The Joint Audit Committee is a representative committee of U.S. futures exchanges and regulatory organizations including the: CBOT, CCFE, CFE, CME, COMEX, ELX, Eris Exchange, ICE Clear Credit, ICE Futures U.S., Inc., INET, MGEX, NADEX, NFA, NFX, Nodal, NYMEX, NYSE Liffe US, OCX and trueEX.

TO: Chief Executive Officers
    Chief Financial Officers
    Chief Compliance Officers

DATE: November 4, 2014

SUBJECT: CFTC Regulations as to Residual Interest and the Undermargined Capital Charge

CFTC regulations provide that FCMs may not use, or permit the use of, the funds of one segregated, secured 30.7 or cleared swaps customer to purchase, margin or settle the trades, contracts, commodity options, or cleared swaps, as applicable, of or to secure or extend credit to any person other than the respective segregated, secured 30.7 or cleared swaps customer. As part of the CFTC’s enhanced customer protections, CFTC Regulations 1.22(c) and 30.7(f) will become effective on November 14, 2014 and require FCMs to maintain sufficient residual interest in futures customer accounts in excess of customer margin deficiencies and reduce the time period for futures customers, noncustomers and omnibus accounts to meet margin calls before a capital charge is applicable.

Residual Interest

Effective November 14, 2014, CFTC regulations will require FCMs to maintain residual interest (i.e. excess funds) in segregated and secured 30.7 customer accounts, respectively, that is at least equal to the residual interest requirement prior to the residual interest deadline. The terms as used in this Alert are defined as follows:

Residual Interest
Excess segregated or secured 30.7 funds, as applicable, computed in the daily statement.

Adjusted Residual Interest
Residual Interest plus any FCM contributions to residual interest and less any FCM withdrawals from residual interest which occur prior to the residual interest deadline. The formula is as follows:

Residual Interest as of close of business Day 1
  (less) FCM distributions from Residual Interest which occur on Day 2
  (plus) FCM contributions to Residual Interest which occur on Day 2
  (equals) Adjusted Residual Interest computed on Day 2

Residual Interest Deadline
The segregated residual interest deadline is the time of the daily derivatives clearing organization (“DCO”) settlement that occurs on the following business day; however, the initial residual interest deadline is 6:00pm Eastern Time on the day of the daily settlement (the “phase-in period”) until the
Commission takes action to terminate or change the residual interest deadline. However, if action is not taken by December 31, 2018, the phase-in period expires.

The secured 30.7 residual interest deadline is 6:00pm Eastern Time on the day of the daily settlement which occurs on the following business day.

U.S. Bank Holidays. CFTC Interpretative Letter 14-129, dated October 23, 2014, provides guidance as to the residual interest deadline if the U.S. futures markets are open and the U.S. banking system is closed. Such guidance provides that if a U.S. bank holiday occurs on an FCM business day, the segregated residual interest deadline will be the next business day when the banking system is open. In addition, since foreign markets are subject to varying holidays, it is the responsibility of the FCM to manage its foreign futures customer accounts to ensure that the FCM is in compliance with secured 30.7 residual interest requirements. Refer to Interpretative Letter 14-129 on the CFTC’s web site at: http://www.cftc.gov/ucm/groups/public/@lrlettergeneral/documents/letter/14-129.pdf.

Residual Interest Requirement
The aggregate undermargined amount (or margin deficiencies) as of the end of business on Day 1, reduced by funds received from undermargined customers and less any disbursements made to such customers, prior to the residual interest deadline. The formula is as follows:

Aggregate of Customers’ Undermargined Amounts as of close of business Day 1
(less) Margin Funds received from Undermargined Customers on Day 2
(plus) Margin Funds paid to such Undermargined Customers on Day 2
(equals) Residual Interest Requirement as of Day 1 computed on Day 2

Undermargined Amount/Margin Deficiencies. When calculating the undermargined amount or margin deficiencies for the residual interest requirement, an account’s risk maintenance margin requirement should be compared to its margin equity, aggregating across all currencies by respective segregated or secured 30.7 origin, and should not be greater than an account’s risk maintenance margin requirement. The formula is as follows:

Risk Maintenance Margin Requirement
(less) Credit Net Liquidating Value
(less) Margin Collateral in Excess of Amounts to Secure Debit/Deficits
(equals) Undermargined Amount (if amount < 0, then the amount is 0)

Non-US Dollar Settlements. Due to the inherent delay in the settlement of certain foreign currency transfers, unsettled non-U.S. Dollar transactions may be considered as margin funds received when

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1 The regulation requires the CFTC to conduct a study and publish for comment the practicality of moving the segregated residual interest deadline during the phase-in period to the time of daily DCO settlement or another time of day. If the phase-in period has not been amended, the phase-in period for segregated accounts shall end on December 31, 2018 and the segregated residual interest deadline will become the point in time that the DCOs’ daily settlement cycle occurs on the following business day.

