March 18, 2024

VIA Email: secretary@cftc.gov
Mr. Christopher Kirkpatrick
Secretary of the Commission
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, D.C. 20581

Re: RIN 3038-AF39: Protection of Clearing Member Funds Held by Derivative Clearing Organizations

Dear Mr. Kirkpatrick:

Introduction

National Futures Association (NFA) appreciates the opportunity to comment on the Commodity Futures Trading Commission's (CFTC or Commission) notice of proposed rulemaking to adopt regulations governing the protection of clearing member proprietary funds held at a Derivatives Clearing Organization (DCO). Currently, Congress and the Commission have established a single registration category for DCOs. Yet over the years the Commission has approved at least two different clearing models as it granted registration to DCOs. Despite the differences in these clearing models, the Commission's proposal appears to apply equally to both models.

The historical or traditional DCO model relied upon intermediation and most, if not all, DCO members were FCMs. A newer model began to emerge twenty years ago when the Commission approved the registration of the first direct clearing DCO, HedgeStreet, Inc., for retail market participants.[1] The Commission also approved this model in connection with the registrations of CX Clearinghouse, L.P.'s predecessor in 2013 and LedgerX, LLC in 2017. The Commission implies that it is necessary, in part, to provide the currently proposed proprietary funds protections because it has granted registration to these DCOs, which clear directly for market participants including natural persons (*e.g.,* retail participants). The Commission indicates that it is proposing the new funds protections to safeguard clearing member proprietary funds in a manner comparable to those applicable to the protections a DCO provides to its FCM clearing members' customers.

[1] HedgeStreet is the predecessor to North American Derivatives Exchange (Nadex).

Given the distinct differences in the traditional DCO model and the direct clearing DCO model, our comments on the Commission's proposal will address each model separately. With respect to the traditional DCO model, if the Commission proposed proprietary funds protection requirements were only applicable to DCOs operating within the traditional clearing model, NFA would likely not comment on the proposal. NFA does not have regulatory oversight over DCOs or the practices they have in place to safeguard FCM proprietary funds. Moreover, clearing FCMs are fully able to assess DCOs' current practices to safeguard their proprietary funds and assess the risks associated with these practices.[2] Therefore, while NFA does not object to the Commission's proposal, we are not in a position to determine the appropriateness of these proposed safeguards in the traditional market structure. We firmly believe, however, that DCOs operating within an intermediated market structure and their FCM clearing members are in the best position to evaluate the necessity and efficacy of the proposed safeguards. Therefore, we strongly recommend that the Commission carefully review the comments received from these market participants.

NFA does, however, have a number of comments regarding the direct clearing DCO model because it directly impacts the customer protection framework in the derivatives industry. We recognize that the Commission's proposed rulemaking does not expressly request comment on the appropriateness of the direct clearing model. However, unlike the traditional DCO model, we are compelled chiefly from the customer protection perspective to comment on the Commission's current proposal and other investor protection issues associated with this model. For several years, NFA has noted that the approved direct clearing DCO model does not offer many key regulatory protections—for "proprietary" funds or otherwise—to retail participants equivalent to those offered to customers within the Commodity Exchange Act's (CEA) intermediated market structure. NFA does not believe this concern is lessened by the fact that the Commission has currently conditioned these DCOs' registrations to offering only fully collateralized, cash settled binary options or similar non-leveraged products.

NFA fully supports the Commission's regulatory objective in issuing the proposal. It is especially important that retail persons clearing their trades directly with a DCO receive protection for their funds on deposit at the DCO. However, we have significant concerns on the Commission's proposed methodology to extend these proprietary funds protections to direct clearing natural person clearing members (particularly when these clearing members are retail market participants rather than Eligible Contract Participants (ECPs). Specifically, even if the Commission can rationalize how to impose the proposed funds protections uniformly on registered DCOs offering these two distinct clearing models, we are concerned that proposal inadvertently creates a false impression that retail clearing members are receiving all appropriate customer protection for at least two reasons.

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[2] We also recognize that traditional DCOs have direct clearing participants that generally meet the eligible contract participant definition. Similar to clearing FCMs, these entities should have the expertise to understand the risks associated with not accessing the markets via an FCM.

