

**SECURITIES AND EXCHANGE COMMISSION**  
**(Release No. 34-68433; File No. S7-13-12)**

**December 14, 2012**

**ORDER GRANTING CONDITIONAL EXEMPTIONS UNDER THE SECURITIES EXCHANGE ACT OF 1934 IN CONNECTION WITH PORTFOLIO MARGINING OF SWAPS AND SECURITY-BASED SWAPS**

**AGENCY:** Securities and Exchange Commission.

**ACTION:** Exemptive order; request for comment.

**SUMMARY:** The Securities and Exchange Commission (“SEC” or “Commission”) is issuing an order granting conditional exemptive relief from compliance with certain provisions of the Securities Exchange Act of 1934 (“Exchange Act”) in connection with a program to commingle and portfolio margin customer positions in cleared credit default swaps (“CDS”), which include both swaps and security-based swaps, in a segregated account established and maintained in accordance with Section 4d(f) of the Commodity Exchange Act (“CEA”).

**DATES:** Effective Date: This exemptive order is effective on [Insert date of publication in the Federal Register].

Comments Due Date: Comments must be received on or before [Insert date 60 days after the date of publication in the Federal Register].

**ADDRESSES:** Comments may be submitted, identified by File Number S7-13-12, by any of the following methods:

Electronic comments:

- Use the Commission’s Internet comment form (<http://www.sec.gov/rules/other.shtml>); or
- Send an email to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number S7-13-12 on the subject line; or
- Use the Federal Rulemaking Portal (<http://www.regulations.gov>). Follow the instructions

for submitting comments.

Paper comments:

- Send paper comments in triplicate to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090. All submissions should refer to File Number S7-13-12. This file number should be included on the subject line if e-mail is used. To help us process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet website (<http://www.sec.gov/rules/other.shtml>). Comments are also available for website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington DC 20549, on official business days between the hours of 10:00 a.m. and 3:00 p.m. All comments received will be posted without charge; the Commission does not edit personal identifying information from submissions. You should only submit information that you wish to make publicly available.

**FOR FURTHER INFORMATION CONTACT:** Emily Westerberg Russell, Senior Special Counsel, Catherine Moore, Senior Special Counsel, and Natasha Vij Greiner, Special Counsel, at 202-551-5550, Division of Trading and Markets, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-7010.

**I. Introduction**

On July 21, 2010, President Barack Obama signed the Dodd-Frank Act into law.<sup>1</sup> Title VII of the Dodd-Frank Act ("Title VII") establishes a regulatory regime applicable to the over-the-counter ("OTC") derivatives markets. Title VII provides the Commission and the

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<sup>1</sup> The Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010).

Commodity Futures Trading Commission (“CFTC”) with tools to oversee these markets.<sup>2</sup> Under the comprehensive framework established in Title VII, the SEC is given regulatory authority over security-based swaps, and the CFTC is given regulatory authority over swaps.<sup>3</sup> The Dodd-Frank Act amended the Exchange Act to require, among other things, that transactions in security-based swaps be cleared through a clearing agency that is registered with the Commission or that is exempt from registration, if the security-based swaps are of a type that the Commission determines must be cleared, unless an exception or exemption from mandatory clearing applies.<sup>4</sup> The Dodd-Frank Act similarly amended the CEA.<sup>5</sup> In addition, the Dodd-Frank Act provided the SEC and CFTC with explicit authority to facilitate portfolio margining by allowing cash and securities to be held in a futures account, and futures and options on futures and related collateral to be held in a securities account, subject to certain conditions.<sup>6</sup>

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<sup>2</sup> Generally, Subtitle A of Title VII creates and relates to the regulatory regime for swaps, while Subtitle B of Title VII creates and relates to the regulatory regime for security-based swaps.

<sup>3</sup> See Section 3(a)(68) of the Exchange Act, 15 U.S.C.78c(a)(68) (as added by Section 761(a)(6) of the Dodd-Frank Act) and Section 1a(47) of the CEA, 7 U.S.C. 1a(47) (as added by Section 721(a) of the Dodd-Frank Act) for the definitions of security-based swap and swap, respectively. See also Further Definition of “Swap,” “Security-Based Swap,” and “Security-Based Swap Agreement”; Mixed Swaps; Security-Based Swap Agreement Recordkeeping, Exchange Act Release No. 67453 (Jul. 18, 2012), 77 FR 48207 (Aug. 13, 2012) (Joint Final Rule with the CFTC) (“Product Definitions Adopting Release”), further defining the terms swap and security-based swap.

<sup>4</sup> See Section 763(a) of the Dodd-Frank Act (adding new Section 3C(a)(1) to the Exchange Act). 15 U.S.C. 78c-2.

<sup>5</sup> See Section 723(a)(3) of the Dodd-Frank Act (adding new Section 2(h)(1)(A) to the CEA).

<sup>6</sup> See Section 713 of the Dodd-Frank Act. Under Section 713 of the Dodd-Frank Act, dually-registered broker-dealers and futures commission merchants may portfolio margin pursuant to an approved portfolio margin program, subject to certain requirements,

On December 16, 2011, the Commission approved a request by a clearing agency for portfolio margining of clearing members' proprietary security-based swaps and swap positions consisting of single-name CDS and CDS indices, respectively.<sup>7</sup> Under such a portfolio margining arrangement, clearing members are able to maintain reduced levels of margin that are commensurate with the risks of the portfolio based on correlations in a member's cleared CDS positions consisting of both swaps and security-based swaps.

Market participants have also sought the use of similar portfolio margining arrangements in the context of customer positions in CDS. On November 7, 2011, ICE Clear Credit, LLC ("ICE Clear Credit") filed with the Commission a petition for rulemaking, regulation or order to provide exemptive relief from certain Exchange Act provisions to allow portfolio margining treatment for customer-related positions in anticipation of ICE Clear Credit offering clearing of security-based swaps for customer-related transactions.<sup>8</sup> ICE Clear Credit requested exemptive relief from the application of certain provisions of the Exchange Act to allow ICE Clear Credit, and any ICE Clear Credit member that is a dually-registered broker-dealer and futures commission merchant ("BD/FCM"), to, among other things: (1) hold customer assets used to margin, secure, or guarantee customer positions consisting of cleared CDS, which include both

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including regulatory action by the SEC and CFTC (pursuant to an exemption, or by rule or regulation). See Exchange Act Section 15(c)(3)C and CEA Section 4d(h). See also infra note 23.

<sup>7</sup> See Order Approving Proposed Rule Change to Adopt ICC's Enhanced Margin Methodology, Exchange Act Release No. 66001 (Dec. 16, 2011).

<sup>8</sup> ICE Clear Credit formally petitioned the Commission to grant exemptive relief from the application of Section 15(c)(3), Rule 15c3-3 and related rules under the Exchange Act. See Letter from Michael M. Phillip, Partner, Winston & Strawn LLP (Nov. 7, 2011) (the petition and comments received on the petition are on file at the Commission's website at <http://www.sec.gov/rules/petitions.shtml>).

swaps and security-based swaps, in a commingled customer omnibus account subject to Section 4d(f) of the CEA; and (2) calculate margin for this commingled customer account on a portfolio margin basis.<sup>9</sup> ICE Clear Europe Limited (“ICE Clear Europe”) also requested substantially similar relief for itself and its members.<sup>10</sup>

The Commission has received four comment letters, one of which was provided by ICE Clear Credit. All of these letters supported ICE Clear Credit’s request for relief.<sup>11</sup> Commenters generally argued that portfolio margining of customer positions in CDS removes economic barriers to customer clearing and would encourage greater clearing, thereby reducing systemic risk.<sup>12</sup> One commenter stated that a portfolio margining program for customer accounts could also improve competitiveness between market participants who are not clearing members and those that are clearing members who are already permitted to portfolio margin in their proprietary accounts.<sup>13</sup> Certain commenters addressed additional issues associated with the approval of ICE Clear Credit’s request for relief, including concerns relating to a potential requirement to provide customers the ability to choose an account type and a request for certainty about the applicable bankruptcy regime, which are more specifically addressed, where

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<sup>9</sup> Id.

<sup>10</sup> See Letter from Paul Swann, President and Chief Operating Office, ICE Clear Europe Limited (May 31, 2012) (on file as a comment to the ICE Clear Credit petition at <http://www.sec.gov/comments/4-641/4641-5.pdf>).

<sup>11</sup> See letter from Managed Funds Association dated June, 13, 2012 (“MFA Letter”); letter from Investment Company Institute (“ICI Letter”) dated April 9, 2012; letter from ICE Clear Credit LLC dated December 22, 2011 (“ICE Letter”); and letter from Association of Institutional Investors dated December 22, 2011.

<sup>12</sup> Id.

<sup>13</sup> See, e.g., MFA Letter.

appropriate, below.<sup>14</sup> Additionally, one commenter argued that the Commission should provide equivalent relief to all clearing agencies seeking exemptive relief, stating that different approaches could lead to inefficiencies in the market because market participants may choose to clear at a particular clearinghouse based on the applicable regulatory standards rather than market efficiencies.<sup>15</sup>

## **II. Discussion**

Portfolio margining of index CDS (subject to CFTC regulations)<sup>16</sup> and single-name CDS (subject to SEC regulations) can offer many benefits to investors and the markets, including promoting greater efficiencies in clearing with respect to off-setting positions and thereby aligning costs more closely with overall risks presented by an investor's portfolio. Further, portfolio margining may help to alleviate excessive margin calls, improve cash flows and liquidity, and reduce volatility.

At the same time, facilitating portfolio margining for customer-owned swaps requires careful consideration to ensure that customer protection concerns are appropriately addressed, as well as to promote appropriate risk management and disclosure. The Commission is mindful of the need to address these issues.

Accordingly, after careful consideration of the requests before the Commission, comments received, and the relevant statutory provisions, the Commission is acting to provide

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<sup>14</sup> See ICE Letter, MFA Letter, and ICI Letter.

<sup>15</sup> See ICI Letter.

<sup>16</sup> Index CDS that are currently cleared are generally swaps subject to CFTC regulation. The definition of "narrow-based security index" is used to help in distinguishing between certain swaps, such as index CDS, and security-based swaps. See Product Definitions Adopting Release.

conditional exemptive relief to facilitate portfolio margining treatment for customer-related positions in CDS that are cleared pursuant to the terms of this Order.

