JAC

Joint Audit Committee

April 22, 2024

Mr. Christopher Kirkpatrick
Secretary of the Commission
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street NW
Washington, DC 20581
Via CFTC Comments Portal: https://comments.cftc.gov

RE: RIN 3038-AF21
Regulations to Address Margin Adequacy and To Account for the Treatment of Separate Accounts by Futures Commission Merchants

Dear Mr. Kirkpatrick:

The Joint Audit Committee ("JAC"), a representative committee of Audit and Financial Surveillance Departments of U.S. futures exchanges and regulatory organizations,[1] appreciates the opportunity to comment on the proposed regulations to address margin adequacy and to account for the treatment of separate accounts by Futures Commission Merchants ("FCMs").

Customer protection is the cornerstone of the futures industry, and it continues to be critical to ensure that the protections afforded under the customer protection regimes are as strong as they can be for market participants and the overall safety and soundness of the FCMs. The JAC, through its member Self-Regulatory Organizations ("SROs"), operates a supervisory program which includes the examination of the SROs' FCM members to assess the member registrants' compliance with Commodity Futures Trading Commission ("CFTC" or the "Commission") regulations and SRO rules.

The JAC appreciates the Commission's efforts to codify previously issued guidance pursuant to CFTC Letter No. 19-17 ("NAL 19-17") and CFTC Letter No. 20-28 ("NAL 20-28") (collectively the "NALS"), initially by issuing the Notice of Proposed Rulemaking to amend its Derivatives Clearing Organization Risk Management Regulations to Account for the Treatment of Separate Accounts by Futures Commission Merchants (the "First Proposal")[2] and subsequently by issuing Regulations to Address Margin Adequacy and To Account for the Treatment of Separate Accounts by Futures Commission Merchants (the "Second Proposal" or the "NPR").[3] The JAC appreciates the opportunity to comment on the Commission's Second Proposal.

[1] The Joint Audit Committee is a representative committee of U.S. futures exchanges and regulatory organizations including Bitnomial, CBOE Digital Exchange, CBOT, CFE, CME, COMEX, IFUS, IMX, LMX, MGEX, NADEX, NFA, Nodal Exchange, NYMEX and SMFE. http://www.jacfutures.com
[2] 88 FR 22934 (April 14, 2023).
[3] 89 FR 15312 (March 1, 2024).

Consistent with the JAC's comments on the First Proposal,[4] the JAC commends the Commission's Second Proposal for extending the customer protection and risk management benefits of regulation § 39.13(g)(8)(iii) to all FCMs and all of their customer accounts by introducing a requirement under its Part 1 regulations that would prohibit an FCM from disbursing funds to a customer in an amount that is greater than the customer's funds in excess of its initial margin requirements (the "Margin Adequacy Requirement") and allowing FCMs, for purposes of the Margin Adequacy Requirement, to treat separate accounts of the same customer as if they are accounts of separate entities if certain conditions are met. While the intent of the Second Proposal appears to apply the Margin Adequacy Requirement and the no-action position in NAL 19-17 to all FCMs,[5] it introduces significant changes to margin calculations and accepted margin practices which the JAC believes require more discussion and analysis of their impacts.

Notably, the Second Proposal suggests new requirements defining customer undermargined amounts (i.e., the amounts required to be called for) and funds available for disbursement to a customer. As further described below in Section I, these new proposed requirements are different than are generally required today under exchange rules, the JAC's Margins Handbook,[6] and current industry practice. As proposed, these new definitions would impact FCMs' residual interest calculations and Legally Segregated Operationally Commingled ("LSOC") compliance calculations for separate account customers but not for other customers of the FCM which are not receiving separate account treatment. Section II describes significant requirements in the Second Proposal on which the JAC requests clarification both for expectations of FCM compliance with these requirements and for the JAC in executing its examination obligations. Section III identifies other features of the Second Proposal with respect to the risk mitigating conditions and reiterates certain comments on the First Proposal to emphasize their importance for the Commission's consideration.

I. The Second Proposal introduces significant new requirements

Undermargined amount

Proposed regulation § 1.44(a) defines the undermargined amount for an account to be, "the amount, if any, by which the customer margin requirements with respect to all products held in that account exceeds the net liquidating value plus the margin deposits currently remaining in that account. For purposes of this definition, "margin requirements" shall mean the level of maintenance margin or performance bond (including, as appropriate, the equity component or premium for long or short options positions) required for the positions in the account by the applicable exchanges or clearing organizations."[7]

This proposed definition is inconsistent with industry practice and the methodologies for calculating the undermargined amount provided in the JAC Margins Handbook. For purposes of the "Net Liquidating Value Method" (also commonly referred to as the "Risk Method" or "Pure SPAN Method"), the JAC Margins Handbook defines the undermargined amount as, "The amount by which margin equity is less than the

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[4] Joint Audit Committee June 30, 2023 Comment Letter to 88 FR 22934 at: https://comments.cftc.gov/Handlers/PdfHandler.ashx?id=34871.

