

Cleared OTC Transactions – Regulatory Treatment Q&A

1. What is a “4d” account?

4d segregated accounts contain the funds of customers trading futures and options on U.S. exchanges, regardless of the customers’ domicile, and 4d funds are held separate from the FCM’s own funds.¹ The CFTC also permits funds margining cleared OTC transactions to be held in 4d accounts by clearing FCMs and clearinghouses, if it has issued a 4d order that covers the specific product being cleared.

2. How do I know what products are covered by a 4d order?

Each 4d order issued by the CFTC identifies the specific products covered by the order. The CFTC’s website provides links to various orders that the CFTC has issued to clearinghouses and exchanges, including 4d orders.²

3. What is a “30.7” account?”

30.7 secured accounts contain funds of U.S.-domiciled customers trading futures and options on foreign exchanges (although FCMs may choose to include the funds of non-U.S.-domiciled customers as well), and may also contain the funds of customers engaged in “non-regulated” transactions, including cleared OTC transactions.³ 30.7 funds are also held separate from the FCM’s own funds.

4. What is the difference in margin risk offsets for 4d and 30.7 accounts?

Customers may receive the full benefit of any margin risk offsets that may be established by CME Clearing if they hold the funds margining both OTC positions and the related futures positions in a 4d account. Currently, no margin risk offsets are permitted between OTC positions in a 30.7 account and related futures positions in a 4d account.

5. What is the difference with respect to position reporting, position accountability or position limits for 4d and 30.7 accounts?

Customers margining cleared OTC transactions in a 4d account will be required to participate in large trader reporting to the CFTC, and the CFTC will require CME Clearing to impose appropriate position accountability or position limits. For customers margining cleared OTC transactions in a 30.7 account, the same CFTC requirements do not apply. However, CME Clearing may require large trader reporting, as well as any appropriate position accountability or position limits as part of its overall risk management policies.

¹ Pursuant to Section 4d of the Commodity Exchange Act and CFTC Regulation 1.20

² <http://services.cftc.gov/sirt/sirt.aspx?Topic=CommissionOrdersandOtherActions>

³ Pursuant to CFTC Regulation 30.7 and the CFTC’s 1-FR Instructions

6. What is the CFTC's proposed "cleared OTC derivatives account class"?

On August 13, 2009, the CFTC issued proposed amendments to its Part 190 bankruptcy regulations that would create a separate "cleared OTC derivatives account class" that would apply in the event of the bankruptcy of an FCM.⁴ As defined by the CFTC a cleared OTC derivatives account class would include cleared OTC contracts that "are required to be held in a separate account for cleared OTC derivatives only, in accordance with the rules or bylaws of a clearing organization." If the CFTC adopts its proposed rules, customer positions in cleared OTC products that are in 30.7 accounts may be transferred into a new OTC derivatives account. However, it is unclear at this time when and in what form the CFTC may adopt relevant rules.

7. What are the differences in bankruptcy protections for 4d accounts, 30.7 accounts, and the proposed cleared OTC derivatives account class?

Under the CFTC's bankruptcy regulations, each "account class" is a separate pool of funds for claims. The claims of customers whose funds are held in defined account classes will have priority over proprietary claims and the claims of general creditors in an FCM bankruptcy. Futures accounts and foreign futures accounts are defined account classes, but cleared OTC transactions are not currently addressed. Neither the CFTC nor the courts have issued an interpretation with regard to the bankruptcy protections that would be afforded to OTC positions in 30.7 accounts, and it is therefore unclear whether they would receive the same protections as foreign futures customers. If the CFTC adopts its proposal for a cleared OTC derivatives account class, there will be explicit bankruptcy protection for cleared OTC transactions in the CFTC's regulations.

8. What is CME Group's position with respect to the CFTC's proposed cleared OTC derivatives account class?

CME Group filed a comment letter with the CFTC on September 14, 2009.⁵ We urged the CFTC to adopt minimum requirements that would provide the same safeguards to OTC customers that are provided to futures customers, by adopting equivalent requirements for cleared OTC derivatives accounts and 4d accounts with respect to the treatment of customer funds, including with respect to the instruments in which FCMs may invest customer funds and recordkeeping requirements. We also encouraged the CFTC to adopt standards that would define the requirements that must be met for a cleared OTC product to qualify for 4d treatment to facilitate and streamline requests for 4d orders. In addition, we suggested that the CFTC should consider whether a structure can be created that would allow for portfolio margining between cleared OTC derivatives accounts and 4d accounts.

This summary is not intended or written to be legal advice to any person and individuals and entities should seek advice from their independent legal advisors with any questions regarding these issues.

⁴ 74 FR 40794 (August 13, 2009)

⁵ Available at: <http://www.cftc.gov/lawandregulation/federalregister/federalregistercomments/2009/09-009.html>