

## CFTC Expands Large Trader Reporting and Increases Customer Account Protection Requirements

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The Commodity Futures Trading Commission (CFTC or Commission) recently adopted several rules to improve large trader reporting, facilitate segregation of customer swap margin and enhance customer protections for futures and swap markets.<sup>1</sup>

### I. Large Trader Reporting: Ownership and Control Reports Enhanced and Expanded

The CFTC unanimously approved final rules<sup>2</sup> that introduce new mandatory forms to report large trader activity in swaps and futures based on volume thresholds, update existing large trader reports to obtain additional ownership and control information, and require all forms to be submitted electronically.

**Volume Threshold Reporting.** The CFTC now will require clearing member firms and certain reporting markets to file Form 102B, a new kind of form on which they must identify the owners and controllers of trading accounts that have daily trading volume in futures, options on futures, and swaps traded on a designated contract market (DCM) or swap execution facility (SEF) in excess of specified levels (volume threshold accounts), regardless of whether the trading accounts maintain reportable positions at the end of the day. The purpose of Form 102B is to capture market information on traders that do not maintain day-end positions, and thus are not currently reportable under the CFTC's large trader reporting system, but are active in derivatives markets nonetheless (e.g., high-frequency traders). The reportable trading volume level (RTVL) is defined as trading volume of 50 or more contracts during a single trading day, on a single reporting market (i.e., a DCM or SEF), in all instruments (i.e., futures, options on futures, and swaps) that are assigned the same product identifier by the reporting market.<sup>3</sup> If requested by the CFTC through a special call, clearing member firms that reported volume threshold accounts on Form 102B identified as customer omnibus accounts will be required to complete Form 71, another new form on which the firm must provide additional ownership and control information regarding any sub-account to which the customer omnibus account allocated trades that resulted in a reportable trading volume for the sub-account receiving such allocations.

**Additional Information Now Required From Large Traders.** Under the new CFTC rules, clearing member firms will now be required to identify on Form 102A any individual trading accounts underlying accounts with reportable futures and option positions (special accounts) and provide additional ownership and control information for special accounts on this updated version of existing Form 102. Such additional information includes Trade Capture Report (TCR) account numbers for purposes of enabling the CFTC to link positional and transactional data within its surveillance

1 This article cites the new rules based on the sections in which they will ultimately be codified in the Code of Federal Regulations (C.F.R.).

2 See Ownership and Control Reports, Forms 102/102S, 40/40S, and 71 (Oct. 30, 2013), available at <http://www.cftc.gov/ucm/groups/public/@newsroom/documents/file/federalregister103013c.pdf> (Ownership and Control Reports).

3 17 C.F.R. § 15.04.

systems. The new rules require Form 102A to be filed by 9 a.m. on the business day following the date on which a special account becomes reportable, which is sooner than the old rules required. Likewise, existing Form 102S, that swap dealers (SDs) and clearing member firms are required under Regulation 20.5 to file for accounts holding positions in one of 47 categories of nonfinancial, paired swaps,<sup>4</sup> also has been updated to require more detailed ownership and control information.

The CFTC has expanded its decades-old Form 40 that large traders (identified on Form 102 reports) must submit if so requested by the CFTC.<sup>5</sup> The updated version of Form 40 requires large traders to provide the CFTC with additional information on the business activities and ownership and control structure of the reporting large trader. The new kinds of information include more detailed information identifying and describing all persons who “control” the special account, as such term is newly defined under the rule, as well as information regarding whether the large trader is engaged in commodity index trading and what business sectors pertain to the large trader’s activities.

Also, after years of accepting large trader forms by email, facsimile or regular mail, the final rules will require all large trader reporting forms to be submitted via either a secure FTP feed or web-based portal. Affected market participants have until 270 days after the final rules are published in the *Federal Register* to comply with the new requirements.

## II. Uncleared Swap Collateral Segregation and Treatment of Portfolio Margin Securities in a Commodity Broker Bankruptcy

**Uncleared Swap Collateral Segregation.** The CFTC unanimously approved rules to implement the provisions in CEA section 4s(1) that afford rights to counterparties to SDs and major swap participants (MSPs) to segregate initial margin for uncleared swaps.<sup>6</sup> Under the new rules, at least once every calendar year, SDs and MSPs must notify their counterparties to uncleared swaps that the counterparties have a right to require segregation of initial margin.<sup>7</sup> The custodian for segregated initial margin for uncleared swaps must be a legal entity that is independent of both counterparties, but the custodian may be an affiliate of a counterparty.<sup>8</sup> SDs and MSPs must identify to the counterparty at least one creditworthy, unaffiliated custodian that is acceptable to the SD or MSP as a depository, and to the extent they know, disclose the price of segregation with each identified custodian.<sup>9</sup> Although the counterparty’s right to segregation does not extend to variation margin, the segregated account may hold variation margin if the SD or MSP agree.<sup>10</sup>

The new rules also include requirements for how the segregated account is structured. The segregated account must be designated as “for and on behalf of the counterparty” and the agreement to segregate margin must be in writing and include the custodian as a party.<sup>11</sup> The agreement also must provide that the SD or MSP can take control of the margin in the segregated account without counterparty consent upon presentation to the custodian of a written statement, made under oath or

4 See 17 C.F.R. § 20.2.

5 Large traders in swaps under the CFTC’s Part 20 rules may be required upon a CFTC special call to file a Form 40S, which entails filing a Form 40 but treating all references to positions in futures and options as references to positions in paired swaps and swaptions.