[5] 89 FR 15317.

[6] The JAC Margins Handbook, prepared by the Joint Audit Committee in an effort to standardize margin procedures where possible, and to establish sound policies for monitoring margin risk exposure and improve operational efficiencies, is available at: http://jacfutures.com/jac/handbook/JAC%20Margins%20Handbook%20-%202nd%20Edition%201999.pdf.

[7] 89 FR 15355.

maintenance margin requirement."[8] Further, for purpose of this method, the JAC Margins Handbook defines margin equity as "Under the net liquidating value method, an account's net liquidating equity plus the collateral value of acceptable margin deposits"[9] and defines maintenance margin requirement as "The minimum amount of margin equity required to be maintained in an account. The maintenance margin requirement is the actual risk margin calculated by the SPAN® margin system."[10],[11] Alternatively, the JAC Margins Handbook provides that an FCM may use the "Total Equity Method" in which the undermargined amount would be the amount by which total equity plus the collateral value of acceptable margin deposits is less than the risk maintenance margin requirement adjusted for the option value (i.e., net long option value reduces the risk margin requirement and net short option value increases it).[12]

As proposed, the definition set forth in proposed regulation § 1.44(a) would require that for all customer accounts, not just separate account customers, an FCM include the equity component of the long and short options in *both* the margin equity (i.e., net liquidating value) and in the margin requirement (i.e., by adjusting the risk margin for the equity component of the long and short options). In contrast, under the JAC Margins Handbook, exchange rules and industry practice, the equity component of the long and short options is only included in *either* the margin equity (Net Liquidating Value Method) or margin requirement (Total Equity Method).

Further, today option premium is already included in margin equity (i.e., it is part of ledger balance and will be included in total equity or net liquidating value) and is not a component of the margin requirement.

Depending on the composition of the account (e.g., if the account contains options), the Second Proposal's definition may result in different undermargined amounts than compared to the Risk Method or Total Equity Method utilized as standard practice by FCMs today. To ensure accuracy with the proposed calculation of margin requirements, the Commission should provide the formula (i.e., the specific calculation) for inclusion of the equity component or premium ("as appropriate") for long or short options positions. Further clarification to the industry of the rationale for the change in methodology would be appropriate in order to understand it and educate market participants, including impacted end-clients.

Relatedly, in Question 5, the Second Proposal asked, "*Should the definition of ''undermargined amount'' apply haircuts to the value of customer collateral held by the FCM?*" In short, the JAC's position is yes, non-cash collateral on deposit in a customer's account should be valued at market value less applicable SEC and CFTC haircuts for determining the margin value of the collateral.

Funds available for disbursement

Proposed regulation § 1.44(b)(1) would require an FCM to "…ensure that a customer does not withdraw funds from its accounts with such futures commission merchant unless the net liquidating value (calculated as of the close of business on the previous business day) plus the margin deposits remaining in the customer's account after such withdrawal are sufficient to meet the customer initial margin requirements with respect to all products held in such customer's account, except as provided for in paragraph (c) of this

[8] Refer to Chapter 1, Definition of "Undermargined Amount" in the JAC Margins Handbook.
[9] Refer to Chapter 1, Definition of "Margin Equity" in the JAC Margins Handbook.
[10] Refer to Chapter 1, Definition of "Maintenance Margin Requirement (MMR)" in the JAC Margins Handbook.
[11] Since the JAC Margins Handbook was written, in addition to SPAN® other risk-based, portfolio approach margining systems have been developed and adopted by the futures industry to calculate the risk margin of futures and options positions.
[12] Refer to Chapter 4," Margin Calls" in the JAC Margins Handbook.

section."[13] It is unclear how the Commission is defining customer initial margin requirements given its definition of the term "margin requirements" (i.e., "…including…the equity component or premium for long or short option positions") within the proposed definition of "undermargined amount" in proposed § 1.44(a).

Similarly, including the equity component of long or short option positions in *both* account equity and in the initial margin requirement would be inconsistent with the calculation of funds available for disbursement in the JAC Margins Handbook and JAC Regulatory Alerts,[14] which define funds available for disbursement under the Net Liquidating Value Method as:

An Account's Net Liquidating Value + Collateral Value of Acceptable Margin Deposits – Initial Margin Requirements (Risk Margin only) ≥ zero.