A. Relevant Provisions

Section 3E of the Exchange Act, as established pursuant to Section 763 of the Dodd-Frank Act, sets forth the framework for the segregation of assets held as collateral in security-based swap transactions. Section 3E(b)(1) of the Exchange Act provides that a broker, dealer, or security-based swap dealer shall treat and deal with all money, securities, and property of any security-based swap customer received to margin, guarantee, or secure a cleared security-based swap transaction as belonging to the customer.<sup>17</sup> Section 3E(b)(2) of the Exchange Act provides that the money, securities, and property shall be separately accounted for and shall not be commingled with the funds of the broker, dealer, or security-based swap dealer or used to margin, secure, or guarantee any trades or contracts of any security-based swap customer or person other than the person for whom the money, securities, or property are held.<sup>18</sup> Section 3E(c)(1) of the Exchange Act provides that, notwithstanding Section 3E(b) of the Exchange Act, money, securities, and property of cleared security-based swap customers of a broker, dealer, or security-based swap dealer may, for convenience, be commingled and deposited in the same one or more accounts with any bank, trust company, or clearing agency.<sup>19</sup> Section 3E(c)(2) of the Exchange Act further provides that the Commission may, notwithstanding Section 3E(b) of the

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<sup>17</sup> See Section 3E(b)(1) of the Exchange Act (15 U.S.C. 78c-5(b)(1)) (as added by Section 763(d) of the Dodd-Frank Act).

<sup>18</sup> See Section 3E(b)(2) of the Exchange Act (15 U.S.C. 78c-5(b)(2)) (as added by Section 763(d) of the Dodd-Frank Act).

<sup>19</sup> See Section 3E(c)(1) of the Exchange Act (15 U.S.C. 78c-5(c)(1)) (as added by Section 763(d) of the Dodd-Frank Act).

Exchange Act, by rule, regulation, or order prescribe terms and conditions under which any money, securities, or property of a customer with respect to cleared security-based swaps may be commingled and deposited with any other money, securities, or property received by the broker, dealer, or security-based swap dealer and required by the Commission to be separately accounted for and treated and dealt with as belonging to the security-based swap customer of the broker, dealer, or security-based swap dealer.<sup>20</sup> Section 3E(d) of the Exchange Act restricts the ability to invest such money, securities, and property of the security-based swap customer,<sup>21</sup> and Section 3E(e) of the Exchange Act places certain prohibitions on the disposition and use of customer money, securities, and property of a security-based swap customer by any person, including any clearing agency and any depository institution that has received any money, securities, or property for deposit in a separate account or accounts, as provided in Section 3E(b) of the Exchange Act.<sup>22</sup> Finally, Section 3E(g) of the Exchange Act provides that an account holding a security-based swap, other than a portfolio margining account referred to in Section 15(c)(3)(C) of the Exchange Act, shall be considered to be a securities account, as defined in 11 U.S.C. 741.<sup>23</sup>

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<sup>20</sup> See Section 3E(c)(2) of the Exchange Act (15 U.S.C. 78c-5(c)(2) (as added by Section 763(d) of the Dodd-Frank Act).

<sup>21</sup> 15 U.S.C. 78c-5(d) (as added by Section 763(c) of the Dodd-Frank Act).

<sup>22</sup> 15 U.S.C. 78c-5(e) (as added by Section 763(c) of the Dodd-Frank Act).

<sup>23</sup> Solely for purposes of Section 3E(g) of the Exchange Act, the Commission interprets “a portfolio margining account referred to in section 15(c)(3)(C)” to include a portfolio margining account that is maintained in accordance with the terms of this Order.

Section 15(c)(3) of the Exchange Act and Rule 15c3-3<sup>24</sup> also provide for the protection of customer securities and funds. Specifically, under Section 15(c)(3) of the Exchange Act, the SEC may prescribe rules and regulations “to provide safeguards with respect to the financial responsibility and related practices of brokers and dealers, including, but not limited to, the acceptance of custody and use of customers’ securities and the carrying and use of customers’ deposits or credit balances.”<sup>25</sup> Under Exchange Act Rule 15c3-3, a broker-dealer must, in essence, segregate customer funds and fully paid and excess margin securities held by the firm for the accounts of customers. The intent of the rule is, among other things, to “facilitate the liquidations of insolvent broker-dealers and to protect customer assets in the event of a SIPC liquidation through a clear delineation in Exchange Act Rule 15c3-3 of specifically identifiable property of customers.”<sup>26</sup> Absent an exemption, a broker-dealer would be required to comply with applicable provisions of Section 15(c)(3) of the Exchange Act and Rule 15c3-3 thereunder as they relate to all securities, including security-based swaps.<sup>27</sup>

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<sup>24</sup> 17 CFR 240.15c3-3.

<sup>25</sup> 15 U.S.C. 78o(c)(3).

<sup>26</sup> See Broker-Dealers; Maintenance of Certain Basic Reserves, Exchange Act Release No. 9856 (Nov. 10 1972), 37 FR 25224 (Nov. 29, 1972).

<sup>27</sup> In addition to the Exchange Act provisions specific to security-based swaps, there are Exchange Act provisions applicable to “securities”, which would apply to security-based swaps. Section 761 of the Dodd-Frank Act amended the definition of “security” under the Exchange Act to include security-based swaps. See Exchange Act Section 3(a)(10), 15 U.S.C. 78c(a)(10) (as revised by Section 761 of the Dodd-Frank Act). The Commission approved an order granting temporary relief and providing interpretive guidance to make it clear that a substantial number of the requirements of the Exchange Act would not apply to security-based swaps when the revised definition of “security” went into effect on July 16, 2011. Order Granting Temporary Exemptions under the Securities Exchange Act of 1934 in Connection with the Pending Revision of the Definition of “Security” to Encompass Security-Based Swaps, and Request for Comment,

Section 724 of the Dodd-Frank Act added provisions to Section 4d of CEA that perform functions similar to those in Section 3E of the Exchange Act in creating a segregation framework for swap customers.<sup>28</sup> Accordingly, in order to permit collateral related to cleared security-based swaps to be commingled with that related to cleared swaps for purposes of portfolio margining and to operate under the segregation framework for swaps, a broker-dealer would need relief from the applicable provisions of Section 3E and Section 15(c)(3) of the Exchange Act as well as Rule 15c3-3 thereunder. Similarly, a clearing agency would need relief from applicable provisions of Section 3E of the Exchange Act.<sup>29</sup>

Moreover, Exchange Act Rules 8c-1 and 15c2-1 (“hypothecation rules”) prohibit, among other things, a broker-dealer from commingling customer securities (the term “customer” for this

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Exchange Act Release No. 64795 (July 1, 2011) (“Exchange Act Exemptive Order”). While the Exchange Act Exemptive Order provided registered broker-dealers a limited exemption from Section 15(c)(3) of the Exchange Act and rules thereunder in connection with security based-swaps (to the extent that these provisions do not apply to security-based swap activities or positions as of July 15, 2011), the exemption from Exchange Act Rule 15c3-3 is not available for the broker-dealer’s activities and positions related to cleared security-based swaps, to the extent that the broker-dealer is a member of a clearing agency that functions as a central counterparty for security-based swaps, and holds customer funds or securities in connection with cleared security-based swaps, because at the time the exemption was granted no clearing agencies were clearing security-based swaps. *Id.* Accordingly, relief separate from Section 15(c)(3) of the Exchange Act and Rule 15c3-3, and certain other Exchange Act provisions applicable to “securities” discussed herein, is necessary to permit the commingling and portfolio margining of customer positions in cleared CDS.

<sup>28</sup> See 7 U.S.C. 6d(f) (as added by Section 724 of the Dodd-Frank Act).

<sup>29</sup> The CFTC would also need to provide relief to allow security-based swaps to be commingled with swaps in an account maintained in accordance with Section 4d(f) of the CEA. The Commission notes that the CFTC has also received similar requests for relief. See Letter from Michael M. Phillip, Partner, Winston & Strawn LLP (Oct. 4, 2011) (the petition and comments received on the petition are on file at the CFTC’s website at <http://sirt.cftc.gov/sirt/sirt.aspx?Topic=CommissionOrdersandOtherActionsAD&Key=22685>).

purpose generally includes affiliates of the broker-dealer) with its own proprietary securities under a lien for a loan made to such broker-dealer.<sup>30</sup> However, pursuant to the CFTC Part 22 Rules, the money, securities, and property of an affiliate (as defined in association with the definition of “Cleared Swaps Proprietary Account” pursuant to CFTC Rule 22.1)<sup>31</sup> of an intermediary (i.e., BD/FCM) must be held in a Cleared Swaps Proprietary Account in accordance with the CFTC regime in order to permit such affiliates to use portfolio margining for CDS.<sup>32</sup> Absent an exemption, affiliates of a broker-dealer that are not excluded from the definition of customer in the hypothecation rules are customers whose securities positions cannot be commingled with the broker-dealer’s proprietary securities and therefore could not be held in a Cleared Swap Proprietary Account, as required by the CFTC’s Part 22 Rules.<sup>33</sup>

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<sup>30</sup> 17 CFR 240.8c-1 and 17 CFR 240.15c2-1. The term “customer” is defined in paragraph (b)(1) of the hypothecation rules and excludes any general or special partner or any director or officer of such broker-dealer, or any participant, as such, in any joint, group or syndicate account with such broker-dealer or with any partner, officer, or director thereof.

<sup>31</sup> Cleared Swaps Proprietary Account means an account for cleared swaps and associated collateral that is carried on the books and records of a FCM for persons with certain relationships with that FCM, including applicable affiliates. In association with the definition of a Cleared Swaps Proprietary Account, an “affiliate” is defined to include a person, directly or indirectly, controls such individual, partnership, corporation or association or, directly or indirectly, is controlled by or is under common control with, such individual, partnership, corporation or association. See CFTC Rule 22.1, 17 CFR 22.1.

<sup>32</sup> Under CFTC Rule 22.1, a firm that is an affiliate of a FCM would not be a cleared swaps customer, which is defined as any person entering into a cleared swap, excluding any owner or holder of a Cleared Swaps Proprietary Account with respect to the cleared swaps in such account and a clearing member of a DCO with respect to cleared swaps cleared on that DCO. See CFTC Rule 22.1, 17 CFR 22.1. Thus, such an affiliate would not be a customer for purposes of a customer portfolio margining program with respect to swaps and security-based swaps.

