Proposed Rules

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This section of the FEDERAL REGISTER contains notices to the public of the proposed issuance of rules and regulations. The purpose of these notices is to give interested persons an opportunity to participate in the rule making prior to the adoption of the final rules.

FEDERAL TRADE COMMISSION

16 CFR Part 1

[File No. R407000]

Petition for Rulemaking of PIRG and iFixit

AGENCY: Federal Trade Commission.

ACTION: Receipt of petition; request for comment.

SUMMARY: Please take notice that the Federal Trade Commission (''Commission'') received a petition for rulemaking from the U.S. Public Interest Research Group Education Fund and iFixit. This petition requests that the Commission initiate a rulemaking to protect consumers' right to repair products they have purchased. The Commission invites written comments concerning the petition. Publication of this petition is pursuant to the Commission's Rules of Practice and Procedure and does not affect the legal status of the petition or its final disposition.

DATES: Comments must identify the petition docket number and be filed by February 2, 2024.

ADDRESSES: You may view the petition, identified by docket number FTC–2023–0077, and submit written comments concerning its merits by using the Federal eRulemaking Portal at *https://www.regulations.gov.* Follow the online instructions for submitting comments. Do not submit sensitive or confidential information. You may read background documents or comments received at *https://www.regulations.gov* at any time.

FOR FURTHER INFORMATION CONTACT: Joel Christie (phone: 202–468–4593, email: *jchristie@ftc.gov*), Office of the Secretary, Federal Trade Commission, 600 Pennsylvania Avenue NW, Washington, DC 20580.

SUPPLEMENTARY INFORMATION: Pursuant to Section 18(a)(1)(B) of the Federal Trade Commission Act, 15 U.S.C. 57a(1)(B), and FTC Rule 1.31(f), 16 CFR 1.31(f), notice is hereby given that the above-captioned petition has been filed with the Secretary of the Commission and has been placed on the public record for a period of 30 days. Any person may submit comments in support of or in opposition to the petition. All timely and responsive comments submitted in connection with this petition will become part of the public record.

The Commission will not consider the petition's merits until after the comment period closes. It may grant or deny the petition in whole or in part, and it may deem the petition insufficient to warrant commencement of a rulemaking proceeding. The purpose of this document is to facilitate public comment on the petition to aid the Commission in determining what, if any, action to take regarding the request contained in the petition. This document is not intended to start, stop, cancel, or otherwise affect rulemaking proceedings in any way.

Because your comment will be placed on the publicly accessible website at *https://www.regulations.gov,* you are solely responsible for making sure your comment does not include any sensitive or confidential information. In particular, your comment should not include any sensitive personal information, such as your or anyone else's Social Security number; date of birth; driver's license number or other state identification number, or foreign country equivalent; passport number; financial account number; or credit or debit card number. You are also solely responsible for making sure your comment does not include any sensitive health information, such as medical records or other individually identifiable health information. In addition, your comment should not include any ''trade secret or any commercial or financial information which . . . is privileged or confidential''—as provided by Section 6(f) of the FTC Act, 15 U.S.C. 46(f), and FTC Rule 4.10(a)(2), 16 CFR 4.10(a)(2).

(Authority: 15 U.S.C. 46; 15 U.S.C. 57a; 5 U.S.C. 601 note.)

Joel Christie,

Acting Secretary.

[FR Doc. 2023–28874 Filed 1–2–24; 8:45 am]

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COMMODITY FUTURES TRADING COMMISSION

17 CFR Part 39

RIN 3038–AF39

Protection of Clearing Member Funds Held by Derivatives Clearing Organizations

AGENCY: Commodity Futures Trading Commission.

ACTION: Notice of proposed rulemaking.

SUMMARY: The Commodity Futures Trading Commission (CFTC or Commission) is proposing regulations to ensure clearing member funds and assets receive the proper treatment in the event the derivatives clearing organization (DCO) enters bankruptcy by requiring, among other things, that clearing member funds be segregated from the DCO's own funds and held in a depository that acknowledges in writing that the funds belong to clearing members, not the DCO. In addition, the Commission is proposing to permit DCOs to hold customer and clearing member funds at foreign central banks subject to certain requirements. Finally, the Commission is proposing to require DCOs to conduct a daily calculation and reconciliation of the amount of funds owed to customers and clearing members and the amount actually held for customers and clearing members.

DATES: Comments must be received by February 16, 2024.

ADDRESSES: You may submit comments, identified by RIN 3038–AF39, by any of the following methods:

- *CFTC Comments Portal: https://comments.cftc.gov.* Select the ''Submit Comments'' link for this rulemaking and follow the instructions on the Public Comment Form.
- *Mail:* Send to Christopher Kirkpatrick, Secretary of the Commission, Commodity Futures Trading Commission, Three Lafayette Centre, 1155 21st Street NW, Washington, DC 20581.
- *Hand Delivery/Courier:* Follow the same instructions as for Mail, above. Please submit your comments using only one of these methods. Submissions through the CFTC Comments Portal are encouraged.

All comments must be submitted in English, or if not, accompanied by an English translation. Comments will be

posted as received to *https://comments.cftc.gov.* You should submit only information that you wish to make available publicly. If you wish the Commission to consider information that you believe is exempt from disclosure under the Freedom of Information Act (FOIA), a petition for confidential treatment of the exempt information may be submitted according to the procedures established in § 145.9 of the Commission's regulations.[1]

The Commission reserves the right, but shall have no obligation, to review, pre-screen, filter, redact, refuse or remove any or all of your submission from *https://comments.cftc.gov* that it may deem to be inappropriate for publication, such as obscene language. All submissions that have been redacted or removed that contain comments on the merits of the rulemaking will be retained in the public comment file and will be considered as required under the Administrative Procedure Act and other applicable laws, and may be accessible under the FOIA.

FOR FURTHER INFORMATION CONTACT: Eileen A. Donovan, Deputy Director, 202–418–5096, *edonovan@cftc.gov,* Division of Clearing and Risk, Commodity Futures Trading Commission, Three Lafayette Centre, 1155 21st Street NW, Washington, DC 20581; Theodore Z. Polley, Associate Director, 312–596–0551, *tpolley@cftc.gov;* or Scott Sloan, Special Counsel, 312–596–0708, *ssloan@cftc.gov;* Division of Clearing and Risk, Commodity Futures Trading Commission, 77 West Jackson Boulevard, Suite 800, Chicago, Illinois 60604.

SUPPLEMENTARY INFORMATION:

I. Background

A. Proprietary Funds

Section 4d of the Commodity Exchange Act (CEA) and part 1 of the Commission's regulations establish a comprehensive regime to safeguard the funds belonging to customers of a futures commission merchant (FCM).[2] Commission regulations define a ''customer'' as any person who uses an FCM, introducing broker, commodity trading advisor, or commodity pool operator as an agent in connection with trading in any commodity interest, and therefore, this customer protection regime does not apply to the funds of any person who clears trades directly through a DCO, who is a ''clearing member.'' [3] At the most general level, the customer protection regime requires FCMs to segregate customer funds from their own funds, deposit customer funds under an account name that clearly identifies them as customer funds,[4] and obtain a written acknowledgment from each depository that holds customer funds.[5] These acknowledgment letters, which must adhere to specific templates contained in the Commission's regulations, require a depository to acknowledge, among other things, that the accounts opened by the FCM hold funds that belong to the FCM's customers. The customer protection regime also establishes accounting and reporting requirements applicable to customer funds,[6] and limits both the types of investments that can be made with customer funds [7] and the type of depositories that can hold customer funds.[8]

Many of the customer protection requirements that apply to FCMs also apply to DCOs that receive customer funds from their FCM clearing members. DCOs must segregate the customer funds of their FCM clearing members from their own funds,[9] deposit customer funds under an account name that identifies the funds as customer funds,[10] obtain acknowledgment letters from depositories,[11] limit the investment of customer funds to instruments listed in § 1.25,[12] and limit depositories for customer funds to those listed in §§ 1.20 and 1.49.[13] These protections, however, do not extend to clearing members of DCOs. Only section 5b(c)(2)(F) of the CEA (Core Principle F) and § 39.15 apply to the treatment of clearing members' funds and assets held by a DCO in relation to cleared contracts (proprietary funds).[14] These provisions require DCOs to establish standards and procedures that are designed to protect and ensure the safety of proprietary funds and require DCOs to hold proprietary funds in a manner that will minimize the risk of loss or delay in access by the DCO to the proprietary funds.[15] These provisions further require any investment of proprietary funds to be in instruments with minimal credit, market, and liquidity risks.[16]

Section 8a(5) of the CEA grants the Commission authority to adopt rules it determines are reasonably necessary to effectuate, among other things, the DCO core principles.[17] The Commission's initial focus in implementing Core Principle F was on the custody and safeguarding of customer funds, consistent with section 4d of the CEA. This approach was largely responsive to the historical prevailing model in which all or nearly all clearing members of a DCO are FCMs. However, the Commission has since granted registration to a number of DCOs that clear directly for market participants without the intermediation of FCMs, including, in most cases, market participants who are natural persons (*i.e.,* individuals).[18] Additionally, many DCOs that use the traditional FCM clearing model have at least some non-FCM clearing members. The Commission therefore is proposing safeguards for proprietary funds to provide protections for clearing members comparable to those applicable to customers.[19] The Commission has preliminarily determined that each of these additional safeguards is reasonably necessary to effectuate DCO Core Principle F.[20]

Specifically, the Commission is proposing to require a DCO to hold proprietary funds separately from the DCO's own funds, in accounts that are named to clearly identify the funds as belonging to clearing members. The

[1] 17 CFR 145.9. Commission regulations referred to herein are found at 17 CFR chapter I (2022), and are accessible on the Commission's website at *https://www.cftc.gov/LawRegulation/CommodityExchangeAct/index.htm.*

[2] 7 U.S.C. 6d; 17 CFR 1.20–1.39. *See also* 17 CFR 22.1–22.17, and 30.7 (establishing similar regimes for cleared swaps customer collateral and foreign futures customer funds).

[3] 17 CFR 1.3.

[4] 17 CFR 1.20(a).

[5] 17 CFR 1.20, 22.5, and 30.7 (requiring an acknowledgment letter for futures customer funds, cleared swaps customer collateral, and foreign futures customer funds, respectively).

[6] 17 CFR 1.32, 1.33.

[7] 17 CFR 1.25.

[8] 17 CFR 1.49.

[9] 17 CFR 1.20(g)(1); 17 CFR 39.15 (b); 17 CFR 22.3(b)(1).

[10] 17 CFR 1.20(g)(1).

[11] 17 CFR 1.20(g)(4); 17 CFR 22.5.

[12] 17 CFR 39.15(e).

[13] 17 CFR 1.20(g)(2), (3); 17 CFR 22.3(b) (cross-referencing 17 CFR 22.4).

[14] This definition of proprietary funds is only for explanatory purposes in the background section. As discussed further below, the Commission is proposing a definition of ''proprietary funds'' that is referred to throughout the remainder of this proposed rulemaking.

[15] 7 U.S.C. 7a–1(c)(2)(F); 17 CFR 39.15.

[16] *Id.*

[17] 7 U.S.C. 12a(5).

[18] Currently, CBOE Clear Digital, LLC; CX Clearinghouse, L.P.; LedgerX, LLC; and North American Derivatives Exchange Inc. allow individuals to be direct clearing members. Further, ICE NGX Canada Inc. clears physically delivered energy contracts directly for clearing members with a net worth exceeding CAD $5,000,000 or assets exceeding CAD $25,000,000.

[19] The U.S. Bankruptcy Code requires a bankruptcy trustee to distribute clearing members' cash and other assets held by a debtor DCO ratably among all clearing members. 11 U.S.C. 766(i)(2); 11 U.S.C. 761(9)(D), (10), (16). Therefore, the Commission cannot effectively create multiple account classes for the clearing members of a DCO—*e.g.,* one for FCM proprietary funds and one for non-FCM proprietary funds—because the different account classes would not be recognized by a bankruptcy court.

[20] CEA section 5b(c)(2)(F), 7 U.S.C. 7a–1(c)(2)(F).

Commission is further proposing to prohibit a DCO or any depository from using proprietary funds in any way other than as belonging to the clearing member.

Additionally, the proposed rules include requirements for a DCO to review, on a daily basis, the amount of funds owed to each clearing member with respect to each of its accounts, both customer (including, as relevant, futures and cleared swaps) and proprietary, and to reconcile those figures to the amount of funds held in aggregate in each such type of account across all of the DCO's depositories.

The Commission is also proposing to require a DCO to obtain a letter from the depository for each account holding proprietary funds (proprietary funds letter) acknowledging, among other things, that the funds belong to clearing members and cannot be used by the DCO for any other purpose. The proposed proprietary funds letter is based on the template acknowledgment letter that a DCO is required to use in connection with customer funds.[21]

In addition to preventing the misuse of proprietary funds, the proposed requirements would help ensure that proprietary funds are appropriately protected in the event of a DCO bankruptcy. The U.S. Bankruptcy Code establishes that in the event of a DCO bankruptcy, member property, which includes funds held for clearing members' proprietary accounts,[22] is repaid to clearing members *pro rata* based on their claims for such funds, and ahead of most other claims against the DCO's estate.[23] Further, part 190 of the Commission's regulations establishes how clearing members' claims against the DCO's estate should be determined and how payments should be allocated among clearing members.[24] By requiring proprietary funds to be held separately from the DCO's funds and easily identified in a proprietary funds letter, the proposed rules will enable a bankruptcy court or trustee to more clearly identify these funds as member property. Further, the proposed rules will require the DCO to verify, on a regular basis, that it is holding the proper amount of proprietary funds, thus ensuring that these funds would be available for distribution in the event of a DCO bankruptcy.

B. Central Bank Depositories

The Commission is also proposing requirements specific to obtaining written acknowledgments from central banks holding customer or proprietary funds.[25] When the Commission adopted the template acknowledgment letter for depositories holding customer funds in 2013, it did not require use of the template letter by Federal Reserve Banks, due to the ''unique role'' of the U.S. central bank.[26] The Commission also recognized that there may be valid reasons why some foreign depositories would require modifications to the letter and stated that, in such circumstances, the Commission would consider ''alternative approaches'' on a case-by-case basis.[27]

Since then, the Commission's Division of Clearing and Risk (DCR) has issued several no-action letters in which the Division confirmed that it would not recommend that the Commission take enforcement action against a DCO for making certain modifications to the template acknowledgment letter in connection with customer accounts maintained at a foreign central bank.[28] To encourage the use of central bank accounts, which can provide a superior alternative to holding funds at a commercial bank from the perspective of credit and liquidity risk, the Commission is proposing to allow a DCO to hold customer and proprietary funds at certain central banks without obtaining the template acknowledgment letter for customer funds or the proposed proprietary funds letter. Instead, a DCO would need to obtain only a written acknowledgment that the central bank was informed that the funds deposited with the bank are customer or proprietary funds (as applicable) held in accordance with section 4d or 5b of the CEA, and that the central bank agrees to respond to requests from specified Commission staff for information about the account, including the account balance (modified written acknowledgments). These proposed requirements are based on the requirements the Commission adopted in 2013 with regard to written acknowledgments from Federal Reserve Banks.[29]

The Commission is proposing to allow use of the modified written acknowledgment only by a DCO that holds customer or proprietary funds at the central bank of a ''money center country'' as defined in § 1.49—Canada, France, Germany, Italy, Japan, and the United Kingdom—to limit risks to customer and proprietary funds. Along with the United States, these countries comprise the Group of Seven (G7). Representatives from the G7 countries meet several times each year to coordinate their cooperation on issues of economic policy, and the United States and its financial regulatory agencies have a history of successful cooperation with the respective financial regulatory agencies of these countries. When the definition of ''money center country'' was first proposed in connection with the adoption of § 1.49, a commenter suggested that the definition include ''other locations with stable currencies and other indicia that customer funds will be relatively secure.'' [30] The Commission rejected this proposal as difficult to apply and noted that it would require the Commission to expend significant resources to conduct a broad evaluation of, among other things, a country's banking, monetary, and economic policies and systems.[31] The Commission believes that limiting the proposed change to central banks of money center countries appropriately considers security for customer and proprietary funds, flexibility for DCOs, and creating a system that is workable in practice.

Further, the Commission is not proposing to require a DCO to obtain an

[21] *See* 17 CFR 1.20 App. B.

[22] *See* 11 U.S.C. 761(16) (defining ''member property'' as cash, a security, or other property, or proceeds of such cash, security, or property, held by a DCO for a clearing member's proprietary account).

[23] *See* 11 U.S.C. 766(i) (providing that member property is distributed ratably to clearing members on the basis and to the extent of their allowed net equity claims based on their proprietary accounts, and in priority to all other claims, except claims related to the administration of member property).

[24] *See* 17 CFR 190.00–190.19.

[25] ''Central bank'' is the term used to describe the authority responsible for policies that affect a country's supply of money and credit. *See, e.g., https://www.clevelandfed.org/publications/economic-commentary/2007/ec-20071201-a-brief-history-of-central-banks.*

[26] Enhancing Protections Afforded Customers and Customer Funds Held by Futures Commission Merchants and Derivatives Clearing Organizations, 78 FR 68506, 68535 (Nov. 14, 2013).

[27] *Id.* at 68536.

[28] *See, e.g.,* CFTC Letter No. 14–124 (Oct. 8, 2014) (related to customer accounts held at the Bank of England); CFTC Letter No. 16–05 (Feb. 1, 2016) (related to customer accounts held at the Deutsche Bundesbank).