Alternatively, under the Total Equity Method, FCMs may compare the total equity plus the collateral value of acceptable margin deposits in an account to the initial margin requirement adjusted for the account's option value. As noted in our undermargined amount discussion above, the definitions of both margin equity and initial margin requirements in the Second Proposal differ from the JAC Margins Handbook, applicable JAC Regulatory Alerts and industry practice today, and if an account holds options, the Second Proposal's approach may result in a different amount of funds available for disbursement. As previously stated, it is the JAC's position that for determining an account's undermargined amount or funds available for withdrawal, the collateral value of non-cash margin deposits should not exceed market value less applicable haircuts.

If the Commission is proposing a different calculation for the amount of funds available for disbursement than required today (including permissibility of *both* the Net Liquidating Method and Total Equity Method), further clarification to the industry of the rationale for the change in the methodology would be prudent in order to understand it and to educate market participants, including impacted end-clients. Importantly, proposed regulation § 1.44(b)(1) would impact all customers (segregated, secured 30.7 and cleared swap); it is not limited to those utilizing separate accounts.

One business day margin call

Proposed regulation § 1.44(f)(1) requires an FCM, for each undermargined separate account, to "…issue a margin call for the separate account for at least the amount necessary for the separate account to meet the initial margin required by the applicable exchanges or clearing organizations (including, as appropriate, the equity component or premium for long or short option positions) for the position in the separate account…"[15]

Such required margin call, albeit *only* applicable to separate accounts, is inconsistent with existing industry practice and the guidance for calculating a margin call in the JAC Margins Handbook.[16] Currently, FCMs calculate a margin call using the following formula:

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[13] 89 FR 15355.

[14] Specifically, refer to Page 10-2 of the JAC's Margins Handbook, and JAC Regulatory Alerts #19-02 and #14-03, available at http://jacfutures.com/jac/RegAlerts.aspx.

[15] 89 FR 15356.

[16] Refer to Chapter 4, "Margin Calls" in the JAC Margins Handbook.

Initial Margin Requirement - Margin Equity - Outstanding Margin Calls = A positive balance represents amount of margin call to be issued.

The JAC Margins Handbook provides that FCMs may calculate a margin deficiency using either the Net Liquidating Value Method *or* the Total Equity Method. In most situations, the margin deficiency will be identical under either method. However, some circumstances involving long options could result in the Total Equity Method having a larger margin deficiency.

By incorporating the Second Proposal's definition of "undermargined amount" as stated in proposed regulation § 1.44(a) into the requirement for the manner in which an FCM must calculate a margin call for a separate account as proposed in regulation § 1.44(f)(1), the equity component of the long and short options would be included in *both* the margin equity (i.e., net liquidating value) and in the margin requirement (i.e., by adjusting the risk margin for the equity component of the long and short options). Conversely, under the JAC Margins Handbook, exchange rules and industry practice, for all other accounts, the equity component of the long and short options is only included in *either* the margin equity (Net Liquidating Value Method) or margin requirement (Total Equity Method) in determining a required margin call. Option premium is already included in the calculation of a margin call as a component of margin equity (i.e., premium is part of ledger balance and will be included in total equity or net liquidating value) and is not a component of the margin requirement.

As previously discussed, the definitions of both margin equity and margin requirements in the Second Proposal differ from the JAC Margins Handbook so that if an account holds options positions it may result in a different required margin call.

Critically to emphasize, FCMs would be required to compute margin calls for separate accounts as required under proposed regulation § 1.44(f)(1) and would be required to compute margin calls *differently* for non-separate account customers.

Residual Interest and Legally Segregated Operationally Commingled ("LSOC") compliance calculations

Proposed regulation § 1.44(g)(5) requires an FCM, for purposes of its residual interest and LSOC compliance calculations, "…to treat the separate accounts of a separate account customer as if the accounts were accounts of separate entities and include the undermargined amount of each separate account, and cover such undermargined amount with its own funds."[17] The undermargined amount for such separate accounts would be as defined in proposed regulation § 1.44(a).

As discussed above, proposed regulation § 1.44(a) defines the undermargined amount differently than how it is currently defined in the JAC Margins Handbook and has been applied for the purposes of an FCM's compliance with regulations §§ 1.22(c), 22.2(f)(6) and 30.7(f)(1)(ii). Moreover, JAC Regulatory Alert #14-06[18] explicitly states that the undermargined amount or margin deficiencies should be calculated as follows for the Residual Interest Requirement:

[17] 89 FR 15357.

[18] JAC Regulatory Alert #14-06 is available at: http://jacfutures.com/jac/jacupdates/2014/jac1406.pdf.

Risk Maintenance Margin Requirement - Credit Net Liquidating Value - Margin Collateral in Excess of Amounts to Secure Debit/Deficits = Undermargined Amount
(if amount < 0, then the amount is 0).