First, the Commission's current proposal is itself inadequate as applied to "proprietary" funds held by direct clearing DCOs because it fails to afford many of the important funds' protections to retail market participants in a non-intermediated direct clearing model that are provided to customers who access the derivatives markets through an FCM. Second, the proposal provides direct retail clearing members with protections in just one key regulatory area (*i.e.,* how their funds are held and protected), and does not touch upon the myriad of other critical customer protections that retail customers receive when accessing the derivatives market through an FCM. NFA notes that in approving these direct clearing DCOs the Commission never imposed on them via rulemaking or otherwise customer protection obligations comparable to those imposed on FCMs.[3] Moreover, the Commission did not, nor does the current proposal, require these DCOs to disclose to retail participants the lack of protections they receive by not accessing the derivatives markets as customers via an FCM. Without this detailed disclosure, NFA is uncertain whether retail market participants appreciate the significance of this difference and that they do not receive *all* the critical protections provided to customers who access the derivatives markets through an FCM.

The CEA and the Commission's regulations are built on a framework in which separate registrants (*e.g.*, designated contract markets, DCOs and FCMs) each play a critical role in the regulatory ecosystem to support the CEA's public interests, and that natural person customers ultimately access the derivatives markets through an FCM. The CEA and the Commission's regulations, as well as SRO requirements, impose a comprehensive regulatory framework over intermediaries (especially FCMs) to protect customers.[4] These CFTC and SRO obligations were developed based on years of experience and have proven to be quite effective in protecting customers.[5]

However, because these direct clearing DCOs meet the CEA's DCO definition,[6] the Commission relies on the CEA's DCO Core Principles and CFTC Regulations to oversee these entities. These regulations, however, were developed to govern traditional DCO activities and neither contemplate nor adequately address direct clearing DCO retail participant-facing activities.[7] Therefore, given that customer

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[3] The Commission may not have the appropriate statutory authority to impose customer protection requirements outside the funds area on a DCO under the Core Principles.

[4] We discuss some of these critical customer protections in the section entitled *Direct Clearing DCOs—Critical Customer Protections are Lacking for Retail Participants.*

[5] Customer complaints and single-event arbitrations filed at NFA, as well as CFTC reparation cases, are at or near all-time lows.

[6] Among other prongs, CEA Section 15(A)(ii) provides that a DCO includes an entity that arranges or provides, on a multilateral basis, for the settlement or netting of obligations resulting from such agreements, contracts or transactions executed by participants in the DCO.

[7] Moreover, NFA notes that direct clearing DCOs do not appear to serve one of the primary purposes of a traditional DCO, that being mutualization of credit risk.

protection is our paramount concern, NFA strongly encourages the Commission to holistically review whether this disintermediated DCO model is consistent with the CEA's current framework and determine if legislative action is necessary to align retail market participant clearing member protections in this model with all the critical customer protections afforded to FCM customers pursuant to the CEA and the Commission's regulations.

NFA respectfully requests that the Commission consider the following specific comments on the proposal as applied to direct clearing DCOs and this market structure framework in general.

The CFTC's Current Proposal does not Provide Direct Clearing Retail Participants with Comparable Protections Received when Trading through an FCM

In the preamble, the Commission states that Section 4d of the CEA and Part 1 of the CFTC's Regulations establish a regime to safeguard customer funds held at an FCM. CEA Section 5b(c)(2)(F) (Core Principle F) requires a DCO to establish standards and procedures that are designed to ensure the safety of member and participant funds. The Commission states that its initial focus in implementing Core Principle F was on the custody and safeguarding of customer funds consistent with Section 4d of the CEA, which was responsive to the historical prevailing model in which all or nearly all clearing members of DCOs were FCMs. Therefore, the Commission applied many of the FCM customer funds safeguards to DCOs to safeguard customer funds received from their FCM clearing members.[8]

The Commission's proposal highlights that pursuant to the Commission's current regulations DCOs afford disparate protections to their FCM clearing members' customer funds compared to their clearing members' proprietary funds. Specifically, in contrast to the specific segregated funds regime applicable to how DCOs treat customer funds received from their FCM clearing member, Core Principle F and Commission Regulation 39.15 only more broadly require DCOs to establish standards and procedures that are designed to protect and ensure the safety of members' proprietary funds and hold them in a manner that will minimize their risk of loss or delay a DCO's access to them. This disparate treatment becomes untenable when the funds of direct clearing retail participants are treated in the same manner as FCM clearing members' proprietary funds.