<sup>33</sup> The Exchange Act Exemptive Order provided registered broker-dealers a temporary exemption from these rules, which expires on February 11, 2013. While the Commission

## B. Exemptive Relief

Given the above requirements for the segregation of assets held as collateral under the Exchange Act, absent relief by the Commission, participants would not be able to operate in accordance with both the Exchange Act and the CEA and establish a program to commingle and portfolio margin cleared customer positions in CDS, which include both swaps and security-based swaps. The Commission has received requests to provide certain exemptive relief<sup>34</sup> to facilitate the establishment of a program providing for portfolio margining of cleared customer positions in CDS. Such a program has the potential to reduce clearing costs through the integration of clearing functions and the potential reduction of margin requirements by taking into account offsetting positions. As discussed above, Section 3E(c)(2) of the Exchange Act provides that, notwithstanding Section 3E(b) of the Exchange Act, in accordance with any terms and conditions the Commission may prescribe by rule, regulation, or order, any money, securities, or property of the security-based swaps customer of a broker, dealer, or security-based swap dealer described in Section 3E(b) of the Exchange Act may be commingled and deposited as provided in Section 3E of the Exchange Act with any other money, securities, or property received by the broker, dealer, or security-based swap dealer and required by the Commission to be separately accounted for and treated and dealt with as belonging to the security-based swaps customer of the broker, dealer, or security-based swap dealer.

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will consider the appropriate treatment of security-based swaps under the provisions of the Exchange Act not amended by the Dodd-Frank Act before expiration of the exemptions set forth in the Exchange Act Exemptive Order, including Exchange Act Rules 8c-1 and 15c2-1, the Commission believes that it is appropriate to provide relief from these rules in the context of this order. See Product Definitions Adopting Release.

<sup>34</sup> See supra notes 8 and 10.

In addition, Section 36 of the Exchange Act authorizes the Commission to conditionally or unconditionally exempt any person, security, or transaction, or any class or classes of persons, securities, or transactions, from certain provisions of the Exchange Act or certain rules or regulations thereunder, by rule, regulation, or order, to the extent that such exemption is necessary or appropriate in the public interest, and is consistent with the protection of investors.<sup>35</sup>

After careful consideration, the Commission believes that providing certain conditional exemptive relief to facilitate portfolio margining, as outlined below, is necessary or appropriate in the public interest, and is consistent with the protection of investors, because it would promote a more accurate measure of the risk of the total position of the customer based on off-setting positions. Portfolio margining would also increase efficiency and reduce costs by closely aligning the costs of maintaining a portfolio of cleared CDS to the risks presented by such a portfolio. Moreover, the conditions to the exemption will provide restrictions designed to protect money, securities, and property of a security-based swap customer, to address certain differences in the statutory requirements of the Exchange Act and CEA, and to promote appropriate risk management and disclosure.

Specifically, consistent with the discussion on the need for relief to facilitate portfolio margining outlined above under the heading “Relevant Provisions,” pursuant to Section 3E(c)(2) and Section 36 of the Exchange Act, the Commission finds that it is necessary or appropriate in the public interest and is consistent with the protection of investors to exercise its authority to grant the following conditional exemptions:<sup>36</sup>

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<sup>35</sup> 15 U.S.C. 78mm(a)(1).

<sup>36</sup> The following conditional exemptions do not in any way limit the Commission’s authority to oversee or regulate security-based swaps under the Exchange Act with

(1) An exemption from Sections 3E(b), (d), and (e) of the Exchange Act and any rules thereunder for a clearing agency registered pursuant to Section 17A of the Exchange Act and registered as a derivatives clearing organization pursuant to Section 5b of the CEA (“clearing agency/DCO”),<sup>37</sup> solely to perform the functions of a clearing agency for CDS under a program to commingle and portfolio margin CDS for customer positions; and

(2) An exemption from Sections 3E(b), (d), and (e) of the Exchange Act and Section 15(c)(3) of the Exchange Act and Rule 15c3-3 thereunder,<sup>38</sup> and from any requirement to treat an affiliate (as defined in association with the definition of “Cleared Swaps Proprietary Account” pursuant to CFTC Rule 22.1) as a customer for purposes of Exchange Act Rules 8c-1 and 15c2-1, for BD/FCMs that elect to offer a program to commingle and portfolio margin customer positions in CDS in customer accounts maintained in accordance with Section 4d(f) of the CEA and the rules thereunder.

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respect to provisions that are not subject to the exemptions, including, among others, the antifraud and anti-manipulation provisions and the Commission’s examination authority provisions.

<sup>37</sup> An entity that clears both security-based swaps and swaps is required to be dually registered as a clearing agency/DCO. See Section 17A(g) of the Exchange Act, (requiring that clearing agencies that clear security-based swaps be registered with the Commission) and Section (h) of the CEA (requiring that DCOs that clear swaps be registered with the CFTC).

<sup>38</sup> ICE Clear Credit and ICE Clear Europe also requested exemptive relief from Rules 15c3-1, 17a-3, 17a-4, 17a-5 and 17a-11(c)(2) of the Exchange Act for their members engaged in the portfolio margining program. However, compliance with these rules depends upon the application of Exchange Act Rule 15c3-3 to CDS covered by the portfolio margining program contemplated under this Order. Therefore, because the Commission is already providing conditional exemptive relief from Section 15(c)(3) of the Exchange Act and Rule 15c3-3 thereunder, the Commission does not need to provide separate exemptive relief from these provisions with respect to the portfolio margining program contemplated under this Order.

As discussed in more detail below, this relief is subject to certain conditions that are designed to help ensure the protection of money, securities, and property received from a security-based swap customer, as well as to address certain differences in the statutory requirements of the Exchange Act and CEA and promote appropriate risk management and disclosure. In particular, the conditions seek to preserve customers' ability to select between the segregation requirements and customer protections afforded a securities account subject to the Exchange Act and the requirements and protections afforded a swap account subject to the CEA, help ensure that BD/FCMs collect sufficient margin from customers to address the risk presented by this business, and help ensure that customers receive relevant disclosures about the legal framework that will apply to their CDS transactions.

C. Conditional Exemptions for Clearing Agencies/DCOs from Sections 3E(b), (d) and (e) of the Exchange Act

As summarized above, pursuant to Section 3E(c)(2) and Section 36 of the Exchange Act from Sections 3E(b), (d), and (e) of the Exchange Act and any rules thereunder, the Commission is issuing an exemption to a clearing agency/DCO. This exemption is available to a clearing agency/DCO solely to perform the functions of a clearing agency for CDS under a program to commingle and portfolio margin cleared CDS for customer positions. This exemption is subject to five conditions that are designed to help safeguard customer money, securities, and property and promote the ability of customers to select an appropriate framework for the segregation of assets.

The first two conditions are intended to provide for portfolio margining within a securities account as an alternative for customers that may desire to conduct portfolio margining under a securities account structure as opposed to in a swaps account, once the Commission adopts final rules setting forth margin and segregation requirements applicable to security-based

swaps consistent with Section 3E of the Exchange Act (“final margin and segregation rules for security-based swaps”).<sup>39</sup>

Specifically, the first condition requires that the clearing agency/DCO, by the later of (i) six months after the adoption date of the final margin and segregation rules for security-based swaps or (ii) the compliance date of such rules, take all necessary action within its control to obtain any relief needed to permit its BD/FCM clearing members to maintain customer money, securities, and property received by the BD/FCM to margin, guarantee, or secure customer positions in CDS in a segregated account established and maintained in accordance with Section 3E of the Exchange Act and any rules thereunder for the purpose of clearing (as a clearing member of the clearing agency/DCO) such customer positions under a program to commingle and portfolio margin CDS. Under this condition, a clearing agency/DCO would be required to have taken steps, by the later of six months after the adoption date of final rules or the compliance date of such rules, that are within its control to obtain relief from all appropriate regulatory agencies, including submitting any applicable request for relief and working diligently to address any questions or issues raised by regulators.<sup>40</sup>

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<sup>39</sup> The Commission has proposed margin, and segregation requirements for security-based swap dealers and major security-based swap participants. See Capital, Margin, and Segregation Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants and Capital Requirements for Broker-Dealers (“Capital, Margin, and Segregation Requirements Adopting Release”), Exchange Act Release No. 68071 (Oct. 18, 2012), 77 FR 70213 (Nov. 23, 2012), at <http://www.gpo.gov/fdsys/pkg/FR-2012-11-23/pdf/2012-26164.pdf>. Once adopted, the Commission’s rules would help establish a more permanent framework for the availability of a securities account as an alternative for customer accounts holding both security-based swaps and swaps. As a result, the Commission may provide further guidance on the application of the exemptive relief provided in this Order after the final rules related to margin and the segregation requirements of security-based swaps are adopted by the Commission.

<sup>40</sup> The Commission anticipates that the CFTC will consider appropriate regulatory action to

The second condition requires that the clearing agency/DCO, by the later of (i) six months after the adoption date of final margin and segregation rules for security-based swaps or (ii) the compliance date of such rules, take all necessary action within its control to establish rules and operational practices to permit a BD/FCM (at the BD/FCM's election) to maintain customer money, securities, and property received by the BD/FCM to margin, guarantee, or secure customer positions in cleared CDS, which include both swaps and security-based swaps, in a segregated account established and maintained in accordance with Section 3E of the Exchange Act and any rules thereunder for the purpose of clearing (as a clearing member of the clearing agency/DCO) such customer positions under a program to commingle and portfolio margin CDS. Until the clearing agency/DCO has developed such rules and operational practices, the clearing agency/DCO must have in place rules requiring BD/FCM clearing members to maintain customer money, securities, and property received to margin, guarantee, or secure customer positions consisting of cleared CDS, which include both swaps and security-based swaps, in a segregated account established and maintained in accordance with Section 4d(f) of the CEA and rules thereunder for the purpose of clearing (as a clearing member of the clearing agency/DCO) such customer positions under a program to commingle and portfolio margin CDS. This condition would ensure that all customer assets are segregated and subject to appropriate regulatory oversight.