Under JAC Regulatory Alert #14-06 unsettled non-U.S. Dollar transactions may be considered as margin funds received when determining a customer's residual interest requirement under certain conditions, generally known as "pending receipts." It is unclear if such pending receipts could be considered as received under proposed § 1.44(g)(5) based on the definition of Undermargined Amount in proposed regulation § 1.44(a) and the discussion throughout the Preamble. Accounting for the settlement of non-U.S. Dollar transactions is discussed further below.

JAC Regulatory Alert #12-03[19] defines a similar calculation for the margin deficiencies to be included in the LSOC compliance calculation in accordance with regulation § 22.2(f).

Thus, for non-separate account customers the undermargined amount to be included in the residual interest requirements/LSOC compliance calculations may be *different* than for separate account customers provided for under proposed regulation § 1.44(g)(5). Such change to the residual interest and LSOC compliance calculations for separate account customers would require FCMs permitting separate account treatment to bifurcate the manner in which they calculate their requirements and update their regulatory reporting records.

Undermargined capital charges & risk based capital requirements

In the Second Proposal's regulation § 1.44(a), the definitions in which the equity components for long and short options is included in margin requirements, and margin equity including non-cash collateral valued at full market value are noted to "…apply only for purposes of this section…"[20] Nonetheless, it would be beneficial to clarify and confirm that for purposes of the undermargined capital charge for a customer account under regulation § 1.17(c)(5), maintenance margin requirements include the risk component only, and non-cash collateral should be valued at market value less applicable haircuts, including for separate account customers. In this regard, such capital charges for undermargined accounts would be consistent with the JAC Margins Handbook[21] and current regulation § 1.17(c)(5).[22] Similarly, the risk-based capital requirement as defined under regulation § 1.17(b)(8) is based on the aggregate risk margin requirements for all customer (including separate accounts) and noncustomer accounts. Basing the risk-based capital requirements on risk margin requirements only (i.e., excluding the equity component of long and short options) is consistent with exchange rules and current regulation § 1.17(b)(8).

As stated in JAC Regulatory Alert #14-06 and consistent with the treatment for residual interest, an FCM may consider "pending" non-US Dollar deposits as received for purposes of the undermargined capital charge if certain conditions are met. The Commission should confirm that under proposed regulation § 1.17(c)(5), such "pending" deposits would be permitted to be considered as received in computing the undermargined capital charge for *all* customers. Refer to Section II Undermargined Capital Charges & Current Calls for further discussion.

[19] JAC Regulatory Alert #12-03 is available at: http://jacfutures.com/jac/jacupdates/2012/jac1203.pdf.
[20] 89 FR 15355.
[21] Refer to Chapter 5, "Undermargined Capital Charges" in the JAC Margins Handbook.
[22] Note that the amount of the "current margin call" for separate account customers would be calculated differently than all other non-separate accounts as required under proposed regulation § 1.44.

As stated previously, performing these margin calculations differently for compliance with these different regulatory reporting requirements may prove burdensome for FCMs that permit separate account treatment under proposed § 1.44.

Multi-settlement margin procedures – funds available for disbursement

The Second Proposal spends considerable time in discussing the calculation of funds available for disbursement – the timing of the determination (i.e., as of the close of business the previous business day) and the inclusion of all products held in such customer's account.[23] Similarly, under proposed regulation § 1.44(f), the Commission makes clear that the FCM "…shall issue a margin call for the separate account for at least the amount necessary for the separate account to meet the initial margin required by the applicable exchange or clearing organization (including, as appropriate, the equity component or premium for long or short options positions) for the positions in the separate account…"[24]

The JAC would like to emphasize that the proposed regulation may impact the way certain FCMs currently settle with their customers on a daily basis. In particular, many FCMs may initiate multiple cash and/or collateral transactions within the same customer account on the same business day in order to settle each individual currency within the account or may call initial margin separately from variation margin within a single customer account (whether treated as a separate account or not). This may result in a withdrawal of margin funds by a single customer account or within a separate account when, in the aggregate including required margin on all positions and total margin equity, the account was undermargined as of the close of business the prior business day. It is a generally accepted practice provided certain controls are in place and adequate records are maintained to demonstrate that margin calls are issued, aged and fully initiated for immediate settlement to support any outgoing disbursements. The JAC requests confirmation whether such margin procedures will continue to be permissible for both non-separate accounts and for separate accounts given the discussion in the Second Proposal, especially concerning funds available for disbursement.

The Second Proposal includes an extensive discussion of receipts of currencies to satisfy a margin call that do not settle same day, setting forth specific requirements for the timing of currency receipts for consideration in meeting the one business day margin call requirement. The NPR does not, however, discuss multiple currency receipts and disbursements within a separate account. For instance, a customer may settle margin on a currency-by-currency basis within a single separate account. However, under the Second Proposal, there appears to be a requirement for each separate account[25] to settle a single undermargined amount pursuant to proposed regulation § 1.44(f), or disburse one excess margin amount pursuant to proposed regulation § 1.44(b), taking into consideration the aggregate of all positions and currencies within the separate account.[26] The JAC seeks clarification on these points as illustrated in footnote 26.