2 On November 3, 2014, the CFTC proposed to revise Regulation 1.22 to remove the December 31, 2018 automatic termination of the phase-in period. Under the CFTC’s proposal, the 6:00pm Eastern Time Residual Interest Deadline may only be revised to a different point in time though a rulemaking process, which affords market participants with notice of the revisions and an opportunity to comment on the revisions. FCMs should monitor developments on the CFTC’s proposal going forward.
determining a customer’s residual interest requirement under certain circumstances. Specifically, at the FCM’s discretion, it may consider a non-U.S. Dollar deposit as “pending” in a customer’s account and included 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 2), (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.

**ACH Payments.** CFTC Interpretative Letter 14-129, dated October 23, 2014, provides that margin payments to an FCM by its customers which are processed by the Automated Clearing House (“ACH”) may be considered as margin funds received upon the FCM’s initiation of the withdrawal from the customer’s bank account subject to certain conditions. Refer to Interpretative Letter 14-129 on the CFTC’s web site at: [http://www.cftc.gov/ucm/groups/public/@lrlettergeneral/documents/letter/14-129.pdf](http://www.cftc.gov/ucm/groups/public/@lrlettergeneral/documents/letter/14-129.pdf).

**Checks.** For customers that consistently meet margin calls by check, the FCM may continue to consider the check as margin funds received on the date the check is physically received by the FCM unless it has reason to believe the check may not clear the customer’s bank account in the normal course of business or it is otherwise part of a scheme to report false or misleading financial information.

**Day Definitions for Residual Interest and Margin Calls.**
For purposes of the residual interest calculation and aging margin calls, days are defined as follows:
- Day 1 - the business day an account becomes undermargined
- Day 2 - the business day a margin call is issued
- Day 3 - the first business day a margin call is outstanding

**Residual Interest Compliance Calculation.**
The calculation the FCM must perform to demonstrate its compliance with residual interest regulations. The calculation is as follows:

<table>
<thead>
<tr>
<th>Residual Interest Compliance Calculation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Residual Interest Requirement:</td>
</tr>
<tr>
<td>Undermargined Amounts as of cob Day 1</td>
</tr>
<tr>
<td>(less) Margin Funds received from Customers on Day 2</td>
</tr>
<tr>
<td>(plus) Margin Funds paid to such Customers on Day 2</td>
</tr>
<tr>
<td>Adjusted Residual Interest:</td>
</tr>
<tr>
<td>Residual Interest as of cob Day 1 computed on Day 2</td>
</tr>
<tr>
<td>(plus) FCM contributions to Residual Interest on Day 2</td>
</tr>
<tr>
<td>(less) FCM withdrawals from Residual Interest on Day 2</td>
</tr>
<tr>
<td>Equals Excess/(Deficiency) of Adjusted Residual Interest over the</td>
</tr>
<tr>
<td>Residual Interest Requirement computed on Day 2</td>
</tr>
</tbody>
</table>

**Example of Residual Interest Compliance Calculation.** On Tuesday morning (Day 2), the FCM prepares its customer segregation statement as of the close of business Monday (Day 1) and determines that it has $750,000 in excess segregated funds. In addition, the FCM calculates $1,000,000 as its aggregate segregated margin deficiencies from all customers and issues margin calls to these customers. The FCM electronically files its segregation statement through WinJammer™ with its DSRO by 12:00 noon on Tuesday. Tuesday afternoon, several customers wire an aggregate of $600,000 into the FCM’s segregated bank account to meet their margin calls and the
FCM withdraws $25,000 from its segregated bank account. The FCM must determine that it maintains residual interest (of $725,000 ($750,000 less $25,000)) in excess of the residual interest requirement (of $400,000 ($1,000,000 less $600,000)) at 6:00pm Eastern Time during the phase-in period. Below is the Residual Interest Compliance Calculation that would be prepared.

