

Regulatory Notice

10-46

FOCUS Reporting

Supplemental FOCUS Filing Requirement Applicable to Certain Joint Broker-Dealers/Futures Commission Merchants

Effective Date: FOCUS Report Due on November 23, 2010, Covering the October 2010 Reporting Period

Executive Summary

Beginning with the monthly FOCUS Report that is due on November 23, 2010 (covering the October 2010 reporting period), each member firm that is a futures commission merchant (FCM) and clears OTC derivatives for customers through Chicago Mercantile Exchange Inc. (CME)—either as a CME clearing member itself or as a carrying, non-clearing firm through a CME clearing member—must file with FINRA a new statement pertaining to customer cleared OTC derivatives. This requirement arises from recent amendments by CME to its financial reporting rules and forms and by National Futures Association (NFA) to its financial requirements rules.

The new statement—the Statement of Sequestration Requirements and Funds in Cleared OTC Derivatives Sequestered Accounts (Sequestration Statement)—is a supplemental schedule to FOCUS Report Parts II and II CSE and firms must file it with FINRA as part of their monthly FOCUS Reports.

The Sequestration Statement is set forth in Attachment A.

Questions concerning this *Notice* should be directed to:

- Yui Chan, Managing Director, Risk Oversight & Operational Regulation (ROOR), at (646) 315-8426; or
- Kathryn Mahoney, Director, ROOR, at (646) 315-8428.

October 2010

Notice Type

- Guidance

Suggested Routing

- Accounting
- Compliance
- Legal
- Operations
- Regulatory Reporting
- Senior Management

Key Topics

- FOCUS Reporting

Referenced Rules & Notices

- SEA Rule 17a-5
- FINRA Rule 4521

Background and Discussion

Effective May 6, 2010, the Commodity Futures Trading Commission (CFTC) adopted new amendments to the CFTC's Regulation Part 190¹ that, among other things, create a new customer account class for "cleared OTC derivatives" (as defined in new CFTC Regulation 190.01(o)), applicable only to the bankruptcy of a commodity broker that is an FCM.² As stated in the CFTC adopting release for these new regulations, "... a position in an OTC derivative (and relevant collateral) that a customer clears through an FCM with a DCO [derivatives clearing organization], which position (and collateral) is not subject to a Section 4d [of the Commodity Exchange Act] Order, would be considered part of the cleared OTC derivative account class, as soon as, but only after, a DCO rule... that requires such positions (and relevant collateral) to be held in a separate account for cleared OTC derivatives becomes effective..."³

Following the CFTC's adoption of the new Regulation Part 190 requirements, CME, as a DCO, adopted new rules requiring that customer "cleared OTC derivatives" be held in a separate account, titled "Customer Cleared OTC Derivatives Sequestered Account," subject to specified requirements, including the preparation of a Sequestration Statement.⁴ NFA also adopted rule amendments that would require its carrying, non-clearing FCM members that clear OTC derivatives for customers through a CME clearing member to comply with CME's new rules as well.⁵

In June, CME advised FCMs to develop the necessary accounting and operational systems, procedures and controls to ensure that they are able to adhere to the new requirements when the rules become effective.⁶ Among other things, CME stated that FCMs should open new bank and safekeeping accounts for cleared OTC customer assets. The new CME sequestration requirements became effective on October 4, 2010.⁷

Pursuant to FINRA Rule 4521(a), FINRA member firms that are FCMs and that clear OTC derivative products through a DCO or any other facility that has OTC derivatives sequestration requirements, in complying with such facility's requirements, must file with FINRA the Sequestration Statement, or such similar form as the facility may require, as a supplement to the electronic FOCUS Report filing (FOCUS Report Parts II and II CSE). FINRA member firms that are FCMs and subject to CME's requirements must file the Sequestration Statement in eFOCUS and WinJammer, commencing with the monthly FOCUS Report that is due November 23, 2010 (covering the October 2010 reporting period).

