BY E-MAIL AND OVERNIGHT MAIL

December 2, 2010

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

Re: Investment of Customer Funds and Funds Held in an Account for Foreign Futures and Options Transactions, 75 Fed. Reg. 67642 (November 3, 2010) RIN 3038-AC15

Dear Mr. Stawick:

Newedge USA, LLC ("Newedge USA") and MF Global Inc. ("MF Global") are pleased to submit this comment letter on the proposed rulemaking by the Commodity Futures Trading Commission ("CFTC" or "Commission") relating to the investment of customer funds under Rules 1.25 and 30.7. As two of the leading broker-dealer/futures commission merchants ("BD/FCM") in the US, Newedge USA and MF Global are fierce business competitors.[1] Nevertheless, we have chosen to file this joint comment letter in light of the important issues raised by these proposed amendments.

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[1] As of the end of December 2009, Newedge USA held the largest pool of customer "segregated" and "secured" funds of all US-based FCMs. Newedge USA's primary function is that of a broker; i.e., to execute and clear customer transactions across multiple asset classes – including securities, futures and over-the-counter ("OTC") derivatives – on an agency or riskless principal basis. Newedge USA conducts only a very limited amount of proprietary trading, and then generally only to hedge positions acquired through customer facilitation.

Newedge Group is one of the world's largest brokerage organizations offering its customers clearing and execution facilities across multiple asset classes including futures, securities (fixed income and equity), options, FX and various OTC instruments ("Newedge" refers to Newedge Group, a 50%-50% joint venture between CA-CIB and Société Générale, headquartered in Paris, France, and all of its worldwide branches, subsidiaries and other units. Newedge Group maintains offices in 17 countries, and is a member of over 80 exchanges worldwide).

MF Global Inc. is a leading futures commission merchant, registered with the U.S. Commodity Futures Trading Commission (CFTC) and as a broker-dealer with the U.S. Securities and Exchange Commission (SEC). MF Global Inc. is a wholly owned subsidiary of MF Global Holdings Ltd., a commodities broker

As a general matter, we applaud the CFTC for seeking new ways to ensure the safety and liquidity of investments made by futures commission merchants under CFTC Rules 1.25 and 30.7. However, as we set forth below, we believe the specific amendments being proposed: (a) are unnecessary, considering that the current permissible investments under Rule 1.25 have not, to our knowledge, resulted in any FCM's inability to provide customers their segregated funds upon request or to continue as a solvent entity, (b) will, in many cases, create new investment risks and logistical difficulties for FCMs, and (c) may well change the pricing dynamics for customers and the industry at large. Recognizing the CFTC's concerns, however, we have set forth our own proposed amendments which we believe satisfy the CFTC's desire for the enhanced security of customer segregated funds without the risk of significantly increasing costs to customers.

DISCUSSION

A. The Proposed Amendments Could Substantially Decrease the Number of FCMs, Which Is Inconsistent with Dodd-Frank and Will Reduce Competition Within The Industry.

1. Dodd-Frank

The CFTC's proposed amendments to Rules 1.25 and 30.7 must be viewed in the context of the most significant financial reform legislation passed during the past seventy years, the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank"). As the CFTC is aware, the fundamental purpose of Title VII of Dodd-Frank is that OTC derivatives be brought into much the same market structure that has operated so efficiently and safely for futures contracts for more than a century, leveraging the most critical risk reducing component of the futures model -- centralized clearing.

Thus, as the CFTC promulgates rules to implement Title VII, we believe it is critical to keep in mind two fundamental notions: (1) more (not fewer) clearing members are to be encouraged, especially as we dramatically increase the number and types of products to be cleared, and (2) each clearing member should be encouraged to maintain as much capital as possible in order to withstand another clearing member's default. With respect to the latter point, as all FCMs are painfully aware, capital is not free; rather, it requires a

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and broker-dealer offering trading and hedging solutions across a broad set of asset classes. Building on a history that extends more than 225 years, MF Global and its affiliates provide institutional and retail clients with access to the world's commodities and financial futures markets as well as to fixed income, equities and foreign exchange markets.