[29] Enhancing Protections Afforded Customers and Customer Funds, 78 FR at 68628. In 2016, the Commission issued an order under section 4(c) of the CEA conditionally exempting Federal Reserve Banks from section 4d of the CEA (Order Exempting the Federal Reserve Banks from Sections 4d and 22 of the Commodity Exchange Act, 81 FR 53467 (Aug. 12, 2016)). The conditions of the order require Federal Reserve Banks to keep customer funds segregated and respond to information requests from the Commission, making a separate written acknowledgment from a Federal Reserve Bank unnecessary. The Commission therefore repealed the 2013 provision (then § 1.20(g)(4)(ii)) concerning written acknowledgments from Federal Reserve Banks and adopted current § 1.20(g)(4)(i), which excludes Federal Reserve Banks from the written acknowledgment requirement.

[30] *See* Denomination of Customer Funds and Location of Depositories, 68 FR at 5546–5547 (Mar. 6, 2003).

[31] *Id.*

acknowledgment letter from a Federal Reserve Bank holding proprietary funds. This is consistent with § 1.20(g)(4), which states that a DCO does not need a written acknowledgment to hold customer funds held at a Federal Reserve Bank. Federal Reserve Banks have previously expressed an inability to agree to all of the terms in the template acknowledgment letter.[32] Because Federal Reserve Banks are the source of liquidity for U.S. dollar deposits, a DCO would face lower credit and liquidity risk with a deposit at a Federal Reserve Bank than it would with a deposit at a commercial bank. In the context of customer funds, the Commission determined that it would not require a written acknowledgment from Federal Reserve Banks in order to facilitate use of these accounts and help obtain these benefits that ultimately serve market participants and the integrity of the financial markets.[33] The Commission believes that the same rationale applies with respect to proprietary funds. Further, the Commission has required DCOs with access to accounts and services at a Federal Reserve Bank to use such accounts and services where practical,[34] and as a policy matter seeks to facilitate use of those accounts.

II. Definitions—§ 39.2

The Commission is proposing to add in § 39.2 a definition for ''money center country'' that is identical to the definition currently in § 1.49. Under the proposed definition, ''money center country'' means Canada, France, Germany, Italy, Japan, and the United Kingdom.

The Commission is also proposing a definition for ''proprietary funds.'' The definition uses language similar to that included in the current definitions of ''futures customer funds'' in § 1.3[35] and ''cleared swaps customer collateral'' in § 22.1.[36] The proposed definition includes all money, securities, and property held in a proprietary account[37] on behalf of clearing members used to margin, guarantee, or secure futures, foreign futures and swaps contracts, as well as option premiums and other funds held in relation to options contracts. The proposed definition also includes clearing member contributions to a guaranty fund to mutualize the losses resulting from a default by a clearing member.[38]

For the avoidance of doubt, a proprietary account may be the ''house'' account of a clearing member that is an FCM, where the clearing member may also maintain a futures customer and/or cleared swaps customer account. The term also would include the account of a direct clearing member (that may or may not be a natural person) that does not intermediate transactions for anyone else.

III. Treatment of Funds—§ 39.15

A. Holding Customer Funds at Central Banks—§ 39.15(b)(3)

The Commission is proposing to amend § 39.15(b) to allow a DCO to hold customer funds at the central bank of a money center country. The proposed amendment would supplement the list of permissible depositories in § 1.49 and §§ 22.4 and 22.9. Currently, § 1.49 and § 22.9 limit foreign depositories for customer funds to a bank or trust company that has in excess of $1 billion of regulatory capital, an FCM, or a DCO. Foreign central banks, as independent government entities, are not structured to meet regulatory capital requirements and are therefore excluded from holding customer funds under § 1.49.

The Commission believes a DCO holding customer funds at a central bank can be a superior alternative to holding commercial bank deposits because it limits the DCO's credit and liquidity risks. The Commission is therefore proposing new § 39.15(b)(3) to permit a DCO to hold customer funds at the central bank of a money center country if the DCO obtains a modified written acknowledgment, rather than the template acknowledgment letter required by §§ 1.20 and 22.5, to which some central banks have objected.[39] The proposed rule would require the central bank of a money center country only to acknowledge that it was informed that the funds deposited with the bank are customer funds held in accordance with section 4d of the CEA and to agree to respond to requests from the Commission for information about the account, including the account balance. The Commission believes the proposed rule would facilitate the holding of customer funds at the central banks of money center countries while ensuring appropriate customer protections.

The Commission believes that central banks are often the safest place to deposit customer funds and has provided exemptions from § 1.49 to permit customer funds to be held at foreign central banks in money center countries.[40] The proposed rule would codify those exemptions and permit DCOs to hold customer funds with the central bank of a money center country. As previously discussed, the Commission is proposing to limit the permissible central bank depositories to those of money center countries after considering security for customer funds, flexibility for DCOs, and the need to create a system that is workable in practice.

B. Permitted Investments—§ 39.15(e)

The Commission is proposing to amend § 39.15(e) to permit a DCO to invest proprietary funds only as permitted for investment of customer funds under § 1.25. The proposed regulation specifies that the DCO would bear any losses from investments, as is the case with customer funds.[41] The list of investments in § 1.25 is a conservative list, and the Commission believes it is appropriate for all types of clearing members. Currently, permissible investments under § 1.25 include, among other investments, general obligations of the U.S. government, general obligations of any U.S. state or municipality, certificates of deposit, and interests in money market funds.[42] Further, § 1.25 specifies a number of terms and conditions with which permitted investments must comply, including limits on the features that an investment can contain, concentration limits, and time to maturity limits.[43] Regulation § 1.25 also includes specific requirements for investments in money market funds and repurchase agreements.[44] By limiting investments of proprietary funds to investments that meet the requirements

[32] Enhancing Protections Afforded Customers and Customer Funds, 78 FR at 68535.

[33] Denomination of Customer Funds and Location of Depositories, 68 FR at 53468 (Mar. 6, 2003).

[34] 17 CFR 39.33(d)(5).

[35] 17 CFR 1.3.

[36] 17 CFR 22.1.

[37] *See* 17 CFR 1.3 (defining ''proprietary account'' as a commodity futures, commodity options, or swaps trading account, for the clearing member itself, or for certain owners and affiliates of the clearing member).

[38] These guaranty fund contributions include those received pursuant to an assessment for additional guaranty fund contributions when permitted by a DCO's rules.

[39] *See, e.g.,* CFTC Letter No. 14–124 (Oct. 8, 2014); CFTC Letter No. 16–05 (Feb. 1, 2016) (regarding modifications to the template acknowledgment letter to enable certain central banks to hold customer funds).

[40] *See, e.g.,* CFTC Letter No. 14–124 (Oct. 8, 2014); CFTC Letter No. 16–05 (Feb. 1, 2016) (granting exemptive relief from § 1.49 to permit certain central banks to act as a depository for customer funds).

[41] 17 CFR 1.29(b).

[42] 17 CFR 1.25(a); *see also Investment of Customer Funds by [FCMs] and [DCOs],* 88 FR 81236 (Nov. 21, 2023) (proposing, among other changes, to add certain foreign sovereign debt and certain U.S. Treasury exchange traded funds, both subject to limitations, to the list of permitted investments and to limit the types of money market funds that are permitted investments).

[43] 17 CFR 1.25(b).

[44] 17 CFR 1.25(c), (d).

of § 1.25,[45] the proposed rule will ensure that any investment of proprietary funds will have minimal credit, market, and liquidity risk as required by Core Principle F.[46]

C. Additional Protections for Proprietary Funds—§ 39.15(f)

The Commission is proposing new § 39.15(f) to establish additional protections for proprietary funds.

1. Segregation of Proprietary Funds—§ 39.15(f)(1)

Proposed § 39.15(f)(1) is based on § 1.20(a) and would require a DCO to account for proprietary funds separately from its own funds, and to hold proprietary funds in accounts that are named to clearly identify the funds being held as belonging to clearing members. The Commission believes this would prevent misuse of proprietary funds by a DCO, and would help a bankruptcy trustee or judge to easily identify the funds that should be treated as member property in the unlikely event of a DCO bankruptcy. The proposed rule also would require the DCO to, at all times, maintain in the accounts holding proprietary funds enough resources to cover the total value of proprietary funds owed to its clearing members. The proposed rule would prevent a DCO from rehypothecating or otherwise using proprietary funds for its own benefit, thus ensuring that the funds are available when needed by clearing members or the DCO for permitted uses.

2. Written Acknowledgment from Depositories—§ 39.15(f)(2)

The Commission is proposing to require a DCO to obtain from any depository holding proprietary funds a written acknowledgment that the funds belong to the DCO's clearing members and cannot be used by the DCO for any other purpose. The Commission is proposing a template proprietary funds letter that DCOs would be required to use, which would be contained in proposed appendix D to part 39. The proposed template proprietary funds letter is substantively the same as the current template acknowledgment letter for DCO accounts holding futures customer funds required by § 1.20, and requires a depository to acknowledge, among other things, that the accounts referenced in the letter hold funds that belong to the DCO's clearing members, that the funds should be accounted for separately from those belonging to the DCO, and that the funds cannot be used to cover the DCO's obligations to the depository.[47] Further, the template proprietary funds letter would require the depository to respond to a request from the director of DCR, or any successor division, or the director's designees, for information about the account, including the account balance. Proposed § 39.15(f)(2) also includes the same procedural requirements as those in § 1.20. Specifically, it would require a DCO to file a proprietary funds letter with the Commission within three days of opening an account, to update a letter when certain information it contains changes, and to maintain a copy of the letter in accordance with § 1.31.

The Commission believes that requiring a proprietary funds letter would ensure that a depository holding proprietary funds would know that the funds belong to the DCO's clearing members and cannot be used by the DCO for any other purpose, which will help prevent the misuse of funds by the DCO or an employee of the DCO. Further, having a letter for each proprietary funds account would help a bankruptcy court or trustee easily identify those funds that constitute member property in the event of a DCO bankruptcy.

The Commission is proposing to exclude accounts at Federal Reserve Banks from the requirement to obtain a proprietary funds letter. This is consistent with § 1.20(g)(4), which states that a DCO does not need a written acknowledgment to hold customer funds at a Federal Reserve Bank. As discussed above, the Commission believes that Federal Reserve Banks would be unable to sign the template proprietary funds letter, and wants to promote the use of Federal Reserve Bank accounts by DCOs when possible.

The Commission is also proposing a simpler written acknowledgment requirement for accounts held at the central bank of a money center country. Although a DCO holding proprietary funds at the central bank of a money center country would have to comply with the same procedural requirements applicable to other depositories, it would not have to use the template proprietary funds letter. The DCO would only have to obtain a written acknowledgment stating that: (1) the central bank was informed that the funds deposited with the bank are proprietary funds held in accordance with section 5b(c)(2)(F) of the CEA and Commission regulations; and (2) the bank agrees to respond to requests from the Commission for information about the account, including the account balance. As was the case with the acknowledgment letter used for accounts holding customer funds, the Commission believes many central banks would have issues with the proposed template proprietary funds letter. The Commission believes the proposed rule would allow DCOs to gain the benefits of holding funds at central banks while adequately safeguarding those funds and ensuring that the Commission has the information it needs to conduct oversight of DCOs.

3. Commingling of Proprietary Funds—§ 39.15(f)(3)

Proposed § 39.15(f)(3) is based on § 1.20(e) and (g) applicable to customer funds, and would permit a DCO to commingle proprietary funds from multiple clearing members in a single account at a depository, but would not permit a DCO to commingle proprietary funds with the DCO's own funds or customer funds. Having a clear separation between proprietary funds and a DCO's own funds will make it more difficult for funds to be misused, and will provide additional clarity in the event of a DCO bankruptcy regarding the funds that should be treated as member property rather than part of the debtor's estate. Further, the ability to commingle proprietary funds from multiple clearing members in one account allows DCOs to limit operational risks by simplifying their banking processes and procedures.

4. Use of Proprietary Funds—§ 39.15(f)(4)

Proposed § 39.15(f)(4) is based on § 1.20(f) and would require a DCO and any depository holding proprietary funds to treat all proprietary funds as belonging to the clearing members of the DCO. The Commission believes the proposed rule will help ensure that proprietary funds are not rehypothecated or otherwise used by a DCO and are readily available if needed either by the clearing member directly, or for a permitted clearing member use by the DCO. However, the Commission does not intend for this requirement to interfere with or alter DCOs' risk management programs. Proposed § 39.15(f)(4)(i)(A) therefore would clarify that the proprietary funds of a

[45] Proposed § 39.15(e) cross-references § 1.25, which provides that an FCM or DCO may invest ''customer money'' in certain instruments. The regulatory text of § 1.25, however, does not refer to ''proprietary funds.'' The Commission recently approved proposed amendments to § 1.25. Based on comments received on those proposed amendments, if appropriate, the Commission may consider further amending § 1.25 either in the final rule or as a re-proposed rule to ensure that the regulatory text provides clarity on the application of § 1.25 to a DCO's investment of ''proprietary funds,'' as permitted under § 39.15(e).

[46] 7 U.S.C. 7a–1(c)(2)(F); 17 CFR 39.15(e).

[47] *See* 17 CFR 1.20 App. B.

clearing member could be used to satisfy obligations of that clearing member's customers, to the extent that use is permitted by the DCO's rules and the DCO's agreement(s) with the clearing member. In addition, proposed § 39.15(f)(4)(i)(B) further would clarify that a DCO use contributions of non-defaulting clearing members to a guaranty fund to cover losses stemming from a default, to the extent that use is permitted by the DCO's rules and its agreement(s) with its clearing members. Nothing in the proposed rule would prevent a DCO from holding guaranty fund contributions in a separate proprietary funds account from proprietary funds held as initial margin.

Moreover, proposed § 39.15(f)(4)(ii) would provide that a depository receiving proprietary funds from a DCO for deposit in a segregated account may not hold, dispose of, or use such funds as belonging to any person other than the clearing members of the depositing DCO. Unlike the DCO, which is responsible for separately considering the proprietary funds owed to each individual clearing member, a depository is only responsible for considering the proprietary funds it has received as belonging to the clearing members as a group.

D. Daily Reconciliation—§ 39.15(g)

The Commission is proposing new § 39.15(g), which would require a DCO to conduct a daily reconciliation for each type of segregated account (futures customer funds, cleared swaps customer collateral, and proprietary funds) it holds for its clearing members. This proposal is based on the requirement applicable to FCMs in § 1.32. Under proposed § 39.15(g), by noon of each business day, the DCO would have to perform these reconciliations on balances held as of the close of the previous business day. The proposed requirement is intended to verify, each business day, that the DCO maintains sufficient funds in each relevant account type to cover its aggregate obligations to clearing members. The Commission believes that the required daily calculation and reconciliation and independent review requirements in the proposed rule would help a DCO to identify quickly any misuse or loss of proprietary or customer funds.

Proposed § 39.15(g)(1), (2), and (3) would require a DCO to calculate the amount of, respectively, futures customer funds, cleared swaps customer collateral, and proprietary funds owed to each clearing member. These provisions would further require the DCO to reconcile the total amount, aggregated across all clearing members, of each of futures customer funds, cleared swaps customer collateral, and proprietary funds, with the amount of each respective type of funds held in separate accounts across all depositories. This reconciliation is intended to confirm, each business day, that the DCO maintains, in each type of account, an adequate value of segregated funds to meet its obligations to clearing members.

Requirements for the method of conducting these calculations are contained in proposed § 39.15(g)(4). Proposed § 39.15(g)(4)(i) would require segregation of duties, consistent with generally accepted auditing standards.[48] Each of the DCO's calculations and reconciliations would need to be approved by a person who did not prepare the initial calculation or the related reconciliation, and who does not report to the person who prepared them.

Proposed § 39.15(g)(4)(ii)(A) would address the valuation of securities in the required calculations of amounts owed and held. Securities would have to be valued at their current market value, with haircuts applied in accordance with existing § 39.11(d)(1).

Proposed § 39.15(g)(4)(ii)(B) would address mismatches in currencies in the same account type by permitting a deficit in one currency to be offset by a surplus in another currency, with conversion based on publicly available exchange rates, and with surpluses subject to haircuts reasonably determined by the DCO, applied consistently.[49]

Proposed § 39.15(g)(4)(ii)(C) would address situations in which customer funds of one type are commingled in a different type of customer account (*e.g.,* futures customer funds in a cleared swaps customer account). In these instances, the proposed rule would require DCOs to treat all funds in a futures customer account as futures customer funds and all funds in a cleared swaps customer account as cleared swaps customer collateral, both in terms of funds owed and funds held, for purposes of the calculation and reconciliation required by proposed § 39.15(g).

Proposed § 39.15(g)(4)(iii) would address the process by which a DCO would calculate the amounts owed to clearing members for each account type by requiring the DCO to apply, for each account type, the approach set forth for FCMs in § 1.20(i). This would include calculating the net liquidating equity for each clearing member (in each account type), taking into account the market value of funds it receives from the clearing member, gains and losses on futures contracts, options, and swaps (applying this approach to cleared swaps), fees lawfully accruing in the normal course of business (which, in the case of a DCO, would include transaction fees), and authorized distributions or transfers of collateral. In aggregating amounts owed, the DCO would not reduce the sum of credit balances owed to clearing members with debit balances owed by other clearing members.[50]

Finally, proposed § 39.15(g)(5) would require the DCO to immediately report to the Commission any discrepancy in any of the relevant calculations or any one or more of the reconciliations that reveals that the DCO did not, at the close of the previous business day, maintain in separate segregated accounts money, securities, and property in an amount sufficient in the aggregate to cover the total value of funds owed to all clearing members.

