The Commission believes that it is inappropriate to grant the requested relief from Rule 1.25 at this time. That rule derives from the statutory limitations set forth in the final proviso of section 4d(2) of the Act. The investment limitations are intended to assure that the pool of customers' funds remains safe, liquid and available for distribution to customers on demand or, following an FCM's bankruptcy, to facilitate transfers to another firm should that become necessary.

The Commission envisions that customer funds related to section 4(c) contract market transactions will be commingled with other customer funds in a combined pool of segregated funds and would be treated as funds of customers involved in traditional futures contracts in the event of an FCM's bankruptcy. Therefore, it is inappropriate and impracticable to apply provisions different from the general provisions of section 4d(2) of the Act and Commission Rules 1.20-1.30, 1.32 and 1.36 concerning segregation of customer funds to section 4(c) contract market transactions. However, as a consequence of the failure of Barings PLC, the Commission, joined by regulators and self-regulators worldwide, currently is reviewing the safeguarding of customer funds, both domestically and internationally, to determine if statutory or regulatory changes are appropriate.

Two commenters also suggested that required subordination agreements relating to customer funds held in foreign depositories be limited. In 1988, the Division of Trading and Markets issued Financial and Segregation Interpretation No. 12 to permit funds of United States-domiciled customers to be segregated in foreign depositories subject to conditions intended generally to prevent the dilution of customer funds held in segregation in the United States in the event that an FCM holding segregated funds offshore became bankrupt.37 Among other requirements, the FCM must obtain a customer's authorization to deposit its funds into a foreign depository. The customer also must agree in writing that, in the event the FCM is placed in bankruptcy and there are insufficient funds in a foreign currency to satisfy customer claims in

that currency, the customer will subordinate its claim attributable to funds held offshore in that particular foreign currency to the claims of customers whose funds are held in dollars or other foreign currencies.

Commenters also suggested that the Commission limit the applicability of the subordination requirement of Interpretation No. 12 with respect to section 4(c) funds. Specifically, one commenter suggested that a subordination agreement should be required only in "cases where access to funds held in a foreign depository is subject to potential restriction by foreign governmental authorities or agencies."

The Commission believes that there is no basis for applying a different standard in requiring subordination of section 4(c) and non-section 4(c) segregated funds. However, as noted above, the Commission is reviewing this and other requirements contained in Interpretation No. 12 in response to the recent collapse of Barings and to address issues that have developed since Interpretation No. 12 was first published.³⁸ Any revision of the current safeguards for funds held outside the United States on behalf of customers trading on futures exchanges in the United States likely will be uniform across section 4(c) and non-section 4(c) contract markets.

c. Margining of Customer and Proprietary Accounts

Two commenters raised issues regarding the margining of section 4(c) contract market transactions. One commenter recommended that the Commission permit eligible participants initially to cross-margin section 4(c) contracts, and subsequently to crossmargin section 4(c) and non-section 4(c) contracts. Although the Commission has not provided for cross-margining as part of this rulemaking, the Commission would consider such a feature as part of the pilot program. In this connection, the Commission notes that it has approved numerous cross-margining plans for exchange trading, beginning in 1988. Accordingly, the Commission encourages interested persons to submit a detailed petition for such a plan during the course of the Part 36 pilot program.

The second commenter suggested that the Commission allow "futures-style" margining for option contracts. Futuresstyle margining would permit the initial purchase of option contracts with a performance bond or margin payment as currently permitted for futures contracts, rather than with full payment of the option premium.

Commission Rule 33.4(a) requires payment of the full amount of each option premium at the time the option is purchased. After that rule was adopted, the issue of whether "futuresstyle" margining is also appropriate for options was raised, culminating in publication in the Federal Register of two petitions to repeal Rule 33.4(a)(2).39 Although a number of supportive comments were submitted, many also opposed the concept. The pilot program for the trading of section 4(c) contract market transactions presents an ideal opportunity to test prudently, within the confines of a limited-access market, the potential benefits and risks of futures-style margining. Accordingly, the Commission has determined, in principle, to permit "futures-style" margining for section 4(c) option transactions under the Part 36 pilot program, and will consider any such proposals submitted.

Finally, an investment banking firm requested clarification of several technical issues relating to financial integrity requirements. Specifically, it inquired regarding the terms on which an FCM may transfer excess funds 40 belonging to the same customer from an account containing section 4(c) contract market transactions to an account containing traditional contracts, e.g., whether a separate signature is required. Because the Commission will treat customer funds related to section 4(c) contract market transactions the same as those of traditional futures contracts for segregation purposes, it would be unnecessary to maintain separate accounts for section 4(c) and traditional contracts of the same customer.

The commenter also expressed the view that although customer and proprietary positions in section 4(c) contract market transactions should be accounted for in the same fashion as in non-exempt futures and option contracts, to the extent that positions in section 4(c) contract market transactions may be margined differently than non-exempt futures and options transactions, a different adjusted net capital treatment might be appropriate. The Commission reiterates that the general financial and segregation rules applicable to non-exempt futures and

CBT believes it should be available with respect to all funds deposited with an FCM by an eligible participant under Part 36, without regard to whether the customer is trading exempt or traditional contracts.

³⁷ 53 FR 46911 (Nov. 21, 1988), reprinted in 1 Comm. Fut. L. Rep. (CCH) ¶7122. Prior to 1988, the Commission required segregated funds to be held in the United States except for certain funds of foreign-domiciled customers.

³⁸ For example, the Federal Reserve Board did not allow banks in the U.S. to accept deposits denominated in foreign currencies until January 1990

³⁹ See 54 FR 11233 (March 17, 1989).

⁴⁰The commenter did not define the term "excess funds." The Commission uses the terms "excess funds" and "free funds" to mean the amount by which the net liquidating equity in an account exceeds the initial margin requirement for the positions in that account.