Through operations in 12 countries, the MF Global group delivers access to more than 70 exchanges and is a leader by volume on many of the largest derivatives exchanges around the world, helping a wide range of clients—including financial institutions, corporations, hedge funds and other asset managers, and government organizations as well as professional traders and individuals—define and execute trading and hedging strategies and capitalize on market opportunities.

competitive return – otherwise, investors will have no motivation to maintain it at current high levels, let alone increase it.

Unfortunately, the CFTC's current proposal to restrict the types of investments, concentration percentages and counterparties permitted under Rules 1.25 and 30.7 threatens, in our view, to seriously alter the pricing structure for futures and other categories of new cleared transactions by increasing the cost of exchange traded and cleared transactions. Taken to the extreme, this could also force some FCMs to consolidate or go out of business entirely, thereby reducing the number of commercially viable and well-capitalized FCMs available to support the broader goals of Dodd- Frank.[2]

2. The Amendments Will Have An Anticompetitive Impact on the Industry.

Not only are the amendments inconsistent with Dodd-Frank's principle of risk mutualization, they will have an anticompetitive effect on the industry which could, ultimately, disadvantage customers. There has been a significant trend toward consolidation among FCMs in the US over the past ten years. Indeed, the CFTC noted in last year's proposal to increase FCM capital requirements that there were 255 FCMs in the US as of August 31, 1995, but only 134 FCMs as of December 31, 2008. Further, a number of the largest FCMs have merged in recent years, including the merger of Fimat USA, LLC and Calyon Financial, Inc. and the acquisition of Refco LLC's futures business by the predecessor of MF Global, which has resulted in approximately 80% of all global segregated customer funds being held by only six FCMs.

We believe the proposed amendments could decrease significantly the income FCMs derive (and could potentially derive) from prudently investing in customer segregated funds. Further, such a loss of revenue is particularly problematic at this time considering the increased costs and decreased commission revenue experienced by many FCMs. In what is already a very difficult economic climate (e.g., because of near 0% interest rates), and a time of dramatically increasing costs (e.g., as the CFTC seeks better information from FCMs through OCR reports and the industry seeks to adapt to the migration of OTC to exchange-traded business), the CFTC proposes to dramatically limit the ability of FCMs to prudently invest customer funds and generate revenue – potentially causing significant commission cost increases for customers in futures or other cleared markets and/or discouraging the continued participation of many FCMs in those markets. Reducing the number of FCMs will, of course, reduce competition and, as the CFTC is aware, it must consider the potential anticompetitive impact when promulgating rules and "take the least anticompetitive means of achieving [its] objectives."[3]

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[2] We also note that Dodd-Frank did not specifically direct the CFTC to review the investment of customer segregated funds; considering the many market enhancements the CFTC was directed to make, we consider this a telling omission.

[3] See Section 15(b) of the Commodity Exchange Act ("[t]he Commission shall take into consideration the public interest to be protected by the antitrust laws and endeavor to take the least anticompetitive means of achieving the objectives of the Act ..... in issuing any order or adopting any Commission rule") and Section 15(a) of the CEA ("Before promulgating a regulation under this Act ..... the Commission shall consider the rule's impact on the "competitiveness ..... of futures markets").

B. The Investments Currently Permitted Under Rule 1.25 Have Not Put Customer Funds at Risk.

We believe strongly that the CFTC's proposed amendments endeavor to "fix something that is not broken." Indeed, the evidence is clear that the investments permitted and safeguards required under Rule 1.25 have met the CFTC's stated "objectives of preserving principal and maintaining liquidity" of customer segregated funds. See Rule 1.25(b). Among other things, since the CFTC's 2004 expansion of permissible investments under Rule 1.25, we are not aware of any FCM that has been unable to liquidate and provide to their customers upon request any segregated funds invested under Rule 1.25 (or under Regulation 30.7 either, for that matter).[4]

