

## CFTC Adopts Final Rule on Protection of Cleared Swap Customer Collateral

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In adopting final rules on the treatment of cleared swap customer collateral, the CFTC has taken a major step in defining the architecture of market-wide swap clearing, a key pillar of the Dodd-Frank Act's derivatives reform. After receiving intense arguments for divergent types of collateral protection, the CFTC adopted the "legal segregation, operational commingling" ("LSOC") model.

The LSOC model is designed to eliminate the "fellow customer risk" to which futures customers are exposed. Under the LSOC model, if a customer of a futures commission merchant ("FCM") defaults on a cleared swap margin obligation and the FCM is not able to satisfy the defaulting customer's obligations, the derivatives clearing organization ("DCO") has no recourse to funds of the FCM's non-defaulting customers. Therefore, LSOC is intended to provide additional protection, albeit at an additional cost, to cleared swap customers beyond the current futures DCO model. In contrast, under the futures DCO model, any FCM customers' swap collateral is available to the DCO upon a default of both the FCM and one of its futures customers. The CFTC has not extended the LSOC model to futures at this time, but will consider doing so.

If you have any questions regarding the matters covered in this publication, please reach out to any of the lawyers listed below or your usual Davis Polk contact.

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