Some commenters raised certain issues associated with a requirement that market participants be provided a choice in account structure. Specifically, ICE Clear Credit stated that offering customers a choice would require changes at ICE Clear Credit and each of its participant

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facilitate portfolio margining.

BD/FCMs and result in needless additional costs.<sup>41</sup> ICE Clear Credit stated that few, if any, customers would choose an account established in accordance with Section 3E of the Exchange Act instead of an account established in accordance with Section 4d(f) of the CEA.<sup>42</sup> Another commenter also stated that granting the petition now would not prohibit customers from later choosing a different portfolio margining option under a Section 3E account structure, if made available.<sup>43</sup>

The Commission appreciates the benefits of providing relief to facilitate portfolio margining now while maintaining discretion for customers to later choose a different portfolio margining option under a Section 3E account structure when it becomes available. The Commission believes that it is important to ultimately provide market participants with the ability to select an account structure to manage their individual risks by taking into account the different regulatory provisions that may apply to different accounts types and that any costs incurred in providing such an option would be based on existing obligations that clearing agencies and markets participants have under Section 3E of the Exchange Act in connection with the clearing of security-based swaps in accordance with Section 3E of the Exchange Act. Accordingly, the Commission is imposing these two conditions in order to facilitate the ability of customers to choose an alternative account option in the future, once the Commission adopts final margin and segregation rules for security-based swaps.<sup>44</sup>

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<sup>41</sup> See ICE Letter.

<sup>42</sup> Id.

<sup>43</sup> See MFA Letter.

<sup>44</sup> The choice of the type of portfolio margining account structure (i.e., security account or swap account) would be made by each intermediary (i.e., BD/FCM) for the benefit of its

The third condition requires the clearing agency/DCO to have obtained any other relief needed to permit a BD/FCM that is a clearing member (at the BD/FCM's election) to maintain customer money, securities, and property received by the BD/FCM to margin, guarantee, or secure customer positions in cleared CDS, which include both swaps and security-based swaps, in a segregated account established and maintained in accordance with Section 4d(f) of the CEA and rules thereunder for the purpose of clearing (as a clearing member of the clearing agency/DCO) such customer positions under a program to commingle and portfolio margin CDS. The conditional exemptions from the requirements under the Exchange Act are based in part on the applicability of the regulatory regime under the CEA. This condition is designed to help ensure the exemption from the Exchange Act regulatory framework would apply only in circumstances where the regulatory regime under the CEA is applicable.

The fourth condition requires the clearing agency/DCO to have appropriate rules and operational practices to permit a BD/FCM that is a clearing member (at the BD/FCM's election) to maintain customer money, securities, and property received by the BD/FCM to margin, guarantee, or secure customer positions in cleared CDS, which include both swaps and security-based swaps, in a segregated account established and maintained in accordance with Section 4d(f) of the CEA and rules thereunder for the purpose of clearing (as a clearing member of the clearing agency/DCO) such customer positions under a program to commingle and portfolio margin CDS. Similar to the prior condition, this condition is designed to help ensure the

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customers, while the clearing agency would be expected to maintain the capacity to allow the intermediary, acting as a clearing member, to select either option. This optionality also will further efforts to achieve more fully the benefits of risk-based portfolio margining, by giving to customers the choice of portfolio margining in a single futures or securities account at a dually-registered BD/FCM. See A Joint Report of the SEC and the CFTC on Harmonization of Regulation (Oct. 19, 2009) "Joint Report".

exemption from the Exchange Act regulatory framework would apply only in circumstances where the regulatory regime under the CEA is applicable.

The fifth condition requires the clearing agency/DCO to have rules mandating that each customer of the BD/FCM participating in a program to commingle and portfolio margin CDS shall be an “eligible contract participant” as defined in Section 1a(18) of the CEA. Persons that are not eligible contract participants may lack the expertise or resources to effectively determine the risks associated with engaging in these types of transactions.<sup>45</sup> Accordingly, the Commission believes it is appropriate to provide conditions that would limit the applicability of the exemptions to customers that are eligible contract participants.

- D. Conditional exemption for BD/FCMs that elect to offer a program to commingle and portfolio margin customer positions in CDS in customer accounts maintained in accordance with Section 4d(f) of the CEA and rules thereunder.

As summarized above, the Commission is issuing an exemption to BD/FCMs from Exchange Act Sections 3E(b), (d), and (e), and Section 15(c)(3) and Rule 15c3-3 thereunder, as well as an exemption from any requirement to treat an affiliate (as defined in association with the

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<sup>45</sup> The Dodd-Frank Act limits the swaps and security-based swap transactions that may be entered into by parties that are not eligible contract participants. For example, under the Dodd-Frank Act, only an eligible contract participant may enter into security-based swaps that are not on a national securities exchange. See Exchange Act Section 6(l), 15 U.S.C. 78f(l) (added by Section 763(e) of the Dodd-Frank Act). In addition, security-based swaps that are not registered pursuant to the Securities Act of 1933 (“Securities Act”) can only be sold to eligible contract participants. See Securities Act Section 5(d), 15 U.S.C. 77e(d) (added by Section 768(b) of the Dodd-Frank Act). Securities Act Section 5(d) specifically provides that it is unlawful to offer to buy, purchase, or sell a security-based swap to any person that is not an eligible contract participant, unless the transaction is registered under the Securities Act. Id. Given that Congress determined it is appropriate to include these limitations in the Dodd-Frank Act with respect to eligible contract participants, we believe it is appropriate to limit the exemptions in this Order to CDS entered into with eligible contract participants.

definition of “Cleared Swaps Proprietary Account” pursuant to CFTC Rule 22.1)<sup>46</sup> as a customer for purposes of Exchange Act Rules 8c-1 and 15c2-1, provided that the BD/FCM complies with the conditions to the exemption discussed below. This exemption is available to BD/FCMs solely to perform the functions of a BD/FCM for CDS with respect to any customer money, securities, and property received by the BD/FCM to margin, guarantee, or secure cleared customer positions in security-based swaps included in a segregated account established and maintained in accordance with Section 4d(f) of the CEA and the rules thereunder under a program to commingle and portfolio margin customer positions in cleared CDS.

The exemption is subject to six conditions that are designed to permit such BD/FCMs to participate in a program to commingle and portfolio margin customer positions in cleared CDS while helping to ensure the protection of customer securities and funds. The first two conditions of this exemption relate to the segregation of customer positions in CDS and impose separate requirements for customers that are not affiliates of the BD/FCM and customers that are affiliates of the BD/FCM.<sup>47</sup> The remaining conditions apply generally to all BD/FCMs participating in the program – regardless of whether they deal with customers that are affiliates of the BD/FCM – and relate to the risk management and other safeguards the BD/FCM must have in place in order to rely on the exemption. Among other things, these conditions establish minimum margin levels and disclosure requirements.

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<sup>46</sup> 17 CFR 22.1. The definition of “Cleared Swaps Proprietary Account” was recently adopted by the CFTC and is substantially similar to the definition of “Proprietary Account” for futures contracts in regulation 1.3. See Protection of Cleared Swaps Customer Contracts and Collateral; Conforming Amendments to the Commodity Broker Bankruptcy Provisions, 77 FR 6336 (Feb. 7, 2012).

<sup>47</sup> “Customer” for purposes of this exemption has the same meaning as in Exchange Act Rules 15c2-1 and 8c2-1.

The first condition consists of two requirements and applies with respect to transactions involving customers that are not affiliates<sup>48</sup> of the BD/FCM.

First, the BD/FCM must maintain customer money, securities, and property received to margin, guarantee or secure customer positions consisting of cleared CDS, which include both swaps and security-based swaps, in a segregated account established and maintained in accordance with Section 4d(f) of the CEA and rules thereunder for the purpose of clearing (as a clearing member or through a clearing member of a clearing agency/DCO operating pursuant to the exemption in this Order) such customer positions under a program to commingle and portfolio margin CDS. This condition is designed to help ensure that the exemption under this Order would apply only in circumstances where customer money, securities, and property are maintained in a segregated account pursuant to the regulatory regime under the CEA.

Second, the BD/FCM must enter into a non-conforming subordination agreement<sup>49</sup> with each customer that is not an affiliate regarding all customer money, securities, or property held in a segregated account established and maintained in accordance with Section 4d(f) of the CEA and rules thereunder under a program to commingle and portfolio margin CDS. The non-

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<sup>48</sup> See supra notes 31 and 32 and accompanying text.

<sup>49</sup> The term “non-conforming subordination agreement” is used broadly to refer to a subordination agreement between a broker-dealer and its client where the client agrees to subordinate its claims to the claims of all customers and other creditors of the broker-dealer. Non-conforming subordination agreements have previously been used in limited circumstances to permit broker-dealer affiliates to be treated as non-customers for purposes of Exchange Act Rule 15c3-3 to allow the positions of the affiliate to be commingled with the positions of the clearing member. See, e.g., Letter from Michael A. Macchiaroli, Associate Director, Division of Market Regulation, to William H. Navin, EVP and General Counsel, The Options Clearing Corporation (June 15, 2000). See also Statement of the SEC Division of Trading and Markets Regarding the Protection of Customer Assets, Sept. 20, 2008 (available at <http://www.sec.gov/news/press/2008/2008-216.htm>).

conforming subordination agreement must contain: (i) a specific acknowledgment by the customer that such money, securities or property will not receive customer treatment under the Exchange Act or Securities Investor Protection Act of 1970 (“SIPA”) or be treated as customer property as defined in 11 U.S.C. 741 in a liquidation of the BD/FCM, and that such money, securities or property will be subject to any applicable protections under Subchapter IV of Chapter 7 of Title 11 of the United States Code and rules and regulations thereunder; and (ii) an affirmation by the customer that all of its claims with respect to such money, securities, or property against the BD/FCM will be subordinated to the claims of other securities customers and security-based swaps customers not operating under a program to commingle and portfolio margin CDS pursuant to this Order. The Commission believes that this condition, along with the disclosure conditions discussed below, should help to ensure that customers clearly understand that any customer protection treatment otherwise available with respect to securities transactions under the Exchange Act, SIPA or the stockbroker liquidation provisions will not be available for CDS held in an account maintained in accordance with Section 4d(f) of the CEA.