E. Exclusions for Foreign Derivatives Clearing Organizations—§ 39.15(h)

The Commission is not, at this time,[51] proposing to apply the new member property protections in proposed § 39.15(e)(3) (permitted investment of proprietary funds), (f) (proprietary funds), and (g)(3) (daily reconciliation of proprietary funds) to certain DCOs organized outside the United States (foreign DCOs). Specifically, proposed § 39.15(h) would provide that proposed § 39.15(e)(3), (f) and (g)(3) do not apply to a foreign DCO that would, in the event of its insolvency, be subject to a foreign proceeding, as defined in the U.S. Bankruptcy Code, in the jurisdiction in which it is organized.[52]

[48] *See* Statement on Auditing Standards 145, Appendix C, ¶ 21 (''Segregation of duties is intended to reduce the opportunities to allow any person to be in a position to both perpetrate and conceal errors or fraud in the normal course of the person's duties''). *See also* 17 CFR 1.11(e)(3)(i)(G) (requiring each FCM's Risk Management Program to include procedures requiring the appropriate separation of duties among individuals responsible for compliance with the Act and Commission regulations relating to the protection and financial reporting of segregated funds.)

[49] For example, one would expect that the haircuts the DCO applies to currency mismatches with respect to its obligations to clearing members here would be no smaller than the haircuts the DCO applies to currency mismatches with respect to collateral posted by a clearing member.

[50] *See* 17 CFR 1.20(i)(4).

[51] The Commission may, in light of ongoing and future developments with respect to clearing models at such DCOs, including with respect to the participation of U.S. market participants (particularly such market participants who are natural persons) reconsider these decisions (both with respect to part 39 and to part 190) in a future rulemaking.

[52] The U.S. Bankruptcy Code defines ''foreign proceeding'' as a collective judicial or

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Member property held at most foreign DCOs would not be protected under part 190 in the event the DCO enters bankruptcy,[53] and the Commission wants to avoid potential conflicts with requirements concerning protection of member property under the applicable law in a foreign DCO's home jurisdiction.[54]

IV. Reporting—§ 39.19

The Commission is proposing new § 39.19(c)(4)(xxvi) to include, together with the other event-specific reporting requirements applicable to DCOs, the requirement in proposed § 39.15(g)(5) that a DCO report any discrepancies in the amount of proprietary or customer funds it holds. The Commission believes that including all reporting requirements applicable to DCOs in § 39.19 may assist DCOs in tracking their reporting obligations.

V. Request for Comment

The Commission is requesting comments on all aspects of its proposal. Additionally, the Commission specifically requests comment on the following:

Would classification of guaranty fund contributions as proprietary funds inhibit DCOs' current guaranty fund programs? The Commission has proposed to specifically include guaranty fund deposits in the definition of proprietary funds, and does not intend for the inclusion to prevent DCOs from continuing to use guaranty funds as one of their default resources.

Should the Commission require DCOs to report to the Commission the daily calculations and reconciliations required by proposed § 39.15(g)?

Anti-money laundering (AML) and know-your-client (KYC) programs are required for many entities registered with the Commission, including intermediaries such as FCMs. In the context of intermediated DCOs, FCMs perform this critical role of assisting U.S. government agencies in detecting and preventing money laundering. However, in the context of non-intermediated DCOs, in the absence of an FCM, DCOs may be exploited by actors seeking to engage in illegal and illicit activities. How might the Commission ensure AML and KYC compliance for DCOs that offer direct clearing services (a market structure that would not include FCMs or other intermediaries that are typically directed to create Bank Secrecy Act compliance programs)? Should DCOs offering direct-to-customer services to non-eligible contract participants or retail customers be required to comply with AML and KYC requirements?

Should the Commission require any additional written acknowledgments (to those contained in proposed § 39.15(b)(3) or § 39.15(f)(2)(vi) as applicable) from central banks of money center countries in order for a DCO to use them to hold futures customer funds, cleared swaps customer collateral, or proprietary funds?

VI. Related Matters

A. Regulatory Flexibility Act

The Regulatory Flexibility Act (RFA) requires that agencies consider whether the regulations they propose will have a significant economic impact on a substantial number of small entities and, if so, provide a regulatory flexibility analysis on the impact.[55] The amendments proposed by the Commission will affect only DCOs. The Commission has previously established certain definitions of ''small entities'' to be used by the Commission in evaluating the impact of its regulations on small entities in accordance with the RFA.[56] The Commission has previously determined that DCOs are not small entities for the purpose of the RFA.[57] Accordingly, the Chairman, on behalf of the Commission, hereby certifies pursuant to 5 U.S.C. 605(b) that the proposed regulations will not have a significant economic impact on a substantial number of small entities.

B. Paperwork Reduction Act

The Paperwork Reduction Act of 1995 (PRA) [58] imposes certain requirements on federal agencies, including the Commission, in connection with conducting or sponsoring any ''collection of information,'' as defined by the PRA. Under the PRA, an agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a currently valid control number from the Office of Management and budget (OMB).[59] The PRA is intended, in part, to minimize the paperwork burden created for individuals, businesses, and other persons as a result of the collection of information by federal agencies, and to ensure the greatest possible benefit and utility of information created, collected, maintained, used, shared, and disseminated by or for the Federal Government.[60] The PRA applies to all information, regardless of form or format, whenever the Federal Government is obtaining, causing to be obtained, or soliciting information, and includes required disclosure to third parties or the public, of facts or opinions, when the information collection calls for answers to identical questions posed to, or identical reporting or recordkeeping requirements imposed on, ten or more persons.[61]

This proposal, if adopted, would result in a collection of information within the meaning of the PRA, as discussed below. This proposed rulemaking contains collections of information for which the Commission has previously received a control number from OMB. The title for this existing collection of information is OMB control number 3038–0076, Requirements for Derivatives Clearing Organizations (''OMB Collection 3038–0076'').

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administrative proceeding in a foreign country, including an interim proceeding, under a law relating to insolvency or adjustment of debt in which proceeding the assets and affairs of the debtor are subject to control or supervision by a foreign court, for the purpose of reorganization or liquidation. 11 U.S.C. 101(23). Further, the U.S. Bankruptcy Code defines ''foreign court'' as a judicial *or other* authority competent to control or supervise a foreign proceeding (emphasis added). 11 U.S.C. 1502(3). Because the definition includes non-judicial authorities, a resolution proceeding where the assets and affairs of a foreign DCO are controlled by a resolution authority would constitute a foreign proceeding under 11 U.S.C. 101(23), and thus a DCO that is subject to such a resolution proceeding would fall within the exclusion of such paragraphs. (*See, e.g.,* In re Tradex Swiss AG, 384 B.R. 34, 42 (Bankr. D.Mass. 2008) (Swiss Federal Banking Commission ''is an administrative agency'' and qualifies as a foreign court under 1502(3)), In re ENNIA Caribe Holding N.V., 594 B.R. 631, 639–40 & n. 11(Bankr. S.D.N.Y. 2018) (where the Central Bank of Curaçao and St. Maarten, as a regulator, controls the affairs of the foreign debtor, an insurance company, it constitutes a foreign court under 11 U.S.C. 1502(3)).

[53] *See* 17 CFR 190.11(b).

[54] As the Commission noted in revising its part 190 bankruptcy regulations in 2020, in the context of certain DCOs organized outside the United States, the Commission has traditionally focused its efforts on the protection of the customers of FCM members of such foreign DCOs. *Bankruptcy Regulations,* 86 FR 19324, 19366 (April 13, 2021). In promulgating those regulations, the Commission attempted to avoid conflicts with insolvency proceedings in the jurisdiction where a foreign DCO is organized. *Id.* Thus, pursuant to 17 CFR 190.11(b), the Commission's part 190 bankruptcy regulations are limited to protecting contracts cleared on behalf of FCM customers at such foreign DCOs and the property margining or securing such contracts. The foreign DCOs to which this limitation applies are those DCOs organized outside the United States that are subject to a foreign proceeding, as defined in 11 U.S.C. 101(23), in the jurisdiction in which it is organized.

[55] 5 U.S.C. 601 *et seq.*

[56] Policy Statement and Establishment of Definitions of ''Small Entities'' for Purposes of the Regulatory Flexibility Act, 47 FR 18618 (Apr. 30, 1982).

[57] *See* A New Regulatory Framework for Clearing Organizations 66 FR 45604, 45609 (Aug. 29, 2001).

[58] 44 U.S.C. 3501 *et seq.*

[59] *See* 44 U.S.C. 3507(a)(3); 5 CFR 1320.5(a)(3).

[60] *See* 44 U.S.C. 3501.

[61] *See* 44 U.S.C. 3502(3).

The Commission therefore is submitting this proposal to the OMB for its review in accordance with the PRA.[62] Responses to this collection of information would be mandatory. The Commission will protect any proprietary information according to the Freedom of Information Act and part 145 of the Commission's regulations.[63] In addition, section 8(a)(1) of the CEA strictly prohibits the Commission, unless specifically authorized by the CEA, from making public any data and information that would separately disclose the business transactions or market positions of any person and trade secrets or names of customers.[64] Finally, the Commission is also required to protect certain information contained in a government system of records according to the Privacy Act of 1974.[65]

1. OMB Collection 3038–0076—Requirements for Derivatives Clearing Organizations

The Commission is proposing a new reporting requirement in § 39.15(f)(2) to require DCOs based in the United States to obtain a template proprietary funds letter from each depository that holds proprietary funds and to file that letter with the Commission. The template letter and filing requirements are substantially the same as the requirement in § 1.20(d) for FCMs to file an acknowledgment letter signed by each depository holding customer funds. In OMB control number 3038–0024, ''Regulations and Forms Pertaining to Financial Integrity of the Market Place; Margin Requirements for SDs/MSPs,'' [66] the Commission estimated that each FCM would file three acknowledgment letters a year and that filing each letter would take two hours to complete. Because the proposed letter and requirements for DCOs are the same as those for FCMs, the Commission believes that the estimates for FCMs filing acknowledgment letters are appropriate for DCOs filing proprietary funds letters. Therefore, the Commission believes that the proposed requirement will require each DCO based in the United States to expend six hours per year to comply, resulting in a total burden of 60 hours for DCOs.

The aggregate burden estimate for proprietary funds template letter reporting in Collection 3038–0076 is as follows:

Estimated number of respondents: 10.

Estimated annual reports per respondent: 3.

Estimated total annual responses: 30.

Estimated average burden hours per response: 2.

Estimated annual burden hours per respondent: 6.

Estimated total annual reporting burden for all respondents: 60.

Finally, the Commission is proposing § 39.15(g) to require DCOs to report in accordance with § 39.19(c)(4) any discrepancies in the results of the required daily calculations and reconciliations. This is a new reporting requirement and thus the Commission is revising its estimate of the burden associated with event-specific reporting under § 39.19(c)(4) in Collection 3038–0076. A discrepancy in one of the required calculations or reconciliations would mean that the DCO is not holding or accounting for the correct amount of either customer or proprietary funds, *i.e.,* that it is not meeting regulatory requirements. The Commission does not anticipate DCOs will need to file this report often, and ideally not at all, such that even one report per year would exceed expectations. Nonetheless, to avoid under-estimating the burden of the proposed regulation, the Commission estimates that DCOs will file the required report once per year. The Commission believes that each report will take approximately 30 minutes to complete. The requirement is for DCOs to file immediately upon learning of the discrepancy, which will necessarily limit the amount of time available to prepare a report. The current burden estimate in Collection 3038–0076 for event specific reporting under § 39.19(c) is 14 reports a year per respondent. Therefore, the Commission amending Collection 3038–0076 and s estimating that 13 covered DCOs will complete an estimated 15 reports per year per respondent, resulting in a total burden of seven-and-a-half hours for event-specific reporting.

The aggregate burden estimate for event-specific reporting under § 39.19(c)(4), as amended by the proposal, is updated as follows:

Estimated number of respondents: 13.

Estimated annual reports per respondent: 15.

Estimated total annual responses: 195.

Estimated average hours per response: 0.5.

Estimated annual burden hours per respondent: 7.5.

Estimated total annual burden hours for all respondents: 97.5.

The Commission's existing recordkeeping rule will require DCOs to maintain records of the information generated though compliance with the proposed rules.[67] Specifically, DCOs will need to maintain records related to the calculations and reconciliations required under proposed § 39.15(g) and the proprietary funds letters required under proposed § 39.15(f)(2). The Commission, however, believes that the impact of the proposed regulations on the recordkeeping burden in Collection 3038–0076 will be negligible. DCOs are already required to maintain all information required to be created, generated, or reported under part 39.[68] DCOs regularly maintain records of items created through their compliance with the Commission's regulations, and the proposed rules will not raise unique recordkeeping challenges or burdens. Therefore, the Commission is retaining its existing recordkeeping burden estimates for Collection 3038–0076.

2. Request for Comment

The Commission invites the public and other Federal agencies to comment on any aspect of the proposed information collection requirements discussed above. Pursuant to 44 U.S.C. 3506(c)(2)(B), the Commission will consider public comments on this proposed collection of information in:

(1) Evaluating whether the proposed collection of information is necessary for the proper performance of the functions of the Commission, including whether the information will have a practical use;

(2) Evaluating the accuracy of the estimated burden of the proposed collection of information, including the degree to which the methodology and the assumptions that the Commission employed were valid;

(3) Enhancing the quality, utility, and clarity of the information proposed to be collected; and

(4) Minimizing the burden of the proposed information collection requirements on registered entities, including through the use of appropriate automated, electronic, mechanical, or other technological information collection techniques, *e.g.,* permitting electronic submission of responses.

The Commission specifically invites public comment on the accuracy of its estimates that the proposed regulations will not impose a new recordkeeping burden and its determination to retain

[62] *See* 44 U.S.C. 3507(d) 5 CFR 1320.11.

[63] *See* 5 U.S.C. 552; *see also* 17 CFR part 145 (Commission Records and Information).

[64] 7 U.S.C. 12(a)(1).

[65] 5 U.S.C. 552a.

[66] For the previously approved estimates for this collection, see ICR Reference No. 202207–3038–001 (conclusion date Aug. 23, 2022, available at *https://www.reginfo.gov/public/do/PRAViewICR?ref_nbr=202207-3038-001*).

[67] *See* 17 CFR 39.20.

[68] *Id.*

its existing burden estimates for recordkeeping for Collection 3038–0076.

Copies of the submission from the Commission to OMB are available from the CFTC Clearance Officer, 1155 21st Street NW, Washington, DC 20581, (202) 418–5714 or from *https://RegInfo.gov.* Organizations and individuals desiring to submit comments on the proposed information collection requirements should send those comments to:

- The Office of Information and Regulatory Affairs, Office of Management and Budget, Room 10235, New Executive Office Building, Washington, DC 20503, Attn: Desk Officer of the Commodity Futures Trading Commission;
- (202) 395–6566 (fax); or
- *OIRAsubmissions@omb.eop.gov* (email).

Please provide the Commission with a copy of submitted comments so that all comments can be summarized and addressed in the final rulemaking, and please refer to the **ADDRESSES** section of this rulemaking for instructions on submitting comments to the Commission. OMB is required to make a decision concerning the proposed information collection requirements between 30 and 60 days after publication of this release in the **Federal Register**. Therefore, a comment to OMB is best assured of receiving full consideration if OMB receives it within 30 calendar days of publication of this release. Nothing in the foregoing affects the deadline enumerated above for public comment to the Commission on the proposed rules.

C. Cost-Benefit Considerations

1. Introduction

Section 15(a) of the CEA requires the Commission to consider the costs and benefits of its actions before promulgating a regulation under the CEA or issuing certain orders.[69] Section 15(a) further specifies that the costs and benefits shall be evaluated in light of the following five broad areas of market and public concern: (1) protection of market participants and the public; (2) efficiency, competitiveness, and financial integrity of futures markets; (3) price discovery; (4) sound risk management practices; and (5) other public interest considerations. The Commission considers the costs and benefits resulting from its discretionary determinations with respect to the section 15(a) factors (collectively referred to herein as Section 15(a) factors).

The Commission recognizes that the proposed amendments impose costs. The Commission has endeavored to assess the anticipated costs and benefits of the proposed amendments in quantitative terms, including PRA-related costs, where feasible. In situations where the Commission is unable to quantify the costs and benefits, the Commission identifies and considers the costs and benefits of the applicable proposed amendments in qualitative terms. The lack of data and information to estimate those costs is attributable in part to the nature of the proposed amendments. Additionally, any initial and recurring compliance costs for any particular DCO will depend on the size, existing infrastructure, level of clearing activity, practices, and cost structure of the DCO.

The Commission generally requests comment on all aspects of its cost-benefit considerations, including the identification and assessment of any costs and benefits not discussed herein; data and any other information to assist or otherwise inform the Commission's ability to quantify or qualitatively describe the costs and benefits of the proposed amendments; and substantiating data, statistics, and any other information to support positions posited by commenters with respect to the Commission's discussion. The Commission welcomes comment on such costs, particularly from existing DCOs that can provide quantitative cost data based on their respective experiences. Commenters may also suggest other alternatives to the proposed approach.

The Commission notes that this consideration is based on its understanding that the derivatives market regulated by the Commission functions internationally with: (1) transactions that involve entities organized in the United States occurring across different international jurisdictions; (2) some entities organized outside of the United States that are prospective Commission registrants; and (3) some entities that typically operate both within and outside the United States and that follow substantially similar business practices wherever located. Where the Commission does not specifically refer to matters of location, the discussion of costs and benefits below refers to the effects of the proposed regulations on all relevant derivatives activity, whether based on their actual occurrence in the United States or on their connection with, or effect on U.S. commerce.[70]

2. Baseline

The Commission identifies and considers the benefits and costs of the proposed amendments relative to the baseline of the status quo. In particular, the baseline for the Commission's consideration of the costs and benefits of this proposed rulemaking is the existing statutory and regulatory framework applicable to DCOs, including: (1) the DCO core principles set forth in section 5b(c)(2) of the CEA; (2) the requirements associated with holding clearing member funds for positions in futures, foreign futures, and swaps under § 39.15; (3) the current DCO reporting requirements under § 39.19; and (4) the requirements for obtaining an acknowledgment letter from a foreign central bank holding customer funds, but not member funds.

