acknowledge that in order to provide the Commission staff and SROs with access to account information, FCMs be required to execute in advance whatever documentation the depository bank may require under existing procedures in order to grant the Commission staff and SROs access to such information. Such consent should also apply to responding to requests from the Commission and SROs for confirmation of account balances and other account information.

It should be noted that the requirement will not achieve the objective the Commission intends. The Commission stated that online viewing of FCM accounts will increase the probability that any discrepancy between balances reported by the FCM on its daily customer segregation account reports and balances actually held by the depository would be identified quickly by the Commission or the SRO.[3] In reality, the balances reflected in an FCM's account at any point during the business day reflect deposits and withdrawals as they are posted by a bank's system, which is unlikely to reflect the actual balance in the account. The actual account balance is determined only after all credits and debits are posted to the account, which typically takes place after the close of business. As result, any balance in the FCM's account the Commission views during the course of the day will not reflect actual balances in the FCM's account and could provide an incorrect impression as to the actual amount of funds in the account.

[3] 77 *Fed. Reg*. at 67913.

2. RELEASING FUNDS AT THE DIRECTION OF THE COMMISSION OR SROS

The Proposal also requires depository banks to agree to release funds in segregated accounts when instructed to do so by an officer designated by the Commission or any appropriate official of an SRO. Such a requirement is impractical and conflicts with well-established security procedures banks have in place with clients to authenticate the identity and authority of parties making funds transfers from client accounts. Moreover, the proposal is inconsistent with Uniform Commercial Code Article 4A and Federal Reserve Board Regulation J,[4] which encourage banks to establish commercially reasonable security procedures with customers to protect against fraudulent funds transfers. Security concerns and safety and soundness considerations mandate that procedures and authorizations be established in advance of any possible need for such actions. It is unrealistic to expect banks to transfer millions of dollars based simply upon a telephone call from an unknown party that the bank has not dealt with previously and who has not been explicitly authorized by the FCM to make transfers from the account.

We suggest, therefore, that the Commission acknowledge that in order to provide the Commission staff and SROs with authority to instruct the bank to make transfers from the accounts containing customer funds, FCMs will be required to execute in advance whatever documentation the depository bank may require under their existing procedures in order to grant the Commission staff and SROs the authority to execute such transactions. We anticipate that FCMs would indemnify banks for following instructions provided by the Commission staff or SROs.

3. PRESUMPTION REGARDING ACCOUNT WITHDRAWALS

The proposed acknowledgment letter states that banks may conclusively presume that any withdrawal by the FCM from the account and the balances maintained in the account are in conformity with the CEA and Commission regulations without any further inquiry, provided that the bank has no notice of, or actual knowledge of, or could not reasonably know of, a violation of the CEA or other provision of law by the FCM.[5]

The Commission itself has questioned whether current audit systems function adequately to monitor FCMs' activities, verify segregated fund and secured amount balances and detect fraud.[6] If the Commission itself recognizes the limitations of existing audit systems, how can it expect depository banks to keep apprised of whether FCM withdrawals are in conformance with the CEA and Commission rules? Moreover, permitting FCMs to maintain their proprietary funds in the account to ensure against becoming under-segregated or under-secured exacerbates the ability of a third party such as the depository bank to know whether proprietary or customer funds are being transferred.

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[4] *Collection of Checks and Other Items by Federal Reserve Banks and Funds Transfers through Fedwire,* 12 C.F.R. Part 210.25(b)(1).
[5] 77 *Fed. Reg*. at 67942.
[6] 77 *Fed. Reg*. at 67869.

Banks are quite concerned that the proposed proviso exposes them to undue and unreasonable risk. Depository banks are complex institutions with large staffs. Many are global institutions. It is not possible for them to determine at any time that the FCM is making a withdrawal whether anyone on their world-wide staff has knowledge or could reasonably know that an FCM's transfer from the account is or will be a violation of the CEA or other provision of law. Indeed, the proviso imposes an unrealistic standard that cannot realistically be applied. Banks cannot and should not be held responsible if FCMs make impermissible withdrawals from the accounts. We, therefore, urge the Commission to delete the proviso from the acknowledgement letter.

4. MONITORING FCM TRANSACTIONS

The acknowledgement letter appears to impose burdens on banks to monitor accounts FCMs establish to ensure that FCMs' actions comply with the CEA, Commission rules and other applicable laws. The acknowledgement letters also states that banks are to "treat and maintain [customer] funds in accordance with the provisions of the [CEA] and CFTC regulations." We believe it is highly inappropriate and unfair to impose such requirements on depository bank. Banks should have no responsibility to ascertain what requirements apply to funds FCMs maintain on behalf of customers. Banks are simply depositories for such funds and should not be assigned responsibility to monitor FCM activities and transactions from the accounts. Compliance with Commission rules and other applicable law is, and should be, solely the responsibility of FCMs, not banks.

