

From: Robert Push <Robert.Push@idcg.com>
Sent: Wednesday, September 8, 2010 3:56 PM
To: secretary <secretary@CFTC.gov>; acknowledgmentletter <acknowledgmentletter@CFTC.gov>
Cc: Garry O'Connor <Garry.O'Connor@idcg.com>; Michael Dundon <Michael.Dundon@idcg.com>; Alan Sobba <Alan.Sobba@idcg.com>
Subject: IDCH Comment Letter: Acknowledgment Letters for Customer Funds and Secured Amount Funds (RIN 3038-AC72)
Attach: CFTC Acknowledgement Letters - IDCH Comments.pdf

Dear Mr. Stawick,

Please find attached the International Derivatives Clearinghouse LLC's comment to CFTC Acknowledgment Letters for Customer Funds and Secured Amount Funds (RIN 3038-AC72).

Thank you for considering these comments and please do not hesitate to contact us with any questions or comments that you may have.

Sincerely,

Robert C. Push, Managing Director/Treasurer
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September 8, 2010

David A. Stawick
Secretary
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, NW
Washington, DC 20581

Re: (RIN 3038-AC72) Proposed Rules 17 CFR Parts 1, 30, and 140 - Acknowledgment Letters for Customer Funds and Secured Amount Funds

Dear Mr. Stawick:

International Derivatives Clearinghouse LLC ("IDCH") commends the Commodity Futures Trading Commission (the "Commission") for its proposed rulemaking for the "Acknowledgment Letters for Customer Funds and Secured Amount Funds" regarding regulations 1.20, 1.26, 30.7 and 140.91 (the "Proposed Rules"). IDCH generally supports the Commission's efforts to provide greater clarity through the Proposed Rules, but has significant concerns regarding the ability of a futures commission merchant ("FCM") or a derivatives clearing organization ("DCO") to create liens on funds in customer accounts in the certain limited circumstances discussed below.

A core financial underpinning of cleared derivatives transactions is the collection and maintenance of adequate margin. The function of quantifying fluctuating risk in a real-time environment and neutralizing risk through margining ensures the financial integrity of markets. As witnessed during the recent financial crisis, in certain markets the absence of a rigorous margining function that regularly neutralizes counterparty risk with certainty led to a high level of investor anxiety, which quickly translated into financial instability.

The safeguards provided by the Commodity Exchange Act (the "Act") and the rules of the Commission adopted thereunder (the "Commission Rules") have served its regulated markets well. IDCH is aware of approximately 10 clearing member defaults at DCOs since the 1980s. In each case, IDCH understands that the integrity of customers' accounts was maintained and there were no losses to customers. IDCH also understands that in some instances, uncertainty associated with the clearing member's bankruptcy resulted in an initial reaction by banks and custodians to cease activity in the defaulting clearing member's customer accounts. The Act and the Commission Rules provided the needed certainty for these customer accounts to remain functional during bankruptcy, allowing the orderly porting of customer transactions or the assumption of customer accounts by solvent clearing members. This ensured market integrity and stability during these periods of stress to the DCO. Any effort to bring greater certainty to the handling of customer deposits upon the default of a clearing member is a highly worthwhile endeavor.

In order to ensure properly functioning customer margining accounts, IDCH believes that the Commission should permit FCMs and DCOs to grant liens to their settlement banks and

custodians for two narrowly defined activities. The first permitted lien should be for margin settlement transactions between DCOs and their clearing members ("DCO Margin Settlement"). The second permitted lien should be for investment activity in a customer account.

DCO Margin Settlements

Commission Interpretative Letter No. 86-9, dated April 21, 1986, confirms that a lien can be granted against the customer cash account or custody account maintained by a FCM to satisfy a DCO Margin Settlement for the FCM's customer account in which the bank or custodian has advanced its own funds. DCOs and FCMs are required to invest customer cash in accordance with Commission Rule 1.25. These investments are generally maintained in a customer custody account that is separate from the cash account used to fund DCO Margin Settlements.

Settlement conventions in the fixed income market and DCO Margin Settlement conventions are such that there are rarely sufficient funds in the FCM's cash account to fund a DCO Margin Settlement. The customer funds are in the customer custody account, which typically has a balance that is substantially greater than the DCO Margin Settlement. Conforming DCO Margin Settlement conventions to fixed income settlement conventions would not be appropriate as it would eliminate a DCO's ability to remove market risk at the end of the day since securities clearinghouses (e.g., Federal Reserve Security Book-Entry System and DTCC) operate during a shorter time period during the business day than the Fed Payment System. This would be a serious disadvantage during periods of market stress or a FCM bankruptcy. Conforming fixed income settlement conventions to DCO Margin Settlement conventions would be desirable. Accomplishing this significant task, however, at least over the short-term, is not attainable since settlement conventions in the securities market correspond with the operating hours of securities clearinghouses and there is little incentive for securities clearinghouses to amend their operations to accommodate the derivatives industry. Banks and custodians play an important role in bridging the timing difference between these two settlement conventions.

IDCH believes that a lack of certainty on the permissibility of a lien against the customer cash account or custody account would at best contribute to payment gridlock and at worst, severely impair the Commission's, an appointed receiver's and/or DCO's ability to operate a defaulting clearing member in bankruptcy and successfully port customer positions and/or customer accounts in a timely manner.

