

New “Customer Sequestered” Account for Cleared OTC Derivatives

Lisa Dunsky
Director and Associate General Counsel

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Dodd-Frank: New CEA Section 4d(f)(2)

CLEARED SWAPS.—

- (A) SEGREGATION REQUIRED.—A [FCM] shall treat and deal with all money, securities, and property of any swaps customer received to margin, guarantee, or secure a swap cleared by or through a [DCO] (including money, securities, or property accruing to the swaps customer as the result of such a swap) as belonging to the swaps customer.
- (B) COMMINGLING PROHIBITED.—Money, securities, and property of a swaps customer described in subparagraph (A) shall be separately accounted for and shall not be commingled with the funds of the [FCM] or be used to margin, secure, or guarantee any trades or contracts of any swaps customer or person other than the person for whom the same are held.

Amendments to CFTC Part 190 Bankruptcy Regulations (Effective May 6, 2010)

“ Account Class means each of the following types of customer accounts which must be recognized as a separate class of account by the trustee: futures accounts, foreign futures accounts, leverage accounts, commodity option accounts and delivery accounts..., and, only with respect to the bankruptcy of a commodity broker that is a [FCM], cleared OTC derivatives accounts...”

- *Proviso: Cleared OTC derivatives in customer segregated account pursuant to a CFTC 4d Order “shall be treated, for purposes of [Part 190], as being held in an account of the futures account class.”*

New Part 190 Definition: “Cleared OTC Derivatives”

“... positions in commodity contracts that have not been entered into or traded on a contract market...or on a derivatives transaction execution facility..., but which nevertheless are submitted through a commodity broker that is a [FCM]...for clearing by a [DCO]..., along with the money, securities, and/or other property margining, guaranteeing, or securing such positions, which are required to be segregated or set aside, in accordance with a rule, regulation, or order issued by the [CFTC], or which are required to be held in a separate account for cleared OTC derivatives only, in accordance with the rules or bylaws of a [DCO]....”

DCO Role (for now) in Pre-Bankruptcy, Substantive Rules for New Account Class

As stated in the Adopting Release for CFTC's amended Part 190 Regulations, until CFTC adopts regulations for the "cleared OTC derivatives" account class:

"... a position in an OTC derivative (and relevant collateral) that a customer clears through an FCM with a DCO, which position (and relevant collateral) is not subject to a Section 4d Order, would be considered part of the cleared OTC derivative account class, as soon as, but only after, a DCO rule...that requires such positions (and relevant collateral) to be held in a separate account for cleared OTC derivatives becomes effective...."

CME Rules for "Cleared OTC Derivatives" Account Class ...

- To date, for cleared OTC derivatives not subject to a 4d Order, CME has utilized CFTC Regulation 30.7 (or "secured") accounts.
- In early October, CME plans to implement new rules with substantive requirements for the treatment of customer "cleared OTC derivatives" that are cleared by CME.
- When CME's rules become effective, customer cleared OTC derivative positions and related collateral currently held in CME's 30.7 "secured" account will be transferred to the new customer OTC account.

... Will Mirror CFTC Regulations for Customer Segregated Accounts

- CME rules for OTC account class essentially mirror CFTC Regulations for 4d/customer segregated accounts (17 C.F.R. §§ 1.20, *et seq*).
- CME rules will be in Chapter 8F (Over-the-Counter Derivative Clearing) of the CME rule book.
- CME rule numbers will track the related CFTC Regulations (*e.g.*, CME Rule 8F120 addresses the same issues as CFTC Reg 1.20).

... With A Few Differences

- Rather than using “segregated” or “secured”, CME rules will refer to new customer account origin as the Cleared OTC Derivatives *Sequestered* Account.
- CME rules won’t include analog to CFTC Reg 1.49, and CME Rule 8F132 won’t require FCMs to compute “on a currency-by-currency basis” the amount of funds required to be in Cleared OTC Derivatives Sequestered Accounts.
- CME rules will require any clearing member carrying a customer omnibus account containing cleared OTC derivatives in the name of a non-clearing FCM to have a written agreement that requires non-clearing FCM to comply with CME rules relating to Cleared OTC Derivatives Customer Sequestered Accounts.