Further, since this expansion, no FCM to our knowledge has failed or otherwise been unable to meet any other of its financial obligations as a result of investments made under Rule 1.25.[5] In short, we believe the current investment criteria set forth under Rule 1.25 have worked, including over the past two years of market instability and uncertainty – the ultimate stress test. Nevertheless, the Commission has proposed changes so sweeping that they may in fact increase systemic risk by imposing new burdens on otherwise effective, efficient and liquid settlement processes. Such a radical overhaul, in our view, is unnecessary considering the Rule's stellar track record. At most, the CFTC should be adjusting only slightly the products, counterparties and concentration percentages currently permitted. [6]

C. Many of the CFTC's Proposals are Unnecessary and Will Create New Investment Risks and Logistical Difficulties for FCMs.

a. Government Sponsored Entities ("GSE")

Citing the Government's bailouts of Fannie Mae and Freddie Mac in 2008, the CFTC proposes to disallow the investment of customer segregated funds in GSE securities unless such securities are guaranteed by the full faith and credit of the US Government.. In our view, the CFTC's proposal is unnecessary and will eliminate a liquid, secure and profitable category of investment for FCMs. Importantly, GSEs continue to carry the implicit support of the US Government; as a practical matter, the federal government stood behind Fannie Mae and Freddie Mac at a time of extreme stress, and such actions imply it would do the same for other GSEs. We also note that (a) both Fannie Mae and Freddie Mac recently implemented comprehensive Corporate Governance Procedures –

[4] Though registered as an FCM, Sentinel Management Group, Inc. was not engaged in the futures brokerage business. See CFTC v Sentinel Management Group, Inc., et al (USDC ND Ill 2008, Civil Action No. 08CV2410).

[5] See, e.g., NFA Comment Letter to SEC (December 5, 2001) ("[t]he customer protections in the futures and securities industries work very well ..... both industries have excellent track records for protecting customer funds from insolvency losses").

[6] Rule 1.25's track record over the past several years was in fact predicted by the CFTC itself when it expanded the scope of investments permitted under the Rule in 2000 ("an expanded list of permitted investments could enhance the yield available to FCMs ..... and their customers without compromising the safety of customer funds"). 65 FR 39008, 39014 (June 22, 2000) (emphasis supplied).

Fannie Mae on July 16, 2010 and Freddie Mac on March 19, 2010 – which will help to ensure that the securities they issue will be more reliable and creditworthy, and; (b) the other GSEs – such as Sallie Mae, Federal Farm Credit, Federal Home Loan and Federal Agricultural Mortgage Corporation – held up quite well during the financial crisis, and we believe that FCMs should continue to be able to invest in them.[7]

Consequently, we recommend that all GSEs continue to be permissible investments under Rule 1.25. However, since the GSEs do not have the explicit full faith and credit of the US government, and implicit support is not absolute, we recognize that it may be prudent to consider limiting FCM's investment in such products to (a) 50% of their portfolio and 10% with any one issuer, or (b) only those GSEs that meet specific outstanding float standards, such as most GSE "general benchmark" securities (as opposed to structured products). At a minimum, we believe the CFTC should allow FCMs to invest in the GSEs other than Fannie Mae and Freddie Mac.

b. Foreign Sovereign Debt

The CFTC proposes to disallow the investment of customer segregated funds in foreign sovereign debt, citing an undisclosed Staff survey conducted some years ago which the Commission asserts "revealed negligible investment [by FCMs] in foreign sovereign debt," and to "recent events undermining confidence in the solvency of a number of foreign countries." In our view, the CFTC's proposal is unnecessary, and will eliminate a liquid, secure, profitable and necessary category of investment for FCMs. We believe the CFTC should recognize that (a) no foreign country that actually defaulted on its debt resulted in any FCM being unable to return funds to its customers upon request, and (b) its proposal will likely have the unintended consequence of creating foreign exchange exposure for FCMs who will be required to convert non-US balances to US dollars in order to invest them thereby taking on significant foreign exchange risk with respect to their customer segregated funds.[8] Moreover, such a rule could result in certain foreign governments taking parallel action by prohibiting their own registrants from investing customer funds in US Government securities.[9]

Consequently, we recommend that foreign sovereign debt continue to be permissible investments under Rule 1.25. However, to the extent the Staff continues to be concerned

[7] We note that although many banks agreed to receive Government assistance during the recent financial crisis the CFTC still proposes to allow FCMs to invest in direct issue CDs.