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[8] Specifically, Commission Regulation 39.15 requires that a DCO hold funds belonging to its FCM clearing members' customers in accordance with CEA Section 4d and Commission regulations, which require that customer funds be segregated, set aside or held in a separate account. Therefore, a DCO must segregate its FCM clearing members' customer funds from its own funds and its members' proprietary funds, deposit customer funds only in certain types of depositories and in accounts named to identify the funds as customer funds, obtain a letter from any depositories acknowledging that they hold customer funds and a DCO may only invest its FCM clearing members' customer funds as permitted by CFTC Regulation 1.25.

To resolve DCO disparate safeguards provided for FCM clearing members' customer funds compared to clearing members' proprietary funds, the Commission proposes requirements designed to treat DCOs' clearing members' proprietary funds comparable to the requirements imposed on FCMs and DCOs under CEA Section 4d and Part 1 of the Commission's regulations with respect to their customer funds and those of their clearing members' customers, respectively. Among other things, the Commission's proposal requires DCOs to segregate clearing member funds from the DCO's own funds, hold those funds at a depository that acknowledges in writing that the funds belong to clearing members and not the DCO, and conduct a daily calculation and reconciliation between each type of segregated account (*i.e.*, futures customer funds, cleared swaps customer funds and clearing member proprietary funds) it holds for clearing members and the amount actually held by the DCO for each of these segregated account types. Further, the proposal also requires DCOs to invest clearing member funds only in permitted investments under Regulation 1.25. The Commission indicates these new protections will prevent the misuse of clearing member funds and help ensure that clearing member funds are appropriately protected in the event of a DCO bankruptcy. For example, the Commission notes that these protections will make it easier for a bankruptcy trustee to identify clearing member proprietary funds and to ensure the funds are available for distribution.

The Commission proposes to implement the new requirements by adopting a broad definition of "proprietary funds" to include all money, securities and property received by a DCO from, for, or on behalf of, a clearing member and held in a proprietary account to margin, guarantee or secure futures, foreign futures and swaps contracts, as well as options premiums and other funds held in relation to options contracts. The proposed definition also includes as proprietary funds clearing member contributions to a guaranty fund to mutualize losses resulting from a clearing member's default. The term does not make any distinction between an FCM's proprietary funds and those of direct clearing members, including natural persons.[9,10]

The Commission's proposal will provide some additional funds protections to DCO direct clearing retail participants. However, as noted above and described below, there are critical differences in the protections provided under this proposal to natural persons' funds in a non-intermediated direct clearing model compared to the

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[9] The Commission notes in the preamble that the U.S. Bankruptcy Code requires a bankruptcy trustee to distribute clearing members' cash and other assets held by the debtor DCO ratably among all clearing members and therefore, the Commission cannot create separate account classes – one for FCM proprietary funds and one for non-FCM proprietary funds (*e.g.*, retail participant funds). This situation is further evidence—in addition to that NFA sets forth below—that the current regulatory framework is not designed to appropriately protect retail participants clearing directly with a DCO.

[10] We strongly encourage the Commission to re-evaluate and change this definition. First, referring to the funds of retail participant direct clearing members as "proprietary" is a misnomer and likely confusing to these individuals who believe that they are customers of the DCO. Further, this new definition confuses other uses of the term, including "proprietary accounts" already contained in CFTC Regulation 1.3. We believe other commenters may address this issue and make suggestions as to how to otherwise characterize these funds, and we encourage the Commission to consider those comments.

safeguards that would flow to these same persons if they were accessing the derivatives markets as customers via FCMs.