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[23] Discussion of proposed regulation § 1.44(b) at 89 FR 15324.

[24] 89 FR 15356.

[25] The JAC considers it understood that an account's regulatory classifications of segregated, secured 30.7, and/or cleared swaps are viewed in isolation from a margin perspective.

[26] For example, assume that a customer's separate account had an overall undermargined amount at the close of business on Monday of $2,000 USD (comprised of an undermargined amount in GBP currency with a USD equivalent value of $6,000 and funds in excess of its margin requirements in USD currency of $4,000). Although the separate account was undermargined overall for Monday's close of business, could the FCM allow the separate account customer to withdraw on Tuesday the excess margin funds denominated in USD of $4,000 while also issuing a margin

It is important to recognize the significant work that FCMs may be required to undertake to update their regulatory records, risk programs, margin calculations and reports for not only separate accounts but all customer accounts due to the impact of the proposed new requirements.

II. Certain provisions require additional clarification

Undermargined capital charge and current calls

Proposed regulation § 1.17(c)(5)(viii)(A) defining the calculation of the undermargined capital charge added: "If, however, a call for margin or other required deposits for an undermargined customer account is outstanding for more than one business day, then no such call for that undermargined customer account shall be applied until all such calls for margin have been met in full."[27] Such addition in requiring that if one margin call is noncurrent, then all margin calls are noncurrent is consistent with how noncurrent margin calls are currently calculated and included for capital charge purposes as detailed in JAC Regulatory Alert #14-06.

Proposed regulation § 1.17(c)(5)(viii)(B) requires that if an FCM carries separate accounts it shall treat all such separate accounts as separately owned entities for purposes of computing the undermargined capital charge. Critically, even in the "ordinary course of business" it further requires the calculation of current calls used in computing a separate account's undermargined capital charge to take into consideration the age of *all* margin calls in *all* separate accounts of the separate account customer. Specifically, proposed regulation § 1.17(c)(5)(viii)(B) states: "If, however, a call for margin or other required deposits for any separate account of a particular separate account customer is outstanding for more than one business day, then all outstanding margin calls for all separate accounts of that separate account customer shall be treated as if the margin calls are outstanding for more than one business day, and shall be deducted from net capital until all such calls have been met in full."[28]

Under proposed regulation § 1.44(f) (one business day margin call requirements), a separate account within the one business day requirement as defined may nonetheless have outstanding calls considered noncurrent for purposes of computing the undermargined capital charge as required under proposed regulation § 1.17(c)(5)(viii)(B).[29] For example, when a margin call is met on the second business day after the margin call was issued (1) in a currency as provided for in proposed Appendix A (proposed regulation

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call on Tuesday for the GBP undermargined amount (for the USD equivalent value of $6,000), and remain in compliance with proposed regulation § 1.44(b)? If so, are there certain requirements and controls that the FCM must have in place? Further, how would the different settlement timeframes of the currencies impact such permissibility including in cases where a specific currency cannot be initiated for immediate settlement (for instance, in the above example suppose Tuesday is a banking holiday in the UK, but not in the US)? As previously stated by JAC in its comments on the First Proposal, the Commission should consider the risks introduced when a margin disbursement is made from a separately margined account and the receipt of funds into another separate account of the same beneficial owner is delayed, especially if the call is made on a foreign holiday. The same principle would apply to separate accounts that are permitted to settle multiple cash and/or collateral transactions, especially in multiple currencies, within the same separate account. Under the Second Proposal, an FCM may disburse funds supported by a margin receipt that was not initiated on the same day as the disbursement. By contrast, within a separate account, and for accounts not receiving separate account treatment, the disbursement would not be allowed in those circumstances.

[27] 89 FR 15354.

[28] *Id*.

[29] At 89 FR 15321, "…the concepts of margin calls that are outstanding no more than one business day (for purposes of § 1.17(c)(5)(viii)), and meeting a one business day margin call (for purposes of § 1.44(f)) are separate and distinct—it is possible that a separate account customer may meet the test for the first, but not the second, or may meet the test for the second, but not the first."

§ 1.44(f)(2)) and (2) in cases of where one additional business day is provided due to a banking holiday in the jurisdiction of the currency (proposed regulation § 1.44(f)(4)).

