The Pulse of Finance

Newedge

BY OVERNIGHT MAIL AND E-MAIL

November 17, 2010

Mr. David A. Stawick
Secretary
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, D.C. 20581
dcodcmsefGovernance@cftc.gov

Re: Newedge Comment Regarding Open Access of Derivatives Clearing Organizations – RIN 3038-AD01

Dear Mr. Stawick:

Newedge USA, LLC ("Newedge USA"), is pleased to submit the attached letter – dated October 21, 2010 and sent initially to The Honorable Gary Gensler – as a comment letter in connection with the above-referenced proposed rulemaking by the Commodity Futures Trading Commission ("CFTC") – i.e., "Requirements for Derivatives Clearing Organizations, Designated Contract Markets, and Swap Execution Facilities Regarding the Mitigation of Conflicts of Interest." Newedge USA submits the attached letter – which contains our views on the importance of open access of derivatives clearing organizations and is incorporated herein by reference – on behalf of itself and its parent company, Newedge Group.

We appreciate the opportunity to comment on this proposed rule. Feel free to contact the undersigned at (646) 557-8458 or at gary.dewaal@newedge.com if you have any questions.

Sincerely,

Newedge USA, LLC

Gary DeWaal

Gary DeWaal
Senior Managing Director and
Group General Counsel

Attachment: October 21, 2010 Letter from Newedge USA to The Honorable Gary Gensler

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October 21, 2010

The Honorable Gary Gensler
Chairman
U.S. Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, D.C. 20581

Re: Newedge USA, LLC Views on Fair and Open Access to Membership in Derivatives Clearing Organizations

Dear Gary,

This is further to our conversation of October 12, 2010 in which Mr. John Fay, Newedge USA, LLC ("Newedge USA") Chief Executive Officer, Mr. John Nicholas, NUSA Acting Head of Compliance and I discussed several topics with you and your staff including fair and open access to membership in derivatives clearing organizations ("DCO"). As you may know, Newedge USA, and its parent organization Newedge Group SA ("Newedge"), are actively involved globally in working with regulators to develop rules and regulations designed to strengthen our financial markets. We appreciate your asking us for our views on the topic of fair and open access to DCOs, which we have set forth below.

As we noted in our meeting with you, providing qualifying market participants with fair and open access to DCOs is mandated by the Dodd-Frank Wall Street Transparency and Accountability Act ("Dodd-Frank"). In addition, such fair and open access will promote participation by more brokers in the clearing process, which will in turn aid competition and result in lower prices for market users.

Specifically, Dodd-Frank states that:

> participation and membership requirements of each derivatives clearing organization shall (I) be objective, (II) be publicly disclosed; and (III) permit fair and open access.

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See Dodd-Frank, Title VII, Subtitle A, Part II, Section 725, Sub-Section (c), Paragraph (2)(C), Part (iii).[1] Not surprisingly, Congress' clear intent in providing for fair and open access to DCOs is consistent with the goals of other legislative bodies currently addressing the topic, such as the European Commission.[2]

With such a clear Congressional mandate for requiring fair and open access, to the extent a DCO does establish "eligibility" requirements, it must bear the burden of proving that such standards are absolutely necessary to ensure its financial strength and integrity (i.e., that such criteria are not simply artificial barriers to reduce competition). For example, if a DCO were to establish a $5 billion net capital requirement for members – which would necessarily exclude all market participants except for the largest banks and dealers – it must be required to show how such a requirement is absolutely necessary from a risk perspective. We do not believe a DCO could make such a case considering there exist other less exclusionary and equally if not more effective measures to protect it, including: (a) requiring clearing members to provide adequate margin and default deposits; (b) examining members' credit, risk and compliance procedures and controls; (c) assessing members' customer concentration risks; (d) ensuring that members are adequately supervised, and; (e) ensuring that members have adequate excess net capital.[3]

Similarly, if a DCO were to require that all clearing members be capable of accepting upon the default of another clearing member a percentage of its open interest in certain derivatives and manage the liquidation of such positions only through its own personnel – which could exclude many market participants not having experienced traders in the products at issue – it must be required to show why such a requirement is absolutely necessary from a risk perspective. Again, we do not believe a DCO could make such a case considering there exist other less exclusionary and equally effective measures to protect it, including: (a) allowing a member to introduce such positions to an entity that does have experience in trading such products, or; (b) hiring a consultant to manage the positions until liquidation.

In short, while Dodd-Frank does allow DCOs to establish admission, fitness and continuing eligibility standards for members – including criteria relating to their financial resources and operational capacity – such standards must be "appropriate," "reasonable" minimize "conflicts of interest" and be related directly to minimizing DCO risk.

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[1] See also Title VII, Subtitle A, Part II, Section 725, Sub-Section (c), Paragraph (2)(N)(I), Part (ii) ("Unless necessary or appropriate to achieve the purposes of this Act, a derivatives clearing organization shall not (i) adopt any rule or take any action that results in any unreasonable restraint of trade; or (ii) impose any material anticompetitive burden").

[2] See, e.g., European Commission's Public Consultation on Derivatives and Market Infrastructure, Section II (5)(a)) (a derivatives central clearing counterparty "should establish the categories of admissible clearing members and the admission criteria. These criteria should be non-discriminatory, transparent and objective so as to ensure fair and open access to the CCP").

[3] Indeed, as we have seen from the fall of Lehman Brothers and Bear Stearns, significant size by itself does not guarantee financial stability. Indeed, large entities often pose a greater risk to clearinghouses than brokers and other market participants because of the large size of their open positions and the manner in which they net their risk exposure.

Congress' clear mandate in this regard again is consistent with that of other legislative bodies addressing this topic.[4]

In addition, ensuring that qualifying brokers may become clearing members and register and clear eligible OTC transactions with DCOs will promote participation by more brokers in the clearing process which will aid competition and result in lower prices for market users. Such lower prices will, in turn, enable the US swaps market to remain competitive with its non-US counterparts.

* * *

In sum, we believe that many of the "high bar to entry provisions" that have been proposed with respect to DCO member eligibility are nothing more than thinly veiled attempts by entities with vested interests in the swaps market to protect their existing franchises. However, protecting these vested interests provides no justification for DCOs to enact exclusionary membership requirements that cannot be reasonably justified, particularly when there are viable alternatives that will better protect DCOs and be less exclusionary. The CFTC must fulfill Congress' clear intent in providing for fair and open access to DCOs.

Thank you for your consideration of our position. If you have any questions regarding the above or would like to discuss these matters further, please do not hesitate to contact me at (646) 557-8548 or, in my absence, John Nicholas, at (646) 557-8516.

Sincerely,

Newedge USA, LLC

Gary DeWaal

Gary DeWaal,
Senior Managing Director and
Group General Counsel, Newedge

[4] See, e.g., European Commission's Public Consultation on Derivatives and Market Infrastructure, Section II (5)(a)) ("[c]riteria that restrict access [to a derivatives central clearing counterparty] should only be permitted to the extent that their objective is to control the risk for the [counterparty]").