By way of example, CFTC regulations impose additional practical safeguards on FCMs to effectively prevent FCMs and their personnel from mishandling customer funds, whether intentionally or unintentionally. The Commission, NFA, CME Group Inc. and the industry put these safeguards in place after two FCM failures to address weaknesses in the segregation requirements and provide essential checks and balances to ensure that an FCM remains in compliance with its segregation requirements. One of these most important customer protections is NFA's and CME Group Inc.'s daily oversight with respect to each FCM's daily reconciliation of the amount it owes to customers and the amount it has on deposit at acceptable depositories, which include banks, carrying brokers and DCOs. These depositories independently report daily to NFA and CME the balances in all accounts that hold funds designated by the FCM as customer segregated accounts. NFA and CME conduct daily comparisons of those balances with the segregated funds reports filed by FCMs and immediately follow up on any material discrepancies. Even if the Commission approves the current proposal, no similar process is currently in place or proposed for direct clearing DCOs to independently ensure that sufficient funds are available to pay any liabilities owed to their retail participants.[11]

A summary of additional customer funds-related protections is attached in Appendix 1. None of these safeguards are contained in the Commission's proposed changes to Part 39 to protect retail participants of DCOs offering direct clearing. Therefore, while the proposed clearing member proprietary funds' safeguards purport to broadly protect retail participant funds (*e.g.*, by requiring separate accounting and segregation), the proposal lacks the safeguards that experience has proven are necessary to ensure the proposed requirements' effectiveness.

In addition to missing key funds' protections, NFA is also concerned with the bankruptcy implications of the proposal. The CEA and Commission Regulations provide customers with a key funds' protection in the event of an FCM's bankruptcy—FCMs are strictly prohibited from commingling customer funds with their proprietary funds. The current proposal, however, does not afford direct clearing retail participants (*i.e.*, retail customers) similar protections because the definition of proprietary funds includes the funds and assets of ***all clearing members***.

Therefore, if a DCO offered a model that combined FCM intermediation and direct clearing retail participants, the proposed regulation not only permits but requires the DCO to commingle direct participant retail customer funds with the FCMs' proprietary funds. As a result, in the event of a DCO bankruptcy, retail participant clearing members will receive no bankruptcy distribution priority over FCM clearing

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[11] Further, we note that FCM and DCO capital requirements differ significantly and direct clearing DCOs are not required to maintain a capital amount based, in part, on its liabilities owed to its direct clearing members.

members. Further, if the DCO also holds funds belonging to the clearing FCMs' customers, those FCMs' customers will receive bankruptcy priority over any direct clearing retail participant, as well as any FCMs with proprietary funds. NFA is extremely concerned that direct clearing retail participants will not understand this critical difference, which arises from being considered a "clearing member" rather than a customer under the Commission's regulations, and they may incorrectly believe that they are on equal footing in bankruptcy priority with a customer accessing the derivatives markets through an FCM.

Direct Clearing DCOs—Critical Customer Protections are Lacking for Retail Participants

Today, there is significant discussion about vertically integrated and direct clearing derivatives market structures and whether the Commission pursuant to the CEA has the authority to appropriately address this structure, including any concomitant customer protection issues. NFA opines that the CEA's regulatory structure is premised on the principle that customer facing activities will flow through an intermediary. Although neither specifically permitted nor prohibited, Congress appears to have never contemplated a direct clearing DCO model. As a result, the DCO Core Principles in CEA Section 5b are focused on protecting the viability of the DCO given its contribution to managing systemic risk, rather than addressing issues related to customer protection outside of the funds area. While on the other hand, beyond protections for proprietary funds, many if not most of the important protections that the CFTC has established for the benefit of retail market participants depend on those participants' status as "customers" of an FCM or other intermediary. These protections simply do not apply to retail market participants of direct clearing DCOs.

At this time, we strongly encourage the Commission to act—with Congress if necessary—to align the protections afforded to natural persons utilizing non-intermediated DCOs to the longstanding critically important regulatory protections afforded to FCM customers.[12] While we commend the Commission for recognizing that direct clearing DCO retail participants' funds should have protections comparable to the requirements imposed on FCMs and DCOs under the CEA and Commission's Regulations with respect to their customer funds and those of their clearing members' customers, we are concerned about what may be perceived as a disjointed approach to addressing the customer protection issues associated with this model. In our view, the Commission's objective should be to provide these direct clearing retail participants with all the comparable safeguards, including funds protections, afforded to customers who access the derivatives markets via an FCM. In the absence of doing so, we do not believe that direct clearing retail participants are in the position to understand that they are not receiving *all* the critical protections provided to customers who access the derivatives markets through an FCM.

