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TUDOR
INVESTMENT CORPORATION

December 22, 2010

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

Re: **Protection of Cleared Swap Customers Before and After Commodity Broker Bankruptcies RIN 3038-AD99**

Dear Mr. Stawick:

Tudor Investment Corporation ("Tudor") appreciates the opportunity to submit its comments in response to the Commodity Futures Trading Commission's (the "CFTC" or the "Commission") Advanced Notice of Proposed Rulemaking and Request for Comment (the "Advanced Notice") regarding protection of cleared swaps customers before and after commodity broker bankruptcies. Tudor fully supports the goals of the Commission in ensuring the protection of collateral posted by swaps customers of futures commission merchants ("FCMs") in a cleared swap transaction, and respectfully suggests that rules requiring full, physical segregation of customer accounts on an individual basis will attain the customer protection goals embodied in the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act").

I. Tudor Investment Corporation

Tudor Investment Corporation is a leading alternative asset management firm currently managing approximately $12 billion in assets on behalf of institutional and individual clients, including governments, pension funds and endowments. Since its inception in 1980, Tudor has grown substantially and, together with its affiliates, currently employs approximately 400 employees worldwide. Through a number of investment funds and other investing vehicles, Tudor invests in the global currency, commodity, fixed income and equity markets. As an active participant in the global financial markets, Tudor has a keen interest in the protection of the assets of its customers.

II. Summary

Tudor requests that any rules governing protection of collateral posted in connection with swap transactions further enhance or, at a minimum, do not diminish, protections currently available to Tudor and its customers. Specifically, Tudor urges the Commission to adopt Model 1 (Full Physical Segregation) proposed in the Advanced Notice (the "Full Physical Segregation Model"), which would require full, physical segregation of customer accounts on an individual basis. With appropriate amendments to the Commission's Bankruptcy Rules, Part 190, for a new "account class," the Full Physical Segregation Model will eliminate credit exposure to both the FCM holding the account and to other customers of the FCM.

III. Omnibus Margining May Not Reduce Systemic Risk

Reduction of systemic risk is one of the many important objectives of the Dodd-Frank Act. In furtherance of this objective, Congress mandated that the Commission formulate rules that will require centralized clearing of eligible swaps, including centralized clearing of "standardized" swap transactions.[1] Tudor supports centralized clearing for several reasons. First, we believe that centralized clearing will result in a more orderly market, particularly in times of stress, by allowing market participants to enter and exit positions without the necessity of going to a single bilateral counterparty. In addition, centralized clearing will allow for greater price and position transparency in the derivatives markets.

However, we believe that for reasons set forth in more detail in Section VII delow, omnibus margining, as proposed by the Commission in Model 2 (Legal Segregation With Commingling) (the "Legal Segregation Model"), Model 3 (Moving Customers to the Back of the Waterfall) (the "Waterfall Model") and Model 4 (Baseline Model) (the "Baseline Model") of the Advanced Notice, may actually increase systemic risk. Under each of these Models, non-dealer market participants that previously relied on extensive credit analyses in determining the creditworthiness of their dealer counterparties will now also be exposed to the creditworthiness of other customers of the dealer on whom they have conducted no such analysis. It is very difficult if not impossible to protect against this type of risk as customers of an FCM do not have access to credit information regarding the FCM's other customers (whether such customers are swap customers or customers of the FCM's other business units). Therefore, even if a market participant does extensive diligence on its FCM, it is possible that a failure by the FCM to do similar diligence on even a single customer could result in significant losses to all of the FCM's customers.