3. Proposed Amendments to § 39.15(b)

a. Summary of Changes

The Commission is proposing new § 39.15(b)(3), which would allow the central banks of money center countries to serve as depositories for customer funds. The proposed regulation would further allow a DCO holding customer funds at the central bank of a money center country to obtain a modified written acknowledgment that is shorter and less detailed than the template acknowledgment letter in §§ 1.20 and 22.4.

b. Benefits

The Commission believes that central banks are often the best option for deposit of customer funds. By using a central bank, DCOs can minimize the credit and liquidity risks they face when holding foreign currency cash deposits. Many foreign central banks do not fit into any of the categories of permissible depositories in § 1.49, and some central banks have expressed unwillingness to sign the template acknowledgment letter. By permitting DCOs to deposit customer funds at the central banks of money center countries and requiring an abbreviated written acknowledgment suitable for the central bank context, the Commission believes that DCOs will be able to avail themselves of the risk management benefits of holding funds at a central bank.

c. Costs

The Commission does not believe the proposed rule will impose costs on DCOs. The proposed rule does not require DCOs to hold customer funds at any particular central bank and merely enables DCOs to hold funds at certain central banks.

[69] 7 U.S.C. 19(a).

[70] *See, e.g.* 7 U.S.C. 2(i).

d. Section 15(a) Factors

In addition to the discussion above, the Commission has evaluated the costs and benefits of the proposed amendments to § 39.15(b)(3) in light of the specific considerations identified in section 15(a) of the CEA. The Commission believes the proposed rule would protect market participants by allowing their funds to be more easily held at foreign central banks. Central banks expose depositors to minimal credit and liquidity risks and are safe depositories for assets belonging to market participants. Similarly, the proposed rules may improve DCOs' risk management because of the low credit and liquidity risks associated with holding funds at a central bank. The Commission has considered the other Section 15(a) factors and believes that they are not implicated by the proposed amendments to § 39.15(b)(3).

4. Proposed Amendments to § 39.15(e)

a. Summary of Changes

The Commission is proposing rules that would limit the investments DCOs can make with proprietary funds to those that are permissible for customer funds under § 1.25. The proposed rule also states that DCOs would be responsible for investment losses.

b. Benefits

The proposed rule would limit investments of proprietary funds to the safe investments listed in § 1.25. This is the same list of investments that can be made with customer funds. The Commission believes this proposal would appropriately protect clearing members from risk of loss by ensuring that any investment is in instruments with minimal credit, market, and liquidity risks.

c. Costs

The proposed rule may impose some costs on DCOs. Some DCOs may have to stop investing proprietary funds in certain instruments that are currently permitted and may incur some operational costs in revising the investments that are offered to clearing members for their proprietary funds. Further, to the extent the permitted investments earn less yield than what a DCO currently invests in, the regulation would impose costs in the form of lost investment revenue for the DCO and clearing member. The total cost of this regulation will depend on a number of factors including the number of clearing members of the DCO and what, if any, investments the DCO currently makes with proprietary funds.

a. Section 15(a) Factors

In addition to the discussion above, the Commission has evaluated the costs and benefits of the proposed amendments to § 39.15(e) in light of the specific considerations identified in section 15(a) of the CEA. The proposed rule would benefit clearing member market participants by ensuring their funds are invested in instruments that minimize the risk of loss. While DCOs currently determine what investments to make with clearing member funds, the proposed rule establishes a list of investments that the Commission believes is appropriately conservative for all clearing members. The Commission has considered the other Section 15(a) factors and believes that they are not implicated by the proposed amendments to § 39.15(e).

5. Proposed Amendments to § 39.15(f)(1)

a. Summary of Changes

The Commission is proposing new § 39.15(f)(1), which would require DCOs to segregate proprietary funds from their own funds, hold the funds in accounts clearly labeled as holding proprietary funds, and hold at all times an amount sufficient in the aggregate to cover the total value of proprietary funds held for all clearing members.

b. Benefits

The proposed rule would benefit clearing members by helping to ensure that proprietary funds on deposit will not be misused. Holding proprietary funds in an account that is exclusively for proprietary funds and clearly named as being for proprietary funds would make it difficult for a DCO or any employee to use the funds for an improper purpose without being detected. Further, the requirement that accounts hold funds adequate to cover the total value of proprietary funds held for all clearing members at all times would prevent a DCO from rehypothecating or otherwise using proprietary funds for its own benefit, thus ensuring that the funds are available when needed by clearing members or the DCO for permitted uses. The proposed rule would also ensure funds are readily identifiable in the event of a DCO bankruptcy, which would facilitate those funds receiving the appropriate preferential treatment.

c. Costs

The proposed rule might add some costs for DCOs if they need to establish new accounts for proprietary funds. DCOs would need to establish new procedures for regularly confirming that the accounts hold funds adequate to cover the total value of proprietary funds of all clearing members. However, as a mitigating factor, the Commission believes that most, if not all, DCOs currently hold proprietary funds separately from their own, and that most DCOs do not rehypothecate or otherwise use funds for their own purposes. In such cases, if there are any costs, they would be related to staff time involved with renaming current accounts holding proprietary funds. The exact costs will depend on a number of factors including how many accounts a DCO maintains for proprietary funds.

d. Section 15(a) Factors

In addition to the discussion above, the Commission has evaluated the costs and benefits of the proposed amendments to § 39.15(f)(1) in light of the specific considerations identified in section 15(a) of the CEA. The Commission believes the proposed rule would benefit market participants by helping to ensure their funds are not misused and by helping to make sure the funds receive the proper, preferential treatment in the event of a DCO bankruptcy. The Commission also believes that requiring DCOs to hold the total amount of proprietary funds at all times would promote sound risk management because it would ensure that the funds are available to the DCO in the event of a clearing member default. The Commission has considered the other section 15(a) factors and believes that they are not implicated by the proposed amendments to § 39.15(f)(1).

6. Proposed Amendments to § 39.15(f)(2)

a. Summary of Changes

The proposed rule would require DCOs to obtain a proprietary funds letter in the form prescribed in the proposed appendix from each depository holding proprietary funds. The proposed letter is based on the template acknowledgment letter for DCOs required by § 1.20, and requires depositories to acknowledge, among other things, that the funds belong to clearing members and cannot be used by the DCO for any other purpose. The proposed rule would also require a DCO to file the letters with the Commission and update the letters when certain information changes. The proposed rule would exclude Federal Reserve Banks from the requirement to obtain a proprietary funds letter from a depository holding proprietary funds. Further, the proposed rule would require a simpler written

acknowledgment from the central bank of a money center country that is holding proprietary funds than that required of other depositories.

b. Benefits

The proposed rule would benefit clearing members by ensuring that all depositories holding proprietary funds would know that the funds belong to clearing members and cannot be used by the DCO for any other purpose, which would help prevent the misuse of funds by the DCO or an employee of the DCO. Further, having a proprietary funds letter for each proprietary funds account would help a bankruptcy court or trustee easily identify that the funds are member property in the event of a DCO bankruptcy.

c. Costs

The proposed rule would impose costs on DCOs. DCOs would be required to work with depositories to obtain proprietary funds letters for existing accounts and to file the letters with the Commission. Further, DCOs would need procedures for obtaining a letter for any new account and for updating letters as information changes going forward. The Commission is attempting to limit the costs of obtaining proprietary funds letters by proposing to use a template that is substantively the same as the template letter required for customer funds and is thus already in use by many DCOs and their depositories. The costs each DCO would incur would depend, in large part, on the number of depositories the DCO uses to hold proprietary funds. The Commission has estimated that the PRA costs for this rule will be $100 per burden hour. Based on the burden estimate discussed above of six hours annually per DCO, the Commission estimates that each DCO will spend $600 in PRA costs under this proposed rule.

d. Section 15(a) Factors

In addition to the discussion above, the Commission has evaluated the costs and benefits of the proposed amendments to § 39.15(f)(2) in light of the specific considerations identified in section 15(a) of the CEA. The Commission believes the proposed rule would benefit market participants by ensuring that all depositories holding proprietary funds know that the funds belong to clearing members and cannot be used by the DCO for any other purpose, thus helping to prevent the misuse of funds. Having a proprietary funds letter for each proprietary funds account would help easily identify which funds are member property in the event of a DCO bankruptcy. Finally, the helping to prevent the misuse of proprietary funds would promote sound risk management by making it more likely that the funds are available if needed to cover a clearing member default. The Commission has considered the other section 15(a) factors and believes that they are not implicated by the proposed amendments to § 39.15(f)(2).

7. Proposed Amendments to § 39.15(f)(3)

a. Summary of Changes

Proposed § 39.15(f)(3) would permit DCOs to commingle proprietary funds belonging to multiple clearing members in the same custodial account. The rule would prohibit a DCO from commingling proprietary funds with the DCO's own funds or with FCM customer funds.

b. Benefits

The Commission believes that permitting DCOs to commingle proprietary funds from multiple clearing members in one account would allow DCOs to minimize operational risk by simplifying their banking processes and procedures. Further, the proposed rule would ensure that proprietary funds are held separately from the DCO's funds at the depository, making it harder for a DCO or an employee of the DCO to misuse the funds without detection.

c. Costs

The Commission does not believe permitting the commingling of multiple clearing members' funds in one account would impose new costs on DCOs. Currently, many DCOs hold clearing member funds in a commingled account, and the proposed rule would only permit, not require, clearing member funds to be commingled. However, the Commission recognizes that a DCO that currently commingles clearing member funds with other funds would need to segregate such funds and establish a separate account for such funds, thereby incurring new costs. But because the prohibition on commingling a DCO's funds with its clearing members' funds codifies sound participant protection and risk management principles that most, if not all, DCOs already apply, the Commission does not believe that it would impose significant new costs on existing DCOs. Additionally, DCOs are currently prohibited by the requirements of section 4d of the Act and the regulations thereunder from commingling customer funds with the funds of clearing members. The proposed rule would therefore not impose new costs with regard to holding clearing member funds and customer funds separately.

d. Section 15(a) Factors

In addition to the discussion above, the Commission has evaluated the costs and benefits of the proposed amendments to § 39.15(f)(3) in light of the specific considerations identified in section 15(a) of the CEA. The Commission believes that prohibiting a DCO from commingling its own funds with proprietary funds would benefit market participants by ensuring a clear delineation between the DCO's funds and proprietary funds. This delineation would make it more difficult to misuse proprietary funds and would make proprietary funds readily identifiable in the event of a DCO bankruptcy. Further, the Commission believes that the proposed rule would promote sound risk management because ensuring that clearing members' funds are held separately from the DCO's would make it more difficult for the funds to be misused without detection and would therefore make it more likely that the funds are available if needed to cover a clearing member default. The Commission has considered the other section 15(a) factors and believes that they are not implicated by the proposed amendments to § 39.12(f)(3).

8. Proposed Amendments to § 39.15(f)(4)

a. Summary of Changes

The proposed rule would prohibit a DCO or any of its depositories from using proprietary funds for any reason other than as belonging to the DCO's clearing members. The rule would specifically provide that an FCM's funds may be used to cover its customers' losses and as part of a DCO's mutualized guaranty fund.

b. Benefits

By eliminating any uses for proprietary funds other than on behalf of clearing members, the proposed rule would help ensure that the funds are readily available if needed either by the clearing member directly, or for a permitted use by the DCO. The clarifications providing that an FCM's funds may be used by a DCO to cover the FCM's customers' losses, or as part of a clearing member-funded, mutualized guaranty fund, ensures that the rule would not hamper DCOs' existing risk management programs.

c. Costs

Because the proposed rule would codify sound participant protection and risk management principles, the Commission does not believe that it

would impose significant costs on DCOs. The Commission does not believe DCOs are currently using clearing member funds in a manner that is inconsistent with this regulation. Further, the proposed rule would not require a guaranty fund or any specific type of FCM guarantee of its customers' performance, but instead would merely permit what is currently common risk management practice among DCOs.

d. Section 15(a) Factors

In addition to the discussion above, the Commission has evaluated the costs and benefits of the proposed amendments to § 39.15(f)(4) in light of the specific considerations identified in section 15(a) of the CEA. The proposed rule would benefit market participants by helping to ensure that their funds are protected and available for their use. Additionally, the proposed rule would promote sound risk management by helping to ensure that clearing member funds are readily available for permitted risk management uses by a DCO, such as in the event of a customer shortfall or clearing member default. The Commission has considered the other section 15(a) factors and believes that they are not implicated by the proposed amendments to § 39.12(f)(3).

9. Proposed Amendments to §§ 39.15(g) and 39.19(c)(4)(xxvi)

a. Summary of Changes

Proposed § 39.15(g) would require DCOs to, on a daily basis, calculate the amount of futures customer funds, cleared swaps customer collateral, and proprietary funds owed to each clearing member, separately for each account class and on a currency by currency basis. The proposed rule further would require DCOs to reconcile, separately for each account class, the amount of funds owed to all clearing members with the amount of funds held in depository accounts for that class of funds. Each calculation and reconciliation would have to be approved by a person who did not prepare the initial calculation or reconciliation. The calculation and reconciliation would have to be performed as of the close of each business day and completed by noon on the following business day. The proposed rule also would require securities to be valued at their current market value, subject to the DCO's haircuts, and calculations of the amount owed to be made in a manner consistent with the requirements of § 1.20(i). Finally, both proposed §§ 39.15(g)(5) and 39.19(c)(4)(xxvi) would require DCOs to immediately report any discrepancy in the calculation or reconciliation to the Commission.

b. Benefits

By requiring a DCO to verify on a daily basis the amount of futures customer funds, cleared swaps customer collateral, and proprietary funds it is holding, for each clearing member and across all clearing members, the proposed rule would facilitate the prompt discovery of any missing futures customer funds, cleared swaps customer collateral, or proprietary funds. Additionally, by requiring the daily calculation and reconciliation to be approved by an independent employee, the proposed rule would help prevent a single bad actor at a DCO from misusing futures customer funds, cleared swaps customer collateral, or proprietary funds, and from concealing that misuse. The requirement to report any discrepancies to the Commission would help ensure that the Commission is immediately made aware of potentially missing funds, and that it can work with the DCO to resolve the matter.

c. Costs

The Commission understands that the daily calculation and reconciliation would impose costs on DCOs. DCOs would need to develop procedures that comply with the timing, valuation, and calculation requirements in the proposed rule, to calculate the amount of funds owed to each clearing member for each account class and to reconcile the amount of funds owed to all clearing members with the amount of funds held at depositories for each account class. Further, at least two DCO employees would have to be involved in the process of performing and approving the calculations and reconciliations each day. DCOs would also need to include the new reporting requirement in their process and procedures for event-specific reporting to the Commission. The Commission has sought to minimize the costs of the proposed regulation by only requiring reporting to the Commission of discrepancies rather than the filing of daily reports. The exact costs would depend on the account class(es) in which a DCO holds funds, and the number of clearing members and customer accounts at issue. The Commission has estimated that the PRA costs for event specific reporting are $79 per hour. Based on the burden estimate discussed above of .5 hours annually per DCO, the Commission estimates that each DCO will spend $39.50 in PRA costs under this rule.

d. Section 15(a) Factors

In addition to the discussion above, the Commission has evaluated the costs and benefits of the proposed amendments to § 39.15(f)(5) in light of the specific considerations identified in section 15(a) of the CEA. The proposed rule would benefit market participants by enabling any loss or theft of funds to be discovered by the DCO and reported to the Commission quickly. The Commission further believes that the proposed rule would promote sound risk management by helping to ensure that the funds are available if needed by the DCO to cover a clearing member or customer default. The Commission has considered the other section 15(a) factors and believes that they are not implicated by the proposed amendments.

10. Proposed Amendment to § 39.15(h)

a. Summary of Changes

The proposed rule would exempt foreign DCOs from the requirements of proposed § 39.15(e)(3), (f), and (g)(3) because in the event of an insolvency, the clearing member funds held by a foreign DCO would not be subject to U.S. bankruptcy law.[71]

b. Benefits

The Commission has determined to seek to avoid conflicts with insolvency proceedings in the jurisdiction where a foreign DCO is organized. The Commission believes that certainty surrounding which insolvency law would apply would benefit the clearing members of foreign DCOs.

c. Costs

The Commission does not believe the rule would impose costs on foreign DCOs. The proposed rule is preserving the baseline, that funds belonging to a foreign DCO's clearing members will be treated in accordance with the insolvency law of the foreign DCO's home jurisdiction.

d. Section 15(a) Factors

In addition to the discussion above, the Commission has evaluated the costs and benefits of the proposed amendments to § 39.15(h) in light of the specific considerations identified in section 15(a) of the CEA. The proposed rule would benefit market participants by providing certainty regarding which insolvency law would apply to their funds in the event a foreign DCO enters an insolvency proceeding. The Commission has considered the other section 15(a) factors and believes that

[71] *See* 17 CFR 190.11(b).

they are not implicated by the proposed amendments.