[8] The CFTC itself concedes in its proposal that the "purpose of permitting investments in foreign sovereign debt is to facilitate investments of customer funds in the form of foreign currency without the need to convert that foreign currency to a U.S. dollar denominated asset, which would increase the FCM's or DCO's exposure to currency risk. An investment in the sovereign debt of the same country that issues the foreign currency would limit the FCM or DCO's exposure to sovereign risk, i.e., the risk of the sovereign's default."

[9] We believe that the "survey" cited in the CFTC's proposal is outdated, and thus should be given limited weight. Further, even assuming that it is still an accurate portrayal of FCM investment practices, the prior lack of FCM investment in foreign sovereign debt does not justify eliminating the category entirely – particularly in today's economy, in which the revenues FCMs generate from customer segregated funds help to keep customer costs down despite decreased commission revenue and increased operating costs.

as to the security of such investments, we recommend that it consider limiting: (a) such investments to the debt issued only by G-20 countries, and/or (b) FCM's investments in non-G20 debt to 25% of the FCM's portfolio and 10% with any one issuer.

c. Money Market Funds

The CFTC proposes to limit the investment of customer segregated funds in money market mutual funds ("MMMF") to 10% of an FCM's portfolio and 2% with any one issuer, citing the Reserve Primary Fund's "breaking the buck" and the fact that approximately twenty other MMMFs received some form of financial assistance from their sponsors during 2008. In our view, the CFTC's proposal will unnecessarily restrict a very liquid and secure investment which has also generated reasonable returns for FCMs and their customers. Among other things: (a) the CFTC has cited to only one instance of a failed fund, and the fact that a small number of other funds received some form of financial assistance from their sponsors does not justify eliminating MMMFs completely; (b) no FCM failed to return 100% of segregated funds to its customers even to the extent it lost funds due to investments in the Reserve Fund, and; (c) the SEC has materially amended its rules to help ensure the safety and soundness of MMMFs.[10]

Consequently, we recommend that FCMs continue to be allowed to invest customer funds in MMMFs at the current portfolio and issuer concentration thresholds (100% for each). However, to the extent the Commission continues to be concerned as to the security of such investments, we recommend that it consider (a) limiting FCM investments in "prime" MMMFs (those that invest in corporate debt) to 50% of their portfolio and 10% with any one issuer, or (b) permitting FCMs to invest only in MMMFs that satisfy certain size, float and diversity of investment requirements.

d. Repurchase and Reverse Repurchase Transactions

The CFTC proposes to reduce counterparty concentration limits on reverse repurchase agreements to 5% of an FCM's portfolio (currently there are no limits), citing the potential credit risk posed to FCMs by investing a substantial portion of their funds with one counterparty. In our view, this proposal will unnecessarily restrict a very liquid and secure investment that has provided important flexibility as well as reasonable returns for FCMs and their customers. We believe the CFTC should focus on the critical fact that the customer segregated account and the secured amount will be fully collateralized with qualified Rule 1.25 products at all times, even in the event of a counterparty default on a reverse repurchase agreement.[11]

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[10] As the Commission points out in its proposal, "portfolio diversification, administrative ease, and heightened prudential standards recently imposed by the SEC, continue to make MMMFs an attractive investment option."

[11] Indeed the Commission itself recognizes that the credit risk posed under the current rules "while concentrated, is significantly mitigated by the fact that in exchange for cash, the FCM or DCO is holding Regulation 1.25-permissible securities of equivalent or greater value."