Some market participants have argued that the use of omnibus accounts effectively spreads the risk of counterparty failure among many other market participants. However, the spreading of risk will not necessarily reduce systemic risk and could even exacerbate a credit related problem. If any Model that relies on omnibus margining were to be adopted, risk that previously was negotiated and allocated between the two parties to a transaction will now be

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[1] See Section 723 of Dodd-Frank, which adds a new Section 2(h) to the Commodity Exchange Act, as amended (the "CEA").

passed to all of the FCM's other customers, despite the unfair fact that such other customers are unable to analyze the credit risk of the parties to the original transaction or the transaction itself. This contagion of risk will result in more creditworthy counterparties being forced to take on the risk of, and effectively subsidize, an FCM's weaker counterparties. Worse yet, in the event that an environment of increasing systemic concerns and market volatility (such as the Fall of 2008) returns, the most creditworthy counterparties may pull back from markets because of concerns about the unknowable credit exposure to which they may be subject via an omnibus account. This type of behavior would lessen liquidity at a time when markets need it most, which could have unfortunate consequences.

Alternatively, increased risk to swap dealers as a result of omnibus accounts could lead certain swap counterparties to seek to protect themselves against this risk by hedging their exposure to their dealers. Hedges could be implemented in several ways including shorting of dealer or parent company shares or the purchasing of protection in the form of credit default swaps, both of which could result in increased market uncertainty with respect to the relevant dealer or parent company.

Furthermore, omnibus margining can result in the mispricing of risk. This mispricing, which could take the form of improper margining rates set by dealers or exchanges, could result if dealers or exchanges know that they can rely on stronger market participants to subsidize weaker market participants.[2] While there is nothing to suggest that mispricing would be intentional, there is no incentive for the dealers or exchanges to price risk correctly if there is a credit backstop in the form of more creditworthy customers.

IV. Current Use of Third-Party Custody Accounts

One of Tudor's primary goals has always been the protection of customer assets. Tudor attempts to minimize credit risk to its swap counterparties several ways. As noted above, Tudor performs extensive credit analysis on each of our swap counterparties. However, even more importantly, Tudor and certain other market participants have been able to negotiate with counterparties for and currently utilize third-party custodians to hold margin in segregated accounts. This is done by establishing a custodial account with a recognized custodian and depositing all initial margin or "independent amounts" relating to swap and other over-the-counter transactions into the account. Individually segregated accounts or sub-accounts are opened for each swap dealer. Tudor, the swap dealer and the custodian then enter into a control agreement that sets forth the rights and obligations of the parties with respect to deposited amounts both prior to and following a credit related event of either party (*e.g.*, failure to meet a margin call, bankruptcy, *etc.*).

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[2] During the Staff Roundtable on Individual Customer Collateral Protection held on October 22, 2010 (the "Roundtable"), it was noted that individual account segregation could result in an increase in required collateral. This suggests that dealers and exchanges may, in fact, be mispricing risk. There is no reason to believe that mispricing will disappear as a result of omnibus margining.

By utilizing third-party custodial accounts, Tudor is able to substantially reduce or even eliminate credit exposure to its swap counterparties. Upon a default by Tudor, the counterparty is able to utilize margin to offset any losses. Similarly, Tudor is assured that a bankruptcy or similar event with respect to its counterparty will not result in Tudor losing its collateral. In addition, the use of a third-party custody account segregates Tudor from any possible loss as a result of losses incurred by another customer of the dealer. In other words, we have attempted to minimize the risk of contagion associated with losses incurred by other market participants by holding posted collateral in segregated accounts with third-party custodians.

V. Elimination of Individual Segregation Will Result in Increased Risk to Many Market Participants

We support the Commission in its attempt to reduce risks associated with counterparty default. Prohibiting swap dealers from comingling customer accounts with proprietary accounts is a large step forward. However, we believe that a move to omnibus margining for customers as proposed by each of the Legal Segregation, Waterfall and Baseline Models does not go far enough. As described above, Tudor and other market participants have already developed a methodology for isolating both their risk to the dealer and their risk to the dealer's other customers that is far superior to omnibus margining. Therefore, for certain market participants like Tudor, omnibus margining is a large step backwards that will result in increased uncertainty as it reinserts both of these risks into their trading.