One commenter similarly requested clarity about how CDS commingled in a Section 4d(f) account would be treated in the event of the bankruptcy of a BD/FCM.<sup>50</sup> The commenter requested that the Commission and the CFTC clarify and confirm in any approval of ICE Clear Credit’s request for relief that commingled accounts held in accordance with the segregation requirements of Section 4d(f) of the CEA would be a cleared swaps customer account for customers trading swaps and would be treated as such under the Bankruptcy Code (rather than a

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<sup>50</sup> See ICI Letter.

securities account subject to SIPA).<sup>51</sup> The Commission believes it is critical for the protection of customer's assets to clarify at the outset the rights of customers, generally, in the event of a bankruptcy of the BD/FCM, and believes that the subordination agreement condition discussed herein, in conjunction with disclosure condition described below, should help provide customers with clarity that the segregation requirements of the Exchange Act and any protections of SIPA and the stockbroker liquidation provisions will not apply to customer positions in CDS that are security-based swaps and are held in a Section 4d(f) account.<sup>52</sup>

The second condition applies with respect to transactions involving customers that are affiliates of the BD/FCM and consists of three requirements.

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<sup>51</sup> Id.

<sup>52</sup> In response to statements in the ICE Letter regarding what occurs when there is a shortfall in customer property in a broker-dealer bankruptcy or SIPA liquidation versus an FCM bankruptcy, the Commission notes that SIPA provides protections to customers that give them priority over general creditors. See Joint Report, supra, note 44, at 39-40. First, in the case of a shortfall in customer property held by a broker-dealer, SIPA and the stockbroker liquidation provisions of the Bankruptcy Code provides that customer property may be supplemented with other property in certain circumstances. See 15 U.S.C. 78lll(4)(E); 15 U.S.C. 78fff-2(c)(3); 11 U.S.C. 741(4)(A)(iv); and 11 U.S.C. 749. In a SIPA liquidation, to the extent customer property and SIPC advances (up to \$500,000 per customer, including a maximum of \$250,000 for cash claims) are not sufficient to pay or otherwise satisfy in full the net equity claims of customers, such customers are entitled, to the extent only of their respective unsatisfied net equities, to participate in the general estate as unsecured creditors.

In response to statements in the ICE Letter that the SIPA insolvency rules do not appear to provide assurances for a prompt liquidation, the Commission notes that SIPA and Commission regulations contemplate expeditious transfer of customer accounts through self-liquidation or a proceeding under SIPA. In general, if the books and records of the broker-dealer are in order and customer accounts are properly margined, customer accounts may be transferred to another broker-dealer in a process known as a bulk transfer. See Joint Report, supra, note 44, at 40.

First, the BD/FCM must maintain affiliate money, securities, and property received to margin, guarantee, or secure positions consisting of cleared CDS, which include both swaps and security-based swaps, in a Cleared Swaps Proprietary Account for the purpose of clearing (as a clearing member of a clearing agency/DCO operating pursuant to the exemption in this Order) such positions under a program to commingle and portfolio margin CDS. The purpose of this requirement is to ensure that a program to commingle and portfolio margin CDS will conform to the regulatory regime of the CFTC, under which certain affiliates are not treated as customers.<sup>53</sup> Specifically, the money, securities, and property of a customer that is an affiliate of the BD/FCM must be held in a Cleared Swaps Proprietary Account in accordance with the CFTC regime.<sup>54</sup>

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<sup>53</sup> Under CFTC regulations, an account in which Cleared Swaps and associated collateral of applicable affiliates of an FCM are held is classified as a proprietary account. See 17 CFR 22.1. As previously noted, the Commission believes the relief being provided with respect to affiliates of a BD/FCM is appropriate because absent an exemption, affiliates of a BD/FCM that are not otherwise excluded from the definition of customer in the hypothecation rules (*i.e.*, Exchange Act Rules 8c-1 and 15c2-1) are customers whose securities positions cannot be commingled with the broker-dealer's own proprietary securities positions and therefore could not be held in Cleared Swap Proprietary Account as required under the CFTC regime.

<sup>54</sup> The Commission has previously granted similar relief to non-broker-dealer affiliates of members of a registered clearing agency. See Letter from Michael A. Macchiaroli, Associate Director, Division of Market Regulation, to William H. Navin, EVP and General Counsel, The Options Clearing Corporation (June 15, 2000). The no-action relief included terms that required each non-broker-dealer member affiliate whose securities positions would be hypothecated to consent to being treated as a non-customer and to execute a non-conforming subordination agreement meeting certain criteria accompanied by an opinion of counsel regarding the legal authority of the member affiliate to so subordinate its claims. In connection with the no action relief, the Commission approved a proposed rule change filed by OCC to allow an affiliate of an OCC clearing member to designate itself as a non-customer under the Commission's hypothecation rules and OCC's By-Laws and Rules in order for the affiliate's transactions and positions to be commingled in its clearing member's firm and/or proprietary cross-margin account. See Self-Regulatory Organizations; The Options Clearing Corporation; Order Granting Approval of Proposed Rule Change Relating to Clearing Member

Second, the BD/FCM must enter into a non-conforming subordination agreement<sup>55</sup> with each affiliate regarding all customer money, securities, or property held in a segregated account established and maintained in accordance with Section 4d(f) of the CEA and rules thereunder under a program to commingle and portfolio margin CDS. The non-conforming subordination agreement must contain: (i) a specific acknowledgment by the affiliate that such money, securities or property will not receive customer treatment under the Exchange Act or SIPA or be treated as customer property as defined in 11 U.S.C. 741 in a liquidation of the BD/FCM, and that such money, securities or property will be held in a proprietary account in accordance with the CFTC requirements and will be subject to any applicable protections under Subchapter IV of Chapter 7 of Title 11 of the United States Code and rules and regulations thereunder; and (ii) an affirmation by the affiliate that all of its claims with respect to such money, securities, or property against the BD/FCM will be subordinated to the claims of other securities customers and security-based swap customers not operating under a program to commingle and portfolio margin CDS pursuant to this Order. The Commission believes that this requirement should help to ensure that affiliates clearly understand that any customer protection treatment otherwise available with respect to securities transactions under the Exchange Act, SIPA or the stockbroker

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Affiliates, Exchange Act Release No. 43668 (Dec. 4, 2000), 65 FR 77413 (Dec. 11, 2000).

<sup>55</sup> Under Exchange Act Rule 15c3-1, a broker-dealer can exclude from its liabilities a subordinated loan that has been approved by its designated examining authority (“DEA”) for purposes determining its net capital. See 17 CFR 240.15c3-1(c)(2)(ii) and 15c3-1d. A non-conforming subordinated loan is one that the DEA has not approved and, therefore, cannot be used to exclude the liability arising from the loan agreement. See Letter from Michael A. Macchiaroli, Associate Director, Division of Market Regulation, to William H. Navin, EVP and General Counsel, The Options Clearing Corporation (June 15, 2000).

liquidation provisions will not be available and the account would be treated as a proprietary account (and not a customer account) under the CEA.

Third, the BD/FCM must obtain from the affiliate an opinion of counsel that the affiliate is legally authorized to subordinate all of its claims against the BD/FCM to those of other customers. The Commission believes that this condition is appropriate to help ensure that affiliates of the BD/FCM do not place in a proprietary account any assets that the affiliate is not legally authorized to subordinate.

The remaining conditions are applicable generally to all BD/FCMs operating pursuant to the exemption in this Order, regardless of whether they deal with customers that are affiliates of the BD/FCM.

The third condition to this exemption states that the BD/FCM must set minimum margin levels, with respect to any customer transaction in a program to commingle and portfolio margin CDS, at least equal to the amount determined using a margin methodology established and maintained by the BD/FCM that has been approved in writing by the Commission or the Commission staff. In conducting this review function, the Commission intends that the Commission staff will consult with the CFTC staff and take into consideration the margin methodology used by the clearing agency/DCO in setting customer margin levels under the CFTC risk management regulations.<sup>56</sup> This condition is designed to help assure that consistent customer margin requirements apply to the BD/FCM, regardless of the type of account in which a security (including security-based swap) is held, and that the BD/FCM is requiring minimum

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<sup>56</sup> See 17 CFR 39.13 (CFTC risk management regulations applicable to DCOs). In appropriate circumstances, the Commission or the Commission staff may provide temporary approval of a BD/FCM's margin methodology while the methodology is still being evaluated prior to granting final approval.

margin that adequately measures the risk in the customer's CDS portfolio in a manner consistent with its appropriate internal risk management procedures.<sup>57</sup> This approach will promote the establishment of consistent margin levels for securities across account types, which in turn will mitigate the risk that clearing agency/DCOs will compete by implementing lower margin levels and help ensure that margin levels are set at sufficiently prudent levels to reduce systemic risk. Finally, the Commission intends that the Commission staff will work with the CFTC staff to see that trading under the program will facilitate both capital efficiency and prudent risk management.

A BD/FCM seeking approval for a margin methodology would be expected to submit sufficient information for the Commission or Commission staff<sup>58</sup> to be able to make a determination regarding the performance of the firm's margin methodology.<sup>59</sup> In reviewing this information, the Commission or the Commission staff will be guided by the standards prescribed in Appendix E of Exchange Act Rule 15c3-1, to the extent relevant to the portfolio margining of

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<sup>57</sup> Nothing in this Order will preclude an FCM from setting a higher margin level for some or all of its customers. See 17 CFR 39.13(g)(8).

<sup>58</sup> The Commission expects and intends that the Financial Industry Regulatory Authority ("FINRA") will be actively involved in reviewing risk management systems and procedures, including margin methodologies, used by BD/FCMs seeking to participate in the program. FINRA has a defined and vital interest in seeing that its members use portfolio margining arrangements involving securities, including security-based swaps, in a manner that is prudent and fully accounts for all the risks that they incur in connection with such arrangements.