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[12] We discuss NFA's recommendation for achieving this alignment in the section entitled *Direct Clearing DCOs Engage in Activities Neither Contemplated by the CEA nor Covered by the CFTC's DCO Regulations.*

Two of the pillars of the CFTC's customer protection regime not present in the DCO direct clearing model are registration of individuals interfacing with the public and disclosure. Intermediary firm personnel who deal with retail customers must generally register with the Commission as associated persons (APs) and become associate members of NFA. APs, unlike other industry employees, must pass proficiency tests administered by NFA as well as go through a background check process that determines whether they are subject to any statutory disqualification (*e.g.*, a past criminal conviction or administrative sanction for dishonesty). Additionally, as NFA associate members, APs are subject to NFA's continuing oversight and, if necessary, NFA's disciplinary process. Disciplinary actions against APs are searchable on NFA's publicly available BASIC database. The current framework that permits a retail participant to clear directly through a DCO neither contemplates nor imposes by regulation these important customer protections or requirements applicable to how these DCOs' employees solicit and onboard these retail participants.[13]

As for disclosure, the Commission from the very beginning has considered accurate risk disclosure to be an essential part of customer protection. *See* Adoption of Customer Protection Rules, 38 FR 31886, 31888 (CFTC July 24, 1978) ("[I]t is absolutely essential that commodity futures professionals who deal with the public be required to disclose to each new customer the substantial risk of loss that generally exists in futures trading") (citation omitted). Thus FCMs, even with the CEA's and Part 1 funds-segregation requirements outlined above, must still disclose to their customers that funds held at an FCM are not protected by government insurance. They must also clearly disclose the risks of trading to their customers and abide by NFA's "know your customer" rule to determine, in part, the appropriate level of risk disclosure to provide. *See generally* CFTC Regulation 1.55 and NFA Compliance Rule 2-30. Yet DCOs—which, as described above, offer less protection for retail funds even under the proposed regulation—are not required to provide their retail members any disclosure about these key risks. Common sense dictates that when the regulatory risk to retail participants increases (as it does in a direct clearing model), disclosure obligations should also increase—not decrease.

There are also a host of other specific customer protection rules under the CFTC's regulations that simply do not apply to direct clearing DCOs that deal with retail market participants. Just a few examples of these "missing" customer protections include the following: the limitation on loans to customers to facilitate trading (CFTC Regulation 1.30); the requirement to make the segregation statement available publicly (CFTC Regulation 1.55(o)); the prohibition on inherently misleading guarantees against loss (CFTC Regulation 1.56); the requirement to notify customers of final disciplinary action against the firm (CFTC Regulation 1.67); conflicts of interest requirements,

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[13] NFA notes that the Commission's February 2004 HedgeStreet Designation Memorandum notes that HedgeStreet has agreed that its Compliance Officer will review promotional material for compliance with NFA Compliance Rule 2-29 and will keep records in accordance with CFTC Regulation 1.31. If this protection is adequate, then FCMs should arguably be permitted to drop their APs' registrations and solicit retail customers if they merely agreed that their employees would comply with the CFTC's and NFA's requirements.

including a prohibition on exercising undue influence over customers (CFTC Regulation 1.71); trading standards, including the requirement not to disclose customer trades to the firm's affiliates (CFTC Regulation Part 155); privacy protections for customers' highly sensitive personal financial information under both the Gramm-Leach-Bliley Act and the Fair Credit Reporting Act (CFTC Regulations Parts 160 and 162); the obligation to supervise their activities (CFTC Regulation 166.3); and strict limitations on the use of contracts of adhesion to impose one-sided arbitration agreements on customers (CFTC Regulation 166.5). Retail customers of an FCM or IB get all these protections; retail members of a DCO get none.