VI. Principal Arguments Against Individual Segregation are Unpersuasive Or May Not Be Valid

Several arguments have been made in opposition to individual customer segregation. Most importantly, the FCM community has argued that the cost of individual segregation will be too burdensome. While we recognize that there will be additional costs, we do not believe that these costs outweigh the costs that non-dealer participants could bear as a result of other customer defaults. As noted above, many FCMs already offer individual segregation for certain of their swaps customers through the use of third-party custodial accounts. Moreover, for those customers that are not offered individual segregation, the FCMs already have systems in place to monitor posted collateral (including movements in value) even if such collateral is placed in an omnibus account. As a result, it is not clear that an extensive (and, as argued, expensive) reworking of systems will necessarily be required.

In addition, to the extent that there are significant additional costs resulting from individual segregation, these costs can, and as the Advanced Notice makes clear, FCMs have stated such costs will, be passed on to the end user. Dealers already use a model similar to this in connection with inter-dealer transactions that are cleared through LCH Clearnet. Tudor would be willing to assume reasonable additional costs associated with individual segregation as a premium for added protection.[3]

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[3] An important factor to note here is that Tudor and other market participants are able to negotiate and therefore anticipate and account for this additional, "premium" cost, whereas the

Moreover, as noted above, it is possible that dealers are currently not properly pricing risk, which would result in more creditworthy counterparties effectively subsidizing less creditworthy counterparties. If dealers are concerned about taking on the risk of less creditworthy counterparties, they always have the option to request additional collateral.

Many sell-side market participants have also argued that buy-side market participants should receive comfort from a move to an omnibus margining regime that is similar to the current futures regime. However, adopting an approach that incorporates the "recovery waterfall" currently used in futures markets (the "Futures Waterfall") imposes substantial additional risks on the buy-side market participants as compared to individual segregation. Under the Futures Waterfall, customers of an FCM will incur losses if the FCM's capital is insufficient to cover a deficit in any one of its customer's account.

We recognize that omnibus margining has been used in the futures markets for many years. However, transactions in the futures market are not what led to the extreme market uncertainty that began in the Fall of 2008 and led the economy to the brink of collapse. Rather, it was the derivatives market that created such uncertainty and Congress, through Dodd-Frank, has sought to regulate the swaps market to avoid that type of situation in the future. In addition, Section 724 of the Dodd-Frank Act specifically refers to segregation of property belonging to the "swaps customer", in the singular, of an FCM whereas, as noted in the Advanced Notice, Section 4d(a)(2) of the CEA refers to "swaps customers", in the plural. The Commission discussed the use of "customers" in its plural form in the CEA and the use of "customer" in its singular form in the Dodd-Frank Act at length during its open meeting on the Advanced Notice that occurred on November 19, 2011. It was clear from this meeting that the Commission drew an obvious, intentional distinction from the difference in usage, and that the use of "customer" in its singular form implies Congressional intent. As a result, Section 4d(a)(2) allows FCMs to treat its customers as a group, and this interpretation has been confirmed by the Commission in Interpretation 85-3[4], which it attached to the Advanced Notice. Therefore, although we believe that individual account segregation is preferable for both swap transactions and futures transactions, it is clear that the CEA and Dodd-Frank allow for a different approach for each regime.

Finally, it has been suggested that buy-side market participants can eliminate the risk of omnibus margining by becoming clearing members of exchanges and clearing organizations. In the vast majority of cases, this is simply unrealistic. First, it is not clear that all asset managers could qualify as clearing members. Moreover, many of the investment funds or direct customers (like pension funds) for whom asset managers manage capital could not qualify for membership either. In addition, membership has the risk of other member defaults that raises many of the same concerns as omnibus margining (including the inability to evaluate the creditworthiness of

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costs associated with, and the likelihood of, defaults of the FCM's other customers are entirely unknowable.

[4] Interpretive Statement, No. 85-3, Regarding the Use of Segregated Funds by Clearing Organizations upon Default by Member Firms. (OGC Aug. 12, 1985)

other members). In most cases, it is far more efficient, operationally, for asset managers to retain the services of their dealer which can apply economies of scale in conducting clearing activities.

