Joint Audit Committee

REGULATORY ALERT

TO: Chief Financial Officers
Chief Compliance Officers

#14-03

DATE: May 21, 2014

SUBJECT: Receipt of Margin Funds and Combining Accounts for Margin Purposes

This Joint Audit Committee Regulatory Alert is intended to serve as a reminder to futures commission merchants ("FCMs") of certain margin policies related to the receipt of margin deposits and the release of excess margin funds.

Generally, deposits should only be applied to a customer or noncustomer's margin equity[1] when funds are actually received by the FCM. A FCM should not apply margin equity credit to an account based solely on the customer or noncustomer's agreement to make a payment, or based on a representation from the account owner that a transfer of funds will be initiated.

However, due to the inherent delay in the settlement of certain foreign currency transfers, unsettled non-U.S. Dollar transactions may be considered in determining a customer's or noncustomer's margin status under certain circumstances. Specifically, at the FCM's discretion, it may consider a non-U.S. Dollar deposit as "pending" in a customer or noncustomer's account and include in the account's margin equity if (i) the FCM assesses that it is prudent to do so based on the account's past history of satisfying margin calls and the operational and credit risk profile of the account owner, (ii) the account is on a 1-day wire transfer basis (i.e., the wire is initiated on day 1 of the margin call), (iii) the FCM has a sufficient basis that the wire was actually initiated, (iv) the FCM continues to age the pending non-U.S. Dollar receipts and retains the ability to recognize a failed deposit immediately upon occurrence, and (v) the FCM treats unsettled non-U.S. Dollar disbursements from the account in the same manner.

Additionally, all accounts of the same beneficial owner within the same regulatory account classification (i.e., customer segregated, customer secured, cleared swaps customer, or noncustomer) should be combined for margin purposes. FCMs should be reminded that when

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[1] For clarity, the JAC Margins Handbook (found at http://www.jacfutures.com) defines margin equity as "An account's net liquidating equity plus the collateral value of acceptable margin deposits." The collateral value of acceptable margin deposits is determined by the individual exchanges, but generally may not exceed market value less applicable haircuts as set forth in SEC Rule 240.15c3-1. Additionally, as noted in JAC Regulatory Update #12-03 (also found at http://www.jacfutures.com), for cleared swaps accounts the components of net liquidating equity shall include cash and all other realized and unrealized components of variation margin including upfront fees/reset to par, initial coupon, accrued coupon, price alignment interest and mark-to-market amounts.

determining an account's margin funds available for disbursement[2], all accounts of the same beneficial owner, even if under different control, within the same regulatory account classification must be combined. However, FCMs may choose to call for margin on an individual underlying account basis, as long as the gross margin calls made are conservative in relation to the aggregate margin call calculated for the combined account.

Further an account's available funds from one regulatory account classification cannot be used for disbursement from another regulatory account classification.

If you have any questions, please contact your DSRO.

[2] Margin funds available for disbursement is defined by the JAC Margins Handbook as an account's net liquidating value + margin deposits – initial margin requirements (risk margin only) $\geq$ zero. Alternatively, FCMs may compare the total equity plus margin deposits in an account to the initial margin requirement adjusted for the account's option value, commonly referred to as the Total Equity Method.