As the Commission's release notes, FCMs also perform a critical role of assisting U.S. government agencies with detecting and preventing money laundering by complying with the AML and KYC programs required of FCMs. While the Commission requests comment on how to impose similar requirements on DCOs, it is important to acknowledge that DCOs are not financial institutions under the Bank Secrecy Act, and the Commission must fully consider what impact that has on its ability to impose these requirements on a DCO.

Direct Clearing DCOs Engage in Activities Neither Contemplated by the CEA Nor Covered by the CFTC's DCO Regulations

NFA understands that each DCO approved to engage in a direct clearing model with retail participants is limited to offering fully collateralized products. As a result, these entities collect funds sufficient to cover the maximum loss possible on a contract before execution and therefore are not engaged in mutualizing credit risk.[14] At closeout or settlement of the contract, the entity pays out gains or subtracts losses from the upfront deposits. Although these entities substitute themselves in as the counterparty to the transaction, they also engage in customer facing activities that more closely resemble the activities of an intermediary (*e.g.*, customer solicitation).

Most of the customer protection issues that arise from the direct clearing retail participant model stem from the fact that there is only one DCO registration category that covers both traditional DCOs as well as direct clearing DCOs, even though their activities are significantly different. As a result, these entities are regulated as DCOs and are not subject to any of the important customer protection requirements that apply to an intermediary, even though they engage in customer facing activities. NFA believes that one way to address this lack of customer protection and to align the protections afforded to natural persons utilizing non-intermediated DCOs to the longstanding critically important regulatory protections afforded to FCM customers is for the CFTC to work with Congress to establish another registration category that addresses all the activities of a direct clearing DCO and to provide the Commission with appropriate rulemaking authority to adopt requirements that provide retail participants

[14] NFA understands that CBOE Clear Digital LLC's DCO registration order also permits it to clear certain margined products but only for FCMs.

with the same level of customer protections provided when dealing with an intermediary.[15]

If a separate DCO registration category for this type of clearing model is established, the Commission and Congress should consider the impact on the Commission's resources if the customer-facing activities of direct clearing DCOs were to be regulated consistent with how the Commission, NFA and CME Group, Inc. oversee FCMs. Currently, independent SROs assist the Commission by performing front-line regulatory oversight over FCMs; however, there is no similar regulatory oversight structure in place today for direct clearing DCOs, and the Commission is the front-line regulator.

Non-Intermediated Margined Derivatives

As noted above, to date the Commission has placed on most direct clearing DCOs a condition that they may only clear fully collateralized, cash settled binary options or similar non-leveraged products. However, in early 2022, the Commission considered a petition by LedgerX LLC d/b/a FTX US Derivatives (LedgerX) to amend its DCO Registration to allow retail participants to directly clear margined digital asset derivatives. LedgerX withdrew this petition shortly after FTX's financial failure and the Commission never had an opportunity to act on this petition.

Given our customer protection perspective, NFA remains deeply concerned about the potential expansion of this direct clearing model to margined derivatives products. The preamble indicates that the Commission is proposing these proprietary funds' protections to address issues surrounding DCOs that offer fully collateralized products on a non-intermediated basis. However, given the proposed definition of "proprietary funds" and evolving business models, the door is open for a direct clearing DCO to request extending these protections to clearing member funds held to margin derivatives trades. NFA strongly recommends that the Commission not approve this type of request until it has the authority (and acts upon it) to provide direct clearing retail participants with the full protections afforded to FCM customers. As fully discussed in our comment letter dated May 11, 2022 in response to the LedgerX petition, the Commission lacks this authority today,[16] because a direct clearing DCO is not legally able to accept funds to margin derivatives transactions without also

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[15] NFA recognizes that a legislative change may take time to accomplish. In the interim, given the paramount customer protection concern, the Commission should follow the construct of the CEA and require the DCO or an affiliate of the DCO to also register as an FCM. Retail market participants would be required to access the DCO via the FCM and would be afforded *all* the customer protections mandated under CFTC Regulation Part 1. Moreover, the Commission would have to ensure appropriate conflict of interest safeguards are in place.