VII. Models Contained in the Advanced Notice

The Commission included several models in the Advanced Notice and has sought comments on each model. As mentioned earlier, these models are: (1) Full Physical Segregation; (2) Legal Segregation With Comingling; (3) Moving Customers to the Back of the Waterfall; and, (4) Baseline Model. We would like to address each model in turn.

(1) Full Physical Segregation – For the reasons noted above, we support the Commission adopting the Full Physical Segregation model. We recognize that this model may result in additional costs and we, and we believe others, would be willing to pay a moderate premium for the added protection. However, as noted in the Advanced Notice, the Commission should consider an "opt-in" mechanism whereby customers that are willing to bear the extra cost can opt to have individual segregated accounts. Customers that do not opt in would remain subject to omnibus margining.

(2) Legal Segregation With Comingling – The Commission has attempted to reach a middle ground by providing for a framework in which margin posted by individual customers is tracked separately on both the books of the relevant dealer and the clearinghouse, but kept in an omnibus account. However, we are concerned that this model does not go far enough for the reasons expressed below.

First, some exposure to other customers would remain to the extent that there is a shortfall in the comingled margin account due to market fluctuations. In such an event, all customers would share that loss, which may be quite large depending on the size and type of collateral posted, pro rata. As a result, customers that post cash for operational or other reasons may be required to pick up a shortfall caused by customers that post securities or other non-cash assets. In addition, because of the timing of the determination of required margin to be posted by individual customers (*i.e.*, as of the close of business on the previous day), this model fails to pick up any intraday collateral movements. Finally, in this model, the dealers and clearinghouses are required to trace margin posted by individual customers which will necessitate additional transparency at additional cost to both dealers and clearinghouses. Given that adequate books and records will be required to be maintained at a cost to the parties, establishing individual accounts is a logical next step. However, unlike the Full Physical Segregation model where a customer would be able to see margin posted to such customer's account, under this model if a dealer fails to maintain adequate books and records, the risk of loss could be passed onto non-defaulting customers.

In addition to the concerns noted above, this model only works to the extent that all clearinghouses require gross margining by its dealer members and the dealer members require gross margining by all of their customers.

(3) Moving Customers to the Back of the Waterfall – The Advanced Notice states that this model is similar to the "Legal Segregation With Comingling" model discussed above, with a

few differences. However, we believe that this model is also similar to the existing Baseline Model with the exception of the Futures Waterfall because in both cases a customer would be ultimately liable as a result of a default by that customer's dealer (whether due to the default of another customer or directly as a result of default by the dealer). Changing the Futures Waterfall so that the DCO's guarantee fund is utilized first is an improvement and solves some of the credit concerns as the clearinghouse uses its own liquidity reserves to make all non-defaulting customers whole prior to spreading losses to non-defaulting customers. However, non-defaulting customers are still at risk. If the Waterfall Model is adopted, we believe a similar model should be adopted for futures.

(4) Baseline Model – For the reasons stated elsewhere in this letter, we believe that the Baseline Model is a large step backwards for many swap market participants and the market as a whole.

VIII. Conclusion

Tudor fully supports the consumer protection goals established by the Dodd-Frank Act and applauds many of the CFTC's initiatives to fulfill those goals. However, we believe that a move to omnibus margining for cleared swaps, while improving the position of some, is a large step backwards for many market participants. It will result in a continuation of the mispricing of risk resulting in more creditworthy counterparties subsidizing the risk of less creditworthy market participants. Moreover, it will contribute more uncertainty for some market participants and perhaps even more systemic risk as these participants are forced to take on the credit risk of other customers of their FCM at a time when they are not in a position to assess such risk. This can be addressed by adopting the Full Physical Segregation model.

We would welcome the opportunity to discuss any of these issues further with the Commission and its staff.

Please do not hesitate to contact John Macfarlane at (203) 863-6753 or Stephen Waldman at (203) 863-8637 if you have any questions regarding Tudor's comments.

Respectfully submitted.

Tudor Investment Corporation

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