D. Antitrust Considerations

Section 15(b) of the CEA requires the Commission to take into consideration the public interest to be protected by the antitrust laws and endeavor to take the least anticompetitive means of achieving the purposes of the CEA, in issuing any order or adopting any Commission rule or regulation.[72]

The Commission believes that the public interest to be protected by the antitrust laws is the promotion of competition. The Commission requests comment on whether the proposed amendments implicate any other specific public interest to be protected by the antitrust laws. The Commission has considered the proposed rulemaking to determine whether it is anticompetitive and has identified no anticompetitive effects. The Commission requests comment on whether the proposed rulemaking is anticompetitive and, if it is, what the anticompetitive effects are.

Because the Commission has determined that the proposed rule amendments are not anticompetitive and have no anticompetitive effects, the Commission has not identified any less anticompetitive means of achieving the purposes of the CEA. The Commission requests comment on whether there are less anticompetitive means of achieving the relevant purposes of the CEA that would otherwise be served by adopting the proposed rule amendments.

List of Subjects in 17 CFR Part 39

Reporting, Treatment of funds.

For the reasons stated in the preamble, the Commodity Futures Trading Commission proposes to amend 17 CFR part 39 as follows:

PART 39—DERIVATIVES CLEARING ORGANIZATIONS

■ 1. The authority citation for part 39 continues to read as follows:

Authority: 7 U.S.C. 2, 6(c), 7a–1, and 12a(5); 12 U.S.C. 5464; 15 U.S.C. 8325; Section 752 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. 111–203, title VII, sec. 752, July 21, 2010, 124 Stat. 1749.

■ 2. Amend § 39.2 by adding definitions of the terms ''Money center country'' and ''Proprietary funds'' in alphabetical order to read as follows:

§ 39.2 Definitions.

* * * * *

Money center country means Canada, France, Germany, Italy, Japan, and the United Kingdom.

* * * * *

Proprietary funds means all money, securities, and property received by a derivatives clearing organization from, for, or on behalf of, a clearing member and held in a proprietary account, as defined in § 1.3 of this chapter:

(1) To margin, guarantee, or secure contracts for future delivery on or subject to the rules of a contract market, derivatives clearing organization, or foreign board of trade or a cleared swap contract, and all money accruing to a clearing member as the result of such contracts;

(2) In connection with a commodity option transaction on or subject to the rules of a contract market, derivatives clearing organization, or foreign board of trade:

(i) To be used as a premium for the purchase of a commodity option transaction for a clearing member;

(ii) As a premium payable to a clearing member;

(iii) To guarantee or secure performance of a commodity option by a clearing member; or

(iv) Representing accruals (including, for purchasers of a commodity option for which the full premium has been paid, the market value of such commodity option) to a clearing member;

(3) That constitutes, if a cleared swap is in the form or nature of an option, the settlement value of the option; or

(4) As a contribution to a guaranty fund to mutualize the losses resulting from a default by a clearing member by covering the losses in accordance with the derivatives clearing organization's rules and its agreement(s) with its clearing members.

* * * * *

■ 3. Amend § 39.15 by adding paragraph (b)(3), revising paragraph (e), and adding paragraphs (f), (g), and (h) to read as follows:

§ 39.15 Treatment of funds.

* * * * *

(b) * * *

(3) *Central banks.* Notwithstanding anything to the contrary in §§ 1.20, 1.49, 22.4, 22.5, or 22.9 of this chapter, a derivatives clearing organization may hold futures customer funds or cleared swaps customer collateral at the central bank of a money center country if it obtains from the central bank a written acknowledgment that:

(i) The central bank was informed that the customer funds deposited therein are those of customers who trade commodities, options, swaps, and other products and are being held in accordance with the provisions of section 4d of the Act and applicable Commission regulations thereunder; and

(ii) The central bank agrees to reply promptly and directly to any request from the director of the Division of Clearing and Risk or the director of the Market Participants Division, or any successor divisions, or such directors' designees, for confirmation of account balances or provision of any other information regarding or related to an account.

* * * * *

(e) *Permitted investments.* (1) Funds and assets belonging to clearing members and their customers that are invested by a derivatives clearing organization shall be held in instruments with minimal credit, market, and liquidity risks.

(2) Any investment of customer funds or assets by a derivatives clearing organization shall comply with § 1.25 of this chapter.

(3) A derivatives clearing organization may invest proprietary funds only in a manner that would be permitted for customer funds under § 1.25 of this chapter. The derivatives clearing organization shall bear sole responsibility for any losses resulting from the investment of proprietary funds.

(f) *Proprietary funds*—(1) *Segregation.* A derivatives clearing organization must separately account for and segregate all proprietary funds as belonging to its clearing members. A derivatives clearing organization shall deposit proprietary funds under an account name that clearly identifies the funds as belonging to clearing members and shows that the funds are segregated as required by this part. A derivatives clearing organization must at all times maintain in the separate segregated account or accounts money, securities and property in an amount sufficient in the aggregate to cover the total value of proprietary funds owed to all clearing members.

(2) *Written acknowledgment from depositories.* (i) A derivatives clearing organization must obtain a written acknowledgment from each depository prior to or contemporaneously with the opening of an account for proprietary funds by the derivatives clearing organization with the depositories; provided, however, a derivatives clearing organization is not required to obtain a written acknowledgment from a Federal Reserve Bank with which it has opened an account for proprietary funds.

[72] 7 U.S.C. 19(b).

(ii) The written acknowledgment must be in the form as set out in Appendix D to this part, except as provided in paragraph (f)(2)(vi) of this section.

(iii) A derivatives clearing organization shall promptly file a copy of the written acknowledgment with the Commission in the format and manner specified by the Commission no later than three business days after the opening of the account or the execution of a new written acknowledgment for an existing account, as applicable.

(iv) A derivatives clearing organization shall obtain a new written acknowledgment within 120 days of any changes in the following:

(A) The name or business address of the derivatives clearing organization;

(B) The name or business address of the depository receiving proprietary funds; or

(C) The account number(s) under which proprietary funds are held.

(v) A derivatives clearing organization shall maintain each written acknowledgment readily accessible in its files in accordance with § 1.31 of this chapter, for as long as the account remains open, and thereafter for the period provided in § 1.31 of this chapter.

(vi) Notwithstanding paragraph (f)(2)(ii) of this section, a derivatives clearing organization may deposit proprietary funds with the central bank of a money center country if it obtains from the central bank a written acknowledgment that:

(A) The central bank was informed that the proprietary funds deposited therein are those of clearing members who trade commodities, options, swaps, and other products and are being held in accordance with the provisions of section 5b(c)(2)(F) of the Act and Commission regulations thereunder; and

(B) The central bank agrees to reply promptly and directly to any request from the director of the Division of Clearing and Risk, or any successor division, or the director's designees, for confirmation of account balances or provision of any other information regarding or related to an account.

(3) *Commingling.* (i) A derivatives clearing organization may for convenience commingle the proprietary funds that it receives from, or on behalf of, clearing members in a single account or multiple accounts with one or more depositories.

(ii) A derivatives clearing organization shall not commingle proprietary funds with the money, securities or property of the derivatives clearing organization, or a customer account of a clearing member of the derivatives clearing organization, or use proprietary funds to secure or guarantee the obligation of, or extend credit to, the derivatives clearing organization.

(4) *Limitation on use of proprietary funds.* (i) A derivatives clearing organization shall not hold, use or dispose of proprietary funds except as belonging to the clearing member that deposited the proprietary funds. The use of proprietary funds as belonging to clearing members may include, but is not limited to:

(A) A derivatives clearing organization may use the proprietary funds belonging to a clearing member to guarantee or cover deficits in a customer account of that clearing member in accordance with the derivatives clearing organization's rules and its agreement(s) with the clearing member; and

(B) A derivatives clearing organization may use non-defaulting clearing members' money, securities, or property that is being held as a guaranty fund to mutualize the losses resulting from a default by a clearing member to cover such losses in accordance with the derivatives clearing organization's rules and its agreement(s) with its clearing members.

(ii) No person, including any derivatives clearing organization or any depository, that has received proprietary funds for deposit in a segregated account, as provided in this section, may hold, dispose of, or use any the funds as belonging to any person other than the clearing members of the derivatives clearing organization which deposited the funds.

(g) *Daily reconciliation*—(1) *Futures customer funds.* By noon of each business day, a derivatives clearing organization that has received futures customer funds from its clearing members shall, as of the close of the previous business day:

(i) Calculate the amount of futures customer funds owed to each clearing member, on a currency by currency basis; and

(ii) Reconcile the total amount of futures customer funds owed, on a currency by currency basis, aggregated across all clearing members, with the amount of futures customer funds held in separate accounts across all depositories.

(2) *Cleared swaps customer funds.* By noon of each business day, a derivatives clearing organization that has received cleared swaps customer collateral from its clearing members shall, as of the close of the previous business day:

(i) Calculate the amount of cleared swaps customer collateral owed to each clearing member, on a currency by currency basis; and

(ii) Reconcile the total amount of cleared swaps customer collateral owed, aggregated across all clearing members, with the amount of cleared swaps customer collateral held in separate accounts across all depositories.

(3) *Proprietary funds.* By noon of each business day, a derivatives clearing organization that has received proprietary funds from its clearing members shall, as of the close of the previous business day:

(i) Calculate the amount of proprietary funds owed to each clearing member, on a currency by currency basis; and

(ii) Reconcile the total amount of proprietary funds owed, aggregated across all clearing members, with the amount of proprietary funds held in separate accounts across all depositories.

(4) *Calculations.* (i) Each calculation and reconciliation required by this paragraph (g) must be approved by a person who did not prepare the calculation or reconciliation and who does not report to the person that prepared the calculation or reconciliation.

(ii) In performing the calculations required by this paragraph (g):

(A) Securities shall be valued at their current market value, with haircuts applied in accordance with § 39.11(d); and

(B) A reconciliation deficit in a particular account type in one currency may be offset by a surplus in that same account type in another currency, based on publicly available exchange rates, with the surplus subject to haircuts reasonably determined by the derivatives clearing organization, consistently applied.

(C) Where customer funds, including funds received to margin, guarantee, or secure futures, options, foreign futures, foreign options, or swaps, are, pursuant to an order of the Commission or a DCO rule filed pursuant to paragraph (b)(2)of this section, received for the purpose of holding such funds in a futures account, they shall be treated as futures customer funds, both for purposes of funds owed and funds held. Where such funds are received for the purpose of holding such funds in a cleared swaps customer account, they shall be treated as cleared swaps customer collateral, both for purposes of funds owed and funds held.

(iii) Calculations of amounts owed in this paragraph (g) shall be made consistent with the requirements of § 1.20(i) of this chapter, as applied to the accounts of a derivatives clearing organization with respect to its members' futures customer, cleared swaps customer, and proprietary accounts.

(5) A derivatives clearing organization shall immediately report to the Commission, pursuant to § 39.19, any discrepancies in the calculation of the amount of funds held for each clearing member and any one or more of the reconciliations that reveals that the derivatives clearing organization did not, at the close of the previous business day, maintain in separate segregated accounts money, securities and property in an amount sufficient in the aggregate to cover the total value of funds owed to all clearing members.

(h) *Exclusions for foreign derivatives clearing organizations*—Paragraphs (e)(3), (f) and (g)(3) of this section do not apply to a derivatives clearing organization organized outside the United States that would, in the event of its insolvency, be subject to a foreign proceeding, as defined in 11 U.S.C. 101(23), in the jurisdiction in which it is organized.

■ 4. In § 39.19, add paragraph (c)(4)(xxvi) to read as follows:

§ 39.19 Reporting.

* * * * *

(c) * * *

(4) * * *

(xxvi) *Discrepancy in customer or proprietary funds.* A derivatives clearing organization shall immediately report to the Commission any discrepancies in the calculation of the amount of funds held for each clearing member and any one or more of the reconciliations required pursuant to § 39.15(g) that reveals that the derivatives clearing organization did not, at the close of the previous business day, maintain in separate segregated accounts money, securities and property in an amount sufficient in the aggregate to cover the total value of funds owed to all clearing members.

* * * * *

■ 5. Add appendix D to part 39 to read as follows:

Appendix D to Part 39—Derivatives Clearing Organization Acknowledgment Letter for CFTC Regulation § 39.15 Proprietary Funds Account

[Date]

[Name and Address of Bank or Trust Company]

We refer to the Segregated Account(s) which [Name of Derivatives Clearing Organization] (''we'' or ''our'') have opened or will open with [Name of Bank or Trust Company] (''you'' or ''your'') entitled:

[Name of Derivatives Clearing Organization] Proprietary Funds Account, CFTC Regulation § 39.15 Proprietary Funds Account under Section 5b(c)(2)(F) of the Commodity Exchange Act [and, if applicable, '', Abbreviated as [short title reflected in the depository's electronic system]'']

Account Number(s): [ ]

(collectively, the ''Account(s)'').

You acknowledge that we have opened or will open the above-referenced Account(s) for the purpose of depositing, as applicable, money, securities and other property (collectively the ''Funds'') of clearing members who trade commodities, options, swaps, and other products, as required by Commodity Futures Trading Commission (''CFTC'') Regulations, including Regulation § 39.15, as amended; that the Funds held by you, hereafter deposited in the Account(s) or accruing to the credit of the Account(s), will be separately accounted for and segregated on your books from our own funds and from any other funds or accounts held by us in accordance with the provisions of the Commodity Exchange Act, as amended (the ''Act''), and part 39 of the CFTC's regulations, as amended; and that the Funds constitute member property as defined by 11 U.S.C. 761(16) and CFTC Regulation § 190.01.

Furthermore, you acknowledge and agree that such Funds may not be used by you or by us to secure or guarantee any obligations that we might owe to you, and they may not be used by us to secure or obtain credit from you. You further acknowledge and agree that the Funds in the Account(s) shall not be subject to any right of offset or lien for or on account of any indebtedness, obligations or liabilities we may now or in the future have owing to you. This prohibition does not affect your right to recover funds advanced in the form of cash transfers, lines of credit, repurchase agreements or other similar liquidity arrangements you make in lieu of liquidating non-cash assets held in the Account(s) or in lieu of converting cash held in the Account(s) to cash in a different currency.

You agree to reply promptly and directly to any request for confirmation of account balances or provision of any other information regarding or related to the Account(s) from the director of the Division of Clearing and Risk of the CFTC, or any successor divisions, or such director's designees, and this letter constitutes the authorization and direction of the undersigned on our behalf to release the requested information without further notice to or consent from us.

The parties agree that all actions on your part to respond to the above information requests will be made in accordance with, and subject to, such usual and customary authorization verification and authentication policies and procedures as may be employed by you to verify the authority of, and authenticate the identity of, the individual making any such information request, in order to provide for the secure transmission and delivery of the requested information to the appropriate recipient(s).

We will not hold you responsible for acting pursuant to any information request from the director of the Division of Clearing and Risk of the CFTC, or any successor divisions, or such director's designees, upon which you have relied after having taken measures in accordance with your applicable policies and procedures to assure that such request was provided to you by an individual authorized to make such a request.

In the event that we become subject to either a voluntary or involuntary petition for relief under the U.S. Bankruptcy Code, we acknowledge that you will have no obligation to release the Funds held in the Account(s), except upon instruction of the Trustee in Bankruptcy or pursuant to the Order of the respective U.S. Bankruptcy Court.

Notwithstanding anything in the foregoing to the contrary, nothing contained herein shall be construed as limiting your right to assert any right of offset or lien on assets that are not Funds maintained in the Account(s), or to impose such charges against us or any account maintained by us with you for the purpose of holding our own funds. Further, it is understood that amounts represented by checks, drafts or other items shall not be considered to be part of the Account(s) until finally collected. Accordingly, checks, drafts and other items credited to the Account(s) and subsequently dishonored or otherwise returned to you or reversed, for any reason, and any claims relating thereto, including but not limited to claims of alteration or forgery, may be charged back to the Account(s), and we shall be responsible to you as a general endorser of all such items whether or not actually so endorsed.

You may conclusively presume that any withdrawal from the Account(s) and the balances maintained therein are in conformity with the Act and CFTC regulations without any further inquiry, provided that, in the ordinary course of your business as a depository, you have no notice of or actual knowledge of a potential violation by us of any provision of the Act or the CFTC regulations that relates to the segregation of proprietary funds; and you shall not in any manner not expressly agreed to herein be responsible to us for ensuring compliance by us with such provisions of the Act and CFTC regulations; however, the aforementioned presumption does not affect any obligation you may otherwise have under the Act or CFTC regulations.

You may, and are hereby authorized to, obey the order, judgment, decree or levy of any court of competent jurisdiction or any governmental agency with jurisdiction, which order, judgment, decree or levy relates in whole or in part to the Account(s). In any event, you shall not be liable by reason of any action or omission to act pursuant to any such order, judgment, decree or levy, to us or to any other person, firm, association or corporation even if thereafter any such order, decree, judgment or levy shall be reversed, modified, set aside or vacated.

The terms of this letter agreement shall remain binding upon the parties, their successors and assigns and, for the avoidance of doubt, regardless of a change in the name of either party. This letter agreement supersedes and replaces any prior agreement between the parties in connection with the Account(s), including but not limited to any prior acknowledgment letter agreement, to the extent that such prior agreement is inconsistent with the terms hereof. In the event of any conflict between this letter agreement and any other agreement between

the parties in connection with the Account(s), this letter agreement shall govern with respect to matters specific to section 5b(c)(2)(F) of the Act and CFTC Regulation § 39.15, as amended.

This letter agreement shall be governed by and construed in accordance with the laws of [Insert governing law] without regard to the principles of choice of law.

Please acknowledge that you agree to abide by the requirements and conditions set forth above by signing and returning to us the enclosed copy of this letter agreement, and that you further agree to provide a copy of this fully executed letter agreement directly to the CFTC (via electronic means in a format and manner determined by the CFTC). We hereby authorize and direct you to provide such copy without further notice to or consent from us, no later than three business days after opening the Account(s) or revising this letter agreement, as applicable.