6 See Protection of Collateral of Counterparties to Uncleared Swaps; Treatment of Securities in a Portfolio Margining Account in a Commodity Broker Bankruptcy. 78 Fed. Reg. 66621 (Nov. 6, 2013).

7 17 C.F.R. § 23.701(a)(1) and (e).

8 See 78 Fed. Reg. at 66627; 17 C.F.R. § 23.702(a).

9 17 C.F.R. § 23.701(a)(2)-(3).

10 See 17 C.F.R. § 23.701(b) and 23.702(b).

11 17 C.F.R. § 23.702.

penalty of perjury, stating that the SD or MSP is entitled to control.<sup>12</sup> Other withdrawals can only be made if both the counterparty and the SD or MSP agree.<sup>13</sup> Segregated margin may only be invested consistent with CFTC Rule 1.25, which provides a list of instruments permitted for the investment of customer funds held by futures commission merchants.<sup>14</sup> When initial margin is not segregated, the SD's or MSP's chief compliance office is required to report periodically to the counterparty on its back office procedures.<sup>15</sup>

The rules require compliance by May 5, 2014, except for those SDs' and MSPs' counterparties existing on May 5, 2014, compliance is required by November 3, 2014.<sup>16</sup>

**Treatment of Securities in a Portfolio Margining Account in a Commodity Broker Bankruptcy.** Pursuant to new CEA section 20(c), which Dodd-Frank added to the CEA, the CFTC adopted rules to clarify the legal status — in the event of a commodity broker's bankruptcy — of (a) the securities held in a portfolio margining account held as a futures account and (b) the owner of such an account. The rules change the definition of “customer” in Rule 190.01 to include “the owner of a portfolio margining account carried as a futures account or cleared swaps customer account.”<sup>17</sup> And for purposes of allocating property of a debtor's estate pursuant to Rule 190.08, the scope of “customer property” has been broadened to include “securities held in a portfolio margining account carried as a futures account or cleared swaps customer account.”<sup>18</sup> These rules become effective on January 6, 2014.<sup>19</sup>

### III. Enhanced Protections for Customers and Customer Funds Held by Futures Commission Merchants and Derivatives Clearing Organizations

The Commission finalized numerous enhancements to its regulatory protections for customer funds held by Futures Commission Merchants (FCMs) and Derivatives Clearing Organizations (DCOs).<sup>20</sup> The Commission said that these rules were largely prompted by the FCM failures of MF Global and Peregrine Financial Group in recent years, although a dissent from Commissioner Scott O'Malia questioned the effectiveness of the new rules and expressed concern about their effects on smaller FCMs.

**Residual Interest.** The most controversial of the new rules is a residual interest requirement applicable to FCMs. This requirement was subject to many comments during the rulemaking and discussed at length during the Commission meeting. The final rules require an FCM by 6:00 p.m. Eastern time on each business day to use its own funds to maintain a “residual interest” in its customer accounts that is at least equal to its customers' aggregate under-margined amounts for the prior trade date.<sup>21</sup> This requirement starts one year after the publication of the final rule.<sup>22</sup> Within five years of the publication of the final rule, the CFTC staff will publish a report regarding the possibility of accelerating the deadline.<sup>23</sup> If the Commission takes no further action after considering the report, the phase-in

12 17 C.F.R. § 23.702(c)(2).

13 17 C.F.R. § 23.702(c)(1).

14 See 17 C.F.R. § 23.703.

15 See 17 C.F.R. § 23.704.

16 78 Fed. Reg. at 66621.

17 17 C.F.R. § 190.01(l).

18 17 C.F.R. § 190.08(a)(1)(i)(F).

19 78 Fed. Reg. 66621.

20 The final rule amends or adopts rules in Parts 1, 3, 22, 30, and 140 of the Commission's regulations.

21 17 C.F.R. § 1.22(c).

22 17 C.F.R. § 1.22(c)(5)(ii).

23 17 C.F.R. § 1.22(c)(5)(iii).

period will expire on December 31, 2018.<sup>24</sup> Then, an FCM will be required to hold the requisite residual interest prior to the time of the daily settlement with each DCO of which the FCM is a member on the same date as the aggregate under-margining exists.

**Other Requirements.** The new rules also will require FCMs to provide more upfront disclosures to their customers, such as general disclosures that customer funds are not protected by the Securities Investor Protection Corporation and are not subject to a DCO guarantee.<sup>25</sup> Additionally, FCMs must disclose that they are not required to hold each individual customer's funds in separate accounts.<sup>26</sup> FCMs will also be required to provide specific disclosures about the FCM itself, such as the FCM's types of business activities, product lines, material business and legal risks, and financial information.<sup>27</sup> FCMs also will be required to make available on their websites various financial information, including daily statements of the funds in segregation for futures and cleared swaps customers, as well as net capital and various other kinds of financial information.<sup>28</sup>

The new rules also raise the standards for certified public accountants that audit FCMs<sup>29</sup> and require FCMs to adopt stronger risk management programs, including written policies and procedures designed to ensure that customer funds are separately accounted for and segregated or secured as belonging to the customers.<sup>30</sup> Self-regulatory programs supervising FCMs also will have more controls and substantive testing requirements.<sup>31</sup>

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24 *See id.*

25 17 C.F.R. § 1.55(b)(3)-(4).

26 17 C.F.R. § 1.55(b)(5).

27 17 C.F.R. § 1.55(k)(3).

28 17 C.F.R. § 1.55(o)(1).

29 17 C.F.R. § 1.16.

30 17 C.F.R. § 1.11.

31 17 C.F.R. § 1.52.