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DERIVATIVES

CFTC Adopts Rules for Segregation of Initial Margin for Uncleared Swaps

On October 31, the Commodity Futures Trading Commission adopted final rules with respect to the segregation of initial margin for uncleared swaps. The rules impose new obligations on swap dealers (SDs) and major swap participants (MSPs) that amplify and go beyond the notification and segregation requirements that are set out in Section 4s(l) of the Commodity Exchange Act.

The notification to each counterparty that it has the right to require segregation of initial margin must now include the following information:

1. The names of one or more possible custodians, one of which must be a creditworthy non-affiliate and all of which must be independent of both parties.

2. Information about the price of segregation for each custodian identified (to the extent the SD/MSP has such information).

The rules also contain detailed specifications concerning the manner in which the notification must be given. The preferred recipient of the notice is the "officer of the counterparty responsible for the management of collateral," but if no such officer had been identified by the counterparty, the notification must be sent to the counterparty's chief risk officer or, if there is no person with that title, to the counterparty's chief executive officer or equivalent. SDs and MSPs must now obtain confirmation of receipt of the notice by the addressee and an affirmative response from the counterparty indicating whether the counterparty is exercising its segregation right. As to timing, the rule states that notice may be given either on a swap-by-swap basis or once per calendar year; so in practice annual notifications should be the norm.

If a counterparty does not elect to segregate initial margin, an SD or MSP must submit a report to the counterparty no later than the 15th business day of each calendar quarter on whether its back-office procedures relating to margin and collateral requirements were in compliance with the agreement of the parties during the preceding calendar quarter. A counterparty has the right to change its election at any time by written notice to its SD or MSP, but only for swaps executed after delivery of such notice.

The rules dictate certain of the terms that must be included in the agreement covering a segregation arrangement elected by a counterparty. In particular, the rules state that (1) the segregated collateral must be held in an account designated as being for and on behalf of the counterparty, (2) withdrawal can be made only by agreement of both parties and (3) any notice to the custodian for the purpose of obtaining exclusive control of the collateral must be given under oath and under penalty of perjury. The rules also limit the investments that can be made with segregated initial margin to those that are consistent with CFTC Regulation 1.25. They do not, however, specify the allocation of the out-of-pocket costs of establishing and maintaining these custodial arrangements. The right to segregation does not apply to variation margin, but a segregated account for initial margin can also be used to hold variation margin if the parties so agree.

The rules are effective on January 6, 2014, and SDs and MSPs must be in compliance with them no later than May 4, 2014 for new counterparties and no later than November 3, 2014 for existing counterparties.

The final rules are available [here](#).

CFTC

CFTC Extends Time-Limited Relief for Foreign Exchange Swaps

The Commodity Futures Trading Commission's Division of Market Oversight issued No-Action Letter No. 13-68, which extends to November 29 the deadline set forth in CFTC No-Action Letters 13-55, 13-56 and 13-58 for swap execution facilities (SEFs) and participating counterparties that effect foreign exchange swaps. Summaries of those letters can be found in the *Corporate and Financial Weekly Digest* edition of October 4, 2013. SEFs and SEF participants that desire to rely on this extension must follow the requirements of those letters in order to be eligible for the extension of time granted in Letter 13-68.

CFTC Letter No. 13-68 is available here.

CFTC Approves Position Limits Proposals

The Commodity Futures Trading Commission has proposed amendments to its existing speculative position limit regulations. The proposed amendments, which are being published in two separate releases, are being re-proposed by the CFTC in response to a 2012 court order that vacated the CFTC's Part 151 Rules, which were adopted in 2011.

The first proposal would expand the scope of the CFTC's current speculative position limits and establish federal speculative limits on 28 physical commodity futures contracts, as well as futures and swaps that are directly or indirectly linked to the price of those contracts or to the price of the same underlying commodity. The 28 contracts include nine "legacy" and ten non-"legacy" agricultural contracts, four energy contracts and five metal contracts. The proposal seeks to establish initial position limits at levels that are based on current futures exchange limits and deliverable supply estimates, with separate spot-month limits for physically delivered and cash-settled contracts. These preliminary limits would be periodically adjusted based on deliverable supply estimates for spot-month contracts and open interest calculations for non-spot-months. Bona fide hedging positions and positions established in good faith prior to the effective date of any final regulations would be exempt from these requirements.

As discussed in detail in the Katten Client Advisory of November 7, 2013, the CFTC also issued a second proposal that addresses the manner in which market participants must aggregate their positions for purposes of determining whether they are in compliance with the CFTC's position limit rules. Under the CFTC's current rules, a trader is required to aggregate, for purposes of applying the speculative position limits, all positions in accounts in which the trader either (i) holds direct or indirect ownership of 10 percent or more, or (ii) controls trading by power of attorney or otherwise, subject to certain limited exceptions. The proposed rules retain but modify many of the existing exemptions to the aggregation requirements, including those for independent account controllers, passive pool participants and futures commission merchant customer trading programs. The CFTC proposal would create new disaggregation exemptions that may be available to persons who own 10 percent to 50 percent of another entity that holds positions that are subject to position limits, as well as a stricter exemption for persons who own more than 50 percent of another entity. Other proposed exemptions would address underwriting and broker-dealer activities and entities that may be prohibited by law from sharing position information.

Each of the two CFTC rule proposals will be open for public comment for a period of 60 days following its publication in the *Federal Register*.

The proposed position limits rules are available here.

The proposed aggregation rules are available here.

CFTC Proposes Rules to Require that IBs, CPOs and CTAs Become Members of a Registered Futures Association

The Commodity Futures Trading Commission has proposed rules requiring that all registered introducing brokers (IBs), commodity pool operators (CPOs) and commodity trading advisors (CTAs) become members of at least one registered futures association. The National Futures Association (NFA) is currently the only registered futures association in existence.

CFTC Regulation 170.15 requires that all futures commission merchants (FCMs) be members of a registered futures association. NFA Bylaw 1101, in turn, prohibits an NFA member from doing business with a person that is required to be registered with the CFTC as an FCM, IB, CPO or CTA if that person is not also an NFA member. Because not all swaps are required to be cleared through a futures commission merchant, IBs, CPOs and CTAs could do business with customers without having to deal with an NFA member FCM and, in turn, without becoming members of the NFA. The CFTC proposal would eliminate this possibility by requiring that all IBs, CPOs and CTAs become members of a registered futures association.

The CFTC's proposing release is available here.

LITIGATION

SEC Issues Latest Whistleblower Award for $150K

On October 30, the Securities and Exchange Commission announced an award of nearly $150,000 to an unnamed whistleblower whose tips helped the agency stop a scheme that was defrauding investors. The tips provided by the whistleblower allowed the SEC to open an investigation and to provide emergency relief before more investors were harmed. The award represents 30 percent of the money collected by the SEC in the action, the maximum permitted by law. The award is a clear sign that the whistleblower provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act continue to gain momentum. This is the sixth whistleblower award since the implementation of the SEC's whistleblower program two years ago. The largest award, announced on October 1, was for more than $14 million. Sean McKessy, chief of the SEC's Office of the Whistleblower, observed that "This is continued momentum and success for the SEC's whistleblower program that is bringing our investigators valuable and timely information to stop ongoing frauds before additional investors can be harmed."

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* Click here to access the *Corporate and Financial Weekly Digest* archive.

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