### Residual Interest Compliance Calculation Example

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Residual Interest Requirement:</td>
<td></td>
</tr>
<tr>
<td>Undermargined Amount as of cob Day 1</td>
<td>$1,000,000</td>
</tr>
<tr>
<td>(less) Margin Funds received from customers on Day 2</td>
<td>(600,000)</td>
</tr>
<tr>
<td>(plus) Margin Funds paid to such Customers on Day 2</td>
<td>0-</td>
</tr>
<tr>
<td></td>
<td>$400,000</td>
</tr>
<tr>
<td>Adjusted Residual Interest:</td>
<td></td>
</tr>
<tr>
<td>Residual Interest as of cob Day 1 computed on Day 2</td>
<td>$750,000</td>
</tr>
<tr>
<td>(plus) FCM contributions to Residual Interest on Day 2</td>
<td>0-</td>
</tr>
<tr>
<td>(less) FCM withdrawals from Residual Interest on Day 2</td>
<td>($25,000)</td>
</tr>
<tr>
<td></td>
<td>$725,000</td>
</tr>
<tr>
<td>Excess Residual Interest computed on Day 2</td>
<td>$325,000</td>
</tr>
</tbody>
</table>

**Residual Interest Compliance**

The FCM must demonstrate that it maintains sufficient excess residual interest as of the respective residual interest deadline. An FCM may prepare its residual interest compliance calculation before the residual interest deadline; however, the FCM must be able to demonstrate residual interest compliance as of 6:00pm Eastern Time considering all withdrawals of FCM funds or disbursements to undermargined customers.

If the FCM determines that the amount of its excess segregated or secured 30.7 customer residual interest is less than its residual interest requirement as of the residual interest deadline, the FCM must provide immediate notification pursuant to CFTC Reg. 1.12(j). The notification must be filed with the CFTC, the DSRO and, if the FCM is also registered as a broker-dealer, the SEC and include a discussion of how the reporting event originated and what steps have been, or are being taken, to address the event.

FCMs must maintain sufficient segregated and secured 30.7 customer funds in excess of the respective segregated or secured 30.7 customer requirements at all times. However, the FCM need only maintain sufficient residual interest over the residual interest requirement at the point in time of the residual interest deadline. Due to the different points of time that the residual interest compliance calculations are required to be prepared, the CFTC did not amend the daily segregation or secured 30.7 customer statements. However, FCMs must demonstrate that they had sufficient residual interest over the requirement through the residual interest compliance calculation within the time frames noted above.

Undermargined Capital Charge

CFTC Reg. 1.17(c)(5)(viii) and (ix) will be amended effective November 14, 2014 to require an FCM to take an undermargined capital charge for futures customer, noncustomer, and omnibus accounts that are undermargined after Day 3. This is a modification to the current regulation which requires an FCM to take a capital charge for futures noncustomer and omnibus accounts which are undermargined after two business days of a margin call being issued (i.e., Day 4) and futures customer accounts which are undermargined after three business days of a margin call being issued (i.e., Day 5). The calculation is as follows:

Risk Maintenance Margin Requirement  
(less) Credit Net Liquidating Value  
(less) Margin Collateral in Excess of Amounts to Secure Debit/Deficits  
(less) Current Margin Calls (i.e. Margin Calls less than 3 Business Days Outstanding)

In the above example, an FCM must calculate an undermargined capital charge as of close of business on Wednesday (Day 3) for any accounts which became undermargined on Monday (Day 1) and which remain undermargined and have not met Monday’s margin call by close of business on Wednesday (Day 3).

The undermargined capital charge should not be greater than an account’s risk maintenance margin requirement. When calculating the undermargined capital charge and consistent with the treatment for residual interest, the FCM may consider “pending” non-US Dollar deposits, ACH payments and checks as received if the respective conditions are met.

For reference, the CFTC’s Final Regulations were published in the Federal Register (November 12, 2013, Vol. 78, No. 220, at page 68506) and can be found on the CFTC’s web site at: http://www.cftc.gov/ucm/groups/public/@lrfederalregister/documents/file/2013-26665a.pdf. The regulations themselves can be found on http://ecfr.gpoaccess.gov/ at http://www.ecfr.gov/cgi-bin/text-idx?sid=7e1068de65d0eb767da92b5ee2740d46&c=ecfr&g=ecfrbrowse/Title17/17cfrv1_02.tpl.

If you have any questions, please contact your DSRO.