Commission and clearinghouse rules require that FCMs routinely transact and fund margin requirements involving large transactions executed against considerable time constraints, often on an intra-day basis. However, the CFTC's proposed concentration limits could severely undermine an FCM's ability to meet these obligations efficiently, thereby creating particular risk for intra-day funding requirements. The CFTC should recognize that imposing a 5% counterparty concentration limit would (a) require FCMs to have relationships with a minimum of 20 (and as many as 25 or more) different counterparties, which would at best be difficult to manage, and would significantly increase systemic risk, and (b) decrease liquidity and increase operational risk, due to a significant increase in the number of required transactions and the resulting potential fails. We believe that introducing these new risks is unwarranted, especially as there is no evidence that any FCM has been unable to timely return customer funds or meet margin requirements as a consequence of investing customer funds with a limited number of reverse repurchase counterparties.

We also believe the CFTC's proposed prohibition on in-house and affiliate repurchase and reverse transactions is unnecessary because such transactions (a) may only involve Rule 1.25-permissible securities, (b) are conducted within a regulated entity and, (c) are contained within properly titled Rule 1.25 segregated accounts, as are the related cash and security movements. Eliminating these transactions is inconsistent with the CFTC's stated objective of reducing FCM investment risk, since FCMs would be unable to enter into and execute such transactions with and through entities and personnel with whom they have created an effective, efficient and liquid settlement framework.

Consequently, we recommend that FCMs not be subject to a 5% counterparty concentration limit on reverse repurchase transactions, and that they continue to be able to enter into repurchase and reverse repurchase transactions with affiliates and on an in-house basis. However, to the extent the Commission continues to be concerned with the safety of such transactions with unaffiliated third parties, we recommend that it consider (a) limiting FCM repurchase and reverse repurchase transactions to those external counterparties maintaining a certain level of capital (such as $50 or $100 million), or (b) reducing the counterparty concentration limits to only 25% per counterparty.

e. <u>CDs</u>

The CFTC proposes to prohibit the investment of customer segregated funds in negotiable CDs, citing to the fact that only direct issuer CDs provide FCMs with an assured buyer. In our view, the CFTC's proposal is unnecessary, inconsistent with its stated objective of allowing FCMs to invest only in "highly liquid" investments, and will eliminate a secure and profitable source of revenue for FCMs and customers. Among other things, (a) brokered CDs receive price quotes, are marked-to-market everyday and have numerous buyers, while direct issuer CDs are not and do not – thus making brokered CDs more liquid than direct issuer CDs; and (b) direct issuer CDs have only one buyer (the issuer) which creates significant counterparty risk for FCMs purchasing such products. Moreover, we are unaware of any instance in which an FCM was unable to

return segregated funds to customers based on losses it may have suffered as a result of investments in negotiable CDs.

Consequently, we recommend that negotiable CDs continue to be permissible investments under Rule 1.25. However, to the extent the Commission continues to be concerned with the security of such products, we recommend it consider limiting (a) FCM investment in negotiable CDs to those issued only by banks meeting certain capital criteria or CDs meeting certain float size thresholds, or (b) FCM investments in negotiable CDs to 50% of their portfolio and/or 10% with any one issuer. We also believe that to the extent the CFTC prohibits brokered CDs, it should at least allow the investment of customer segregated funds in puttable CDs which not only may be traded in the secondary market but also may be put back to the issuer.

f. <u>Commercial Paper and Corporate Notes</u>

The CFTC proposes to limit the investment of customer segregated funds to only commercial paper and corporate notes that are backed by the full faith and credit of the US Government, citing the need to "simplify the regulation by eliminating rarely-used instruments" and "the credit, liquidity, and market risks posed by corporate debt securities." In our view, the CFTC's proposal is unnecessary, and eliminates a profitable category of investments for FCMs and their customers. Among other things: (a) the Staff's outdated survey of FCM investment practices does not, as discussed above, provide adequate justification for eliminating entirely an important source of revenue for FCMs, particularly considering that in this difficult economy many FCMs may rely more heavily on revenue generated from customer funds given the decrease in commission revenue and increase in operating costs, and (b) many corporate notes and commercial paper are secure and creditworthy products. Again, we are unaware of any instance in which an FCM was unable to meet its obligations under Rule 1.25 as a result of investment losses it suffered involving corporate notes or commercial paper.