This is further clarified in the preamble of the Second Proposal, where in discussing proposed regulation § 1.44(f) the Commission states: "This is separate from, e.g., requirements for margin aging under regulation § 1.17(c)(5)(viii), which requires payment by the end of the business day after the business day on which the margin call is made. For example, if a margin call for a separate account is made on Tuesday based on events on Monday, and the margin call is to be met in JPY, payment by close of business on Thursday would be timely for purposes of proposed regulation § 1.44(f), because JPY is a currency listed in proposed Appendix A to part 1, and that payment would be considered in compliance with the requirements of paragraph (f) of regulation § 1.44 ''if received by the applicable futures commission merchant no later than the end of the second business day after the day on which the margin call is issued.'' However, payment for that margin call would not be timely for purposes of regulation § 1.17(c)(5)(viii) unless received by close of business on *Wednesday*."[30]

Under the Commission's example, any separate account customer who meets a margin call in JPY (or any proposed Appendix A currency) on the second business day after the day on which the call was issued would not be able to deduct any margin calls in any separate accounts of the separate account customer in calculating undermargined capital charges. For example, suppose a separate account customer has two separate accounts – Account A and Account B. If Account A is undermargined at the close of business on Monday, with a timely margin call made in JPY on Tuesday and met on Thursday, the call issued on Tuesday would be considered a noncurrent margin call as of the close of business Wednesday. If Account B was properly margined on Monday and Tuesday but became undermargined as of the close of business on Wednesday, then the FCM would be required to take an undermargined capital charge for both separate account A and B as of the close of business Wednesday as it could not reduce the undermargined amount in Account B by any outstanding margin calls (as the JPY margin call in Account A is outstanding greater than one business day (i.e., is noncurrent)).

Although the JAC is not taking a position on this new requirement, it believes that the Commission should highlight this point if included in its final rulemaking. FCMs may be subject to significant capital charges for such separate accounts (i.e., those that meet margin calls in proposed Appendix A currencies or currencies (other than USD or CAD) where a foreign holiday is involved), even when each separate account is individually meeting its calls on "a one business day basis" as required under proposed regulation § 1.44(f).

Additionally, the JAC issued previous guidance in Regulatory Alert #14-06 which noted: "When calculating the undermargined capital charge and consistent with the treatment for residual interest, the FCM may consider "pending" non-US Dollar deposits, [31] ACH payments and checks as received if the respective conditions are met." The JAC requests confirmation that, such "pending" deposits would be permitted to be considered as received in computing the undermargined capital charge for *all* customers under proposed regulations § 1.17(c)(5)(viii)(A) and (B). Further, as regulation § 1.17(c)(5)(xi) requiring undermargined capital charges for noncustomer and omnibus accounts is unchanged, unless the Commission amends or

[30] 89 FR 15333.

[31] JAC Regulatory Alert #14-03, available at http://jacfutures.com/jac/jacupdates/2014/jac1403.pdf, notes certain conditions under which an FCM may consider a non-USD deposit as pending in an account and reflect in the account's margin equity.

confirms otherwise, the JAC will assume that FCMs would still be able to apply the treatment for "pending" deposits as detailed in JAC Regulatory Alert #14-06 to noncustomers and omnibus accounts.

In summary, undermargined capital charges may increase for all FCMs who otherwise consider "pending" deposits in an account's margin equity for purposes of determining margin calls outstanding for more than one business day. Further, as previously mentioned under the Second Proposal, FCMs would be required to take undermargined capital charges on separate accounts based on the margin calls outstanding for more than one business day of other separate accounts of the same separate account customers. FCMs may need to consider additional capital needs that may result from these requirements.

One day debit or deficits

If an FCM carries separate accounts, proposed regulation § 1.17(c)(2)(i) would require that it shall treat all such separate accounts as separately owned entities for debit/deficits (and, for clarity, cannot secure those debit/deficits with collateral across separate accounts). Under the Second Proposal, "if the separate account is subject to a call for margin by the FCM it may be included in current assets until the close of business on the business day following the date on which the deficit or debit ledger balance originated, provided that the separate account timely satisfied previous day's debit or deficits in its entirety. If the separate account does not satisfy a previous day's deficit in its entirety, then the deficit for the separate account, and any other deficits of the separate account customer in other separate accounts carried by the FCM, shall not be included in current assets until all such calls are satisfied in their entirety."[32]

Although JAC does not object to this new requirement, we would like to highlight that this would be a change from the current requirements related to the treatment of separate account debit/deficits in NAL 19-17. Proposed regulation § 1.17(c)(2)(i) will require FCMs to look across all separate accounts of a separate account customer (i.e., beneficial owner) when determining one day debit/deficits to be considered current assets for net capital. Currently, such determination is solely made based on the separate account.