[Name of Derivatives Clearing Organization]
By:
Print Name:
Title:
ACKNOWLEDGED AND AGREED:
[Name of Bank or Trust Company]
By:
Print Name:
Title:
Contact Information: [Insert phone number and email address]
DATE:

Issued in Washington, DC, on December 26, 2023, by the Commission.

Christopher Kirkpatrick,

Secretary of the Commission.

Note: The following appendices will not appear in the Code of Federal Regulations.

Appendices to Protection of Clearing Member Funds Held by Derivatives Clearing Organizations—Commission Voting Summary, Chairman's Statement, and Commissioners' Statements

Appendix 1—Commission Voting Summary

On this matter, Chairman Behnam and Commissioner Johnson voted in the affirmative. Commissioner Pham concurred. Commissioners Goldsmith Romero and Mersinger voted in the negative.

Appendix 2—Statement of Support of Chairman Rostin Behnam

I support the issuance and publication of the proposed rule on the protection of clearing member funds held by derivatives clearing organizations (DCOs). The Commission has longstanding regulations that provide comprehensive protections for funds belonging to customers of a Futures Commission Merchant (FCM).[1] Similar protections, however, do not exist for funds belonging to clearing members of a DCO, whether they are individual market participants or FCMs themselves. The proposed rule would implement a regime for the protection of clearing member funds largely analogous to the current regime applicable to FCM customer funds. Specifically, the proposed rule would ensure that clearing member funds and assets receive proper treatment if a DCO enters bankruptcy by requiring segregation of clearing member funds from the DCO's own funds[2] and that the funds be held in a depository that acknowledges in writing that the funds belong to clearing members,[3] not the DCO. The proposed rule would require new regulations regarding the commingling of clearing member or proprietary funds;[4] limitations on the use of these funds;[5] and limit investments of the funds to the investments permitted for customer funds under Regulation § 1.25.[6] In addition, the proposed rule would permit DCOs to hold customer and clearing member funds at foreign central banks subject to certain requirements. Finally, the proposed rule would require DCOs to conduct a daily calculation and reconciliation of the amount of funds owed to customers and clearing members and the amount actually held for customers and clearing members.[7]

Commission regulations addressing the custody and safeguarding of customer funds have historically responded to the characteristics of the prevailing model in which all, or nearly all, clearing members of a DCO were FCMs acting as intermediaries. However, as noted in the proposed rule, the Commission has granted registration to a number of DCOs that clear directly for market participants without the intermediation of FCMs.[8] Additionally, many DCOs that use the traditional FCM clearing model have at least some non-FCM clearing members. The growth and evolution of the non-intermediated clearing model necessitates ensuring that our regulations establish a regime for the safeguarding and protection of clearing member funds that addresses the issues and risks presented.

Lastly, I am pleased that the proposed rule would, in effect, codify the no-action and exemptive relief previously given to four DCOs[9] by permitting DCOs to hold customer funds at foreign central banks and use a modified acknowledgment letter. The proposed rule would also extend these amended provisions to clearing member funds. Permitting DCOs to hold customer and clearing member funds at a central bank allows them to take advantage of the credit and liquidity risk management benefits that central bank accounts provide. This is sound policy and risk management.

I look forward to hearing the public's comments on the proposed rule. The 60-day comment period will begin upon the Commission's publication of the proposed rule on its website.

Appendix 3—Statement of Commissioner Kristin N. Johnson

Trust is the core issue that motivates today's notice of proposed rulemaking (Proposed Rule) regarding the protection of clearing member funds held by derivatives clearing organizations (DCOs) advanced by the Division of Clearing and Risk.

On March 30, 2022, I commenced service as a Commissioner of the Commodity Futures Trading Commission (Commission or CFTC). In a hearing before the Senate Agriculture, Nutrition, and Forestry Committee a few weeks earlier, I committed to promote the

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[1] *See* 7 U.S.C. 6d; 17 CFR 1.20 through 1.39. *See also* 17 CFR 22.1 through 22.17, and 30.7 (establishing similar regimes for cleared swaps customer collateral and foreign futures customer funds, respectively). DCOs that receive customer funds from their FCM clearing members must also apply many of these customer protection requirements.

[2] *See also* 17 CFR 1.20(a) (requiring FCMs to segregate customer funds from their own funds); 17 CFR 1.20(g)(1), 17 CFR 39.15 (b), 17 CFR 22.3(b)(1) (requiring DCOs to segregate the customer funds of their FCM clearing members from their own funds).

[3] *See also* 17 CFR 1.20, 22.5, and 30.7 (requiring an FCM to obtain an acknowledgment letter for futures customer funds, cleared swaps customer collateral, and foreign futures customer funds, respectively); 17 CFR 1.20(g)(4), 17 CFR 22.5 (requiring a DCO to obtain an acknowledgment letter from depositories).

[4] *See also* 17 CFR 1.20(e) and (g).

[5] *See also* 17 CFR 1.20(f).

[6] 17 CFR 1.25.

[7] *See also* 17 CFR 1.32, 1.33.

[8] Currently, CBOE Clear Digital, LLC; CX Clearinghouse, L.P.; LedgerX, LLC; and North American Derivatives Exchange Inc. allow individuals to be direct clearing members. *See* In the Matter of the Application of CBOE Clear Digital, LLC For Registration as a Derivatives Clearing Organization (June 5, 2023), *available at https://www.cftc.gov/IndustryOversight/IndustryFilings/ClearingOrganizations/39855;* In the Matter of the Application of CX Clearinghouse, L.P. For Registration as a Derivatives Clearing Organization (Aug. 3, 2018), *available at https://www.cftc.gov/IndustryOversight/IndustryFilings/ClearingOrganizations/16767;* In the Matter of the Application of LedgerX, LLC For Registration as a Derivatives Clearing Organization (Sept. 2, 2020), *available at https://www.cftc.gov/IndustryOversight/IndustryFilings/ClearingOrganizations/30998;* In the Matter of the Application of the North American Derivatives Exchange for Registration as a Derivatives Clearing Organization (Jan. 17, 2014), *available at https://www.cftc.gov/IndustryOversight/IndustryFilings/ClearingOrganizations/38.*

[9] *See* CFTC Letter No. 16–59 (June 21, 2016), *available at https://www.cftc.gov/csl/16-59/download* (granting an exemption to the Chicago Mercantile Exchange, Inc (CME) from the requirements of Regulation § 1.49(d)(3) to permit CME to hold customer funds at the Bank of Canada and permitting the use of a modified acknowledgment letter for customer accounts maintained by the CME. at the Bank of Canada); CFTC Letter No. 16–05 (Feb. 1, 2016), *available at https://www.cftc.gov/csl/16-05/download* (granting an exemption to Eurex Clearing AG (Eurex) from the requirements of Regulation § 1.49(d)(3) to permit Eurex to hold customer funds at Deutsche Bundesbank and permitting the use of a modified acknowledgment letter for customer accounts maintained by Eurex at Deutsche Bundesbank); and CFTC Letters No. 14–123 (Oct. 8, 2014), *available at https://www.cftc.gov/csl/14-123/download* and 14–124 (Oct. 8, 2014), *available at https://www.cftc.gov/csl/14-124/download* (granting an exemption to ICE Clear Europe Limited and LCH Ltd, respectively, from the requirements of Regulation § 1.49(d)(3) to permit ICE Clear Europe Limited and LCH Ltd to hold customer funds at the Bank of England and permitting the use of a modified acknowledgment letter for customer accounts maintained by ICE Clear Europe Limited and LCH Ltd, respectively, at the Bank of England).

integrity and stability of our markets and protect customers, particularly vulnerable and marginalized individual retail customers who participate in our markets. This commitment is among the most compelling reasons for my public service.

Over the last few decades, the Commission has adopted and refined protections for customers of intermediaries in our markets, namely by imposing rigorous obligations on intermediaries to segregate the funds of their customers, designating specific authorized depositories, and outlining permitted investments of customer funds.

Over the course of my tenure as a Commissioner, in numerous public speeches, statements, and interviews, I have called on the Commission to advance parallel customer protections for direct participants of non-intermediated clearinghouses registered with the Commission as DCOs.[1]

Today's Proposed Rule takes the first steps to close this gap. I support this Proposed Rule that advances the protection of clearing member proprietary funds held by a DCO. Specifically, the Proposed Rule:

- Requires a DCO to segregate clearing member proprietary funds from the DCO's own funds, hold such funds in an account labeled as proprietary funds, and obtain a written acknowledgment letter from a depository;
- Requires a DCO to treat clearing member proprietary funds as belonging to the clearing member while permitting the DCO to use clearing member proprietary funds as part of the DCO's default waterfall, consistent with the DCO's rules and agreement with its clearing members;
- Permits the DCO to commingle proprietary funds of multiple clearing members in a single omnibus account for convenience while prohibiting the commingling of proprietary funds with the DCO's own funds or futures commission merchant (FCM) customer funds;
- Permits the DCO to invest clearing member proprietary funds in highly liquid financial instruments pursuant to CFTC Regulation § 1.25 and requires DCOs to be responsible for investment losses; and
- Requires the daily reconciliation of balances of FCM customers and clearing members and segregated funds and the reporting of any discrepancies.

In my capacity as a Commissioner at the CFTC, I have strongly advocated for the development of these important regulatory protections that parallel existing protections in intermediated market structures. This Proposed Rule reflects the tremendous efforts of coordination among the Division of Clearing and Risk, the office of the Chairman, my office, and my fellow Commissioners' offices and their staff. Our collective engagement reflects years of dialogue with market participants, CFTC staff, other market and prudential regulators and engagement with the U.S. Department of the Treasury, members of Congress, academics, and public interest advocates.

This Proposed Rule offers a transformational reform that brings to markets in which clients may interact directly with a DCO foundational protections currently established in CFTC regulations and enforced in markets that rely on intermediaries.[2]

In a direct clearing model (non-intermediated market structure), clearing members are not customers of intermediaries,[3] and therefore, do not qualify for the regulatory protections available under part 1 of the Commission's regulations, including the requirement to separately account for and segregate customer funds as belonging to customers, deposit customer funds in specific locations, obtain written acknowledgment letters from depositories, and use customer funds as belonging to such customers.[4] The Proposed Rule reflects the historic development and evolution of markets and refers to the assets or funds on deposit from a customer of an intermediary as ''customer funds.'' The Proposed Rule adopts the term ''clearing member'' to describe those directly interacting with the clearinghouse and ''proprietary funds'' to describe clearing members' assets or funds on deposit.

The Commission acts to ensure parallel protections in the market for every asset class, adopting and seeking to implement the existing, well-tested, and effective regulatory framework under certain provisions of part 1 of the CFTC's regulation to the preservation of clearing member proprietary funds. This may be increasingly important as the Commission anticipates market participants' introduction of novel financial products.

In adopting the Proposed Rule, the Commission seeks to ensure that clearing member proprietary funds are easily identified and receive the proper treatment in the event the DCO enters an insolvency or bankruptcy proceeding.

Today, the Commission takes a first step to ensure that there are parallel protections for both the ''customers'' of intermediaries, and the ''clearing members'' of DCOs who may include (in a direct clearing model) individual retail market participants.

Regulatory Gap for Direct Participants in Non-Intermediated Clearing Models

Section 4d of the Commodity Exchange Act (CEA) and parts 1, 22 and 30 of the Commission's regulations establish a comprehensive regime to safeguard the funds belonging to customers of FCMs in the context of intermediated DCOs.

The customer protection regime requires FCMs to segregate customer funds from their own funds, deposit customer funds under an account name that clearly identifies them as customer funds, and obtain a written acknowledgment from each depository that holds customer funds. The customer protection regime does not apply to the funds of a person that clears trades directly through a DCO and is a ''clearing member'' because such market participants do not meet the legal and regulatory definitions of the term ''customer.''

Therefore, direct participants that are not ''customers'' of intermediaries may not benefit from the Commission's well-established customer protection regime.

The Commission seeks to offer parallel customer protections to direct participants in non-intermediated DCOs—clearing members—to preserve the value of their proprietary funds, mitigate the risk of loss, and improve the availability of those funds for return to the clearing member should the DCO fail. Section 5b(c)(2)(F) of the CEA (Core Principle F) and CFTC Regulation § 39.15 apply to the treatment of clearing members' funds and assets held by a DCO.

CFTC regulations require DCOs to establish standards and procedures designed to protect and ensure the safety of proprietary funds and require DCOs to hold proprietary funds in a manner that will minimize the risk of loss or delay in access by the DCO to the proprietary funds. Section 8a(5) of the CEA grants the Commission authority to adopt rules it determines are reasonably necessary to effectuate the DCO core principles.[5] The safeguards in this Proposed Rule are indeed reasonably necessary to effectuate DCO Core Principle F.[6]

In light of the lack of parallel protections for ''clearing members'' who directly interface with DCOs, there is a significant gap in the Commission's ability to ensure the protection and preservation of funds or assets of direct participants. This Proposed Rule closes the gap.

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[1] Kristin N. Johnson, Commissioner, CFTC, Statement on Preserving Trust and Preventing the Erosion of Customer Protection Regulation (Nov. 3, 2023), *https://www.cftc.gov/PressRoom/SpeechesTestimony/johnstatement110323;* Kristin N. Johnson, Commissioner, CFTC, Keynote Address at the World Federation of Exchanges Annual Meeting: Creating Rules of the Road for (Dis)Intermediated and (De)Centralized Markets (Sept. 21, 2023), *https://www.cftc.gov/PressRoom/SpeechesTestimony/opajohnson5;* Kristin N. Johnson, Commissioner, CFTC, Keynote Address at Salzburg Global Finance Forum: Future-Proofing Financial Markets Regulation (June 29, 2023), *https://www.cftc.gov/PressRoom/SpeechesTestimony/opajohnson4;* Kristin N. Johnson, Commissioner, CFTC, Statement Calling for the CFTC to Initiate A Rulemaking Process for CFTC-Registered DCOs Engaged in Crypto or Digital Asset Clearing Activities (May 30, 2023), *https://www.cftc.gov/PressRoom/SpeechesTestimony/johnsonstatement053023;* Kristin N. Johnson, Commissioner, CFTC, Keynote Address at Digital Assets @Duke Conference, Duke's Pratt School of Engineering and Duke Financial Economics Center: Mitigating Crypto-Crises: Applying Lessons Learned in Governance, Risk Management, and Compliance (Jan. 26, 2023), *https://www.cftc.gov/PressRoom/SpeechesTestimony/opajohnson2;* Kristin N. Johnson, Commissioner, CFTC, Statement in Support of Notice of Proposed Amendments to Reporting and Information Requirements for Derivatives Clearing Organizations (Nov. 10, 2022), *https://www.cftc.gov/PressRoom/SpeechesTestimony/johnsonstatement111022b.*

[2] Although the focus of my statement is on direct participants in the context of non-intermediated clearing models, the Proposed Rule has broader implications. It applies to the proprietary funds of FCMs in the context of an intermediated model as well.

[3] The term ''customer'' is generally reserved for the individuals or businesses that rely on an intermediary such as an FCM to facilitate a transaction. Where a DCO offers direct services, the individuals or businesses engaged with the clearinghouse are generally described as ''members.''

[4] 17 CFR 1.20.

[5] 7 U.S.C. 12a(5).

[6] 7 U.S.C. 7a–1(c)(2)(F).

The Collapse of the FTX Complex

The bankruptcy of FTX illustrates the magnitude of the losses that customers may experience in the absence of regulation that prohibits commingling of client assets or imposes obligations to segregate client assets for the benefit of customers.

In November 2022, FTX Trading Ltd. d/b/a/FTX.com (FTX), Alameda Research LLC (Alameda) and approximately one hundred and thirty FTX-affiliated entities filed for bankruptcy in the United States. Contemporaneous with the bankruptcy filing, the Department of Justice (DOJ), Commission, and other federal regulators began to investigate claims that FTX employed omnibus accounts that commingled customer funds with the FTX enterprise resources, allegedly misappropriating more than $10 billion in client assets.[7]

The CFTC has alleged that Mr. Bankman-Fried and FTX solicited customers on the premise that the FTX platform could be trusted.[8] The CFTC's complaint alleges that despite these statements, FTX permitted Alameda to access customer deposits and commingle customer assets with Alameda's proprietary assets, which were used for Alameda's and its executives' own business operations, personal purchases, acquisitions of other businesses, and risky investments.

While soliciting customers to trust in the integrity of its business, FTX is alleged to have siphoned off billions in customer deposits.

The Benefits and Limits of Alternatives to Regulation: LedgerX

LedgerX, a non-intermediated clearinghouse registered with the Commission as a DCO and owned by parent company FTX, illustrates the importance of the protections advanced in the proposed rulemaking.

On October 25, 2021, FTX.US acquired LedgerX through a Delaware company doing business as West Realm Shires Services Inc. (West Realm Shires). When parent company FTX filed a petition seeking bankruptcy protection on November 11, 2022, the bankruptcy court declared LedgerX a non-debtor entity. LedgerX was one of the few assets within the network of FTX-affiliated companies that remained solvent.

In 2017, years before the acquisition by West Realm Shires, LedgerX submitted an application with the Commission seeking authorization to register as a DCO offering fully-collateralized (crypto) derivatives contracts. The Commission's order, amended in September 2020, imposed a number of important conditions, including a condition requiring LedgerX to ''at all times maintain funds of its clearing members separate and distinct from its own funds.'' [9]

When FTX filed for bankruptcy protection, the conditions in the LedgerX order and Commission staff's enforcement of compliance with the conditions contributed significantly to the preservation of LedgerX's customer property.[10] The LedgerX order serves as an important precedent for the framework the Commission must consider when adopting parallel protections for DCO direct clients, particularly retail clients, in the non-intermediated context.