Consequently, we recommend that corporate notes and CP continue to be permissible investments under Rule 1.25. However, to the extent the Staff continues to be concerned as to the security of such products, we recommend that it consider (a) permitting FCMs to invest only in corporate notes or CP issued by entities with a certain minimum capital or which meet a certain float size, or (b) limiting FCM investments in such product to 25% of their portfolio and 5% with any one issuer.

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In sum, neither Dodd-Frank nor the financial crises of 2008 merit the CFTC's seeking the elimination of virtually all risk taking by FCMs in connection with the investment of customer funds – particularly where FCMs (a) maintain extensive risk policies to ensure they prudently minimize such risk (<u>e.g.</u>, prudently diversify both the asset classes and issuers in which they invest customer funds), (b) maintain substantial excess capital to cushion against any shortfall in segregated funds as a result of market cataclysmic events (<u>e.g.</u>, the default of the Reserve Fund), and (c) follow existing CFTC guidelines regarding

the investment of customer funds. Further, we note that the CFTC's proposed rules will not eliminate all risk-taking by FCMs, but rather may shift it from credit risk to duration and currency risk. Specifically, by eliminating virtually all higher yield short-term instruments, the CFTC will necessarily encourage FCMs to invest in securities with significantly longer maturities in order to obtain competitive rates for their customers and to purchase instruments with which they may be less comfortable and which are subject to decreased liquidity, wider spreads and greater volatility.[12]

Rather than impose these specific additional restrictions on the investment of customer funds, we respectfully request that the CFTC recognize that it is important to carefully evaluate these "protections" in light of the prudent risk management currently employed by FCMs, as well as the mutually important need for FCMs to be profitable. No one is arguing that FCMs do not have important obligations to invest customer funds carefully and prudently; however, this is different from imposing investment restrictions that are designed to eliminate all risk. Indeed, we are surprised that the CFTC has not proposed, as an alternative, that the current investments under Rule 1.25 continue to be permitted so long as FCMs that invest in such securities be required to maintain robust risk management policies, including diversity of investment requirements. If FCMs apply prudent standards through the application of sound risk policies, and have sufficient capital to cover any losses in customer funds because of their investments, they should be permitted to take reasonable and limited risks in the investment of customer funds – as they do now, under a CFTC regime that has functioned successfully for many years.[13]

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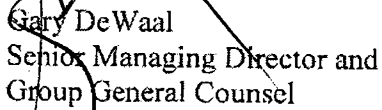
[12] We believe that another side-effect of the CFTC's proposals would be that, since many FCMs will be prevented from paying their clients competitive rates of return on their cash, some clients will decide not to give FCMs cash but rather collateral, such as Treasuries. This movement from cash to collateral will, in our view, cause liquidity and logistical issues for FCMs.

[13] We also recommend that since many FCMs pledge securities they have purchased with customer segregated funds as collateral at clearinghouses, they should be permitted to place as collateral any of the different financial products they are allowed to purchase under Rule 1.25. To hold otherwise effectively limits the types of products that can be purchased under Rule 1.25, since many FCMs will not purchase securities they cannot post as collateral. And, since such products must conform to the strict marketability, concentration and maturity requirements set forth in Rule 1.25, we do not believe clearinghouses should or would be reluctant to accept them as collateral. We encourage the CFTC to encourage clearinghouses to ensure their rules regarding permitted collateral parallel the CFTC's rules regarding eligible investments for customer segregated funds.

We appreciate the opportunity to comment on these proposed rules. Feel free to the contact Gary DeWaal at (646) 557-8458 or at gary.dewaal@newedgegroup.com, or Laurie Ferber at (212) 589-6235 or at lferber@mfglobal.com, if you have any questions.

Sincerely,

Newedge USA, LLC



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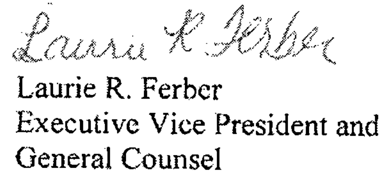

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