Additionally, based on extensive discussions concerning the receipt of non-U.S. currencies in the Second Proposal, it would be beneficial for the Commission to clarify how an FCM should consider if a separate account "timely satisfied previous day's debit or deficits in its entirety." If, as expected, margin calls are only considered satisfied when receipts are settled for purposes of proposed regulation § 1.17(c)(2)(i), margin calls met in non-US Dollars in one separate account may impact the current or noncurrent classification of debit/deficits in all separate accounts of a separate account customer. FCMs permitting separate account treatment may need to consider additional capital needs that may result from this requirement.

Further, as the Second Proposal changes the calculation of one day current debit/deficits for separate accounts (a strong enhancement), FCMs may need time to update their regulatory systems and records to comply.

Omnibus accounts

The Commission proposes to amend regulations § 1.58(a) and (b) in the Second Proposal to extend the gross margin requirements of domestic futures and options accounts to Cleared Swaps accounts. However, while doing so the Commission specifically declined to require the gross margining for omnibus

[32] 89 FR 15320.

accounts of secured 30.7 futures and options positions held by FCMs.[33] As noted in the Second Proposal's preamble discussion, proposed amended regulation § 1.58(a) allows for an FCM carrying a secured 30.7 omnibus account to margin such account on a net basis. As written, this would be true even if the DCO (as required by regulation § 39.13(g)(8)(i)), a non-US clearing house or broker carrying an omnibus account collects margin on a gross basis from the FCM. Thus, the FCM under amended regulation § 1.58(a) would be collecting less margin than they are paying to the DCO, non-US clearing house or carrying broker.

The Commission should consider requiring gross margining for secured 30.7 omnibus accounts. In the preamble discussion related to the proposed amendment to regulation § 1.58(a), the Commission justified its exclusion of secured 30.7 omnibus accounts from the gross margin requirement by referencing regulation § 30.7(c). In particular, the Commission noted "Requiring an FCM to send a larger amount of 30.7 funds upstream to a foreign broker or foreign clearing organization would run counter to the regulation's goal of limiting such amounts. Accordingly, the Commission is not proposing to require gross margining with respect to 30.7 accounts."[34] However, requiring a secured 30.7 omnibus account to be gross margined under proposed regulation § 1.58 would only require the FCM to collect gross margin (i.e., verses a lower net margin amount) from the depositing FCM or foreign broker not for the FCM to send the amount along nor outside of the U.S. Finally, the requirement of gross margining of secured 30.7 omnibus accounts will ensure that the FCM's risk based capital requirement[35] is accurately based on the risk margin required for all customer and noncustomer positions.

Margin calls

The Second Proposal discusses the critical importance of the Margin Adequacy Requirement to mitigate the risk that an FCM fails to hold, from a customer, funds sufficient to meet the required initial margin for that customer's positions. The Margin Adequacy Requirement in proposed regulation § 1.44(b), although applicable to all customer accounts, only discusses the determination of funds available for *withdrawal* from customer accounts. However, the Second Proposal only establishes a requirement to *collect* margin from separate account customers subject to proposed regulation § 1.44(f)(1).[36] The Commission should consider implementing a collection requirement (e.g., analogous to regulation § 39.13(g)(8)(ii)[37]) that would be applicable to all accounts carried by clearing and non-clearing FCMs in order to fully implement its stated risk mitigating objectives. In the absence of such requirement, margin collection defaults to requirements under exchange rules while disbursements for customers will be defined by Commission regulations (unless the exchange or clearing organization imposes a more stringent requirement).

III. The JAC reiterates prior positions and requests the Commission consider additional risk mitigating conditions

We appreciate the CFTC's consideration of all comments to the First Proposal in reproposing regulations to address margin adequacy and to account for the treatment of separate accounts in this Second Proposal.

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[33] 89 FR 15340, footnote 220.
[34] *Id.*
[35] Pursuant to regulation § 1.17(a)(1)(i)(B).
[36] 89 FR 15356, specifically in proposed § 1.44(f)(1) "…if, as a result of market movements or changes in positions on the previous business day, a separate account is undermargined (i.e., the undermargined amount for that account is greater than zero), the futures commission merchant shall issue a margin call for the separate account for at least the amount necessary for the separate account to meet the initial margin required…"
[37] Regulation § 39.13(g)(8)(ii) states in part: "A derivatives clearing organization shall require its clearing members to collect customer initial margin…"

Nonetheless, we reiterate our comments[38] to the First Proposal and ask the Commission to reconsider them as appropriate.

Further, the JAC has the following additional comments with respect to the risk mitigating conditions. These comments, in certain places, include and expand on certain points from our comments to the First Proposal that we wish to reemphasize due to their significance in ensuring strong customer protections remain in place for all customers and the industry as a whole.