In 2022, LedgerX applied to amend its order of registration as a DCO to allow it to modify its existing non-intermediated model to clear margined products for retail participants while continuing with a non-intermediated model.

In May 2022, the Commission held a convening to examine the implications of a derivatives clearing market structure that offers direct-to-client services. The convening outlined important issues addressed in this Proposed Rule.

The Rise of Non-Intermediated DCOs

DCOs play an increasingly important role in the financial markets, though DCOs have been central to facilitating access to the derivatives market since the founding of our nation and the futures market. The Dodd-Frank Act introduced a framework for the regulation of swaps that imposed central clearing and trade execution requirements, registration and comprehensive regulation of swap dealers, and recordkeeping and real-time reporting requirements.

The clearing market structure has evolved from a traditional clearing model, where an FCM served as an intermediary in transactions between a customer and a DCO, to a direct clearing model, where the transactions are between the customer and the DCO directly.[11] As I have previously stated:

FCMs solicit and accept orders for derivatives transactions on behalf of customers and receive customer funds to margin, guarantee, or secure derivatives transactions. FCMs are subject to significant regulatory requirements, including customer protection safeguards, safety and soundness capital requirements, risk management, conflicts of interest requirements, and anti-money laundering and know-your-customer programs.[12]

At the core, in a traditional, intermediated model, customer protection rules apply to FCMs and require FCMs to segregate customer funds, including when such funds are held at a DCO, among other safekeeping measures.

In newly emerging disintermediated market structures, the absence of an intermediary creates a gap in the application of the CFTC's customer protection rules because key customer protections are triggered by the presence of a ''customer,'' as defined by the CFTC, and an FCM that facilitates the clearing of a customer's derivatives transactions at the DCO.[13]

The Proposed Rule achieves parallel protections by applying key aspects of the customer protection regime to proprietary funds of clearing members and imposing parallel asset protection requirements on DCOs—both in intermediated and non-intermediated clearing models.

In addition, the Proposed Rule contains important requests for comments, soliciting feedback and engagement from the industry on a number of potential future actions.

Future Rulemaking: Anti-Money Laundering Requirements for DCOs

Anti-money laundering (AML) regulations ensure that all transactions in our markets are subject to identification verification standards and prevent illicit activity in our markets.

It is imperative that the Commission continue to engage with the U.S. Department of Treasury to ensure that AML regulations apply to all applicable market structures involving activities that create obligations to comply with AML regulations.

The Proposed Rule includes a request for comment that asks how might the Commission ensure AML and KYC compliance for DCOs that offer direct clearing services (a market structure that would not include FCMs or other intermediaries that are typically directed to create Bank Secrecy Act compliance programs)? Should DCOs offering direct-to-customer services to non-eligible contract participants or retail customers be required to comply with AML and KYC requirements?

Following consultation with the U.S. Department of Treasury, the Commission may need to engage in a formal rulemaking that imposes AML requirements on DCOs.[14]

Technical Clarifications in CFTC Regulation 1.25

The Proposed Rule allows DCOs to invest proprietary funds in permitted investments pursuant to CFTC Regulation § 1.25. The drafting cross-refers to CFTC Regulation § 1.25, but the Commission is currently engaged in a proposed rulemaking that amends CFTC Regulation § 1.25. My supporting statements to amendments to CFTC Regulation § 1.25 note that it is imperative that the Commission consider an equivalent application of CFTC Regulation

[7] FTX Demonstrates Need for More Oversight: CFTC's Johnson (Bloomberg TV Nov. 9, 2022), *https://www.bloomberg.com/news/videos/2022-11-09/ftx-demonstrates-need-for-more-oversight-cftc-s-johnson.*

[8] *See* Commodity Futures Trading Commission v. Samuel Bankman-Fried, FTX Trading Ltd d/b/a FTX.com, and Alameda Research LLC (S.D.N.Y. 2022) (Compl.).

[9] Press Release No. 8230–20, CFTC, CFTC Approves LedgerX, LLC to Clear Fully-Collateralized Futures and Options on Futures (Sept. 2, 2020), *https://www.cftc.gov/PressRoom/PressReleases/8230-20.*

[10] LedgerX's ''customers'' are clearing members as described above and would not otherwise qualify for protections under parts 1 and 22 of the Commission's regulations.

[11] Currently, CBOE Clear Digital, LLC, CX Clearinghouse, L.P.; LedgerX, LLC, and North American Derivatives Exchange Inc. allow individuals to be direct clearing members. Additionally, ICE NGX Canada Inc. clears physically delivered energy contracts directly for clearing members with a net worth exceeding CAD $5,000,000 or assets exceeding CAD $25,000,000.

[12] Kristin N. Johnson, Commissioner, CFTC, Keynote Address at the World Federation of Exchanges Annual Meeting: Creating Rules of the Road for (Dis)Intermediated and (De)Centralized Markets (Sept. 21, 2023), *https://www.cftc.gov/PressRoom/SpeechesTestimony/opajohnson5.*

[13] *See supra* note 1.

[14] I note that the Commission has negotiated the inclusion of AML requirements in the registration order for several DCOs, including CBOE Clear Digital, LLC and LedgerX LLC. I commend DCOs that have implemented these conditions.

§ 1.25 in the context of a DCO's investment of the member property of retail customers.[15]

Comments to the Proposed Rule should indicate how best to ensure equivalence.[16]

Periodic Reporting of Daily Reconciliations

The Proposed Rule requires a DCO to notify the CFTC of discrepancies in its daily calculations. The Commission exercises direct oversight with respect to DCOs, meaning DCOs are not supervised by self-regulatory organizations (SRO) or designated self-regulatory organizations (DSRO). The Commission performs the examination functions. DCOs may benefit from a similar oversight as FCMs, which involves a regular reporting of reconciliation and not just the reporting of discrepancies.[17] DCOs are subject to robust Commission regulations, examinations, and oversight. It will be important to receive comments from all stakeholders regarding the reporting of DCO reconciliations.

Conclusion

It is my hope that this Proposed Rule will move forward so that we can begin to introduce greater protections for clearing members, including retail customers. I thank the Division of Clearing and Risk—Clark Hutchinson, Eileen Donovan, Theodore Polley, and Scott Sloan—for their tremendous efforts in advancing this very important, significant, and transformative Proposed Rule.

Appendix 4—Dissenting Statement of Commissioner Christy Goldsmith Romero

This week, the Commission in a split vote, on which I dissented, approved the first proposed rule related to FTX's bespoke direct-to-retail market structure. That structure removed the intermediary (known as a futures commission merchant or FCM) where the CFTC's customer protection and anti-money laundering regimes sit. I believe that before my tenure, the Commission made a mistake in approving two clearinghouses (LedgerX owned by FTX before FTX's bankruptcy, and Nadex, which is now Crypto.com) for this direct-to-retail market structure before analyzing and addressing the risks of a lack of AML requirements, customer protections, and other checks and balances.

After FTX's bankruptcy, the CFTC is now trying to remedy the consequences of its mistake, one of which is that retail participants do not have customer protections under this model because they lose their status as ''customers,'' instead becoming ''clearing members.'' In the open meeting, the CFTC staff said that the proposed rule was an attempt to provide parallel protections to those individuals who we would normally consider to be ''customers,'' but who now are ''members.'' But it fails to provide parallel protections to retail participants. The proposed rule attempts to port over to this direct-to-retail model one protection (segregation of funds, which I support) without the other protections, or checks and balances present in an intermediated model with an FCM.

I do not know if it is even possible for the CFTC to give parallel protections to retail participants under a direct-to-retail model, because the Commodity Exchange Act and Commission rules contemplate the presence of an FCM. Additionally, anti-money laundering controls sit with the FCM, and clearinghouses have no AML requirements. AML is a critical guardrail for national security and customer protection. The Financial Stability Oversight Council's (FSOC) 2023 Annual Report says, ''Crypto-assets remain susceptible to misuse by terrorist organizations and other sanctioned individuals' efforts to move funds in support of illicit activities.'' [1]

I do not believe that the rule, which was rushed in three weeks at the end of the year, is sufficient to remedy that earlier mistake. The rule would benefit from more time than three weeks.[2] We should step back and assess the impact of changing the tried and true market structure by removing the FCM. Without addressing a number of serious issues, the rule may give a false sense of security about the safety of a direct-to-retail model, while hiding the threats. The CFTC staff in the open meeting said that there are a number of applications pending for this model and they expect more. Without an assessment, we may just move risk around the system, while creating an illusion of safety.

Such an assessment would implement a recommendation from the FSOC. In its October 2022 Report on Digital Asset Financial Stability Risks and Regulation, the FSOC recommended that member agencies (including the CFTC) ''assess the impact of vertical integration (*i.e.,* direct access to markets by retail customers) on conflicts of interest and market volatility, and whether vertically integrated market structures can or should be accommodated under existing laws and regulations.'' The CFTC has not conducted this analysis, leaving the CFTC out of step with FSOC's recommendation.

I invite the public to watch this week's CFTC public meeting, which showed that there are serious issues that the CFTC should assess and address before accommodating this crypto industry model.[3] The first is whether the CFTC can impose AML requirements on clearinghouses to prevent retail funds from being commingled with funds belonging to terrorists, cyber criminals and drug cartels—a question on which the CFTC is in the middle of its analysis.[4] This rule also does not require disclosures to inform retail participants that they are giving up customer protections and bankruptcy customer priority, instead taking the status of ''clearing members,'' similar to the roles and duties that normally falls to an FCM such as a large bank.[5] The rule also would not limit clearinghouses to depositing these ''member'' funds in only banks or trusts, as FCMs are required, which would allow the clearinghouse to deposit funds with an unregulated affiliate.[6]

Instead of learning the lessons of FTX, I worry that rushing to approve this proposal leaves the Commission out of step with other federal financial regulators that are asking whether a direct-to-retail model can or should be accommodated under current law, and assessing its implications. I also worry that this proposed rule will form the basis for the CFTC to approve more crypto companies for this direct-to-retail model under the false impression that this model is safe. I am concerned about rushing this rule through at the end of the year in three weeks' time, when these are critical post-FTX issues. I must dissent.

The CFTC's Laws and Regulations Protect Customers and Guard Against Illicit Finance Through a Market Structure That Has Stood the Test of Time

Clearinghouses play an important public interest role—they are critical market infrastructure intended to foster financial stability, trust, and confidence in U.S. markets. Dodd-Frank Act reforms increased central clearing, thereby increasing financial stability. Those reforms also concentrated risk in clearinghouses. With that concentrated risk, it is critical that the Commission maintain vigilance in its oversight over clearinghouses to identify and monitor risk and promote financial stability. This is most important for the CFTC's monitoring of systemic risk.

FCMs also play an important role. First, they stand as a shock absorber, providing additional financial support to the clearinghouse to safeguard the financial system. Second, because they are customer-facing, they are responsible for providing customer protections. The customer protection regime under the Commodity Exchange Act and CFTC rules are found in

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[15] Kristin N. Johnson, Commissioner, CFTC, Statement on Preserving Trust and Preventing the Erosion of Customer Protection Regulation (Nov. 3, 2023), *https://www.cftc.gov/PressRoom/SpeechesTestimony/johnstatement110323.*

[16] In footnote 45 in the Proposed Rule, the Commission notes: Proposed § 39.15(e) cross-references § 1.25, which provides that an FCM or DCO may invest ''customer money'' in certain instruments. The regulatory text of § 1.25, however, does not refer to ''proprietary funds.'' The Commission recently approved proposed amendments to § 1.25. Based on comments received on those proposed amendments, if appropriate, the Commission may consider further amending § 1.25 either in the final rule or as a re-proposed rule to ensure that the regulatory text provides clarity on the application of § 1.25 to a DCO's investment of ''proprietary funds,'' as permitted under § 39.15(e).

[17] *See supra* note 15.

[1] *See* Financial Stability Oversight Council, *Annual Report 2023, https://home.treasury.gov/system/files/261/FSOC2023AnnualReport.pdf,* (December 14, 2023).

[2] Commissioners received it late Wednesday, the day before Thanksgiving, three weeks before the meeting, with no prior engagement with Commissioners on the content of the rule. Because, it raised serious questions, I asked that it be pulled from the meeting and that Commissioners would have more time. My request was denied with no reason given.

[3] *See* CFTC to Hold and Open Commission Meeting on December 13, *https://www.youtube.com/watch?v=zANNkH5STzk,* (December 13, 2023) at 2:12:00.

[4] *See Id.* at 3:07:40–3:08:40; 3:16:52–3:17:40.

[5] *See Id.* at 2:37:45–2:39:10.

[6] *See Id.* at 2:44:20–2:44:55.

requirements for FCMs. In its October 2022 report, the FSOC discussed: [7]

The current framework of markets regulation is generally structured around the requirement or presumption that markets are accessed by retail customers through intermediaries such as broker-dealers or future commission merchants (FCMs). Those intermediaries perform many important functions, such as processing transactions, acting as agent and obtaining best execution for customers, extending credit, managing custody of customer assets, ensuring compliance with federal regulations, and guaranteeing performance of contracts. As a result of the special role these intermediaries play in traditional market structures, they are subject to unique regulations often focused on customer protections, such as regulations around conflicts of interest, suitability, best execution, segregation of funds, disclosures, and fitness standards for employees.

Upending this traditional market structure, without analysis, can have unintended consequences.

There Are No Customers or Customer Protections in a Direct-to-Retail Model

The CFTC does not require disclosures to retail participants about the consequences of participating in this model. In the direct-to-retail model, customers lose their status as ''customers,'' thereby losing all of the customer protections in the CFTC's regulatory framework, and instead take the status of ''clearing members,'' raising a host of issues. It is unlikely that retail customers know and understand that they gave up all of their customer protections. It is also unlikely that retail customers know and understand that in the event of a bankruptcy, they lose their ''customer'' priority in a distribution. It is also a question whether these retail customers would have to take on the FCM's shock absorbing role.

When FTX's application for authority to issue margined crypto products [8] was pending before us, on May 25, 2022, the CFTC held a roundtable on the disintermediated model. We heard then and later received comments from many stakeholders expressing serious concerns over this model.

The FSOC also expressed concerns over direct-to-retail models, warning in its October 2022 report:

Financial stability implications may arise from vertically integrated platforms' approaches to managing risk . . . Direct exposure by retail investors to rapid liquidations of this kind also raises investor and consumer protection issues. Platforms dealing directly with retail investors would need to ensure the provision of adequate disclosures, responsibilities otherwise taken on by intermediaries. The vertically integrated model presents conflict of interest. . . . [9]

The CFTC has not conducted the assessment that FSOC recommended more than one year ago. It is an open question of whether the CFTC should accommodate these direct-to-retail models given how much is lost, including the loss of the CFTC's customer protection regime and AML regime.

This Rushed Proposed Rule Does Not Replace Customer Protections, AML, and Other Checks and Balances, Lost by Removing the FCM

The CFTC has had a year to learn the lessons from FTX's application and assess direct-to-retail models as FSOC recommended. I am strongly in favor of strengthening customer protections, particularly for retail, including banning commingling of customer funds,[10] but this proposal is not about ''customer'' funds. In a direct-to-retail model, legally, there are no customers. I am not in favor of retail losing their status as customers and losing customer protections.[11] The proposed rule would be the first post-FTX rule on this model, but it was rushed and as a result, lacks sufficient analysis.

The question raised by the FSOC of whether we should accommodate this market structure from crypto is a critical one to answer. The deliberations at last week's open meeting confirmed that it may not be possible to give retail participants the same protections in a disintermediated model as in the intermediated model. And just last week, the FSOC Annual Report again warned about the vulnerabilities arising from collapsing regulatory functions into a single entity, including ''conflicts of interest, inappropriate use of clients' funds, and market manipulation.'' [12]

This rule would not resolve the FSOC's concerns. It does not contain the assessment needed as to risk and what regulatory requirements would be required in a direct-to-retail model to meet a ''same risk, same regulatory outcome approach'' that makes up for the checks and balances lost from removing the FCM. That would require establishing the basic foundation of customer protections and guardrails (including against illicit finance). Without that analysis, this proposal puts the CFTC out of step with other federal financial regulators.

The Direct to Retail Model Raises Many Questions the CFTC Has Not Adequately Considered

My concerns about a direct-to-retail model include:

1. *Losing status of ''customer'':* Regular people lose their protections as ''customer'' under the law in the direct-to-retail model. Instead, they are treated as clearinghouse ''members,'' a role that traditionally has been reserved for FCMs, which include the largest financial institutions. The regular person trading in bitcoin futures or event contracts is not the same as J.P. Morgan or Wells Fargo. Clearing members have obligations to the clearinghouse to stave off clearinghouse failure. This presumably would also be the case for retail acting as members. I have serious concerns about whether retail participants understand what they are giving up and that this is the role they are taking on. The CFTC should consider requiring plain English disclosures delivered in a manner that actually informs people of their rights and risks, as opposed to a click-wrap agreement or lengthy legal document.

2. *No AML/CTF/KYC:* Because the Commodity Exchange Act envisions the presence of an FCM that has significant responsibilities, including anti-money laundering/Know Your Customer requirements, clearinghouses do not have currently have any obligation to implement Anti-Money Laundering, Countering Terrorist Financing or Know Your Customer safeguards, opening up our market to illicit finance. The Commission staff are still analyzing what safeguards the CFTC can require.