Although IDCH does not believe that it is the Commission's intention to rescind Commission Interpretative Letter No. 86-9 by adopting the Proposed Rules, IDCH believes it would be beneficial to adopt regulations that expressly recognize the permissibility of these liens, as has been practice since this interpretive letter was released.

Investment of Customer Funds

In Katten Muchin Rosenman LLP's ("Katten") comment letter to the prior iteration of the Proposed Rules, Katten addresses the topics of funds advanced for DCO Margin Settlements and investment activity. In IDCH's review of the Commission's response to Katten's comment, IDCH believes that the Proposed Rules would only permit a lien for DCO Margin Settlements, as discussed above.

IDCH believes that it is important for the Proposed Rules to permit a limited lien on securities purchased in the customer account with advances made by a bank or custodian. Until these securities have been paid for by the customer account they are not considered customer-owned

securities. As described below, the absence of this conventional lien might force behavior that IDCH views as undesirable.

There is a timing difference of approximately three hours at the end of the day between the daily operating hours of the Fed Wire Payment System and the Federal Reserve Security Book-Entry System and DTCC. In an effort to manage overdrafts within the Fed Wire Payment System, banks leave large payments in a payment queue until the end of the day – an hour during which securities clearinghouses (including the Federal Reserve Security Book-Entry System) have discontinued settlements for the day. Generally, payments in the amount of \$25 million or more are pushed into this late day queue. FCMs have little influence over this behavior as they have no control over their customers' banks. Additionally, banks frequently charge significant fees for processing these large payments earlier in the day.

In order to manage this timing difference, banks and custodians often will advance payment for securities settlements and rely on a lien on the securities to support this advance. IDCH believes that prohibiting a lien against specific securities purchased through an advance by the bank or custodian would result in the banks and custodians forcing DCOs and FCMs to settle customer funds investment activity in a non-segregated clearance account or refuse to settle a purchase until funding has arrived.

In the event of a refusal to provide an advance, the DCO or FCM would be forced to leave cash on deposit in a bank demand deposit account if funds were received after the securities clearinghouses were closed for the day. This would result in lost interest income, a situation that may be resolved in the event that Reg Q is repealed. Alternatively, DCOs and FCMs could use money market funds. However, DCOs and FCMs may not prefer to take on the risk associated with the use of bank demand deposits or money funds.

More importantly, this action could cause DCOs and FCMs to take on larger bank depository risk. This runs counter to Commission Rule 1.25, which limits the investment in time deposits and certificates of deposits to no more than 5% of the DCOs and FCMs customer deposits. With the exception of time to maturity, time deposits and certificates of deposit have the same risk profile as a demand deposit. As such, DCOs and FCMs should be afforded tools to limit their demand deposit exposure.

The use of a non-segregated clearance account would require an additional transaction to settle an investment in the customer account. The purchase of the security would settle in the non-customer clearance account pending delivery of cash into the customer account. Once the cash arrived, the DCO or FCM would have to arrange a delivery-versus-payment instruction between its non-segregated clearance account and its customer account. These would be transactions on the books of the bank or custodian and as such, would be settled after securities clearinghouses are closed for the day. This requirement would add additional operating, accounting and audit complexity and would be expensive as it would add another layer of fees associated with the customer account investment activity.

While these are not insurmountable challenges, IDCH believes that these additional costs outweigh any potential reductions in risk to customers by permitting a limited lien against the customer account. Indeed, not permitting such a lien may marginally harm customers as the DCOs and FCMs likely will pass these costs along to their customers.

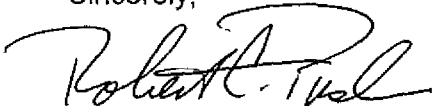
IDCH believes that the integrity of the customer account would not be at risk if the Commission permitted a lien on the specific securities in which the bank advanced funds to facilitate the

settlement of an investment in the customer account provided that the lien was immediately extinguished once the securities were paid for – full or partial. IDCH recommends the use of the following lien language:

"In the event that any Securities are not delivered "free" to the Custodian but are delivered against payment and there are insufficient funds in the account to fully pay for the Securities, the Custodian shall have the right to not accept and/or to return or reverse such delivery. In the event that the Custodian advances its own funds to settle any Securities, the Custodian shall have a lien and claim only on such Securities held in the Segregated Account and not on any other Cash or Securities held in any Segregated Account and only for the amount of the payment made or the credit extended. Interest charged thereon will be at such rate or rates as have been agreed between [DCO or FCM] until such Securities have been fully paid for and such interest will be for the account of [DCO or FCM] and not for the account of any Segregated Account. [DCO or FCM] agrees to repay the Custodian upon demand for the amount of any payment made or credit extended and for the interest accrued thereon."

IDCH thanks the Commission staff for its hard work and diligence in drafting the Proposed Rules and its consideration of the above comments. If the Commission staff has questions or comments, please do not hesitate to contact us.

Sincerely,

A handwritten signature in black ink, appearing to read "Robert C. Push". The signature is fluid and cursive, with a large initial "R" and "P".

Robert C. Push
Managing Director/Treasurer
646-867-2538