[16] Consistent with our position on LedgerX/FTX, NFA does not believe it is appropriate for the Commission to grant an exemption under CEA Section 4(a) to allow a direct clearing DCO to operate as an unregistered FCM. To do so, the CFTC must make findings that the exemption is in the public interest and given the customer protection concerns raised in this letter, we do not believe that such a finding could be made.

registering as an FCM.[17] Therefore, this type of direct clearing DCO model is wholly inconsistent with the current Congressionally established regulatory structure and is entirely contrary to retail customer protection.

Conclusion

Although this proposal provides non-FCM clearing members, particularly natural person retail participants, with additional funds protections, it falls far short of providing the protections provided to a retail customer trading through an intermediary. As a result, the framework of customer protections that the Commission has implemented based on several decades of experience, and which SROs are integral in overseeing, are completely lacking, and it is not clear that the Commission could impose similar customer protection requirements on a DCO. NFA encourages the Commission to consider all of the issues that arise from the non-intermediated market structure and propose solutions that ensure retail participants receive the appropriate customer protections. We believe this likely requires that the CEA be amended to adopt a new registration category to cover these types of activities and provide the Commission with appropriate rulemaking authority.

NFA appreciates the opportunity to provide our views on these important issues, which have a significant impact on the derivatives markets. We support the Commission's efforts to evolve the regulatory framework but continue to caution the Commission to ensure that any changes do not lessen the current regulatory protections that have contributed to making the derivatives markets strong. We are available to discuss any of these issues with Commission staff. If you have any questions on this letter or the topic in general, please do not hesitate to contact me at cwooding@nfa.futures.org.

Respectfully submitted,

Carol A. Wooding
Senior Vice President
and General Counsel

[17] Congress specifically requires persons engaging in certain activities (*e.g.,* accept any money, securities or property to margin, guarantee or secure derivatives trades) to register as FCMs. See CEA Sections 1a(28) and 4d. The omission of these activities in other CFTC registration definitions does not mean that persons are permitted to substitute one Congressionally defined CFTC registration (*e.g.,* DCO or DCM) for another (*e.g.*, FCM). To the contrary, when Congress speaks affirmatively in one area of the CEA and omits similar language in other CEA provisions, legislative intent is clear, and the omission is purposeful.

APPENDIX 1
CUSTOMER FUNDS RELATED PROTECTIONS PROVIDED BY AN FCM

- An FCM is required to compute daily the total amount of futures customer funds on deposit in a segregated account, the amount of futures funds required to be on deposit in a segregated account and the FCMs residual interest (*i.e.,* excess funds) in those funds. FCMs must document those computations and submit them to the firm's DSRO and the CFTC. *See* CFTC Regulation 1.32(a)-(d).

- An FCM is required to file, both with their DSRO and the CFTC, a more detailed report on segregated customer funds on a bi-monthly basis. *See* CFTC Regulation 1.32(f).

- An FCM is required to establish a targeted residual interest in its segregated accounts, which is designed to ensure that the FCM remains in compliance with its segregation requirement at all times. *See* CFTC Regulation 1.23(c).

- An FCM is also prohibited from withdrawing funds from a segregated account that are not for the benefit of a customer before first completing its daily segregation calculation. *See* CFTC Regulation 1.23(b).

- An FCM may not withdraw funds in a single transaction or a series of transactions that are not made to or for the benefit of customers if the withdrawals exceed 25% of the FCM's residual interest in segregated accounts, unless the FCM complies with a number of safeguards including filing notice of the withdrawal with the Commission and the FCM's DSRO. *See* CFTC Regulation 1.23(d).

- An FCM is also limited to holding customer funds in certain named types of depositories. *See* CFTC Regulation 1.49. The requirements for DCO depositories are far less prescriptive. *See* CFTC Regulation 39.15(c). The absence of bright-line rules, while generally appropriate for DCOs, also means that DCO employees and regulatory staff must correctly gauge the risk associated with different types of depositories, or else risk the loss of retail members' funds.

- An FCM must provide its customers information about their accounts regularly (*i.e.,* monthly statements and daily confirmation statements), which enables customers to promptly find errors or other issues with the FCM's handling of the customers' accounts. *See* CFTC Regulation 1.33.