5. ACKNOWLEDGE AND AGREE

The proposed acknowledgement letter requires that banks "acknowledge and agree" that the FCM has opened the accounts for the purpose of depositing funds of customers. The term " and agree" should be deleted from the phrase "acknowledge and agree" wherever that phrase appears, with the exception of the "no lien" provision. While banks could acknowledge that they were informed by the FCM of the purpose of the accounts, they have no ability to agree that the accounts will only be used for such purpose. How an FCM uses as account is solely within the control and discretion of the FCM itself. Banks have no ability to determine the source of the funds FCMs deposit into their accounts. Indeed, as the Commission has indicated, FCMs are likely to place proprietary funds into the account in order to avoid being under-segregated or under-secured. Given the likelihood that FCMs will also deposit proprietary funds into the account, how could a bank ever be certain whether the FCM is withdrawing customer funds or proprietary funds from the account? Accordingly, we believe banks should not be required to "agree" to information supplied by FCMs.

6. RECOVERY OF BANK ADVANCES

The Proposal states that banks may recover funds advanced in the form of cash in lieu of liquidating non-cash assets held in the account. This language is too narrow, particularly since such accounts may hold no non-cash assets. It is imperative for banks

to be able to recover funds which they advance that result in overdrafts in the accounts. Such a right should be afforded whether or not there are non-cash assets in the FCM's customer funds account.

7. FORM OF WRITTEN ACKNOWLEDGEMENT LETTER

Section 1.20(d)(1) of the proposed rule requires an FCM to obtain a written acknowledgement letter from each bank when it opens an account in which it will deposit and maintain customer funds. Section 1.20(d)(2) provides that the written acknowledgement letter must be in the form set out in the Appendix. We do not believe that the Commission should mandate the form of the acknowledgement letter as proposed by the standard template. The proposed template letter conflicts in several areas with the terms and conditions often contained in deposit account and other agreements as well as with established procedures designed to protect accounts from unauthorized access. Moreover deposit account terms and conditions often vary from bank to bank. Mandating a specific form of letter fails to take these differences into account. Accordingly, we believe that the Commission should continue the current practice of specifying the elements that should be included in the letter but leave the actual form up to the bank and the FCM.[7] As an alternative, the Commission could develop a model form that banks and FCMs could choose to use, but would not be required to do so.

8. OBLIGATION TO OBTAIN NEW ACKNOWLEDGEMENT LETTERS

The Proposal would require an FCM to obtain a new acknowledgement letter from each of its depository banks within 120 days of a change in the name, change of address or certain other changes. We believe that a better approach that reduces burden on FCMs and banks is to include "binding effect" language which will ensure that the bank and the FCM remain subject to the terms of the acknowledgement letter. Language that states that the terms of the acknowledgement letter remain binding on the parties regardless of a change in name should address the Commission's concerns.

9. EXAMINATION OF ACCOUNTS

The proposed acknowledgement letter requires banks to agree to permit the Commission or an SRO to examine the account at any reasonable time. We believe that additional limitations should apply to the ability of the Commission and SROs to examine the accounts. For example, the Commission and SROs should be required to provide advance notice before being permitted to examine FCM accounts. Most importantly, banks should have the ability to obtain appropriate consent from FCMs authorizing banks to permit such examinations by appropriate agency and SRO representatives, as well as appropriate indemnification.

[7] It should be noted that the proposed form of acknowledgement letters are not uniform. For example, the acknowledgment letter specified in Appendix E states that it constitutes the FCM's consent and authorization for the depository to respond immediately to requests from the Commission or and SRO. Appendix A does not contain similar language.

10. ACCOUNT TITLING

Section 1.20(a) of the proposed rule requires an FCM to deposit customer funds in an account with a title that clearly identifies the funds as customer funds and indicates that such funds are segregated as required by section 4d(a) and 4d(b) of the Commodity Exchange Act ("CEA") and Part 1 of the Commission's rules. As the Commission is aware, operating system constraints often limit the number of characters that may appear in account titles. We believe that the proposed language requirement may not provide sufficient flexibility to banks and FCMs to use account titles that are consistent with banks' operating systems. While the Proposal indicates that abbreviations may be used to accommodate system requirements, we are concerned that the prescribed title must still be used as the name of the account. We believe that additional flexibility should be provided with regard to account titles so long as the accounts are clearly identified as custodial accounts held for the benefit of the FCM's customers. Accordingly, we recommend that the Commission should not mandate the form of title for such accounts, but rather specify what should be included in the title, subject to any operational constraints that banks may have.

C. CONCLUSION

We believe that if the requirements set forth in the Proposal and acknowledgement letters are left unchanged, operational and financial risk for banks will increase significantly. As a result, it is quite likely that banks currently serving as depositories for customer funds of FCMs will choose to no longer permit FCMs to deposit customer funds with them. This will have the adverse consequence of reducing the number of depositories available to FCMs.

Accordingly, we urge the Commission to reassess the language of the proposed acknowledgement letters and revise the required provisions of the rule and acknowledgement letter as indicated above. The changes we have requested will enable banks to maintain important safeguards without compromising customer protections that the Commission seeks to achieve.

Sincerely yours,

Gilbert T. Schwartz