<sup>59</sup> If a BD/FCM's margin methodology is approved for purposes of this exemption, the performance of the methodology would be subject to ongoing regulatory supervision, and the BD/FCM would be expected to submit for approval any material changes to its margin methodology.

cleared CDS that are swaps and security-based swaps.<sup>60</sup> In reviewing the BD/FCM's submitted margin methodology, we expect that the Commission or Commission staff would consider, among other things, whether the type and amount of securities permitted to be held for margin purposes are restricted to those which would facilitate the portfolio margining program and whether the BD/FCM's VaR model meets the standards set forth in Appendix E to Exchange Act Rule 15c3-1, as applicable.<sup>61</sup> In cases where a BD/FCM proposes to use a standardized, rather than model-based, methodology, the Commission or Commission staff would consider whether the methodology could be expected to be at least as conservative in setting margin amounts as a model meeting the requirements just described.

By conducting this review, the Commission will be approving margin methodologies for customer positions in securities as well as non-securities held in a portfolio margin account. Due to the nature of portfolio margining, in which the margin methodology is applied to all positions in an account as a single portfolio, security-based swaps cannot be singled out for margin treatment that differs from the treatment applied to swaps. This order by its terms does not apply to, and the Commission is not seeking to establish margin requirements with respect to, accounts that hold no positions in security-based swaps.

The fourth condition requires that the BD/FCM be in compliance with applicable laws and regulations relating to risk management, capital, and liquidity, and be in compliance with

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<sup>60</sup> See generally 17 CFR 240.15c3-1e(a). Information submitted as part of such application shall be accorded confidential treatment, subject to provisions of applicable law.

<sup>61</sup> The amount and type of securities held for margin purposes should be commensurate with the risk and activity contained in the portfolio margining program and must not be designed to evade the requirements generally applicable to securities pursuant to Exchange Act Rule 15c3-3.

applicable clearing agency/DCO rules and CFTC requirements (including segregation and related books and records provisions) for accounts established and maintained in accordance with Section 4d(f) of the CEA and rules thereunder and subject to a program to commingle and portfolio margin CDS. The purpose of this condition is to help assure that the exemption under this Order is available only where the applicable regulatory requirements are appropriately followed.

The fifth condition requires that each customer of the BD/FCM participating in a program to commingle and portfolio margin CDS be an “eligible contract participant” as defined in Section 1a(18) of the CEA. Similar to the condition under the exemption for clearing agencies/DCOs, the Commission believes that it is appropriate to limit the availability of this exemption to eligible contract participants, as persons that are not eligible contract participants may lack the expertise or resources to effectively determine the risks associated with engaging in these types of transactions.

The sixth and final condition requires that, before receiving any money, securities, or property of a customer to margin, guarantee, or secure positions consisting of cleared CDS, which include both swaps and security-based swaps, under a program to commingle and portfolio margin CDS, the BD/FCM must furnish to the customer a disclosure document containing (i) a statement indicating that the customer’s money, securities, and property will be held in an account maintained in accordance with the segregation requirements of Section 4d(f) of the CEA and that the customer has elected to seek protections under Subchapter IV of Chapter 7 of Title 11 of the United States Code and the rules and regulations thereunder with respect to such money, securities, and property, and (ii) a statement that the broker-dealer segregation requirements of Section 15(c)(3) and Section 3E of the Exchange Act and the rules thereunder,

and any customer protections under SIPA and the stockbroker liquidation provisions, will not apply to such customer money, securities, and property. The disclosure document may be provided to a customer at or prior to the time that the customer opens an account to commingle and portfolio margin CDS positions in accordance with Section 4d(f) of the CEA, but must be provided prior to the BD/FCM receiving any money, securities or property to margin, guarantee or secure positions consisting of cleared CDS, which include both swaps and security-based swaps, under a program to commingle and portfolio margin CDS. The Commission believes that this condition will help to provide market participants that elect to participate in a portfolio margining arrangement, as contemplated under this Order, with important disclosures regarding the legal framework that will govern their transactions. As noted above, the Commission views the disclosure requirements as essential to highlight to customers who elect to commingle and portfolio margin their positions in CDS in accounts maintained in accordance with Section 4d(f) of the CEA that the account will be governed by the segregation requirements under the CFTC's regulatory regime and that any protections under the SIPA will not be available to the account in the event of insolvency.<sup>62</sup>

### **III. Solicitation of Comments**

The Commission requests comment on this exemption for clearing agencies/DCOs and BD/FCMs. The Commission is soliciting public comment on all aspects of this exemption, including whether other conditions should apply. If so, what conditions and why?

### **IV. Conclusion**

IT IS HEREBY ORDERED, pursuant to Section 3E(c)(2) and Section 36(a) of the Exchange Act, the following exemptions from Exchange Act requirements will apply:

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<sup>62</sup> See supra note 52 and associated text.

(a) Exemption for dually registered clearing agencies/derivatives clearing organizations.

A clearing agency registered pursuant to Section 17A of the Exchange Act and registered as a derivatives clearing organization pursuant to Section 5b of the CEA (a “clearing agency/DCO”) shall be exempt from Sections 3E(b), (d), and (e) of the Exchange Act and any rules thereunder, solely to perform the functions of a clearing agency for CDS under a program to commingle and portfolio margin cleared CDS for customer positions, subject to the following conditions:

- (1) The clearing agency/DCO, by the later of (i) six months after the adoption date of final rules setting forth margin and segregation requirements applicable to security-based swaps consistent with Section 3E of the Exchange Act or (ii) the compliance date of such rules, takes all necessary action within its control to obtain any relief needed to permit its clearing members that are registered under Section 15(b) of the Exchange Act (other than paragraph (11) thereof) and also registered as a futures commission merchant pursuant to Section 4f(a)(1) of the CEA (a “BD/FCM”) (at the BD/FCM’s election), to maintain customer money, securities, and property received by the BD/FCM to margin, guarantee, or secure customer positions in cleared CDS, which include both swaps (as defined in Section 1(a)(47) of the CEA and the rules thereunder) and security-based swaps (as defined in Section 3(g)(68) of the Exchange Act and the rules thereunder), in a segregated account established and maintained in accordance with Section 3E of the Exchange Act and any rules thereunder for the purpose of clearing (as a clearing member of the clearing agency/DCO) such customer positions under a program to commingle and portfolio margin CDS.
- (2) The clearing agency/DCO, by the later of (i) six months after the adoption date of final rules setting forth margin and segregation requirements applicable to security-based

swaps consistent with Section 3E of the Exchange Act or (ii) the compliance date of such rules, takes all necessary action within its control to establish rules and operational practices to permit a BD/FCM (at the BD/FCM's election) to maintain customer money, securities, and property received by the BD/FCM to margin, guarantee, or secure customer positions in cleared CDS, which include both swaps and security-based swaps, in a segregated account established and maintained in accordance with Section 3E of the Exchange Act and any rules thereunder for the purpose of clearing (as a clearing member of the clearing agency/DCO) such customer positions under a program to commingle and portfolio margin CDS. Until such rules and operational practices have been developed, pursuant to the clearing agency/DCO's rules, clearing members that are BD/FCMs must maintain customer money, securities, and property received to margin, guarantee, or secure customer positions consisting of cleared CDS, which include both swaps and security-based swaps, in a segregated account established and maintained in accordance with Section 4d(f) of the CEA and rules thereunder for the purpose of clearing (as a clearing member of the clearing agency/DCO) such customer positions under a program to commingle and portfolio margin CDS.

- (3) The clearing agency/DCO has obtained any other relief needed to permit a BD/FCM that is a clearing member (at the BD/FCM's election) to maintain customer money, securities, and property received by the BD/FCM to margin, guarantee, or secure customer positions in cleared CDS, which include both swaps and security-based swaps, in a segregated account established and maintained in accordance with Section 4d(f) of the CEA and rules thereunder for the purpose of clearing (as a clearing member of the clearing

agency/DCO) such customer positions under a program to commingle and portfolio margin CDS.

(4) The clearing agency/DCO has appropriate rules and operational practices to permit a BD/FCM that is a clearing member (at the BD/FCM's election) to maintain customer money, securities, and property received by the BD/FCM to margin, guarantee, or secure customer positions in cleared CDS, which include both swaps and security-based swaps, in a segregated account established and maintained in accordance with Section 4d(f) of the CEA and rules thereunder for the purpose of clearing (as a clearing member of the clearing agency/DCO) such customer positions under a program to commingle and portfolio margin CDS.

(5) The rules of the clearing agency/DCO require that each customer of the BD/FCM participating in a program to commingle and portfolio margin CDS shall be an "eligible contract participant" as defined in Section 1a(18) of the CEA.

(b) Exemption for certain BD/FCMs that elect to offer a program to commingle and portfolio margin customer positions in CDS in customer accounts maintained in accordance with Section 4d(f) of the CEA and rules thereunder.

Solely to perform the functions of a BD/FCM for cleared CDS, with respect to any customer money, securities, and property received by the BD/FCM to margin, guarantee, or secure customer positions in security-based-swaps included in a segregated account established and maintained in accordance with Section 4d(f) of the CEA and rules thereunder under a program to commingle and portfolio margin customer positions in CDS, a BD/FCM shall be exempt from Exchange Act Sections 3E(b), (d), and (e), and Section 15(c)(3) and Rule 15c3-3 thereunder and any requirement to treat an affiliate (as defined in association with the definition of "Cleared

Swaps Proprietary Account” pursuant to CFTC Rule 22.1) as a customer for purposes of Exchange Act Rules 8c-1 and 15c2-1, subject to the following conditions:

- (1) With respect to customers that are not affiliates of the BD/FCM,
  - (i) the BD/FCM shall maintain customer money, securities, and property received to margin, guarantee or secure customer positions consisting of cleared CDS, which include both swaps and security-based swaps, in a segregated account established and maintained in accordance with Section 4d(f) of the CEA and rules thereunder for the purpose of clearing (as a clearing member or through a clearing member of a clearing agency/DCO operating pursuant to the exemption in paragraph (a) above) such customer positions under a program to commingle and portfolio margin CDS; and
  - (ii) the BD/FCM shall enter into a non-conforming subordination agreement with each customer. The agreement must contain a specific acknowledgment by the customer that such money, securities or property will not receive customer treatment under the Exchange Act or SIPA or be treated as customer property as defined in 11 U.S.C. 741 in a liquidation of the BD/FCM and that such money, securities or property will be subject to any applicable protections under Subchapter IV of Chapter 7 of Title 11 of the United States Code and rules and regulations thereunder; as well as an affirmation by the customer that all of its claims with respect to such money, securities, or property against the BD/FCM will be subordinated to the claims of other securities customers and security-based swap customers not operating under a program to commingle and portfolio margin CDS pursuant to this Order.