3. *No requirements to deposit funds in a regulated entity:* FCMs are required to hold customer funds at a bank, trust or a CFTC-regulated entity. That requirement is absent for member funds and is not added in this rule, allowing clearinghouses to place the funds anywhere, even an affiliate. That means that FTX's registered clearinghouse LedgerX could have deposited retail ''member'' funds with Alameda, the trading firm involved in the loss of billions of customer funds.

4. *No checks and balances:* FCMs who interface with customers have regulatory requirements for customer protections, and have incentives to monitor the clearinghouse to make sure it is not misusing customer funds. This role sits empty in a direct-to-retail model.

5. *No customer bankruptcy priority:* In the case of the clearinghouse bankruptcy under this model, the bankruptcy code would not consider retail participants to be ''customers,'' and they would not receive the customer priority in any distribution.

More Time Is Needed To Analyze New AML Requirements for Clearinghouses

I want to call special attention to the proposal's lack of anti-money laundering (AML) and know your customer (KYC) requirements for clearinghouses. Without

[7] *See* Financial Stability Oversight Council, *Report on Digital Asset Financial Stability Risks and Regulation, https://home.treasury.gov/news/press-releases/jy0986,* (October 3, 2022).

[8] The CFTC conditioned LedgerX's registration on the trades being fully collateralized. FTX applied to eliminate this condition to issue margined products directly to customers. I was not in favor of FTX's application, and signaled that weeks before FTX's failure. *See* CFTC Commissioner Christy Goldsmith Romero, Financial Stability Risks of Crypto Assets: Remarks before the International Swaps and Derivatives Association's Crypto Forum 2022, *https://www.cftc.gov/PressRoom/SpeechesTestimony/oparomero3,* (Oct. 26, 2022).

[9] *See* Financial Stability Oversight Council, *Report on Digital Asset Financial Stability Risks and Regulation, https://home.treasury.gov/news/press-releases/jy0986,* (October 3, 2022).

[10] *See* CFTC Commissioner Christy Goldsmith Romero, Crypto's Crisis of Trust: Lessons Learned from the FTX's Collapse, *https://www.cftc.gov/PressRoom/SpeechesTestimony/oparomero5#_ftnref10,* (Jan 18, 2023) (I warned in the aftermath of FTX's collapse about how commingling presents ''a significant threat to customers that can leave customers in a musical chairs dilemma.'')

[11] All participants, retail or institutional, are considered clearinghouse members. This is not some technical, legalistic distinction. Our laws will treat those retail participants the same as the largest financial institution.

[12] *See* Financial Stability Oversight Council, *Annual Report 2023, https://home.treasury.gov/system/files/261/FSOC2023AnnualReport.pdf,* (December 14, 2023).

these protections, retail funds may be at serious risk of seizure if they are commingled with funds of terrorist organizations, drug cartels, or other illicit actors. It is well known that cryptocurrency transactions are used to finance cybercrime, terrorism, sanctions avoidance, and the drug trade.[13] News reports suggest that Hamas used cryptocurrency to receive significant funding preceding its October 7th attacks.[14]

FCMs have regulatory responsibilities to implement AML and KYC procedures, to perform standardized diligence, to verify customer identify and to assess whether customers may be known or suspected terrorists or sanctioned individuals. That AML/CTF/KYC responsibility puts them at the front lines of combating illicit finance. The legal requirement also means the CFTC and the National Futures Association can examine how FCMs are implementing required anti-money laundering controls. That makes it more likely we will identify material weaknesses before an FCM becomes a conduit for illicit funds. Reporting requirements also may make it easier for law enforcement to identify suspicious patterns and investigate them.

The proposed rule would not impose any AML responsibilities for clearinghouses. Under the proposal, retail participants could have their funds commingled with those deposited by terrorist or cybercriminals, including state-sponsored cybercrime gangs. In a seizure, the FBI, other law enforcement or Treasury would seize all of the funds. I would consider that a very serious risk to member funds, one that the proposal does not address.

At the open meeting, when I asked whether the CFTC could impose AML requirements on clearinghouses, the CFTC's General Counsel said that they had not completed their analysis, but had not foreclosed the possibility that the CFTC has authority to impose AML requirements on clearinghouses and that ''it has some promise.'' [15] The proposed rule contained no analysis of this issue. That was one of the reasons why I asked that this proposed rule be pulled off of the meeting, so that the CFTC could continue to work on that analysis and include AML requirements. My request was denied. At the open meeting, the Office of the General Counsel said that while the analysis was ongoing, ''it was decided on a policy basis that we save that for another day.'' [16] That was not a policy decision made by a majority of the Commission as that was never before us.

More Analysis Is Needed To Determine Whether Other Customer Protections and Other Checks and Balances Can Be Provided to Clearinghouses in the Direct-to-Retail Model

This proposal would impose some safeguards for member funds held at a disintermediated clearinghouse by banning commingling and imposing certain limits on how funds can be used.[17] But it is narrowly targeted, and serious gaps remain, leaving the proposed requirements far from the same regulatory outcome as the traditional model.

Location of Deposits

FCMs and clearinghouses in the traditional model are only permitted to deposit customer funds with regulated entities—a bank or trust, a clearinghouse, or another FCM—giving the CFTC visibility into customer funds, and layering customer protections. This proposal would not have the same limitation because these would not be ''customer'' funds. This proposed rule could benefit from adding in the same requirement. Otherwise, member funds could be deposited with an unregulated entity, including an unregulated affiliate with conflicts of interest, that introduces more risk, leaving the CFTC blind to risk.[18] At the meeting, the Commission heard from staff that they were concerned about whether the current requirement for where FCM's can deposit funds provided sufficient protections for customers.[19] The proposal does not have any analysis of these concerns, likely because it was rushed.

Oversight From Checks and Balances

The proposal also does not replicate another important guardrail of traditional market structure: checks and balances. Separate clearinghouses and brokers (FCMs) create natural bumper guards not present in the direct-to-retail model. However, the proposed rule contains no analysis of the impacts of moving forward with this non-traditional model. Instead, at the open meeting, comments were made to the effect about how certain companies have determined that they prefer this market structure, and the staff expect there to be more applications for this model. It is concerning to me that this rushed rule may be used to facilitate expanding the use of this model, which is not responsible without further assessment as FSOC recommended.

Bankruptcy Priority for Customers

The failures of FTX and Celsius show bankruptcy priority is a serious issue, especially in the retail space. Retail participants do not have the same ability as institutions to withstand losses or delay. Existing bankruptcy law assumes a traditional market structure.[20] Customers take priority over FCMs in distributions.[21] Retail participants in a disintermediated clearing model may not realize that they are losing bankruptcy priority as customers because the CFTC requires no disclosures. This loss of priority is not discussed in the proposal. We should consider requiring clear disclosures.

Conclusion

It is not responsible to rush our first post-FTX rule on direct-to-retail models in three weeks at the end of the year, without conducting the necessary assessment of the impact of this model as FSOC recommended more than one year ago. I asked for this proposed rule to be pulled off this open meeting. I am concerned about the lack of that assessment, including but not limited to specific analysis of: (1) whether the CFTC should require disclosures to inform retail participants that they are losing their customer status in this direct-to-retail model, disclosures that describes their rights and risks; (2) whether it is possible to take a same risk, same regulatory outcome approach on issues such as where funds can be deposited and other concerns raised in comments to the FTX application about these models; and (3) whether the CFTC can require clearinghouses to conduct AML/CTF/KYC. Although there are some existing retail participants currently in this model, at the open meeting, the staff said that they were already ensuring that the two crypto direct-to-retail clearing houses were taking steps aligned with the proposed rule.

Thirteen months after the collapse of FTX, I am glad that we are starting to address the direct-to-retail model as I have serious concerns about it, and remain concerned about any expansion of that model. However, the risks to retail, financial stability, market integrity and our national security, are too great to rush this in three weeks without analysis as FSOC recommended. Therefore, I must dissent.

Appendix 5—Concurring Statement of Commissioner Caroline D. Pham

I concur on the Notice of Proposed Rulemaking on Protection of Clearing

[13] *See* Attorney General, U.S. Department of Justice, *The Role of Law Enforcement in Detecting, Investigating, and Prosecuting Criminal Activity Related to Digital Assets, https://www.justice.gov/d9/2022-12/The%20Report%20of%20the%20Attorney%20General%20Pursuant%20to%20Section.pdf,* (Sept. 6, 2022).

[14] Wall Street Journal, ''Hamas Needed a New Way to Get Money From Iran. It Turned to Crypto,'' *https://www.wsj.com/world/middle-east/hamas-needed-a-new-way-to-get-money-from-iran-it-turned-to-crypto-739619aa?mg=prod/com-wsj,* (Nov. 12, 2023). The CFTC has brought enforcement actions against two spot crypto exchanges, BitMEX and Binance, for failing to follow AML controls. Our action against Binance found that instead of implementing those controls, Binance turned a blind eye and even advised users to circumvent the superficial controls it claimed to have.

[15] CFTC to Hold and Open Commission Meeting on December 13, *https://www.youtube.com/watch?v=zANNkH5STzk,* (December 13, 2023) at 3:16:20–3:17:50.

[16] *Id.*

[17] It would require direct clearing customer funds to be held in a separate account from the clearinghouse's funds, in an account identifying them as belonging to the customers. Those funds could only be used on behalf of the customer, not on behalf of the company or its affiliates. The funds would need to be accounted for daily, and reconciled with the total amount the clearinghouse owes its customers. It would also limit what clearinghouses can invest those funds in, with the same limits that apply to brokers today under Commission Regulation § 1.25. These protections are largely in line with the representations made by FTX about LedgerX's rules in its application.

[18] *See* Commissioner Christy Goldsmith Romero, Crypto's Crisis of Trust: Lessons Learned from the FTX's Collapse, *https://www.cftc.gov/PressRoom/SpeechesTestimony/oparomero5#_ftnref10,* (Jan 18, 2023).

[19] CFTC to Hold and Open Commission Meeting on December 13, *https://www.youtube.com/watch?v=zANNkH5STzk,* (December 13, 2023) at 2:42:40–2:46:08.

[20] Called ''customer funds other than member property.'' *See* CFTC, Bankruptcy Regulations, 86 FR 19324 at 19365 (April 13, 2021).

[21] *Id.* at 19378. There are also rules allocating customer property among account classes.

Member Funds Held by Derivatives Clearing Organizations (DCOs) (Proposed Amendments to Clearing Member Funds Requirements or Proposal) because it seeks to protect the proprietary funds of futures commission merchants (FCMs), and I understand that it essentially codifies the existing good practices most of the CFTC's registered DCOs already follow. However, with respect to retail participants, I believe that the Commission should consider whether there should be a new registration category for direct clearing retail DCOs. I also renew my call for an Office of the Retail Advocate. Both of these steps would better ensure customer protection in our regulated markets.

I would like to thank Scott Sloan, Tad Polley, Eileen Donovan, and Clark Hutchison in the Division of Clearing and Risk for their work on the Proposal. I appreciate the time staff took to answer my questions.

Existing Protections for Both House Accounts and Customer Funds Have Worked Well for Decades Without Issues

First, to be clear, the Commission already has extensive rules in place for protecting FCM customer funds.[1] Arguably, it is one thing the CFTC is best-known for. For these FCM customers, FCMs must segregate customer funds from their own funds, deposit customer funds under an account name that clearly identifies them as customer funds, and obtain a written acknowledgment from each depository that holds customer funds.[2] This customer protection regime also establishes accounting and reporting requirements applicable to customer funds, and limits both the types of investments that can be made with customer funds and the type of depositories that can hold customer funds.[3]

With respect to clearing member proprietary funds or house accounts,[4] consistent with our system of self-regulation set forth in the Commodity Exchange Act, DCOs have to establish standards and procedures designed to protect and ensure the safety of proprietary funds, and hold them in a manner that will minimize the risk of loss or delay in access by the DCO to the funds.[5] DCOs also have to invest clearing member proprietary funds in instruments with minimal credit, market, and liquidity risks.[6]

Today, the Commission is proposing new regulations for the protection of clearing member funds, based largely on the customer segregation requirements for FCMs and DCOs in Regulation § 1.20.[7] The Proposal explains that new safeguards are needed for the direct participants at DCOs because (1) the Commission has registered a number of DCOs that clear directly for market participants without the involvement of FCMs (*i.e.,* these DCOs are only clearing for individuals), and (2) many DCOs that use the traditional FCM clearing model have at least some non-FCM clearing members.

While I appreciate the intent of today's Proposal, with respect to DCOs that have FCMs as clearing members, I believe we must be careful in changing a regulatory framework that has served our markets without any real issues for decades. I believe that the Commission must have had a good reason when it originally distinguished between house accounts and customer funds. There have been a lot of spectres raised today that have nothing to do with our actual regulated markets. Speaking from a practical perspective, I worry that ''if it ain't broke, don't fix it.'' For example, we should recognize that DCOs might have operational reasons for the accounts distinction in our current rules. I encourage the public to comment on whether the Proposal is workable for DCOs in that regard.

There Should Be a New Registration Category for Direct Clearing Retail DCOs and an Office of the Retail Advocate To Ensure Customer Protection

I share the concerns where DCOs clear directly for retail participants without FCMs. I would go further and state that I am concerned that the Proposal's targeted approach may miss larger issues. When a DCO faces direct retail participants that our rules categorize as clearing members, we effectively allow a model that eliminates intermediaries and the protections that they provide for customers. Intermediaries perform critical functions, and that is why markets all over the world require registered brokers and stringent protections for customers.

If the Commission anticipates this type of DCO clearing model to proliferate, we should step back and consider all issues that these direct clearing retail DCOs raise.[8] These types of concerns around retail participants are why I have proposed that the Commission needs an Office of the Retail Advocate.[9] I continue to believe that having an Office of the Retail Advocate is a tried-and-true way to advance customer protection, and may be especially effective in the area raised by today's Proposal.

For example, perhaps there should be a distinct registration category and requirements for direct clearing retail DCOs because they raise singular issues, risks, and concerns—foremost, who provides retail customer protection when there are no brokers or intermediaries.

Frankly, I dislike a model where DCOs have clearing members that are retail. To achieve the same market structure outcome, I think it is better that a DCO has an affiliated FCM that only provides services for its retail participants on an affiliated DCM and DCO and would provide customer protections required under our rules. This would, therefore, not disrupt our existing regulatory framework and the current scope and application of the Bank Secrecy Act.[10]

Conclusion

I believe the Commission should further study the direct clearing model for retail participants, together with the increase in retail binary option contracts. I hope that my proposal for an Office of the Retail Advocate comes to fruition, and that this is one of the first issues that we tackle.

Again, I thank staff for the hard work on the Proposal. I look forward to the public's comments on the Proposed Amendments to Clearing Member Funds Requirements. Thank you.

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[1] Commodity Exchange Act (CEA) section 4d, 7 U.S.C. 6d, and Regulations §§ 1.20 through 1.39, 17 CFR 1.20 through 1.39 (futures customer funds), 22.1–22.17, 17 CFR 22.1 through 22.17 (cleared swaps customer collateral) and 30.7, 17 CFR 30.7 (foreign futures) establish a comprehensive customer protection regime to safeguard the funds belonging to customers of FCMs.

[2] *See* 17 CFR 1.20, 22.5, and 30.7. The acknowledgment letters must adhere to specific templates in the Commission's regulations, and require a depository to acknowledge, among other things, that the accounts opened by the FCM hold funds that belong to the FCM's customers.

[3] *See* 17 CFR 1.32, 1.33, 1.25, and 1.49.

[4] Regulation § 1.3, 17 CFR 1.3, defines a ''customer'' as ''any person who uses [an FCM], introducing broker, [CTA or CPO] as an agent in connection with trading in any commodity interest.'' DCOs have to apply many of the customer protection requirements that apply to FCMs to the customer funds DCOs receive from FCM clearing members. DCOs must segregate the customer funds of their FCM clearing members from their own funds, deposit customer funds under an account name that identifies the funds as customer funds, obtain acknowledgment letters from depositories, limit the investment of customer funds to instruments listed in Regulation § 1.25, and limit depositories for customer funds to those listed in Regulations §§ 1.20 and 1.49. *See* 17 CFR 1.20(g)(1), 39.15 (b), 22.3(b)(1), 1.20(g)(1) and (g)(4), and 22.5. However, these protections do not apply to DCO clearing members (*i.e.,* those that are not FCMs).

[5] *See* CEA section 5b(c)(2)(F), 7 U.S.C. 7a–1(c)(2)(F) (Core Principle F), and 17 CFR 39.15.

[6] *Id.*

[7] For instance, the Commission is proposing to require a DCO to hold proprietary funds separately from the DCO's own funds, in accounts that are named to clearly identify the funds as belonging to clearing members, to prohibit a DCO or any depository from using proprietary funds in any way other than as belonging to the clearing member, to have DCOs review, on a daily basis, the amount of funds owed to each clearing member with respect to each of its accounts, both customer (including, as relevant, futures and cleared swaps) and proprietary, and to reconcile those figures to the amount of funds held in aggregate in each such type of account across all of the DCO's depositories, and, to have DCOs obtain proprietary funds acknowledgment letters.

[8] The Commission provided exemptions from the current regulations for these DCOs in 2020. *See* Derivatives Clearing Organization General Provisions and Core Principles, 85 FR 4800 (Jan. 27, 2020). However, I am suggesting a more holistic assessment of these DCOs and their clearing members.

[9] Keynote Address by Commissioner Caroline D. Pham at CordaCon 2022 (Sept. 27, 2022), available at *https://www.cftc.gov/PressRoom/SpeechesTestimony/opapham5.*

[10] 31 U.S.C. 5311 *et seq.*