Endnotes

- 1 See 17 CFR Chapter 1 Part 190 (Bankruptcy).
- 2 See 75 FR 17297 (April 6, 2010).
- 3 See *supra* note 2 at 17301.
- 4 CME's new cleared OTC derivatives sequestration rules are set forth in CME Group Audit Information Bulletin #10-07 (issued July 16, 2010). For further information regarding the CME's implementation of the new rules, see also CME Group Audit Information Bulletin #10-09 (issued August 17, 2010) and CME Group Advisory Notice #10-256 (Updates #1 and #2) (issued June 17, 2010).
- 5 See Letter from Thomas W. Sexton, Senior Vice President and General Counsel, NFA, to David A. Stawick, Office of the Secretariat, CFTC, dated August 30, 2010. The new NFA rule—NFA Financial Requirements Section 4(b)—states that any NFA member FCM “that receives money, securities and/or other property from, for or on behalf of a customer to margin, guarantee or secure the customer’s positions in cleared OTC derivatives... must comply with CFTC requirements and the requirements established by the applicable contract market and/or derivatives clearing organization for such activity.”
- 6 See CME Group Advisory Notice #10-256 (Update #1).
- 7 See CME Group Audit Information Bulletin #10-09.

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SUPPLEMENT TO
FINANCIAL AND OPERATIONAL COMBINED UNIFORM SINGLE REPORT
PART II

BROKER OR DEALER

as of _____

STATEMENT OF SEQUESTRATION REQUIREMENTS AND
FUNDS IN CLEARED OTC DERIVATIVES SEQUESTERED ACCOUNTS

CLEARED OTC DERIVATIVES CUSTOMER REQUIREMENTS

1. Net ledger balance		
A. Cash	\$ _____	8500
B. Securities (at market)	_____	8510
2. Net unrealized profit (loss) in open cleared OTC derivatives	_____	8520
3. Cleared OTC derivatives options		
A. Market value of open cleared OTC derivatives option contracts purchased	_____	8530
B. Market value of open cleared OTC derivatives option contracts granted (sold)	(_____)	8540
4. Net equity (deficit) (add lines 1, 2 and 3)	\$ _____	8550
5. Accounts liquidating to a deficit and accounts with debit balances		
- gross amount	\$ _____	8560
Less: amount offset by customer owned securities	(_____)	8570
6. Amount required to be sequestered for cleared OTC derivatives customers		
(add lines 4 and 5)	\$ _____	8590

FUNDS IN CLEARED OTC DERIVATIVES CUSTOMER SEQUESTERED ACCOUNTS

7. Deposited in cleared OTC derivatives customer sequestered accounts at banks		
A. Cash	\$ _____	8600
B. Securities representing investment of customers' funds (at market)	_____	8610
C. Securities held for particular customers or option customers in lieu of cash (at market)	_____	8620
8. Margins on deposit with derivatives clearing organizations in cleared OTC derivatives customer sequestered accounts		
A. Cash	_____	8630
B. Securities representing investment of customers' funds (at market)	_____	8640
C. Securities held for particular customers or option customers in lieu of cash (at market)	_____	8650
9. Net settlement from (to) derivatives clearing organizations	_____	8660
10. Cleared OTC derivatives options		
A. Value of open cleared OTC derivatives long option contracts	_____	8670
B. Value of open cleared OTC derivatives short option contracts	(_____)	8680
11. Net equities with other FCMs		
A. Net liquidating equity	_____	8690
B. Securities representing investment of customers' funds (at market)	_____	8700
C. Securities held for particular customers or option customers in lieu of cash (at market)	_____	8710
12. Cleared OTC derivatives customer funds on hand	_____	8715
13. Total amount in sequestration (add lines 7 through 12)	\$ _____	8720
14. Excess (deficiency) funds in sequestration (subtract line 6 from line 13)	\$ _____	8730

SUPPLEMENT TO
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