- (2) With respect to customers that are affiliates of the BD/FCM,
- (i) the BD/FCM maintains money, securities, and property of affiliates received to margin, guarantee, or secure positions consisting of cleared CDS, which include both swaps and security-based swaps, in a Cleared Swaps Proprietary Account for the purpose of clearing (as a clearing member of a clearing agency/DCO operating pursuant to the exemption in paragraph (a) above) such positions under a program to commingle and portfolio margin CDS;
  - (ii) the BD/FCM enters into a non-conforming subordination agreement with each affiliate. The agreement must contain a specific acknowledgment by the affiliate that such money, securities or property will not receive customer treatment under the Exchange Act or SIPA or be treated as customer property as defined in 11 U.S.C. 741 in a liquidation of the BD/FCM, and that such money, securities or property will be held in a proprietary account in accordance with the CFTC requirements and will be subject to any applicable protections under Subchapter IV of Chapter 7 of Title 11 of the United States Code and rules and regulations thereunder; as well as an affirmation by the affiliate that all of its claims with respect to such money, securities, or property against the BD/FCM will be subordinated to the claims of other securities customers and security-based swap customers not operating under a program to commingle and portfolio margin CDS pursuant to this Order; and
  - (iii) the BD/FCM obtains from the affiliate an opinion of counsel that the affiliate is legally authorized to subordinate all of its claims against the BD/FCM to those of customers.

- (3) The BD/FCM requires minimum margin levels with respect to any customer transaction in a program to commingle and portfolio margin CDS at least equal to the amount determined using a margin methodology established and maintained by the BD/FCM that has been approved by the Commission or the Commission staff.
- (4) The BD/FCM must be in compliance with applicable laws and regulations relating to risk management, capital, and liquidity, and shall be in compliance with applicable clearing agency/DCO rules and CFTC requirements (including segregation and related books and records provisions) for accounts established and maintained in accordance with Section 4d(f) of the CEA and rules thereunder and subject to a program to commingle and portfolio margin CDS.
- (5) Each customer of the BD/FCM participating in a program to commingle and portfolio margin CDS is an “eligible contract participant” as defined in Section 1a(18) of the CEA.
- (6) Before receiving any money, securities, or property of a customer to margin, guarantee, or secure positions consisting of cleared CDS, which include both swaps and security-based swaps, under a program to commingle and portfolio margin CDS, the BD/FCM must furnish to the customer a disclosure document containing the following information:
  - (i) a statement indicating that the customer’s money, securities, and property will be held in an account maintained in accordance with the segregation requirements of Section 4d(f) of the CEA and that the customer has elected to seek protections under Subchapter IV of Chapter 7 of Title 11 of the United States Code and the rules and regulations thereunder with respect to such money, securities, and property; and

- (ii) a statement that the broker-dealer segregation requirements of Section 15(c)(3) and Section 3E of the Exchange Act and the rules thereunder, and any customer protections under SIPA and the stockbroker liquidation provisions, will not apply to such customer money, securities, and property.

## **V. Paperwork Reduction Act**

Certain provisions of this Order contain “collection of information requirements” within the meaning of the Paperwork Reduction Act of 1995.<sup>63</sup> The Commission has submitted this Order to the Office of Management and Budget (“OMB”) for review in accordance with 44 U.S.C. 3507(d) and 5 CFR 1320.11. An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a currently valid control number.

### **A. Collection of Information**

The Commission found it necessary or appropriate in the public interest and consistent with the protection of investors to grant the conditional exemptions discussed in this Order. Among other things, the Order would require BD/FCMs that elect to offer a program to commingle and portfolio margin customer positions in CDS in customer accounts maintained in accordance with Section 4d(f) of the CEA and rules thereunder, to obtain certain agreements and opinions from its customers regarding the applicable regulatory regime, and to make certain disclosures to its customers before receiving any money, securities, or property of a customer to margin, guarantee, or secure positions consisting of cleared CDS, which include both swaps and security-based swaps, under a program to commingle and portfolio margin CDS. The Order

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<sup>63</sup> 44 U.S.C. 3501 et. seq.

would also require BD/FCMs that elect to offer a program to commingle and portfolio margin CDS positions in customer accounts maintained in accordance with Section 4d(f) of the CEA and rules thereunder, to maintain minimum margin levels using a margin methodology approved by the Commission or the Commission staff.

**B. Proposed Use of Information**

The collection of information requirements are designed, among other things, to provide appropriate agreements, disclosures, and opinions to BD/FCM customers to clarify key aspects of the regulatory framework that will govern their participation in a program to commingle and portfolio margin CDS positions and to ensure that appropriate levels of margin are collected.

**C. Respondents**

The collections of information as required by this Order would apply to those BD/FCMs that are seeking to offer a program to commingle and portfolio margin customer positions in CDS in customer accounts maintained in accordance with Section 4d(f) of the CEA. Based on conversations with industry participants and the Commission's market oversight experience, the Commission estimates that approximately 57 firms would be likely to participate in the CDS market in the future.<sup>64</sup> Consequently, the Commission estimates that approximately 57 firms may seek to avail themselves of the conditional exemptive relief provided in this Order.

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<sup>64</sup> Based on a review of FOCUS reports filed with the Commission there are approximately 57 broker-dealers that also completed the Commodity Futures Account segregation page on the FOCUS report and therefore would be BD/FCMs. The Commission is assuming that all 57 BD/FCMs would be likely to participate in the CDS market. In addition, the Commission notes it had previously estimated that approximately 50 entities may fit within the definition of security-based swap dealer ("SBSD") and up to 5 entities may fit within the definition of major security-based swap participant ("MSBSP"). See Registration of Security-Based Swap Dealers and Major Security-Based Swap Participants, Exchange Act Release No. 65543 (Oct. 12, 2011), 76 FR 65784 (Oct. 24, 2011), at 65808. The Commission believes that the number of BD/FCMs likely to

#### **D. Total Annual Reporting and Recordkeeping Burden**

Paragraph IV(b)(1)(ii) of this Order applies with respect to customers that are not affiliates of the BD/FCM and requires BD/FCMs that elect to offer a program to commingle and portfolio margin customer positions in CDS in customer accounts maintained in accordance with Section 4d(f) of the CEA and rules thereunder to enter into a non-conforming subordination agreement with the non-affiliate customer. The non-conforming subordination agreement must contain: (i) a specific acknowledgment by the customer that such money, securities or property will not receive customer treatment under the Exchange Act or SIPA or be treated as customer property as defined in 11 U.S.C. 741 in a liquidation of the BD/FCM and that such money, securities or property will be subject to any applicable protections under Subchapter IV of Chapter 7 of Title 11 of the United States Code and rules and regulations thereunder; and (ii) an affirmation by the customer that all of its claims with respect to such money, securities, or property against the BD/FCM will be subordinated to the claims of other securities customers and security-based swap customers not operating under a program to commingle and portfolio margin CDS pursuant to this Order.

The Commission estimates that the average number of non-affiliate CDS customers of a BD/FCM to be approximately 1,000<sup>65</sup> and the average number of hours to develop a

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engage in the CDS business would be approximately equal to the previously estimated number of security-based swap dealers and major security-based swap participants given that CDS make up a significant portion of the current security-based swap market.

<sup>65</sup> This estimate is based on a previous estimate in the Capital Margin and Segregation Release that each of SBSB and MSBSP has 1,000 counterparties at any given time. See Capital, Margin, and Segregation Requirements Adopting Release. Commission staff believes that the number of counterparties of a SBSB or MSBSP may likely be equivalent to the number of customers of a BD/FCM that may participate in a portfolio margining program for customer positions in cleared CDS offered by the BD/FCM. However, as

subordination agreement for each non-affiliate CDS customer to be approximately 20 hours. In addition, based on a consultation with industry representatives, the Commission estimates that each non-affiliate customer will do business with more than one BD/FCM, averaging out to 2.5 BD/FCMs per customer. Consequently, the Commission estimates the total one-time burden associated with this requirement to be 2,850,000 hours.<sup>66</sup> In addition, because the BD/FCM would enter into these agreements with CDS customers, the Commission staff estimates that a BD/FCM would have outside counsel review a standard non-conforming subordination agreement and that the review would take approximately 100 hours at a cost of approximately \$400 per hour.<sup>67</sup> As a result, the Commission staff estimates that each BD/FCM would incur one-time costs of approximately \$40,000, resulting in an industry-wide one-time cost of approximately \$2,280,000.<sup>68</sup>

Paragraph IV(b)(2)(ii) of this Order applies with respect to customers that are affiliates of the BD/FCM and requires BD/FCMs that elect to offer a program to commingle and portfolio margin customer positions in CDS in customer accounts maintained in accordance with Section 4d(f) of the CEA and rules thereunder to enter into a non-conforming subordination agreement. The non-conforming subordination agreement must contain: (i) a specific acknowledgment by the affiliate that such money, securities or property will not receive customer treatment under the

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portfolio margining programs are not yet being offered for CDS customers, it is difficult to estimate with precision the number of customers that may participate in customer clearing of CDS. Furthermore, the number of customers that seek to clear CDS through a portfolio margining program may change after final mandatory clearing determinations are made with respect to various product types within CDS.

<sup>66</sup> 57 BD/FCMs x 1,000 non-affiliate customers per dealer x 2.5 BD/FCMs used by each customer x 20 hours for each agreement.

<sup>67</sup> See PRA Analysis in Capital, Margin, and Segregation Requirements Adopting Release (providing an estimate of \$400 an hour to engage an outside attorney).

<sup>68</sup> 57 BD/FCMs x 100 hours to review x \$400 per hour.