Noncustomers

Proposed regulation § 1.44 setting forth the Margin Adequacy Requirement as well as providing for Separate Account Treatment pertains to accounts as defined under proposed regulation § 1.44(a) to include only segregated, secured 30.7, and cleared swaps customers (collectively “Customers”)[39] and does not include noncustomers. Consistent with the Commission’s stated goal of sound and rigorous risk management, the Margin Adequacy Requirement should include accounts of noncustomers who pose risk to the FCM if such noncustomers are permitted to withdraw margin funds that would create or exacerbate an undermargined situation, or not be required to deposit and maintain sufficient margin to cover the risk of their positions. The Commission may then determine to allow for separate account treatment under the provisions detailed in proposed regulations § 1.44(c) through (h).

Separate account listing

A complete and accurate listing of separate accounts is a critical cornerstone to ensuring the risk mitigating requirements proposed can be effectively carried out by an FCM, monitored by SROs and the Commission for compliance with proposed regulation § 1.44, monitored by DCOs for customer gross margin reporting under proposed regulation § 39.13(g)(8)(i), and to assist DCOs and/or bankruptcy trustees in porting accounts in the event of an FCM’s insolvency. Currently, by certain FCMs offering separate account treatment under NAL 19-17, when such listing is requested, the JAC has observed there is a practice to include *all* of the FCM’s accounts or all potential accounts on the separate account listing instead of only including those currently subject to separate account treatment (i.e., beneficial owners that maintain more than one account at the FCM which are being treated separately).

To ensure (1) proper focus and attention to the additional risks posed by allowing separate account treatment, (2) effective monitoring of the reporting of separate accounts and (3) proper and efficient porting of separate accounts, *only* accounts currently receiving separate account treatment should be included on the listing. For these same reasons, separate accounts should be clearly identified as such in the FCM’s books and records including on the separate account customer’s statements which will assist in ensuring a current and accurate, as well as complete, listing of accounts receiving separate accounts treatment is maintained.

Ordinary course of business

The determination of “outside the ordinary course of business” regarding a specific separate account customer, or the FCM itself, is a regulatory requirement imposed on the FCM under proposed regulation § 1.44(e). The FCM has full and complete knowledge to identify situations that are outside of the ordinary

[38] Joint Audit Committee June 30, 2023, Comment Letter.
[39] 89 FR 15355.

course of business and, if it so determines, provide as required under proposed regulation § 1.44(e)(3), notification of an "outside the ordinary course of business" occurrence to the CFTC and their DSRO.

To assist FCMs in determining "outside the ordinary course of business" under proposed regulation § 1.44(e), and as much has happened during the years since the NAL 19-17 relief was initially issued, the JAC suggests that it might be helpful for the Commission to provide examples of non-enumerated events that would constitute "operating outside the ordinary course of business." This way FCMs and their customers can better understand the circumstances in which separate account treatment is permitted and when it is not permitted.

Margin receipts and disbursements same day

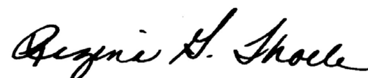
The Commission reaffirmed in the Second Proposal that a margin disbursement may be made from a separately margined account even when the receipt of funds is delayed into another separate account of the same beneficial owner. Today an FCM may not disburse funds supported by a margin receipt that was not initiated (and could not be initiated) for payment on the same day as the disbursement. For example, suppose Monday is a U.S. business day but a banking holiday in Japan. In such case, under proposed regulations § 1.44(f)(3) and (4), excess funds in U.S. dollars could be disbursed on Monday from a separate account, while a margin call to the separate account of the same beneficial owner in Japanese Yen could not be initiated for payment on that Monday and would not be required to be received until the end of business Thursday. However, today for a customer that settles margin with its FCM in multiple currencies, either within a single account or within a separate account, the disbursement would not be permitted in those circumstances (i.e., withdrawal of USD would not be permitted on Monday as the JPY deposit was not initiated). As detailed in Section I, the JAC is requesting confirmation that such multi-settlement margin procedures within a customer account or within a separate customer account would be permitted under the Second Proposal.

Bona-fide margin call

Although it is not the primary topic of the Second Proposal, as the Second Proposal touches on the subject, the JAC reiterates that if an FCM and customer enter a contractual agreement to arrange for margin calls to be met in longer than one business day,[40] the FCM is not making a bona fide attempt to collect margin within one business day after the occurrence of the event giving rise to the margin deficiency.

The JAC thanks the Commission for the opportunity to comment on the NPR and would be happy to discuss any of our comments with the Commission. If you have any questions or comments, feel free to contact us (Debbie at (312) 930-3235 or Debbie.Kokal@cmegroup.com or Regina at (312) 781-1327 or rthoele@nfa.futures.org).

On Behalf of the Joint Audit Committee,



Debra K. Kokal
Co-Chairman

Regina Thoele
Co-Chairman

[40] Aside from reasonable, one-day administrative or operational exceptions.