Exchange Act or SIPA or be treated as customer property as defined in 11 U.S.C. 741 in a liquidation of the BD/FCM, and that such money, securities or property will be held in a proprietary account in accordance with the CFTC requirements and will be subject to any applicable protections under Subchapter IV of Chapter 7 of Title 11 of the United States Code and rules and regulations thereunder; and (ii) an affirmation by the affiliate that all of its claims with respect to such money, securities, or property against the BD/FCM will be subordinated to the claims of other securities customers and security-based swap customers not operating under a program to commingle and portfolio margin CDS pursuant to this Order. The Commission estimates that the average number of customers that are affiliates of the BD/FCM to be approximately 11<sup>69</sup> and the average number of hours to develop a subordination agreement for a non-affiliate CDS customer to be approximately 20 hours based on the Commission's prior experiences with the development of subordination agreements.<sup>70</sup> Consequently, the Commission estimates that the total one-time burden associated with this requirement to be 12,540 hours.<sup>71</sup>

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<sup>69</sup> FINRA CRD data indicate that the 17 largest broker-dealers (i.e., those with total assets of \$50 billion or more) reported a total of 188 affiliates that are themselves registered with the SEC (i.e., they have their own CRD numbers), representing approximately 11 affiliates per broker-dealer. The Commission believes that this would be a useful approximation of the average number of customers that are affiliates of the BD/FCM, as many affiliates of a BD/FCM that would seek to use portfolio margining are likely to be subject to some form of a registration requirement with the SEC. Furthermore, the assumption that all such registered affiliates would seek to engage in portfolio margining (when some may not) should help to offset any discrepancy associated with customers that are affiliates but would not be subject to an SEC registration requirement.

<sup>70</sup> The Commission has previously considered the development of subordination agreements in other contexts. See Letter from Michael A. Macchiaroli, Associate Director, Division of Market Regulation, to William H. Navin, EVP and General Counsel, The Options Clearing Corporation (June 15, 2000).

<sup>71</sup> 57 BD/FCMs x 11 affiliate customers x 20 hours.

As stated previously, the Commission staff believes that a BD/FCM would have outside counsel review a standard non-conforming subordination agreement and that review would result in a one-time industry cost of \$2,280,000. Because the same requirements and acknowledgements in the non-conforming subordination agreements with non-affiliate customers must be included in the non-conforming subordination agreements with affiliate customers (with an additional acknowledgement by the affiliate that its money, securities, or property will be held in a proprietary account in accordance with CFTC requirements), we believe that a BD/FCM would not need to engage an outside counsel to perform a review of a separate review of a standard non-conforming subordination agreement for affiliate customers.

Paragraph IV(b)(2)(iii) of this Order applies with respect to customers that are affiliates of the BD/FCM and requires BD/FCMs that elect to offer a program to commingle and portfolio margin customer positions in CDS in customer accounts maintained in accordance with Section 4d(f) of the CEA and rules thereunder to obtain from its affiliates an opinion of counsel that the affiliate is legally authorized to subordinate all of its claims against the BD/FCM to those of customers. Again, the Commission estimates that the average number of customers that are affiliates of the BD/FCM to be approximately 11 and the average number of hours to develop the required opinion for an affiliate CDS customer to be approximately 2 hours.<sup>72</sup> Consequently, the Commission estimates that the total one-time burden associated with this requirement to be 1,254

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<sup>72</sup> This estimate is based on the Commission's currently approved Collection of Information Supporting Statement for Rule 15c3-1 of the Exchange Act, which discusses obtaining an opinion of counsel as required by Appendix C to Rule 15c3-1 of the Exchange Act (available at [http://www.reginfo.gov/public/do/PRAViewDocument?ref\\_nbr=201006-3235-004](http://www.reginfo.gov/public/do/PRAViewDocument?ref_nbr=201006-3235-004)). The Commission believes that obtaining an opinion of counsel as required by this order will require additional time to adequately research the issue to provide an opinion of counsel and, therefore, has provided additional time in its estimation.

hours.<sup>73</sup> The Commission staff also estimates that the BD/FCM will engage outside counsel to review a standard opinion of counsel and that the outside counsel would need approximately 20 hours at a cost of approximately \$400 per hour. As a result, the Commission staff estimates that the BD/FCM would incur a one-time cost of approximately \$8,000, resulting in an industry-wide one-time cost of approximately \$456,000.<sup>74</sup>

Paragraph IV(b)(5) of this Order requires that BD/FCMs that elect to offer a program to commingle and portfolio margin customer positions in CDS in customer accounts maintained in accordance with Section 4d(f) of the CEA and rules thereunder, to maintain minimum margin levels with respect to any customer transaction in a program to commingle and portfolio margin CDS at least equal to the amount determined using a margin methodology established and maintained by the BD/FCM that has been approved by the Commission or its staff. As part of the approval process, a BD/FCM would be expected to submit certain information in order to make a determination regarding the performance of the margin methodology. The Commission anticipates that information would be substantially similar to information required in Appendix E to Exchange Act Rule 15c3-1 to the extent relevant to portfolio margining CDS that are swaps and security-based swaps. Based on similar estimates, the Commission estimates that each BD/FCM that seeks approval from the Commission would spend approximately 1,000 hours to create and compile the various documents to provide to Commission staff and to work with Commission staff through the approval process.<sup>75</sup> This includes approximately 100 hours for an

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<sup>73</sup> 57 BD/FCMs x 11 affiliate customers x 2 hours.

<sup>74</sup> 57 BD/FCMs x 20 hours for outside counsel to review x \$400 per hour.

<sup>75</sup> This estimate is based on the Commission's currently approved Collection of Information Supporting Statement for Rule 15c3-1 of the Exchange Act, which discusses the reporting burden for broker-dealers to apply and receive approval from the Commission

in-house attorney to complete a review of the information and documentation provided to the Commission staff. Consequently, the Commission estimates the total one-time burden associated with this requirement to be 57,000 hours.<sup>76</sup>

Paragraph IV(b)(6) of this Order requires each BD/FCM receiving any money, securities, or property of a customer to margin, guarantee or secure positions consisting of cleared CDS, which include both swaps and security-based swaps, under a program to commingle and portfolio margin CDS in an account maintained in accordance with Section 4d(f) of the CEA and the rules thereunder to disclose to its customers that (i) the customer's money, securities, and property will be held in an account maintained in accordance with the segregation requirements of Section 4(d)f of the CEA and that the customer has elected to seek protections under Subchapter IV of Chapter 7 of Title 11 of the United States Code and the rules and regulations thereunder with respect to such money, securities, and property and (ii) that the broker-dealer segregation requirements of Section 15(c)(3) and Section 3E of the Exchange Act, and any customer protections under SIPA and the stockbroker liquidation provisions, will not apply to such customer money, securities, and property. These disclosures provide customers important disclosures regarding the legal framework that will govern their transactions if a liquidation were to occur. The Commission believes that the BD/FCM could use the language in the Order that describes the disclosure that must be made as a template to draft the disclosure statement. Consequently, the Commission estimates that it would take a BD/FCM clearing member

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to use Appendix E to Rule 15c3-1 of the Exchange Act (available at [http://www.reginfo.gov/public/do/PRAViewDocument?ref\\_nbr=201006-3235-004](http://www.reginfo.gov/public/do/PRAViewDocument?ref_nbr=201006-3235-004)).

<sup>76</sup> 1,000 hours x 57 BD/FCMs.

approximately 8 hours to draft the disclosure statement.<sup>77</sup> Further, the Commission believes the BD/FCM will include this disclosure statement with other documents or agreements provided to cleared CDS customers and as a result the BD/FCM should not be subject to any additional burden associated with relaying this information to the customer. Therefore, the Commission estimates that aggregate burden from this requirement will be 456 hours<sup>78</sup> to comply with this requirement.

#### **E. Collection of Information is Mandatory**

The collections of information contained in the conditions to this Order are mandatory for any entity wishing to rely on the conditional exemptions granted by this Order.

#### **F. Confidentiality**

The Commission expects to receive confidential information in connection with the proposed collections of information. To the extent that the Commission receives confidential information pursuant to these collections of information, the Commission is committed to protecting the confidentiality of such information, subject to the provisions of applicable law.<sup>79</sup>

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<sup>77</sup> This estimate is based on the Commission’s currently approved Collection of Information Supporting Statement for Rule 15c3-3 of the Exchange Act, which discusses the reporting burden to prepare a disclosure statement pursuant to Rule 15c3-3 of the Exchange Act ([http://www.reginfo.gov/public/do/PRAViewDocument?ref\\_nbr=201103-3235-025](http://www.reginfo.gov/public/do/PRAViewDocument?ref_nbr=201103-3235-025)).

<sup>78</sup> 57 BD/FCMs x 8 hours.

<sup>79</sup> See, e.g., Exchange Act Section 24, 15 U.S.C. 78x (governing the public availability of information obtained by the Commission) and 5 U.S.C. 552 et. seq. (Freedom of Information Act – “FOIA”). FOIA Exemption 4 provides an exemption for “trade secrets and commercial or financial information obtained from a person and privileged or confidential.” 5 U.S.C. 552(b)(4). FOIA Exemption 8 provides an exemption for matters that are “contained in or related to examination, operating, or condition reports prepared

**G. Request for Comment on Paperwork Reduction Act**

The Commission requests, pursuant to 44 U.S.C. 3506(c)(2)(B), comment on the collections of information contained in this Order to:

(i) evaluate whether the collections of information are necessary for the proper performance of the functions of the Commission, including whether the information would have practical utility;

(ii) evaluate the accuracy of the Commission's estimates of the burden of the collections of information;

(iii) determine whether there are ways to enhance the quality, utility, and clarity of the information to be collected; and

(iv) evaluate whether there are ways to minimize the burden of the collections of information on those required to respond, including through the use of automated collection techniques or other forms of information technology.

Persons who desire to submit comments on the collection of information requirements should direct their comments to the OMB, Attention: Desk Officer for the Securities and Exchange Commission, Office of Information and Regulatory Affairs, Washington, DC 20503, and should also send a copy of their comments to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090, and refer to File No. S7-13-12. OMB is required to make a decision concerning the collections of information between 30 and 60 days after publication of this document in the Federal Register; therefore, comments to OMB are best assured of having full effect if OMB receives them within 30 days of

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by, on behalf of, or for the use of an agency responsible for the regulation or supervision of financial institutions.” 5 U.S.C. 552(b)(8).

this publication. The Commission has submitted the proposed collections of information to OMB for approval. Requests for the materials submitted to OMB by the Commission with regard to these collections of information should be in writing, refer to File No. S7-13-12, and be submitted to the Securities and Exchange Commission, Records Management Office, 100 F Street, NE, Washington, DC 20549.

By the Commission.

Elizabeth M. Murphy  
Secretary